BUSINESS ENVIRONMENT
(DBUS02)
(MBA)

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BLOCK 1 ECONOMIC AND SOCIAL ENVIRONMENT

You will appreciate that a thorough understanding of the economic and social environment of business is essential for running business enterprises successfully. Needless to say, any business enterprise, whether large or small, public or private, is affected by the environment in which it operates. The purpose of this Block is to acquaint you with as many aspects of the environment of business as possible. This Block has three units.

Unit 1, **Economic Environment of Business,** explains the total environment of business in general and then discusses the basic propositions about business. It explains the chief constituents of an economic environment. The main points of Indian economic environment arc briefly highlighted. The interrelationship between economic environment and business management is explored. Finally, the device of Interaction Matrix for understanding the relationship between two sets of variables, e.g., economic and non-economic environments, is explained.

Unit 2 is concerned with **Socio-cultural and Politico-legal Environment.** This unit has two parts.

Part I deals with **Socio-cultural Environment.** The critical elements of Social Environment are first explained. Thereafter the various social movements which have affected social institutions and are thus important constituents of the social environment are briefly examined. The movements discussed are: the Trade Union Movement, the Consumer Movement, the Shareholders' Movement, the Management Movement, and the Environmental Movement. Finally, the social responsibility of business is discussed.

Part II of this unit presents **Politico-legal Environment.** Some critical elements of politico-legal environment are explained. The Government machinery dealing with industrial economy of the country is briefly presented. Thereafter the salient features of the various laws constituting the legal environment of business are discussed. It goes without saying that a thorough understanding of these laws is indispensable for a business manager without which s/he might stumble and fall. The various laws discussed include: the Companies Act, the Securities Contracts (Regulation) Act, the Foreign Exchange Regulation Act (FERA), the Sick Industrial Companies Act, the Monopolies and Restrictive Trade Practices Act (MRTP), the Consumer Protection Act, and the Environment Protection Act.

Unit 3, **Changing Role of Government,** presents different perspectives about the role of Government in capitalistic and socialistic/communistic economies. The unit examines the assumptions implicit in the capitalistic economic system. The unit then proceeds to examine the pitfalls of the communistic economic system. Thereafter the unit highlights the Indian experience with regard to the changing role of the Government. Towards the end, the unit briefly talks about the consensus that seems to be emerging about the role of the Government all over the world.

UNIT 1 ECONOMIC ENVIRONMENT OF BUSINESS

Objectives

After studying this unit, you should be able to —

- *define* what you mean by "environment"
- *classify* the complex environmental variable on the basis of objective criteria
- *identify* the critical elements of economic environment of business
- *analyse* the interactions between economic and non-economic environment
- *explain* the impact of economic environment on business management; and
- *illustrate* your understanding of economic environment with reference to the Indian business situation.

Structure

1.1 Introduction

1.2 Environment of Business

1.3 Some Basic Propositions

1.4 Economic Environment

1.5 Critical Elements

1.6 Indian Economic Environment

1.7 Economic Environment and Business Management

1.8 Economic and Non-economic Environment: The Interaction Matrix

1.9 Summary

1.10 Key Words

1.11 Further Reading

1.12 Self-assessment Questions

1.1 INTRODUCTION

You may have a variety of reasons for studying this course, but the main reason, we presume, is to become a successful manager. Your success or failure as a manager depends on a number of factors and these factors may not always be within your control very often such factors constitute your work environment. These include your job, your department, your organisation, your nation and the world around you. After all, as a manager you do not function in a vacuum. You exist and operate within, and not without, an environment. Therefore, as a manager when you think, or take decisions, you cannot neglect the limitations of your environment. Just think for a while and then answer: Don't you arrive at *decisions* after examining the possible *reactions* from the environment in which you are placed? Say, as a marketing manager, would you not study your market environment before launching a new product? Or, as a finance manager wouldn't you study how the capital and money markets of the country are *structured* and organised before deciding on the sources and uses of your funds? Or, as a personnel manager wouldn't you care to find out the rules and regulations laid down by the government on subjects like reservation before undertaking recruitment and selection of your required staff? When you have answered these questions, you will discover that all your answers

are in the affirmative: "Yes, I would". You can't do without thinking about your environment. As a business manager, you have to constantly evaluate your business environment.

This opening unit aims to set you thinking about these ideas. It aims to help you to precisely define "environment", classify your business environment on the basis of some criteria; identify some of the critical elements of economic environment of business establish the nature of interaction between economic environment and business management; and analyse the interaction between economic and non-economic environmental variables.

In pursuing these aims and objectives, our focus will primarily be on the Indian environment of business. We shall try to identify, describe and analyse the Indian situation to understand its impact on our business. Our ultimate purpose is to train our business managers to face the macro-level environment of business. As managers, wherever you are, be it in the public or the private sector, you have to remain alive and alert to your environment so that you are successful in your day-to-day business operations.

1.2 ENVIRONMENT OF BUSINESS

The term "environment" refers to the totality of all the factors which are external to and beyond the control of individual business enterprises and their managements. Environment furnishes the macro-context, the business firm is the micro-unit. The environmental factors are essentially the "givens" within which firms and their managements must operate. For example, the value system of society, the rules and regulations laid down by the Government, the monetary policies of the central bank, the institutional set-up of the country, the ideological beliefs of the leaders, the attitude towards foreign capital and enterprise, etc., all constitute the environment system within which a business firm operates. These environmental factors are many in numbers and various in form. Some of these factors are totally static, some are relatively static and some are very dynamic — they are changing every now and then. Some of these factors can be conceptualised and quantified, while others can be only referred to in qualitative terms. Thus, the environment of business is an extremely complex phenomenon.

The environmental factors generally vary from country to country. The environment that is typical of India may not be found in other countries like the USA, the (former) USSR, the UK, and Japan. Similarly, the American/Soviet/British/Japanese environments may not be found in India. There may be some factors in common, but the order and intensity of the environmental factors do differ between nations. What to say of countries, the magnitude and direction of environmental factors differ over regions within a country, and over localities within a region. Thus, one may talk of local, regional, national (domestic) and international (foreign) environment of business. For example, the local custom of "coolie" labour, the climate of the northern region of Assam, the policies of the State and Central Governments in India and the size of the world market: all these factors together will have an important bearing on the tea industry. The production, consumption and marketing of tea will be affected by environmental factors.

The environment differs not only over space but also over time within a country. As such, we can talk of temporal patterns of environment, i.e., past, present and future environment. Future environment is the product of past and present environments. The Indian economy of tomorrow will be influenced by what the state of the economy is at present and what it was in the past.

Sometimes the environment may be classified into market environment and non-market environment depending upon whether a business firm's environment is influenced by market forces like demand, supply, number of other firms and the resulting price

competition, or non-price competition etc., or by non-market forces like Government laws, social traditions, etc.

Finally, we may classify the environment into economic and non-economic. Non-economic environment refers to social, political, legal, educational and cultural factors that affect business operations. Economic environment, on the other hand, is given shape and form by factors like the fiscal policy, the monetary policy, the industrial policy resolutions, physical limits on output, the price and income trends, the nature of the economic system at work, the tempo of economic development, the national economic plan, etc. The non-economic environment has economic implications just as the economic environment may have non-economic implications. Since the environment is the sum total of the history, geography, culture, sociology, politics and economics of a nation, the interaction between economic and non-economic forces is bound to take place.

Activity 1

Can you now recapitulate the various *criteria* on the basis of which a business environment may be classified? Place the criterion on the left hand side and the suggested classification of environment according to that specific criterion on the right hand side.

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Now, think of your own organisation and its business operations. If you are not working in any organisation, then think of a firm, farm, factory, establishment or institution you are familiar with. Considering its present operations, identify some of its environmental factors as in the model given below.

Organisation: Indian Airlines (IA)

Environmental factors / forces within which IA is operating

Social	Political	Economic	Physical
IA carries various types of passengers : businessmen, Government officials, private individuals and tourists.	IA comes under the Ministry of Civil Aviation; it is subject to parlimentary control.	' IA's traffic is growing despite the fact that air travel is becoming costlier. ' Fuel economy is IA' primary concern today.	The fleet composition of IA is quite modern. However, IA cannot use the Airbus for all its sectors because the airport facilities are not adequate.

YourOrganisation : ....

Environmental factors/forces :

Social	Political	Economic	Physical

Do not proceed further without completing this Activity. It should be emphasised at this initial stage that you will miss much of the potential benefit of the course if you do not attempt the Activities given in this unit. If you have worked through the above Activity as directed, you will find that it is easier to describe than to identify and classify the environmental factors.

In this unit, our primary concern is the study of economic environment of business. You may be wondering why we have chosen the economic environment to begin with. Let us examine some of its basic propositions.

1.3 SOME BASIC PROPOSITIONS

As a prelude to the description and analysis of the business environment in any economy, you may examine the three basic propositions given below:

1. Business is an economic activity.
2. A business firm is an economic unit.
3. Business decision-making is an economic process.

These propositions may be examined separately or jointly to justify the study of the economic environment of business in any country.

Business is an economic activity

An economic activity involves the task of adjusting the means (resources) to the ends (targets), or the ends to the means. An economic activity may assume different forms such as consumption, production, distribution, and exchange. The nature of business differs, depending upon the form of economic activity being undertaken and organised. For example, manufacture is primarily concerned with production: the stock exchange business is mainly concerned with the buying and selling of shares and debentures; the business of Government is to run the administration. The Government may also own, control and manage public enterprises. The business of banks is to facilitate transactions with short-term and long-term funds. These examples can be easily multiplied. The point to be noted is that each business has a target to achieve, and for this purpose each business has some resources at its disposal. Sometimes the target has to be matched with the given resources, and sometimes the resources have to be matched with the given target. Either way, the task of business is to optimise the outcome of economic activities.

A business firm is an economic unit

A business firm is essentially a transformation unit. It transforms inputs into outputs of goods or services, or a combination of both. The nature of input requirements and the type of output flows are determined by the size, structure, location and efficiency of the business firm under consideration. Business firms may be of different sizes and forms. They may undertake different types of activities such as mining, manufacture, farming, trading, transport, banking, etc. The motivational objective underlying all these activities is the same viz.. profit maximisation in the long run. Profit is essentially " a surplus value" — the value of outputs in excess of the values of inputs or the surplus of revenue over the cost. A business firm undertakes the transformational process to generate this "surplus value". The firm can grow further if the surplus value is productively invested. The firm, therefore, carefully plans the optimum allocation of resources (i.e., men, money, materials, machines, time, energy, etc,) to get optimum production. The entire process of creating, mobilisation and utilisation of the surplus constitutes the economic activity of the business firm.

Business decision-making is an economic process

Decision-making involves making a choice from a set of alternative courses of action. Choice is at the root of all economic activity. The question of choice and evaluation arises because of the relative scarcity of resources. If the resources had not been scarce, an unlimited amount of ends could have been met. But the situation of resource constraint is very real. A business firm thinks seriously about the optimum allocation of resources because resources are limited in supply and most resources have alternative uses. The firm, therefore, intends to get the best out of given resources or to minimise the use of resources for achieving a specific target. In other words, when "input" is the constraining factor, the firm's decision variable is the "output". And when "output" is the constraining factor, the firm's decision variable is the "input". Whatever may be the decision variable, procurement or production, distribution or sale, input or output, decision-making is invariably the process of selecting the best available alternative. That is what makes it an economic pursuit.

Since business is an economic activity, a business firm an economic unit, and business decision-making an economic process, it is the economics environment of business which is the primary consideration in evaluating the business policies, business strategies and business tactics of a corporate entity in any national economy.

Activity 2

Briefly answer each of the following questions

1. What is an economic problem?

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2. What is the optimum economic activity?

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3. Why, or why not, should the organisation you work for be treated as an economic unit?

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Activity 3

Get some printed literature concerning your own organisation or any other business organisation, or you can even read the "corporate news" in magazines like *Business India, Business World, Business Today.* Attempt an *economic interpretation* of the facts and figures that you have at your disposal. You may begin by asking similar questions as given in Activity 2. Briefly jot down the points.

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You may elaborate and substantiate these points, wherever required.

1.4 ECONOMIC ENVIRONMENT

You may now consider a firm as an economic institution in a market system. The market behaviour of the firm reflects the nature of the economic decisions taken by the manager of the firm. Micro-economic decision-making by the firm has nevertheless to be made

within the broader macro-economic environment. The economic environment of business refers to the broad characteristics of the economic system in which a business firm operates.

The present day economic environment of business is a complex phenomenon. The business sector has economic relations with the Government, the capital market, the household sector and the foreign sector. These different sectors, together, influence the trends and structure of the economy. The form and functioning of the economy varies from country to country. The design and structure of an economic system is conditioned by socio-political arrangements. Such arrangements are relevant from the standpoint of macro-economic decision making.

For example, in a democratic set up, people exercise an influence, direct or indirect, through the system of casting votes, on the nature of the decisions,taken by the Government. In a parliamentary system, most decisions are processed by Cabinet ministers, whereas under a presidential form of Government the President acts as the real manager of the state: it is he who takes or makes decisions. Similarly, macro-decision-making is more decentralised in a federal form of Government than in a unitary form of Government.

You may argue that the decisions being referred to are political decisions. True, but it must be emphasised that political decisions have far reaching economic implications. After all, the Government is the manager of the economy. The nature of Government ownership, control and regulation of the economic activities of a country provides form and shape to the nature of economic organisations. In a capitalist society, the private sector, induced by *the* profit motive and *led* by the free market, takes the major economic decisions of investment, production and distribution. In a socialist society, most of the economic decisions are taken by the Government which is gu ided by the social wefare motive and central planning. In a communist society, economic decisions, including those of consumption are taken by the state in the interest of the community as a whole. In a mixed economy, the private, public and joint sectors and the like all have some say in the major decisions that influence the functioning of an economy.

All modem economies, whether capitalist, socialist, communist or mixed, have certain fundamental economic problems to deal with. In each and every economy, including the so-called "affluent society", some or many resources are scarce. Consequently, choices concerning the resource use have to be made together by individuals, by business corporations, and by society. It is the social choice and community preferences which give substance to the question of macro-economic decisions. From the standpoint of resources, the basic economic problem of every economy is that of just allocation of resources and subsequent optimum production. There are many aspects to this problem: What to produce? How to produce? For whom to produce? When to produce?

Every economy has to decide on the quality and quantity of the goods and services to be produced. It has to decide on the nature of the technology and technique of production in view of factor endowment. It has to decide on the course and pattern of distribution of goods and services produced. It has to decide on the timing of production. The process of decision-making differs depending on how these problems are solved in different economies. This is what constitutes the functioning of the economy, or the nature of the economic environment. At the risk of over-simplification, certain points can be made about the organisation and functioning of modern economies:

i) In most economies, both "free market mechanism" and "centralised planning" exist in different degrees even today. By "free market mechanism" or "price mechanism", we mean a free play of the market forces of demand and supply to determine an equilibrium solution of the allocation problem. Market mechanism determines commodity

prices, factor prices, and income distribution. By "planning", we mean a programme of action based upon consistency and feasibility of attaining a set of targets in view of a set of objectives through a set of instruments. In the present day world around us, planning is combined with free pricing to arrive at macro-economic decisions yielding "the maximum good to the maximum number". Thus, the economy in which a business firm operates today is not an exclusively free economy making an indiscriminate use of prices and the markets. Rather, it is directed by a system of planning, control, regulation and coordination.

ii) In most economies, positive intervention by the Government in day-to-day economic affairs has existed over several decades in the past. Planning is a form of Governmental intervention. Besides this, the Government can also intervene through a system of controls and regulations. The "welfare state" principle induces the Government to enforce minimum wages, commodity controls, fair trade practices, etc, through legislation. The basic objectives of such economic legislations and policies are: growth, efficiency and equity. It is the intervening role of modern Governments that has made most business firms socially responsible. However, intervention by the Government is now on the decrease. Many economies have relaxed regulations and controls through economic reforms, and are allowing a free play of market forces.

iii) Modern economies are not "closed", but "open"; they are actively engaged in international trade and cooperation. So, the international transmission effect today is stronger than ever before. Though there are disparities in the levels of income and standards of living over space and time, there is a conscious effort to develop the poor nations. The maintenance of steady growth in developed countries is dependent on the acceleration of growth in underdeveloped countries. This idea has given new dimensions to issues like the role of multinational corporations, the ecological balance, the recycling of petrodollars, and the transfer of technology. The technological revolution is making strident moves. In order to keep their dynamism, the economies are determined to develop science and technology, and to balance environment and ecology, and this is going to act as a unifying force for the world economic order.

These facts define the environment and set the constraints within which modern business firms must operate. The managements cannot overlook the environment, whether market or non-market. No management can ignore the functioning of markets, the objectives of national planning, the policies of the Government or their social responsibilities, or the rate, pattern and structure of economic changes, or the forms of international cooperation. Progressive managements must keep themselves continuously informed about the magnitude and direction of changes in the national as well as international economic environment. Of course, both economic and non-economic environment have an important bearing on managerial decisions.

Activity 4

List some of the basic observations concerning the nature and functioning of modern economics in general.

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Activity 5

Read the Latest *World Development Report* of the. World Bank. if it is not accessible; you may fall back on your general knowledge. Write down the firsthand information available to you on

World Economy	Indian Economy
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Note that you are required to take stock of the latest developments i.e., the current situation.

Let us now move to more specific issues. When you attempt to analyse the economic environment of business in any country, first of all, you have to identify the critical elements of that environment.

1.5 CRITICAL ELEMENTS

In what follows, we intend to identify and describe a few critical elements of the economic environment. These critical elements are relevant from the standpoint of both corporate business management and national economic management in India.

The critical elements of macro-economic environment are:

- economic system
- nature of the economy
- anatomy of the economy
- functioning of the economy
- economic planning and programmes
- economic policy statements and proposal
- economic controls and regulations
- economic legislations
- economic trends and structure, and
- economic problems and prospects.

These critical elements may not always be mutually exclusive. But you may treat them separately for analytical purposes.

An economic system defines the *institutional framework of the environment.* The ownership, control and management of enterprises reveals the nature of the economic system. The role and responsibility of the private sector, public sector, joint sector, etc. throw light on the philosophy and practice of an economic system — capitalist, socialist or mixed. The mixed economic system operates through a combination of planning and pricing.

The level of economic development and the structure of the economy define the *physical framework* of the environment. The level and composition of per capita income indicate the level of growth and development. Available natural resources, human resources and material resources of a country set a limit to its factor endowment which determines its production. The occupational distribution of the labour force, the structure of the national output, the composition and pattern of foreign trade, the structure of savings, investment and capital formation, the pattern of income distribution (inter-personal and inter-regional), and the degree of urbanisation — all

these bring out the significance of the agriculture, industry, and service sectors in the national economy.

The structure of the national economy can also be discussed in terms of its *physical anatomy.* The national economy is, after all, a combination of the household sector, the corporate business sector, the Government administration, the capital market, and the foreign sector. This is suggested by the national income and the social accounting approach. The order and strength of each of these sectors, therefore, also throws light on our understanding of the macro-economic environment.

If you can describe the economic environment with reference to the terms discussed above, you may now attempt an explanation of its *functioning.* You will discover that money is the life and blood of business activity and of the economic system. The flows of consumption, investment, saving, income, employment and output are all affected by transactions of money. Monetary transactions affect the price level, thereby influencing the real value of all macro-economic variables. Significant developments have taken place in macro-economics to define the role of money. The essential question is: Does money matter?

There are different answers to this question: (1) Money does not matter at all (Classical);(2) Money matters least (Keynesian); and (3) Money matters most (Monetarist). The theoretical debate is quite interesting. But you have to examine its empirical relevance in the economic environment of a country like India. This will provide you with a further insight into the role of centralised planning in the present context, administered price system as well as free market pricing, and central banking.

Economic planning is supposed to give a direction to the changes in the economic environment . Most countries function today on the basis of planning. Either it is planning by direction — typical of a socialist economy, or it is planning by incentives, i.e., democratic planning typical of a mixed economy, or it is indicative planning typical of the French economy. It is through the system of a perspective planning, five-year planning and annual planning that the economies try to overcome their environmental constraints and optimise their achievements over a period to time.

Planning is a programme of action, it is not a guarantee in itself. The formulation of plans and programmes must, therefore, be followed by proper implementation. This calls for *economic policy statements* and *legislations.* Apart from having general policy statements affecting industry and agriculture, the Government often formulates and executes fiscal-cum-budgetary policies. The central bank will work through the instruments of money and credit policies, exchange rate policies, etc. Some sort of physical policies of controls and regulations may also be needed. Price control, trade control and exchange control are all moves in the same direction. Sometimes legislations and enactments become necessary for effective implementation of all these policy statements and proposals. The national economic environment of business is determined by the existing macro-economic policy framework.

These policies, planning and pricing together make the economy function effectively. The functioning of an economy is reflected in *short-period fluctuations* and *long-term trends, in macro-economic variables* like income, money supply, prices, production, employment, balance of trade and payments, foreign exchange earnings, etc. These trends decide the course of the prevailing economic environment. Some of these economic trends may define the nature and dimension of various *macro-economic problems* like inflation, unemployment, recession and the like. The problems have to be analysed with the objective of making the national economic management efficient. Economic problems and economic prospects in the environment throw challenges to the corporate business management as well as national economic management.

Activity 6

Somebody picked up at random the following headlines from newspapers and magazines published in India. Identify each one of them and place it under the broad categories of critical elements of the economic environment.

Headlines : "Finance Minister announces drought relief measures"
"MODVAT being reviewed"
"20-Point Economic Programme"
"Bonus Ordinance"
"Wholesale Price Index still rising"
"FERA Amnesty Scheme"
"Non-resident Indians' investment incentives"
"Power in the private sector"
'Liquidation of sick units within public sector"
"Public sector units to float bonds"
"More autonomy for the RBI"
"Zero-base budgeting introduced by the Government"
"More items of import under OGL"
"Industrial relations elimate better"
"A mid-term review of the 8th Plan by the end of 1992"
"Pay Commission Report released"
"Trade unions on war path"
"Department of Environment for Ecological Balance"

Economic System

Economic Planning and Policies

Economic Controls and Regulations

Economic Legislations

Economic Trends and Structures

Economic Anatomy

1.6 INDIAN ECONOMIC ENVIRONMENT

Now, you may be anxious to evaluate the Indian economic environment in terms of the conceptual framework just suggested. You may note that the national economic environment of a country can be described and analysed in terms of its (a) *data* environment, and (b) system environment. In subsequent units you will be exposed to the details of the Indian economy's data environment, i.e., the *physical* trends and structural co-efficients. The system environment of the Indian economy will also be dealt with in detail, in terms of various policy statements, planning techniques, organisation and structure of the capital market, role and responsibility of the private and public sector, etc. The system environment encompasses the entire *institutional* framework of the economy. An overview of this system environment is presented in this section. For the time being, you should be more interested in the evaluation rather than evolution of the present Indian economic system.

You might have come across the statement that *India's is a mixed economy*. In fact, India has a very complex mixed economic system. Let us elaborate this further.

Firstly, a simple mixed economic system is characterised by the existence of the private and public sectors. India has a multiplicity of sectors: private (dominant undertakings, foreign companies, etc.), public, joint, co-operative, workers' sectors and also "tiny sector". We hear of different sectors in different areas of the Indian economy: big sector, small sector, heavy sector, light sector, licensed sector, delicensed sector, national sector, core sector, reserved sector, etc. India is a complex vector of sectors.

Secondly, a simple mixed economy is characterised by complementarity between central planning and pricing. India has a multiplicity of mechanisms at work: five-year plans, annual plans during plan holidays, pointed economic reform and reconstruction programmes during and after plan vacations, ideas of rolling plans; an elaborate system of controls and regulatory measures, attempts towards streamlining and simplification of procedures, private traders and public distributors for the same product and hence a system of dual prices, ceiling prices, floor prices, subsidised prices, statutory prices, retention prices, procurement prices, levy prices, and free market prices contractionary monetary policies and expansionary fiscal policies, etc. In India there is a complex system of literal rules, strict regulations, control mechanisms, planning and a host of price regulations (which of course are being gradually relaxed).

Finally, a simple mixed economy is expected to reach a target level of social welfare, and for this task, the profit policies are to be designed according to a social purpose. The social welfare function in India is defined by the multiplicity of objectives which are sometimes conflicting in nature. For example, in terms of our five-year plans, India is aiming at efficiency, justice and stability. Productive efficiency in a static sense refers to the efficiency-allocation of the given resources. Productive efficiency in its dynamic sense refers to economic growth. The fruits of economic growth have to be distributed. Fairly among the masses; social justice is to be so attained so as not to endanger stability of prices, incomes, balance of payments, etc. The Indian plans have always emphasised objectives like full employment of labour, full capacity utilisation of plant and equipment, and self-sufficiency. In the long run, these objectives may be compatible with each other, but operationally these objectives come in conflict with each other. For example, in order to promote a higher rate of growth, heavy industrialisation and large investments are undertaken. Such investments increase the flow of money faster than the flow of output. This generates inflationary forces. Thus, price stability comes in conflict with economic growth. Similarly, economic growth comes in conflict with social justice. A progressive tax system is used as a means to reduce income inequalities, but the same tax policy hampers private incentives to invest and to generate the growth forces thereby. Foreign exchange remittances help the country in overcoming balance of payments difficulties, but they increase the domestic money supply and prices. Examples can be multiplied to demonstrate the inherent conflict among the objectives which the mixed economy of India hopes to achieve. To top it all, different instruments have been used to attain different target variables — fiscal policies for growth with justice, monetary policies for price stability with growth, price and output controls for price stability with justice. This has led to further confusion.

To sum up, the so-called mixed economic system of India sometimes gives the impression of a mixed-up economic system that is characterised by a multiplicity of sectors, a multiplicity of instruments, a multiplicity of objectives, and a multiplicity of adjustments to resolve the conflict between various sectors, between instruments and between objectives.

The present day mixed economy of India has evolved through a series of policy formulations and legislations. It started with the Industrial Policy Resolution of 1948. This was followed by the Industries (Development and Regulation) Act 1951, the Directive Principles of Stale Policy 1950, the Industrial Policy Resolution 1956, the Monopolies and Restrictive Trade Practices (MRTP) Act 1969 and its subsequent amendments, the Industrial Licensing Policy, 1970, and its subsequent amendments and the Foreign Exchange Regulation Act (FERA) 1973 and its subsequent amendments. These enactments and policy formulations

have been modified or supplemented from time to time by comprehensive five-year plans, the 20-Point Programme, controls and regulations on prices, output, production, distribution and trade, various nationalisation schemes, anti-poverty schemes, and finally the economic reforms initiated in 1991.

During the decade of the 1980s the Indian mixed economy took a decisive direction. It all started with the announcement of the Industrial Policy Statement of 1980. The purpose of this policy was to ensure attainment of socio-economic objectives such as optimum utilisation of capacity, maximum production, employment generation, export promotion, import substitution, consumer protection, correction of regional imbalances through the development of industrially backward areas and "economic federalism" with an equitable spread of investment among large and small units, among urban and rural units, etc. Some important provisions of the 1980 policy were:

- regularisation of excess capacity
- an automatic expansion at the rate of 5% per annum to the maximum of 25% in five years, in all the industries of basic, critical and strategic importance
- promotion of 100% export-oriented units
- revival of sick units through a package of modernatisation measures
- development of "nucleus plants" (on the lines of District Industries Centres)
- reorientation of the public sector, including the development of its managerial cadres.

As a follow-up of the 1980 Statement, the Government announced some further concessions on April 21, 1982. Among these, the important ones were the following:

- The list of "core sector" industries was revised by including five more industries. It implied that the FERA companies and large houses would be allowed to set up industries in those areas.
- Industry was allowed 33.3% capacity over the best production during the previous five years over and above the 25% excess production.
- Large houses and multinationals would be permitted to set up units outside the core sector if the units were predominantly export-oriented, i.e., 60% export in respect of items not reserved and 75% for items reserved for the small-scale sector.

Such liberalisation measures were supplemented by relaxation in price and distribution controls, amendments in the provisions of the MRTP Act relating to the definition of "market dominance", exemption from the need to obtain MRTP clearance for production in sectors of "national priority", etc. Such measures were specifically designed to assist the expansion of industrial production during 1982, which was designated the Productivity Year.

During 1983-85, the Industrial Policy pursued by the Government of India placed emphasis on modernisation and technological upgradation for better capacity utilisation and larger production. For example, in order to promote demand, excise duties were reduced on commercial vehicles, refrigerators, batteries, tyres and tubes. Major concessions in excise and import duties were given for the benefit of the electronics industry with effect from October 1, 1983.

During 1985-87, the Government took a large number of measures to encourage the private sector. Some of these measures which were broadly referred to as "privatisation" and "liberalisation" included: Inviting private bids for oil drilling by both the Oil and Natural Gas Commission and the Oil India Limited on a contract basis; setting up of the Mangalore and Karnal refineries in the joint sector; setting up of new power units in the private sector; decision in principle to encourage private funds including foreign capital for setting up container terminals and port development; acceptance of an 'air taxi service' in the private sector; permitting private and co-operative bodies to put up TV terminals, and to run Post Offices; enlisting private enterprises in the field of building roads and bridges; permitting the private sector to manufac-

ture solar cells which were hitherto the monopoly of public undertakings namely, Bharat Heavy Electiricals Ltd., and Central Electronics Ltd; and a decision to reconstitute the Board of Directors for units like Air India and Indian Airlines, so as to run them on the principle of professional management by experts drawn from both the private and public sectors.

The New Economic Policy

The new economic policy was announced in July 1991 which is of far reaching importance. The new economic policy, among other things, has a bearing on: (1) Industrial Licensing, (ii) Foreign Investment and Foreign Technology Agreements, (iii) MRTP regulations, and (iv) Public Sector. Our purpose is to acquaint you with the main ideas or philosophy behind the economic policy. And this we intend to do by taking up all these aspects briefly. (All these aspects will be taken up for further discussion in the appropriate units).

Industrial Licensing: The statement of new economic policy emphasised that the system of industrial approval needed a number of changes to actively encourage and assist Indian entrepreneurs to exploit and meet the emerging domestic and global opportunities and challenges. The bedrock of policy measures must be to let the entrepreneurs make investment decisions on the basis of their own commercial judgement. Government policy and procedures must be geared to assist the entrepreneurs in their efforts by making essential procedures fully transparent, by eliminating delays, and removing restraints on capacity creation, while, at the same time, ensuring that overriding national interests are not jeopardised.

The decisions taken in this respect are listed as under:

- Abolition of industrial licensing for all projects except for a short list of industries related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons and items of elitist consumption. Industries reserved for the small-scale sector would continue to be so reserved.
- Areas where security and strategic concerns predominate will continue to be reserved for the public sector.
- In projects where imported capital goods are required, automatic clearance will be given in certain cases.
- In locations other than cities of more than 10 lakhs (1 million) population, there will be no need for obtaining industrial approvals from the Central Government except for industries subject to compulsory licensing.
- Existing units will be provided a new broad-banding facility to enable them to produce any article without additional investment.
- Exemption from licensing will apply to all cases of substantial expansion of existing units.
- The mandatory convertibility clause will no longer be applicable for term loans from the financial institutions for new projects.

Foreign Investments and Foreign Technology Agreements: Regarding direct foreign investment, the Government announced its decision to grant approval for investment up to 51% foreign equity in high priority industries without any bottlenecks in the process of approval. This was intended to invite foreign investment in industries requiring large investments and foreign technology. The list of high priority industries identitified for the purpose include 34 broad areas like metallurgy, electrical equipment, transportation, food processing, and hotel and tourism industry. However, clearance will be given if foreign equity covers the foreign exchange requirements for imported capital goods. Proposals which do not meet the above criteria will continue to need prior clearance. But foreign equity proposals need not necessarily be accompanied by foreign technology

agreements. Payment of dividends on foreign equity would be monitored through the Reserve Bank of India so as to ensure that outflows on that account are balanced by export earnings over a period of time.

Direct foreign investment up to 51% foreign equity is allowed for trading companies primarily engaged in export activities to provide access to international markets.

Foreign Institutional Investors (FIIs) have been permitted to enter the Indian capital market and allowed to trade both in the primary and secondary markets, without any restriction on the total volume of investment and lock-in period.

With the amendment of the Foreign Exchange Regulation Act in January 1992, there were further changes in the policy frame. The limits on the operations of FERA companies in non-priority sectors were removed. These companies were also enabled to take up any trading, commercial and industrial activity, as also acquire any company in India, or acquire shares in any company without prior approval of the Reserve Bank. Their export obligations and commitments stood annulled. Earlier, FERA companies having a 74% stake were to commit 74% of turnover to priority sector activity. To retain 51% to 60% stake, such companies were required to commit 60 per cent of turnover to priority or sophisticated technology industries with a minimum 10 per cent export commitment, or export commitment of 60 per cent of turnover.

Foreign Technology Agreements: The policy statement emphasised that there is a great need for promoting an industrial environment where the acquisition of technological capability receives priority. Towards that end, governmental interference with commercial technology relationships of Indian entrepreneurs with foreign technology suppliers was unnecessary.

As viewed by the Government, in the fast-changing world of technology the relationship between the suppliers and users of technology must be a continuous one, whereas governmental interference on a case-to-case basis involved inordinate delays and fostered uncertainty. The Indian entrepreneur had come of age and no longer needed bureaucratic clearances of technology relationships.

Thus, Indian companies will, hereafter, be free to negotiate the terms of technology transfer with their foreign counterparts according to their own commercial judgment within the specified parameters. This is expected to induce industry to develop indigenous competence for the efficient absorption of foreign technology, and invest more in R&D due to greater competitive pressure.

Changes in MRTP Regulations: A significant change initiated by the new policy was the removal of the threshold limits of assets in respect of MRTP companies and dominant undertakings. With this decision, prior approval of the Central Government will not be required for the establishment of new undertakings, expansion of undertakings, merger, amalgamation and takeover of companies. Instead, emphasis will be on controlling and regulating monopolistic, restrictive and unfair trade practices as provided under the MRTP Act. At the same time, the MRTP Commission will be empowered and authorised to initiate investigations *suo moto* or on complaints received from individual consumers or classes of consumers in regard to monoplistic, restrictive and unfair trade practices.

Public Sector Policy: In the context of massive investments made, the policy statement noted two aspects of the performance of public enterprises. The mature enterprises have successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in a number of areas. On the other hand, in many of the enterprises, serious problems have manifested themselves, which are observed in insufficient growth of productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate attention to R&D and human resource development. The consequent low rate of return has inhibited the ability of such enterprises to regenerate themselves in terms of new investment as well as in technology

development. Thus, many of the public enterprises have become a burden on rather than an asset to the Government.

The original concept of public sector has undergone considerable dilution. The take-over of sick units from the private sector has resulted in losses of a certain category of public sector units amounting to almost one-third of the total losses of Central Government enterprises. A number of enterprises in the consumer goods and services sector do not fit into the original idea of the public sector being at the commanding heights of the economy.

The policy decisions in the above context are based on a new approach as follows:

- The portfolio of public sector investments will be reviewed with a view to focus the public sector on strategic, high-tech and essential infrastructure.
- Public enterprises which are chronically sick and which are unlikely to be turned around will be referred to the Board for Industrial and Financial Reconstruction (BIFR), or other similar institutions created for the purpose, for the formulation of revival/rehabilitation schemes. A social security mechanism will be created to protect the interests of workers likely to be affected by such rehabilitation packages.
- In order to raise resources and encourage wider public participation, a part of the Government's shareholding in the public sector would be offered to mutual funds, financial institutions, general public and workers.
- Boards of public sector companies would be made more professional and given greater powers.
- There will be a greater thrust on performance improvement through the Memorandum of Understanding (MoU) by which managements would be granted greater autonomy and would be held accountable. Technical expertise on the part of the Government would be upgraded to make the MoU negotiations and implementation more effective.
- To facilitate a fuller discussion on performance, the MoU signed between the Government and the public enterprises would be placed in Parliament. While focusing on major management issues, this would also help place matters of day-to-day operations of public enterprises in their correct perspective.

In February 1992, the Government of India announced its decision to permit public sector undertakings to float bonds. The move was aimed at mobilising extra-budgetary resources for the public sector and was applicable to all state enterprises fully owned by the Central Government. Guidelines were issued by the Controller of Capital Issues in this connection for floatation of bonds by existing as well as new corporate undertakings including finance corporations. We shall now talk about competition and quality.

Challenge of Global Competition and Quality Standards: Industrial enterprises in India, after years of protection from foreign competition, have been exposed to competitive markets both within and outside since the policy of liberalisation was initiated in 1991. With the entry of MNCs and growth of foreign companies, domestic product markets are being increasingly subjected to forces of competition. On the other hand, export promotion is directly linked with the competitiveness of Indian products in markets abroad

Price and quality are two major factors by which the competitive strength of a company is determined. Except for elitist products, price has been the more important factor determining the sales performance of firms. However, brand images of foreign companies are making a dent in the domestic market with buyers becoming more quality conscious. In export markets, although price influences buying decisions to a large extent, the quality of the product is an equally important factor in export marketing.

It is in the above context that the significance of quality standards has been recognised

widely in Indian industries. At the national level quality standards have been developed by the Bureau of Indian Standards (BIS) for a large number of products and components. BIS, at present, manages 16,000 standards developed over the years for over 14,000 products. The Standard Mark of Certification — the ISI Mark — is granted by the Bureau where the goods conform strictly to the relevant standards set by it. The certification scheme is designed to ensure the quality of goods, particularly those affecting the health and safety of consumers. It also ensures that mass-produced and mass-consumed products conform to the required standards of quality, safety and durability.

Grading and standardisation of agricultural commodities is provided for under the Agricultural Produce and Marketing Act, 1937. For fixing grade standards there are sixteen regional laboratories besides the Central Agmark Laboratory at Nagpur. Among others, commodities graded include vegetable oil, butter, eggs, wheat flour, rice, cotton, potatoes, gur, maize, honey and ground spices. The graded products are stamped with the seal of the Agricultural Marketing Department — AGMARK. Compulsory grading is done before export in the case of 34 commodities.

Of late, a great deal of importance has come to be attached to Quality Systems Standards — the ISO 9000 series of Standards — which, the International Organization for Standardisation (ISO) brought out in 1987, and were published in India by the BIS in 1988 as IS 14000 series of standards. These standards are based on Quality Management Systems, and provide an effective means of ensuring that the producer is consistently capable of delivering goods of the desired quality at optimum cost. The emphasis is to provide for quality not only in manufacturing but in every other activity of the organisation from marketing to delivery and feedback from after sales services. The BIS launched the Quality Systems Certification Scheme in September 1991 under the provisions of the BIS Act, 1986. The operation of the scheme entails initial assessment and subsequent surveillance of the quality systems installed and implemented by the firm for verification of its conformity to the prescribed requirements. The operation of the scheme is in harmony with international practices. It meets the criteria enunciated by ISO, the European Community and its accreditation from Ms. Raad Voor de Cerificates, Netherlands.

However, ISO 9000 certification by itself cannot yield results unless people on the shop floor and in Board rooms are continuously motivated to keep their performance levels high. The demand for certification of quality systems from a wide cross-section of industry is increasing, primarily from export-oriented units. A number of certification bodies — companies catering to quality management systems certification — have come up and are reported to be vying with each other to offer their services. In the absence of a national quality accreditation body, it is feared that quality systems certification by different agencies may be lacking in credibility.

1.7 ECONOMIC ENVIRONMENT AND BUSINESS MANAGEMENT

If you have undertaken Activity 6 seriously, you would realise that there is a lot of overlapping, i.e., one item may fall under different heads. This suggests a difficulty in the classification of environmental variables. At the same time, it points towards *interaction* among environmental factors.

Let us now examine the interaction between Economic Environment and Business Management.

The business environment influences business management. The critical elements of the business environment often interact with the critical elements of business management. The critical elements of business management are: planning, direction, organisation, control

or coordination, leading and motivation and evaluation. Management at all levels, top, middle as well as supervisory, is concerned with these critical elements to a certain degree. Similarly, these very critical elements are the concerns of the management that specialises in different functions such as production, finance, marketing, purchase, inventory control, personnel, public relations, research and development, etc.

Management, at all levels of specialised functions, is influenced by the critical elements of the business environment. For example, when an industry faces business recession, the management may decide to cut down the rate of production or to pile up inventory. When the market is being invaded by an increasing number of closely substitutable products, the management may decide to go in for aggressive advertising to face cut-throat competition. When the financial institutions start interfering too much with the day-to-day business operations of a firm, the firm's management may decide to do away with borrowed capital and depend upon its own resources. When the Government enforces minimum wage legislation and other social security measures for all permanent workers, the management may decide to recruit only casual workers through a labour contractor. Such examples can be multiplied. The point is that the management always studies the environment and then makes/takes a decision accordingly.

The existing business environment may act either as a stimulant or as a constraint for business management. If the prevailing environment is favourable to business growth and prosperity, then the management feels happy and responds positively. Small business owners, for example, are often encouraged to produce more when the Government pays them a subsidy. On the other hand, when the prevailing environment is unfavourable, it acts as a disincentive. For example, when the Government tries to impose a high tax rate on corporate profits, many business concerns try to evade tax by under-reporting their profits. It is interesting to note that the same environment may act both as a stimulant and a constraint — stimulating for some and constraining for others. Reconsider the last example. A high tax rate increases the propensity to evade taxes; it induces the corporate tax payers to restrict their output, sales or profits. At the same time, this very situation provides an opportunity to the tax consultant for a thriving business.

For the management, the environment is not limited to the institution of the Government. There are other institutions and forces as well. The management has to take care of the interests of other groups also, such as the workers, suppliers and contractors, consumers, shareholders and many others. The workers, organised in trade unions, often ask for higher wages. The salaried middle-level managers, through their associations, may also ask for a particular package of pay and perks. The suppliers, organised in guilds, may not always supply materials as per the specifications of the management, and they may seek revised rates or change the quality and schedules of delivery. The shareholders may ask for higher dividends or may like to have a greater say in management. The consumer cooperatives may seek lower prices and better quality for the products they buy. All in all, the top management has to balance the interests of all the stakeholders — Government, trade unions, manufacturers' association, financial institutions, consumer cooperatives and so on. Very often, the management's own economic aspirations may come in conflict with those of other groups. If the management can readily resolve these conflicts, it gets the better of the environment. And if the management accentuates these conflicts, it becomes the victim of the environment. The management may dictate or be dictated to by the negative/positive forces of the environment.

A good amount of managerial skill is required in adjusting to the environment. The managers must have a thorough knowledge and understanding of the immediate business environment. With experience and maturity, the alert managers acquire the skill to deal with the environment. When an environment repeats itself, experienced managers effectively display their capability to take care of it. When the changing dimensions of the

environment establish a sudden departure from past trends and tendencies, the managers are called upon to demonstrate their capability to deal with the situation of risk and uncertainty. The environment, thus, poses a challenge to the management. Managerial efficiency and/or effectiveness is a measure of adaptability to the existing business environment.

Environmental scanning, thus, becomes an important step towards corporate planning and business policy decisions. Corporate managers analyse the Strengths(S), Weaknesses(W), Opportunitics(0) and Threats(T) that exist for their organisations in the context of its environment. The SWOT analysis precedes the making/taking of strategic and tactical decisions by the management.

Irrespective of the tact whether it is office management, factory management, farm management, hospital management, bank management or any other management, business management everywhere is determined by, and determines, the business environment. We have so far treated a firm and its management as a dependent variable, the explanatory variable being the environment. Let us now consider the opposite situation. The totality of business behaviour of different corporate entities may also determine the form and content of the environment. If the managements of different public enterprises ask for more automony, there emerges a possibility towards a *laissez faire* business environment. Or suppose management-labour relations deteriorate day-by-day first in one firm, then in other firms, then in one industry, then in different industries, because of some sort of demonstration effect, then the national economic environment sooner or later will be affected by such unhealthy industrial relations. Another example is that the preparation of the balance-sheets of a growing number of companies is directed by considerations of accounting convenience, rather than accounting conventions. A study of such balance-sheets may present a distorted picture of the national investment climate. With the help of these examples, you may argue that the behaviour patterns of individual firms and their respective managements together determine the macro-level enrivonment of business and industry.

The environment and management thus influence each other. The existing environment influences corporate level planning, business strategy and business tactics; it also affects the size, structure, location, integration and growth of business. The management's success or failure is determined by its adjustment to favourable/adverse environmental factors. The nature of such realisation, its frequency and duration, inuuces corporate managers to cultivate some standards of business philosophy, business ethics and business practice. Simultaneously, Government managers, the labour managers and the like also start adjusting to the changing organisation-culture. This yields a new business environment. And so the process continues. It is thus, a never-ending process of interactions: Environment —» Management -> Environment -». It is like a biological organism which keeps both the environment and the management continuously responsive to each other.

Activity 7

Think about your own organisation or any other. You may now attempt a SWOT analysis of its business environment. Do name the organisation and the industry it belongs to before you start.

Name:

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Strengths

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Weaknesses :

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Opportunities :

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Threats :

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Let us now turn our attention to interaction between the economic environment and Business Management. You may also like to consider the interaction between the economic and non-economic environment.. B.M. Richman and M.R. Copen, in their book *International management and Economic Development,* have, in fact, developed the concept of Interaction Matrix to stress the significance of this or other forms of inter-dependence among environmental variables.

1.8 ECONOMIC AND NON-ECONOMIC ENVIRONMENT: THE INTERACTION MATRIX

The economic environment of business exercises a strong influence on the non-economic environment of business just as the non-economic environment influences the economic environment The economic environment is, thus, both exogenous and indigenous; it determines as well as it is determined by the non-economic environment. Let us consider a few specific interactions..

The social environment affects and gets affected by the economic environment of business. Social attitudes towards business and management determine how many people get attracted to private business as an activity and to management as a career. If business gets social sanction as a respectable profession, the occupational structure of a country will reflect a sizable category of professional managers. On the other hand, if more and more of the active labour force joins professional management, the social attitude towards business and its management also changes.

Let us take another example. Social movements largely determine the economic system. If the workers cultivate an attitude of confrontation, rather than cooperation, with management, a repressive economic system may be needed to cope with industrial disorder. On the other hand, if the attainment of rapid economic growth is the target, the management must bring about a labour productivity revolution and the wages may be based on productivity of labour rather than profitability of business. To operate on productivity-based wages is to operate on the system of incentives and positive attitudes of labour. The attainment of a specific economic objective is, thus, conditioned by a specific social attitude and discipline.

The educational-cultural environment and the economic environment of business are also interdependent. The state of economic development acts as a decisive factor in the choice of a system of education. For example, only a relatively high-income country can afford to impart costly higher education in science and technology. The system of education, on the other hand, may be responsible for a given economic environment. For example, the emphasis on education in the arts and a lack of vocational courses may be held responsible for the economic problem of unemployment in many countries. At the corporate level, the interdependence between educational and economic environmental

factors may at times take the form of a vicious circle. For example, a business concern with low profits may not find resources to finance management training or executive development programme. As a result, there may be a shortage of highly qualified and trained management personnel. Thus, lack of trained competent managers may lead to business inefficiency.

The politico-legal environment and economic environment of business are also interlocked to such an extent that we sometimes think of the political economy of business. In a situation of political stability, business enterprises happen to be forthcoming and businessmen are willing to take more economic risks. But if there is political instability, business uncertainties multiply and, therefore, entrepreneurs may not like to take up new business ventures. The state of business in Punjab during the period of terrorism is a recent example. Similarly, the ideology of the ruling party influences the economic system. The ruling party which believes in using socialism as a strategy and nationalisation of enterprises as a tactic to strengthen the economy may not be favourably viewed by the private business sector. On the other hand, sometimes a series of political legislations may be necessary to cope with the economic environment. To fight economic and industrial recession, the strategy of streamlining the administration and simplifying the procedure may be adopted. In fact, different legislations of the Government (like MRTP Act, FERA, and Urban Land Ceiling Act) are often politico-economic in character. This is borne out by an analysis of the content and intent of different legislations and political announcements. Also, the state of economic environment decides the continuity or discontinuity of a particular political administration. The state of the political environment, in its turn, decides the pattern of economic legislations.

The historical environment and the economic environment of business are also interdependent. The present (economic) environment of business can be treated as a legacy of its past (historical) environment. Every business has a history, and history always has a lesson to teach. As such, the present is a reflection of the past, and the present can also be handled in terms of the experiences of the past. A number of examples may be quoted. The present economic environment of a country is partly determined by the available structure of industry in that country. Today you find a number of extractive industries such as mines and plantations in our country. These industries can be traced back to the colonial pattern of investment in the past. The British empire was interested in the colonies so that it could easily (a) get the raw materials for its industries, and (b) dump the finished manufactured products in the colonial markets. The colonies, thus, supplied the market as well as the raw materials. In other words, the economic environment of business in the newly independent nation-states is the outcome of the colonial infrastructure which these countries had in the past. Similarly, history is a record of events, and a storehouse of lessons which can provide guidelines for present economic policy decisions. The achievements of the Five-Year Plans in the past may provide a direction to the formulation and implementation of the current Five-Year Plan of an economy. And the present performance of a plan will decide the future course of planning. It suggests that the environmental factors are interrelated on the time scale too.

Finally, *we come to the interaction between the physical environment of a country and the economic environment of business in that country.* A number of legislations have been enacted in many countries to conserve natural resources and to preserve natural the physical environment. These environmental legislations may impose a constraint on the expansion of a given business concern like a factory. Thus environmental considerations limit the expansion activities of a business firm. On the other hand, the size of a plant, the scale of output, the organisation of firms, the structure and location of industries may lie at the root of either environmental improvement or environmental decay. Thus, the social responsibility of business today means taking care of the environmental impact of various economic and technological activities. To the extent this social responsibility is not discharged, laws relating to business and industry will increasingly turn out to be laws relat-

ing to the physical environment of business. From this standpoint, one may feel that in addition to the existing functional areas of management (production, finance, persc[illegible]el and marketing), we are soon going to have a new area of environment. The point rer[illegible]s that the physical environment as a factor is becoming so significant day by day that it [illegible]y be treated as a critical element within the economic environment of business.

In the foregoing pages, we have discussed how the economic environment in general interacts with non-economic environmental factors. If you think a little more, you will discover that individually each critical element of the economic environment (namely, economic system, economic structure, functioning of the economy through sectors, economic policies, programmes and controls) interacts with each critical element of the non-economic environment (namely, sociological, political, historical and physical) and their respective sub-elements. We can conceptualise this interdependence or interlocking of various environmental factors in terms of an Interaction Matrix. For example, in Interaction Matrix below we have listed the critical elements of the non-economic environment along the rows and the critical elements of the economic environment along the columns thus yielding a seven by five matrix. When a given element of the economic environment influences a given element of the non-economic environment, you draw a short line vertically, and when an element of the non-economic environment influences a given element of the economic environment, you draw a short line horizontally. Thus in case of interdependence among the environmental elements, you end up with a plus sign which suggests a two-way interaction. The Interaction Matrix serves as a ready-reference for understanding environmental relations and reactions.

Interaction Matrix

Economic Environment → / Non-Economic Environment ↓	Economic System	Economic Structure (Anaomy)	Functioning of the Economy via Sectors	Economic Planning (Long-term)	Economic Programme (Short-term)	Economic policies- Fiscal & Monetary	Economic Control & Regulations	Economic Growth & Development
(1) Sociological	+	+	+	+	+	+	+	+
(2) Educational cultural	+	+	+	+	+	+	+	+
(3) Political-legal	+	+	+	+	+	+	+	+
(4) Historical	+	+	+	+	+	+	+	+
(5) Physical-Geographical	+	+	+	+	+	+	+	+

Activity 8

Treat the preceding Interaction Matrix as a model and figure out a few more Interaction Matrices. You should try to inler-relate the environmental variables classified on various criteria such as space, time, factors and forces. Corresponding to each element in a given matrix, think of a real specific example from the Indian business world.

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1.9 SUMMARY

The environment is a complex phenomenon. The term environment consists of several subsets, e.g., economic environment, socio-cultural environment, politico-legal environment, technological environment, etc. It thus represents the totality of all kinds of environments which have an impact on business. To a large extent, the environment is external to the firm. Business firms in general have little influence on external forces. Depending upon the nature and composition of several subsets of the environment, the business environment varies form country to country, and may even vary in the same country from one point of time to another. A number of problems are involved in the identification, description, explanation and prediction of environmental factors. The environmental factors are dynamic. It is difficult to conceptualise and/or quantify the proportion of change as well as the direction of change in environmental factors.

Some basic propositions about business are: it is an economic activity; the business firm is an economic unit; and business decision making is an economic process.

The environment may be classified (for convenience of analysis) based on different criteria such as :

Space — Local, regional, national and international environment.

Time — Past, present and future environment.

Forces — Market and non-market environment.

Factors — Economic and non-economic environment.

The environmental factors can be treated as exogenous as well as endogeneous. The factors are inter-locked to such an extent that you may like to make use of the concept of Interaction Matrix to illustrate their interdependence.

The environment consists of all economic institutions, the structure of the economic system, market forces, Government's economic policies and plans. All modem economies have certain fundamental economic problems to deal with. Most of the countries of the world have mixed economies. There is a tendency towards the marketisation of economic institutions and opening up of economies.

The critical elements of any economy are: the nature of the economic system, the structure of the economy; mode of functioning of the economy, economic planning and programmes, policy statements, controls and regulations, economic legislations, economic trends and structures, current economic problems and prospects. The national economic environment under which business operates may act either as a positive stimulant or as a negative constraint for the management, thus affecting business efficiency.

After independence, India embarked upon a system of mixed economy based on the concept of central planning with socialistic bias. With economic reforms initiated in 1991 the economy is gradually being opened up in order to integrate it with the economies of the rest of the world. The main purpose of economic liberalisation is to attract foreign direct investment and modem technology for speedy economic progress. Several significant changes have been made in the MRTP Act, public sector policy, industrial licensing, trade polices, etc., to bring them in tune with the new realities.

Since the environment and the economic institutional framework affect business organisations, it is imperative on the part of the management to scan the environment before taking any decisions. The success of any business enterprise, in a large measure, would depend upon the proper understanding of the business environment.

A device called Interaction Matrix can be helpful in understanding the relationship between two sets of variables, e.g., economic and non-economic factors.

1.10 KEY WORDS

Environment **:** The totality of all factors or forces affecting business and external to and often beyond the control or influence of individual business enterprises. The environment comprises several subsets, e.g., economic environment, socio-cultural environment, politico-legal environment, technological environment, etc.

Economic Activity : Any activity undertaken with economic or financial motive or consideration. In the business context, it is the task of adjusting the means/ resources to the needs/targets.

Decision-Making : Making a choice from a set of alternative courses of action.

Economic Environment : A subset of the environment consisting of economic institutions, frameworks, nature and structure of the economic system, market forces, economic, fiscal and monetary policies, planning and programmes of the Government, etc.

Interactive Matrix : A two-dimensional tabular device showing the relationship or interdependence between two sets of factors or variables, e.g., economic and non-economic factors, economic and social factors, etc.

1.11 FURTHER READING

Adhikary, M., 1997. *Economic Environment of Business.* (Ch. I & VIII), Sultan Chand & Sons; Delhi.

Ghosh, Alak, 1997, *Indian Economy : Its Nature and Problems,* The New Book Stall, Calcutta.

1.12 SELF-ASSESSMENT QUESTIONS

1. How would you classify business environment? What could be some criteria? Explain.
2. Examine the basic propositions about business?
3. Discuss some important points about how modern economies are organised and function.
4. "All modern economies have certain fundamental economic problems to deal with". Examine and illustrate the statement.
5. Explain the critical elements of economic environment with examples drawn from Indian experience.
6. Briefly review the development of the economic environment in India. What do you think were the landmark developments?
7. Discuss the salient features of new economic policy of 1991 and the initiatives taken by the Government for economic restructuring.
8. How does the economic environment impinge upon business management? Explain with suitable examples.
9. How are economic and non-economic environment interrelated? Explain.

UNIT 2 SOCIO-CULTURAL AND POLITICO-LEGAL ENVIRONMENT

PART-1 SOCIO-CULTURAL ENVIRONMENT

Objectives

After reading this unit, you should be able to —

- *define* the socio-cultural environment of business
- *identify* the critical element of social environment
- *explain* the interaction between social and economic environment
- *describe* the social responsibilities of business, and;
- *outline* the current socio-cultural environment of Indian business and industry.

Structure

2.1 Introduction
2.2 Social Environment
2.3 Critical Elements
2.4 Understanding the Social Environment of Business
2.5 Social Responsibilities of Business
2.6 Summary
2.7 Key Words
2.8 Further Reading
2.9 Self-Assessment Questions
Appendix 1 : Social Respcnsibilities of Business — The Indian Dilemma

2.1 INTRODUCTION

In the previous unit, we concentrated on the economic environment of business. Business is an economic activity and decision-making by the management is an economic process. However you will recall that we could not confine ourselves just to the *economic* environment. We talked about the interaction between the economic and non-economic environment of business. You will appreciate that the business environment is quite complex, with heterogeneous elements in the environment. These elements, economic and non-economic, market and non-market, often interact with each other. A manaer must understand and analyse this process of interaction. In particular, you must note that all non-economic environmental variables have economic implications, and that is why these variables, singly or jointly, affect business activity. In this unit, we have, therefore, decided to dwell on the non-economic environment of business.

The present unit aims to help you define the socio-culltural environment of business; identify the critical elements of the socio-cultural environment; explain the interaction between the social and economic environment; and outline some of the emerging trends in our society which have a bearing on Indian business.

2.2 SOCIAL ENVIRONMENT

Business must have a social purpose; business concerns must discharge social respon-

sibility and social obligations and have social commitment. Otherwise, business cannot enjoy social sanction. This makes it necessary for us to understand the social environment of business. You may question: what factors constitute this environment? There are a host of factors like social values, culture, beliefs, tradition and convention, social attitudes, social institutions, class structure, social group pressure and dynamics, and what have you. The nature of social objectives and priorities, along with the set of social constraints, give form and content to several social movements. Successful business managers cannot afford to neglect these movements, and their underlying ethos. Business ethics are very much influenced by social movements, social systems and social preferences. In a very broad sense, therefore, the social environment happens to be the culmination of forces operating from different platforms such as history, culture, polity, ethics and morality, values and institutions, geography and ecology, and the like. Society itself has to balance the achievements and aspirations of various individuals, groups, communities and institutions. No business can survive and grow without social harmony. Different countries, over different time periods, attain social harmony and order of different forms, through different ways and means. Thus the social environment differs over space, time and methods

Activity 1

Suppose you encounter a foreigner who is interested to know about "Indian society". List the points of observation you would like to share with him.

1 ....

2 ....

3 ....

4 ....

5 ....

6 ....

Activity 2

The same foreigner is also interested to know something about the "Indian business commu nity". List the points of observation you would like to share with him.

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2.3 CRITICAL ELEMENTS

Based on your experience in Activity 1 and Activity 2, you will appreciate that from the standpoint of description and analysis, it is important to begin by identifying the critical elements of any environment. You will recall that in the preceding unit we identified the critical elements of the economic environment. In the same way, we may also identify the critical elements of the sociological environment of business. These elements are:

- social institutions and systems
- social values and attitudes

- education and culture
- role and responsibility of the Government
- social groups and movements
- socio-economic order
- social problems and prospects.

This is just a suggested classification which may help you to analyse the socio-cultural environment of business.

Social institutions and systems develop through history, culture and heritage. The caste system, the joint family system, child marriage, sati, and the patriarchal family are all examples of social institutions and systems. Until the recent past the caste system ensured a very simple occupational division of labour in our society. The place of the individual was very clearly defined in the social hierarchy of the joint family system where decision-making was centralised in the head of the family who commanded respect for his age and experience. The position of women and children was also defined by the then social set up.

In India today, most of these age-old social institutions are dying fast. It is because the *social values and attitudes* are changing very fast. The Western values of individualism have caught our imagination. Indian women no longer remain satisfied as housewives. Business does not remain confined any more within a given community or caste. Customs, traditions and conventions are no longer rigid. They have become flexible. Society's view of its authorities, responsibilities and delegation, its attitude towards business as a profession, towards achievement and work, towards ownership and management — all have very definite implications for the sociol-ogical environment of business.

Then come *education and culture* as an ingredient icnt of the sociological environment. In this category you may list the attitude towards education; the need for business education; education matching the skill requirement of industry and manpower utilisation; the role of business schools and executive development programmes; education versus training; correlation between formal literacy and the level of culture; the spread of education and its the impact on business ethics; material progress and business morality; business culture and organisational culture.

At a given point of time, society has a level of achievements and aspirations. Such achievements and aspirations have to be defined clearly and categorically, and any divergence between the two has to be bridged through relentless social effort taking care of social welfare and social constraints. This is where the *role of the Government* as a welfare state comes in. The Government is the apex social institution. Particularly in a democracy the Government has the very responsible function of maintaining social order and harmony in view of the interests of the majority. It is the Government which has to make sure that social progress is not handicapped by the tyranny of the majority, otherwise social tensions will mount even under democracy. Certainly, business cannot grow under social tension.

Social tension originates in groups composed of frustrated individuals. In a society, individuals form groups on the basis of caste, creed, religion, language, trade and profession and similar other factors. *Social groups and the social movements* that they engineer are a critical variable of the non-economic environment. Some of these groups have direct business interests. Thus, consumerism, trade unionism, the cooperative movement, professional management, and shareholders' associations all pose challenges for business operation.

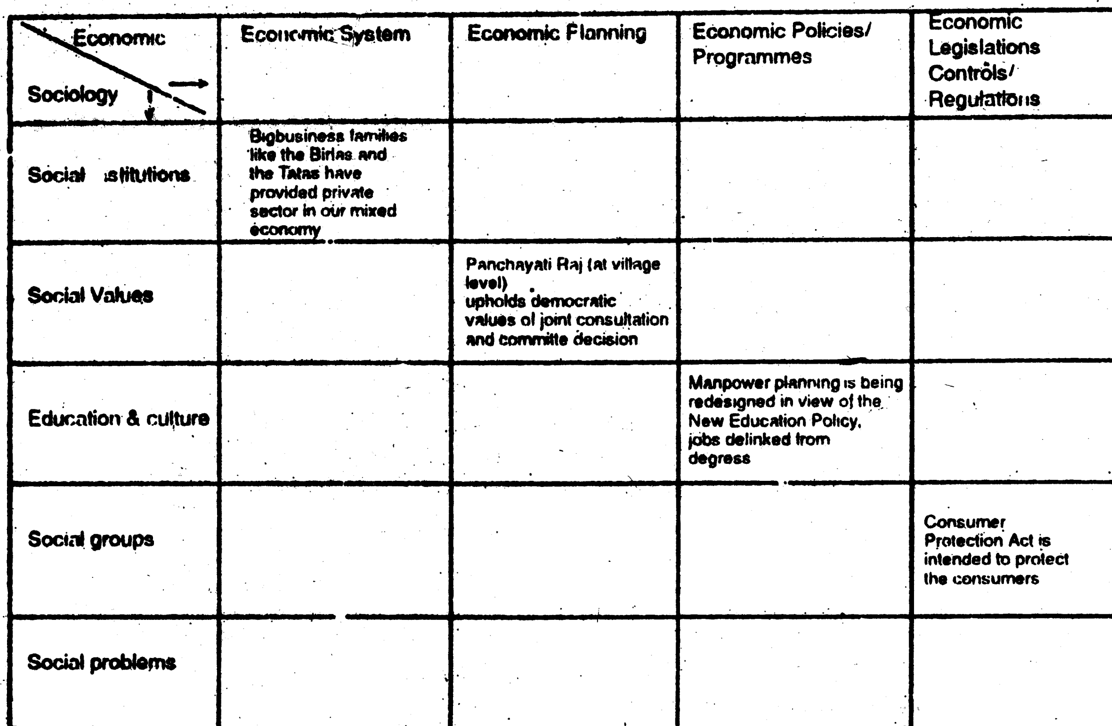
In a country like India, we have a *plural society.* Ours is a land of a variety of food, dress, languages, religions and culture. We also have a dual economy with the traditional (sub-sistence or unorganised) sector co-existing with the modern (commercialised or organised) sector. Technological dualism in India is very pronounced. Bullock carts ply on the road and the Airbus flies through the sky. All these make a very unique *socio-economic order* for India today. From time to time, this social order gets disturbed and modified, hopefully

for the better, through social movements and social-policy formulation on subjects like science and technology, ecology and forestry, family planning, animal husbandry, etc.

Social *problems and prospects* are just offshoots of a changing socio-economic order. You might be aware that consequent to industrialism and socio-economic development in many developing countries, the death rate has fallen faster than the birth rate, and this has resulted in an explosive growth of population. This in turn has brought about growing unemployment and poverty, poor housing and sanitation, urban congestion, pollution and increasing incidence of anti-social activities. Economists, therefore, suggest that you should always attempt a *social cost-benefit analysis of* industrial development. As society moves from the pre-industrial stage to the post-industrial stages of development, social benefits must outweigh social costs, otherwise the emerging new social order will prove unstable.

Activity 3

You have now some idea of the critical elements of the social environment of a country. You may have noted that we have used expressions like "socio-economic order" and "social cost-benefit analysis". The point is that the economy and sociology interact with each other. It will not be difficult for you to conceive in this context an Interaction Matrix. Can you now think of live Indian examples which may substantiate each element in this Matrix? To have direction, you may like to observe the kind of examples we have incorporated for some of the diagonal elements in this Matrix.



Economic → / Sociology ↓	Economic System	Economic Planning	Economic Policies/ Programmes	Economic Legislations Controls/ Regulations
Social Institutions	Bigbusiness families like the Birlas and the Tatas have provided private sector in our mixed economy			
Social Values		Panchayati Raj (at village level) upholds democratic values of joint consultation and committe decision		
Education & culture			Manpower planning is being redesigned in view of the New Education Policy, jobs delinked from degress	
Social groups				Consumer Protection Act is intended to protect the consumers
Social problems				

2.4 UNDERSTANDING THE SOCIAL ENVIRONMENT OF BUSINESS

Surely you have not run out of your stock of examples. There are plenty of examples Aren't there? The more you think of such examples, the more you find how complex anc varied our society is. You also find how the economic and social environments react with each other. Read the following statements:

"Social justice and economic growth must go together."

"Socio-economic problems have to be tackled in one go."

"All social movements are basically economic in content and intent"

"Soci-' welfare is the ultimate goal of economic planning."

"Business and economic activity must be tinged with a sense of social responsibility."

"Society cannot materially progress without a significant structural development of the economy."

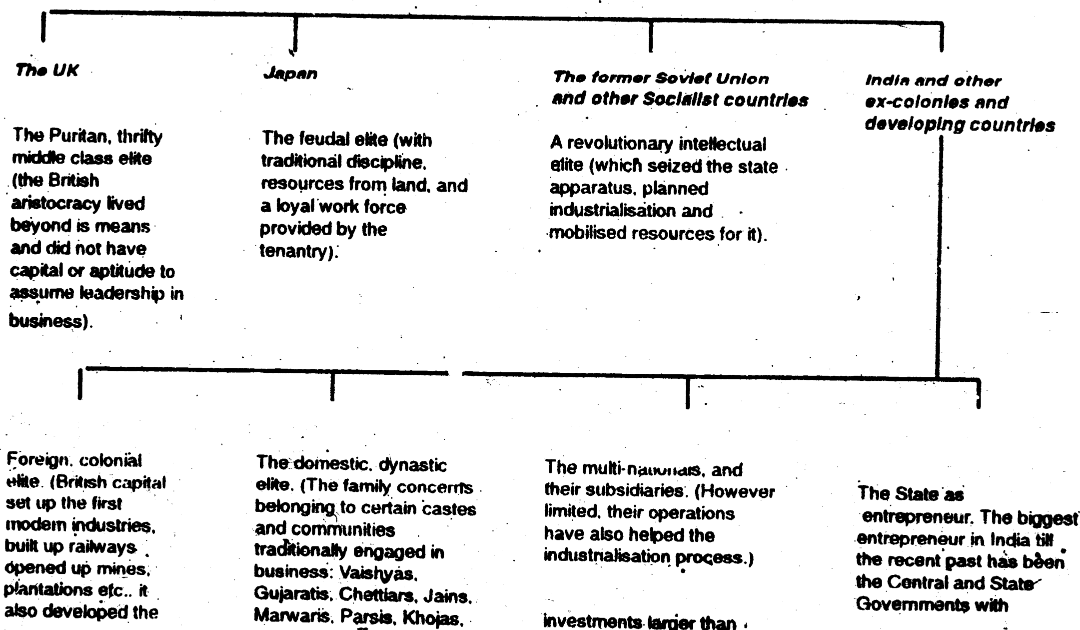
You must have come across thousands of statements like these. You may note that these statements are not emotional outbursts; these are facts concerning the interaction between sociology and the economy. In what follows, we would like you to familiarise yourself with certain specific social developments, social movements and social policy formulations so that you may work out their business implications in the Indian context. This is a task which will establish more clearly the interaction between the sociological environment and business economic activity.

Social Developments, Industrialisation Process and Management Culture

The industrialisation process in every society in the modem era can be traced to the work of a small elite group. The group which assumes leadership in the initial period o' industralisation has certain general characteristics:

- some knowledge of business, trade and commerce
- access to capital or saving, or ability to mobilise such resources
- thrifty habits and bourgeois spirit.

The Industrialisation Process
(The elite leadership in different countries)



system.)	Bhatias, Suvarna Baniks, etc. In this group the son succeeds the father not because of any superior professional competence but by virtue of birth; or top management is confined to close relatives. This type of entrepreneurship is true even of the small-scale enterprises, using modern technology.)	those in organised private sector).

Source : N.N. Chatterjee, 1975, *Management of Personnel in Indian Industries*, Allied Book Agency. Calcutta.

Each kind of industrial elite built up its own management style and managerial personnel in India.

The foreign-colonial elite group and their successors, the foreign firms operating in India, including the subsidiaries of multinationals, used the *ethnocentric or racial approach* to recruiting managerial talents. Young Britons used to be recruited on contract (known as Covenanted Officers) and brought over to India to manage the various interests of companies incorporated in the U.K. Similarly, other foreign firms recruited managers from their own race and cultural background. They have Indianised fast under the pressure of the Government. Now Indians even head the subsidiaries of some multinationals.

The same practice was followed in India by the big family concerns till recently. If the original family could not provide the talents needed, the extended family (i.e., close relatives and kinsmen) was drawn upon. Failing that, the community to which the family belonged provided the recruits. However, like the foreign firms, these also gradually had to recruit professional managers who had no ties of blood or community with the owners, though in family concerns such professionals are rarely the real decision-makers *even* today.

The practice of recruiting the best talent available from the country of operations may be described as *polycentric*. In joint stock companies which are not controlled by family concerns and in the public sector enterprises professionals are now gradually coming into their own. The public sector initially drew upon the civil services, but the transfer of the bureaucratic culture to business organisations, by and large, proved unrewarding. The emphasis is now largely on professional talent built up from within or recruited from the open market or drawn from the Industrial Management Pool of the Government (while it lasted). Deputationists from the IAS cadre had been given the option to get merged with the managerial cadre of the unit they had been serving.

The multinationals do try to make a *geocentric approach*, i.e., they try to tap any effective source available anywhere. But in practice, they do not often flout national sentiments. In India the preference has generally been for Indians.

It follows from the above observation that the process of industrialisation and the management style or recruitment culture are dictated by social convenience and compulsions. The history of social movements in other countries also is not different. The development of capitalist enterprises in India and elsewhere was very much conditioned by the moves and motivations of the business community — their "capitalist spirit" of "earning like a king and living like a sage". As and when the philosophy of capitalism was replaced by that of socialism, a new business culture took shape. The private profit motive was replaced by the social welfare motive. The private property rights were replaced by the social ownership — the state sector was created through the process of nationalisation. The free market price mechanism was replaced by comprehensive planning by the Central Government. Historically, neither pure capitalism nor pure socialism could survive as a stable social movement, and so came the philosophy of a "mixed economy". The resultant

social movement was to combine the private and public sectors, the market mechanism and centralised planning, commercial profitability and social desirability. Whatever may be the nature of the mixed economy we find today in India, it has been the outcome of a long-drawn process of social development and ideological revolution. If you look back on the history of such social development (capitalist, socialist or mixed) in any country including India, you will find that corresponding to different stages of development, there developed different patterns of industry and business culture. And the culture in its turn also influenced the process of social development

Activity 4

If you are interested in the historical perspective of the socio-cultural environment of our business, you may give a quick look to some of these classics:

1. D.H.Buchanan, *The Development of Capitalistic Enterprise in India*
2. Gunnar Myrdal, *Asian Drama. Vol. II* (Kalyani Publishers. 1982)
3. Maurice Zinkin, *Development of the Free Asia*

In these works, you may expect to find some critical but well documented observations on the operations of private enterprises in India.

Let us now move from the historical social development process to a few current social movements. With the passage of time, as industrialisation proceeded either in the form of a revolution or evolution, sooner or later organised movements were engineered by various social groups to protect their own class interests. The class-conflict grew in intensity, and consequent upon that grew a variety of social movements. As a result today, in every country without an exception, on the industrial front we are face to face with the trade union movement, the consumer movement, the professional management movement, the shareholders' movement and so on. Let us review some of these movements in the Indian context.

The Trade Union Movement

Trade unionism is the child of industrialisation. With the growth of the industrial culture, workers have felt that their socio-economic interests cannot be protected if they do not come together in some sort of organised union.

The history of the trade union movement in India dates back to the first quarter of the twentieth century. The two important landmarks were the formation of the All India Tradc Union Congress (AITUC) in 1920 and the enactment of the Trade Union Act, 1926. But due to ideological differences among several socio-political groups, the movement did not gather momentum during the inception stage; it only got split from time to time. After Independence, the disunity in the movement was aggravated by the starting of three central organisations — the Indian National Trade Union Congress (INTUC) by the Congress Party (1947), the Hind Mazdoor Sabha (HMS) by the Praja Sociulist Party (1948), The United Trade Union Congress (UTUC) by some radicalists (1949), the Bharatiya Maz.door Sangh (BMS) in 1955 and the Hind Mazdoo-r Panchayat ((IMP) in 1965. Despite the existence of different unions with different ideologies, the trade union movement is now better organised, more widespread and on a more permanent tooling.

The present position of the trade union movement may be summarised as follows: the number of registered trade unions in the country is around 25,000 of which about 3,000 are affiliated to INTUC, AITUC, UTUC and HMS. INTUC and AITUC are more popular than others. The membership of the unions submitting returns is around 50 lakhs.

The major defects of the present trade union movement may be listed as follows:

the predominance of small sized unions — nearly 3/4ths of the unions have a membership of less than 500

- poor financial position because of the small size and also because of the small subscription.
- the absence of wholetime paid officers
- leadership by professional politicians and hence political, inter-union and intra-union rivalry
- illiteracy and ignorance, migratory character, differences in language, caste, creed and customs and hence lack of harmony and unity among workers, low wages and productivity, etc., are characteristics of Indian labour
- preoccupation with strikes (rather than social security benefits)
- multiplicity of unions and ideologies causing a decline in the average size of unions.

It is obvious that unless the above defects are removed and the trade union movement is strengthened, the socio-economic environment of business cannot be improved. The interests by employees can be protected and promoted by the creation of a labour union having a bargaining power matching that of managements. The present idea of "participative management" or what is called "industrial democracy" through workers' participation can be successfully implemented only if the economy has strong and responsible trade unions in all spheres of activities rather than in industry alone. In a country like ours, where there is a vast unorganised sector in agriculture, agricultural unions are conspicuous by their absence. We need to (a) promote unionisation of agricultural workers, and (b) curb politiciaiion of labour unions.

Before we conclude this section, we would like to make a passing reference to the newly emerging phenomenon of managerial unionism. In India, managers and officers are increasingly banding themselves into associations which are gaining the aspect of trade unionism. Such managers and officers hail from diverse organisations such as manufacturing enterprises, banks, insurance companies, universities, electricity boards, trading corporations, the merchant navy, the civil service and the like. Thus managerial unions or what may be called officers' associations are growing stronger both in the private and public sectors. Such a growth and transformation in the character of unionism is suggested to be the natural outcome of the development of an economy with proliferation of the service sector. The Industrial Revolution witnessed the growth of blue collar trade unions. The post-industrial society will experience the rise of white collar unions. This is the global trend. India cannot escape it. Thus managing the work and worker is the problem of today and tomorrow; but managing the managers is the challenge of the future.

The Consumer Movement

Like the labour movement, the consumer movement also exercises a considerable influence on the socio-economic environment of business. A strong consumer movement is the sine *qua non* of a healthy household sector in an economy.

In the Indian economy today, because of imperfections in both the product and factor markets, some sort of exploitation of consumers often results.

In a country like India, where a large percentage of the masses are illiterate and poorly informed, and have limited purchasing power, where most of the critical goods are always in short supply and where growth for social justice is the guiding principle of national planning, the Government has a significant role in safeguarding the interests of the consumer by promoting a climate of fair competition and influencing business decisions concerning what to produce, promote, and sell.

Some legislative measures have already been taken by the Central Government to safeguard the interests of the Indian consumer. There are a wide range of enactments to protect the consumer. Some are of general application covering particular aspects of a

wide range of products: others apply only to specific products. The first category consists of the Standard of Weights and Measures Act, 1956, the Sale of Goods Act, 1930, the Trade and Merchandise Marks Act, 1958, the Display of Prices Order, 1973, the Packaged Commodities (Regulation) Order, 1979, the Standard Institutions Certificate Marks Act, 1952, etc. Some of the important legislations relating to particular goods and transactions are the Essential Commodities Act, 1955, the Prevention of Food Adulteration Act, 1959, the Drugs and Magic Remedies (Objectionable Advertisement) Act, 1954, and the Cigarettes (Regulation of Production, Supply and Distribution) Act, 1975. Lately, our Government has brought in the Consumer Protection Act 1986. Through this Act, an attempt is being made to strengthen the institutional framework to protect? the consumer at the local, state and central levels. There are various institutional factors which account for growing concern about consumer protection in India.

First, the Indian Government is concerned with the protection of vulnerable sections of the community through schemes like streamlining the public distribution system. Over the years, because of chronic inflation, different anti-social elements have emerged to exploit the vast majority of poor consumers through unethical trade practices like adulteration, underweighment, high prices, etc., of goods in short supply. The Government has, therefore, become more alert to protect consumers through the Defence of India Rules (DIR), the Monopolies and Restrictive Trade Practices Act (MRTP), 1969, and the Consumer Protection Act (CPA), 1986.

Secondly the Indian business community did not, till very recently, bother about consumers because it operated in a seller's market. Today, the market environment has changed: it is now a buyer's market in several sectors at least. Unless consumers arc protected against the fraudulent practices of traders, long-run business interests are likely to suffer. Indian business has lately realised the social responsibility of providing customer or client service.

Thirdly, in developed urban areas the consumers themseives have become more conscious of their rights and legitimate demands Present day consumers are not ignorant of the market environment. They are quality conscious. They are conscious of customers' rights. They have some notion about the legitimate distribution margin of profit for each product. To protect their interests, they form organisations like consumers' councils, service cooperatives, consumer cooperatives, vigilance committees, etc. They seek legal protection under laws like the Essential Commodities (Amendment) Act, 1974. They write in columns of "consumers grievances" or "consumers forum", "action line" etc. in magazines / newspapers.

Last but not the least, the burden on consumers imposed by our own Government has been on the increase in the last few years. In the name of fiscal discipline, the Government at various levels — central, state or local — imposes or enhances annually the tax burden. Additionally, it has now become customary to announce pre-Budget hikes in administered prices of items like petroleum-products, auxilliary duties on imported items, and postal and telegraph rates. Consumers' resistance to such growing additional imposts is but natural.

Owing to the factors listed above, the consumer movement has gathered considerable momentum in recent years, but it is still in its infancy. It suffers from several defects:

- lack of leadership and management
- lack of financial resources
- lack of permanent organisations, i.e., *ad hoc* character
- still confined to a few urban pockets rather than spreading to the [illegible] rural areas where consumer resistance is conspicuous by its absence
- politicisation of the consumer movement
- lack of consumer education.

These defects have to be removed immediately if the movement is to become strong and serve a useful social purpose. In this context, the Civil Supplies Department of the Government and organisations like consumer cooperatives and consumer councils have an important role to play.

In spite of the wide array of enactments to protect him, the consumer in India is subjected to a number of unfair practices indulged in by the suppliers of goods and services. These enactments fall short of providing adequate safeguards to consumer interests as they cover specific products or malpractices. Whatever protection is available to the consumer under these legislations is piecemeal. There is no branch of law dealing specially with consumer trade practices as such. Legislations like the MRTP Act have not really protected the vast majority of consumers. There is an urgent need today for legislative control regarding (a) misleading and deceptive advertising, and (b) sale of products (goods and services) not meeting safety standards. It is the Government's commitment, along with consumers' awareness, which can promote a strong and healthy consumer movement in our country. To an extent, it is the consumer movement which led to the passing in 1986 of the Consumer Protection Act which we shall discuss in the next part of this unit.

Management Movement and Philosophy : Emerging Trends

After labourers and consumers, the next important group in our industrial society is constituted by the managers.

Compared to trade unionism and consumerism, the management movement in India has been relatively strong and distinct. Since Independence, one finds certain distinct trends in our corporate management philosophy and structure. Independent India inherited a structure of corporate management which was dominated organisationally by the Managing Agency System, and entrepreneurially by particular business communities and, among them again, by a group of families of big business houses. Historically, the Managing Agency System developed to overcome the problems of finance and management faced by our business and industry. Eventually, the system resulted in the growth of monopoly capitalism and concentration of economic power through practices like multiple directorships, interlocutory directorships and interlocking of funds, etc. Hence, through a series of enactments up to 1969, the Government attempted to abolish the system. However, the abolition of managing agency did not really mean the end of the system of group management or the end of the domination of big business houses. In a large number of cases, the erstwhile managing agents entered into various types of service agreements with their former employers and became available to them in areas such as administrative services, financial services, management consultancy and secretarial work. Some of the managing agency houses converted themselves into consultancy organisations. In some cases, managing agency houses merged with the companies formerly managed by them, thus retaining their control.

Another distinctive trend has been the Indianisation of management. Industrial development and business growth in colonial-era India owes much to European management. With the rise of Indian business communities during the inter-war and post-war periods, European management agencies were increasingly replaced by Indian managing agencies. Following Independence, our industrial development encouraged the flow of foreign management in some basic fields like steel and fertilisers. Over the years, as the country became more and more self-sustained, foreign management was replaced by Indian management. In the process, both the Government and private business houses either separately or jointly secured an increasing degree of managerial control and ownership over our business and industry.

With Indianisation, two contrasting patterns of management developed : (1) hereditary management of family-owned businesses and (2) bureuiicratic management of Government-owned businesses. By and large, this contrast boiled down to a contrast

between private sector management and public sector management: and this matched in a way with our philosophy of a mixed economy.

As the Indian socio-economic environment was thus gradually getting exposed to two different types of management culture, the philosophy of industrial democracy was gaining popularity in the political environment. Consequently, in recent years, "workers' participation in management" has been talked about and tried in some business units. The history of participative management dates back to 1958, when the scheme of Joint Management Councils was introduced on a voluntary basis to ensure closer association of workers in management on a formally defined basis. Workers are also serving on the Boards of Directors of all nationalised banks. On October 31, 1975, the Government introduced through a resolution the scheme of workers' participation in industry at the shop-floor level to begin with. The Central Government also appointed a few representitives of workers on the boards of management of a few public sector undertakings. Despite all these steps, the impression one gathers is that participative management still remains more an idea than a reality.

There are five stages of participation: (i) informative participation, (ii) consultative participation, (iii) associative participation, (iv) administrative participation, and (v) decisive participation. By and large, Indian labour, is still confined to the first three stages. In fact, if participative management has to become a reality, a shift is necessary from slogan to action. Further, the pattern which suits our cultural environment is what Peter Druckcr calls, "participative decision-thinking" (the Japanese pattern) rather than "participative decision-making" (the American pattern).

Last and perhaps the most important development in the world of Indian management is the growing tendency towards professionalisation. The idea of professionalistion of management is of recent origin. Professionalisalion of management has a number of implications:

1. Management is separated from ownership though, as an individual, a professional manager may own some shares of his own firm.
2. Taking up management as a career or profession involves intensive pre-entry education and post-entry training. A professional manager is formally educated in a specialised discipline like finance, production, marketing, personnel system, etc. Such education gives him "knowledge". Then comes his on-the-job experience whereby he tries to apply his knowledge and modify it if necessary. Through experience, he acquires "skill". Finally, it is through periodic training that a professional manager updates his knowledge and conceptualises his skill. That is how he avoids professional obsolescence.
3. As a professional manager, he has a mental make-up and a value system. which together are quite different from the "tunnel vision" of the typical owner-manager for profit.
4. A professional manager enjoys a lot of discretionary powers. He is found committed more to his profession than to his organisation, such that if he finds his present employment unsuitable for his aspirations and values, he can always take his skill and knowledge to another employer.

As for the growth and profile of the professional managers in India, whether in the public or private sector, a number of studies have already been made. Their findings are more or less the same. Most of the present professional managers come from a middle class background. They are better educated in the context of international and/or inter-temporal in comparison with other managers. They are relatively younger.

Managers from a background of backward classes form a very small group in the private sector and are a slightly larger group (growing rapidly) in the public sector. The concept of

the "barefoot manager" is still a myth: most at them are "expense account" managers aspiring to enjoy the "five star calture", and many of them still move in their, narrow social elitist circle, go to the same club, enjoy drinking in Light circles, and have very liltle perception of the needs and aspirations of the common workers around them. Our professional managers arc quite conscious of this status gap between themselves and the rank and file of workers. In other words, exclusiveness rather than openness characterises this callure. In such a culture, the managers lend to be "benevolent autocrats" and "corrective rather than communicative and participative" except within narrow limits. On the subject of the emerging value profile of the Indian manager, a researcher observes:

"Today's Indian manager is more concerned with (a) happiness, contentment and peace for himself and his near and dear ones, (b) achieving goals set for himself, (c) a "good man" image, and (d) self-actualisation. Spiritual values have decidedly taken a back seat, though stark materialistic Western values like success, prestige and power and money have not yet made any major inroads into his life. His elitist origin, which could have proved a handicap in the relationship with the work force because of social distance and the value gulf is no longer so because he had acquired a value system tinged with concern for genuineness in human relationships, a humane attitude, devotion to task, concern for being diplomatic coupled with a deep regard for other people's feelings and interests. What our manager seeks from the work situation is job satisfaction, credibility, competence, creativity, truthfulness and achievement/success. His ethical value system is somewhat blurred; in the abstract, he holds strongly to positive ethical values, whereas in concrete situations which are difficult and threatening, idealism gives way to pragmatism. Nonetheless the country's interests are very much at his heart."

"In value relations, the Indian manager stands somewhere midway; he has been able to realise his values moderately. Perhaps, this is a healthy discontentment, for, in the arena of chaotic industrial life today, it is seen that his prone to take a proactive rather than reactive stance, act rather than react, confront rather than withdraw, assume responsibility rather than apportion blame. May be this proactive stance is the unconscious instrument through which greater value realisation will become a reality for him."

In India today, professionally trained managers are being manufactured in large numbers from a number of management institutes within and outside universities. There has been a mushroom growth of organisations imparting management education. Executive Development Programmes (EDP) are also being organised for management at various levels — top, middle or lower; some of the firms in the modem organised sector have started their own management training or manpower development centres. Despite all these, Indian enterprises still suffer from a mismatch between professionally qualified managers and the existing organisational culture. A strong need is being felt to Indianise management education and training programmes. Unless the management education and training programme is free from Western bias (in terms of concepts, precepts, tools and techniques), it cannot serve the requirements of Indian business and industry. But for this, there is a need for a closer link between business, industry and institutcs/universities. So long as this link is not established and maintained on a permanent footing, the management movement cannot grow strong and healthy.

Reviewing the nature of the management movement in India, a few concluding observations may be made:

1. Professional managers as a class have gained social recognition and as a result, Indian business-and-industry is growing towards professionalisation of the management cadre. But the spread of this culture has not been uniform. One may, therefore, observe at least three contrasting styles of management prevailing in three distinct types of enterprises — multinationals, domestic, private sector and public sector.

2. Professional managers are now due for legal protection — some of the recent amendments to labour laws have created certain common interests among the

professional managers at lower levels and industrial workers. These laws are : The Payment of Bonus Act, the Payment of Gratuity Act, the Employees Provident Fund Act, the Workmen's Compensation Act, etc. The concept of "workmen" is gradually being replaced by the concept of "employee", a term which also includes the professional manager. The Janata Government, for the first time, thought of the Employment Security and Miscellaneous Provisions (Management Employees) Bill in 1975 to ensure job security to middle management.

3. Professional managers, despite having adequate knowledge and appropriate skill, still do not enjoy full functional autonomy in their day-to-day operations. It is often heard that the managers in our public enterprises are subject to parliamentary control and ministerial interference just as the managers in private enterprises are subject to the directives or whims of their chief executives.

4. Lately management insecurity is on the increase. Report about suspension of bank officers, airport managers, Government engineers, etc., suggest that the middle-level managers are no longer secure, particularly if they are corrupt and inefficient.

5. As management is growing as a profession, it is getting more and more specialised. In the process, management consultancy is emerging as a new trade.

The Shareholders' Movement

In our socio-cultural environment of business, the shareholders' movement is a recent offshoot of the professional management movement.

Shareholders' associations have been in existence since the days of company formation. But the Annual General Meetings (AGM) of most companies seem to be mere rituals to please the gods in the Department of Company Affairs, and fulfil the clauses of the Company Act For a long time, the shareholders have remained blissfully unaware of their rights.

Things have changed in recent years. The shareholders are increasingly becoming aware of their legitimate rights. With the spectacular boom in the stock markets in the early eighties the companies started paying attention to AGMs.

In India, we have the so-called "closely-held companies" and the "widely-held companies". In the widely-held companies, management is supposed to be diffused over the representatives of a large body of shareholders. Till very recently, even in widely-held companies, the owners of minority shares have been occupying the top executive positions of the company and have been perpetuating the traditional family management culture. A large majority of shareholders have thus been left outside the ambit of top management; they have not enjoyed their legitimate rights of having decisive participation in management.

As someone observed, in India AGMs are a corporate farce. A shareholder is supposed to make relevant statements at an AGM, but instead one finds people clamouring for gifts, refreshments and discount coupons. Thus the shareholders themselves fritter away their right to be heard. Over the years, managements have come to adopt the attitude — "Give them a good dividend and close their mouths with a sandwich"... As long as the dividend cheque comes through periodically and the company is doing well, the overwhelming majority of shareholders rarely come to attend AGMs.

Of late, however, the situation is changing. The AGMs have to be taken seriously. The shareholders today are an enlightened body of investors. The gifts and meals given at the AGMs cannot buy them any longer, though those, things do have some goodwill value. Today's shareholders are knowledgeable and are quite conscious of their rights. They are quite anxious to exercise their legitimae rights. If they so desire, they can supply both risk capital and effective manage ient on professional lines. In fact, they may even destabilise the existing management through takeover bids. Takeover bids, as experience shows, may originate with resident Indi-

as much as with non-resident Indians. The nominee directors (of the financial institutions) on the Board need not always support the existing management; they may have a strategic alignment with the shareholders as well. All these have now come into the limelight through a number of recent AGMs. For Escorts Chairman H.P. Nanda, the three AGMS during the early 80 and the much publicised extraordinary general meeting of 1984 were a rich experience. Though the Escort-Swaraj Paul affair ultimately ended as much ado about nothing, it did provide some direction to the shareholders' movement. In the same way, the 63rd AGM of Dharamasi Morarji Chemicals Company Ltd., lasting ten hours with a packed gathering of 400 odd shareholders, is another recent example which shows that the AGM can be used to decide issues one way or the other. You can discover many instances if you read magazines like *Business India, Business World* and *India Today*.

Activity 5

Read these magazines regularly and try to get some latest facts and figures concerning developments within the Indian corporate world. Choose some selected companies that interest you most.

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Reproduced on the next page is a chart which shows the size of shareholders in a few widely-held companies. Additionally, you may also note that as per the latest figures of the Reserve Bank of India (RBI) the number of block shareholders has increased to nearly 30 million from a mere 6 million in 1978. It is thus obvious that the shareholders can no longer be neglected. Companies have been increasingly turning to the capital market for their financial needs. Capital raised through new issues during April-December 1996 was around Rs. 10,400 crore which means around Rs. 15,000 crore are raised currently through capital markets on an annual basis. With so much at stake, AGMS can no longer be considered a residual activity to be dispensed with on a lazy afternoon. The shareholders' movement is gaining momentum and, therefore, you may hope that in the near future the quality of the AGM will improve substantially. We should welcome this as a healthy development in the socio-economic environment of Indian business. Shareholders' movement is partly responsible for necessary modifications in the Companies Act from time to time and in the enactment of SEBI Act, 1992.

THE MOST WIDELY-HELD COMPANIES

Reliance Industries Limited	700,000	Sharholders
GNFC	422,104	"
Lohia Machines	225,105	"
TISCO	210,000	"
Gwalior Rayon	191,485	"
ITC	165,810	"
TELCO	152,000	"
J.K. Synthetics	147,861	"
Ambalal Sarabhai Enterprises	144,765	"
The Indian Rayon Corporation	118,689	"
Lipton (India) Limited	117,112	"
Glaxo	115,766	"
Hindustan Lever	108,000	"

Activity 6

Make a list of companies in India which you think are professionally managed.

Private sector companies		Public sector units	
Domestic	Foreign	Central	State

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What criteria have you used in selecting your companies/enterprises/units in the above list ?

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Activity 7

Name the national level trade unions in India and also name the political parties to which they are affiliated.

Trade Unions	Political Parties

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Environmental Movement

Issues related to protection of the environment and ecology have received world wide attention not only in developed countries but also in the developing countries. Increasing concern has been expressed about environmental degradation which can risk human life and existence. Though environmental problems are not new, the scale, in spite of technological advances, on which environmental degradation has been taking place has assumed alarming proportions. For example, of the 266 mha of land considered productive

in India, about 175 mha are degraded in varying degrees (arid, alkaline, saline, water-logged, ravines, etc.). About 90 mha are acutely degraded, chiefly on account of a loss of tree cover and top soil, leading to floods and droughts. Similarly, the forest cover has been depleted to about 19 per cent of the total geographical area, instead of the desirable 33 percent. India has only 2 per cent of the forest land of the world but supports 16 per cent of the world population.

The terms ecology and environment are interlinked. Ecology is the study of plants, animals, peoples, and institutions in relation to the environment. It thus refers to the interrelationship between people, the fauna (birds and animals), the flora (plants and forests) and their physical surroundings. The eco-system embraces the sea, forests, reservoirs of water, plants, trees, flora and fauna which, in fact, comprise an eco-chain underlining their interdependence. The ecosystem is the totality of living and non-living elements in the ecological community communicating with one another and their environment The term environment is defined as the complex of bedaphic (soil related), climatic and biotic (biological) factors that act upon an organism or a community.

It is important for us to understand the interrelationship between ecology and development. You might be aware of the rapid decline in the qualify of the environment over the recent past. Imprudent use of natural resources resulting from the developments in science and technology has led to negative consequences which have prompted many a thinker to advocate a slow down of economic growth for the sake of environmental protection. Modem developments in agriculture and industry have brought about fundamental changes in the consumption habits *of* people which have given rise to several problems — pollution of the air and water, soil erosion, deforestation, exhaustation of traditional sources of energy etc.— affecting the quality of life and wen-being of human beings. Today, society faces a strange dilemma. While uncontrolled and unplanned industrial development may destroy the health of society and may have a negative impact on the quality of life, excessive concern with environmental issues may halt the process of technological and industrial growth. It is, therefore, necessary to follow a balanced approach wherein the conservation of natural resources and quality of environment complement the objectives of economic growth.

Environmental deterioration has been a matter of serious concern in India and has gained widespread attention during the last two-three decades. Environmental problems may partly be attributed to the negative effects of the process of industrialisation and economic development; they are partly attributable to the continuing state of poverty and underdevelopment. Poverty is directly linked with the growth of population. Environmental degradation takes place if development efforts do not provide the necessary life support systems. Undoubtedly, scientific and technological progress have raised the pace of economic growth with considerable increase in the production of foodgrains and agricultural crops, and the development of the infrastructure, transport and communication facilities, but poverty and unemployment continue to pervade the nation's majority due to imbalances.

On the other hand, development efforts have put a continuing pressure and have imposed strains on the limited supply of natural resources, and the negative effects of development have created environmental problems.

In urban areas, more particularly in metropolitan cities, the quality of the environment is steadily deteriorating. Air pollution is increasing due to congestion of traffic and the fast increasing number of automobiles which release .fuel exhausts and add dangerous pollutants like carbon monoxide, nitrogen oxide, organic vapours, lead, smoke and other particulates and non-particulate effluents to the urban atmosphere. Discharge of fly ash from thermal power stations and emission of smote from industrial establishments in and around cities continue to increase the level of atmospheric pollution in spite of devices to regulate their impact.

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The pollution of river water takes place in and around cities as well as suburban towns due to lack of sewerage, discharge of sewage, and effluents from industries which do not have adequate water treatment equipment installed. Discharge of industrial wastes and chemicals causes toxic effects and inhibits the growth of fish. Safe drinking water is not available to the majority of city dwellers due to the contamination of subsoil water on account of leaking or choked sewerage and overflowing drains. The problems of garbage disposal persists. Open garbage dumps with overflowing filth and rags are a common sight in many cities, adding to the insanitary living conditions. Contaminated drinking water and lack of sanitary facilities make people suffer from water-borne and airborne diseases.

A number of man-made chemicals are known to have harmful effects on various components of the ecosystem besides being toxic for human life. Chemicals used as pesticides and insecticides in agriculture are known to have harmful side effects when applied indiscriminately. Some of these when ingested by human beings are suspected to have cancer-producing effects. According to WHO'sInternational Agency for Research in Cancer, "there is good circumstantial evidence that 80-90 p.c. of all cancers are dependent, directly or indirectly, on environmental factors, and at least 89 p.c. of these factors are chemical in nature."

Industrial effluents are not easily biodegradable and are often beyond the natural assimilation capacity of rivers, with the result that water bodies remain polluted, affecting the health of people. According to a survey undertaken by the Cental Pollution Control Board, in 241 Class II cities spread over 17 States, about 90 per cent of the water supplied is polluted.

The fragile ecosystems of the country have been disturbed in various ways. *Coral* reefs have been adversely affected by indiscriminate exploitation, mangroves have been under biotic pressure due to fishing and pollution of water caused by oil spillage from ships and coastal refineries and discharge of domestic sewage and industrial effluents. The country's unique wetlands, covering an area of 1.45 million hectares (which are rich in aquatic and bird life and provide food and shelter as well as breeding and spawning ground for marine and fresh water fish) have been confronted with problems of weed infestation, siltation, chemical and organic pollution, conversion to industrial sites, urbanisation and habitation. Out of 85 wetlands of international importance in the country, 45 per cent are subject to moderate or high threats. Mountain ecosystems have also been witnessing serious pressures. The Chipko movement launched by Sunderlal Bahuguna for preservation of Himalayan ecology is well known.

You would be glad to know that a rich biological diversity exists in India with the widest variety of biomass and over 75,000 species of fauna and 45,000 species of flora. Of these, according to the Union Government 79 species of mammals, 44 of birds, 15 of reptiles and three of amphibians plus 1500 plant species face the threat of extinction.

Several pressure or activist groups have emerged to champion the cause of the preservation and protection of the ecology and the environment in the country. For example, the "Narmada Bachao Andolan" launched by Medha Patkar and the cause of animal welfare and environment espoused by non-Government organisations like People for Animals (Initiated by Maneka Gandhi). and KARE are well known.

Environmental Management

Environmental deterioration is a multi-dimensional problem of which resource depletion is only a part. Business leaders in general have a significant and practical role to play in managing the environment. No organisation can now sensibly ignore its Environmental obligations.

Environmental Management encompasses environmental planning, protection, monitoring,

assessment, research, education, conservation and sustainable use of resources. It can be accepted as a major guiding factor for the sustainable development of the nation. It is realised that while environment problems attributable to provcrty (and underdevelopment) could be tackled by more rapid development, the unintended side-effects of the process of development have given rise to many of the environmental problems confronting the nation today. Thus, to achieve the long-term goal of making development sustainable environmental and ecological imperatives need to be built into the total planning process right from the beginning. The logic is simple. The degree to which a nation can prosper depends on its productivity, i.e., the efficiency with which it is able to utilise the resources of the environment to satisfy human needs and rising aspirations. This requires that; while providing for current needs, the'resource base should be managed in such a manner that it achieves sustainable development in harmony with the environment.

Government Policy and Measures

You would appreciate that no civilised government could afford to neglect the problems posed by environmental degradation. White legislations were passed in the seventies and eighties aimed at conservation of natural resources and prevention and control of environmental pollution, more concerted efforts have since been made by the Government towards these ends. The creation of a separate Department of Environment in 1980 and an integrated Ministry of Environment and Forests in 1985 at the Centre indicates the Government's recognition of the seriousness of environmental problems. While it is not possible to list all the measures taken by the Government, we shall focus our attention on some major steps taken in this respect

A policy statement was announced by the Union Ministry of Environment and Forests in June 1992. It outlined India's National Conservation Strategy on Environment and Development. It emphasised sustainable development as the key element in die Ministry's action plan. The task set before the Ministry was "to ensure snstainable and equitable use of resources for meeting the basic needs of the present and future generations without causing damage to the environment."

Based on the above policy statement, an integrated strategy has been adopted by the Government for better protectioii of environment. Thestrategy is aimed at strengthening the existing programmes of pollution control, ensuring better disposal of solid wasies and hazardous substances, and conserving forests, bio-diversity and the rich ecosystem. All these measures form part of the National Conservation Strategy and the National Forest Policy which was formulated in December 1988 with the primary objective of ensuring environmental stabilitv and maintenance of the ecological balance.

The Government has set up the National Afforestation and Eco-Development Board (NAEB) to undertake a programme of natural regeneration in degraded forest lands in the country.

To bring about a qualitative change in the afforestation programme, a National Wastelands Development Board was set up by the Government in June 1985 with the principal aim of reclaiming wastelands through a massive programme of afforestation with people's participation.

The National Policy for Abatement of Pollution stresses on utilising economic and policy instruments for the introduction of pollution control measures. Seventeen environmentally critical and highly polluting industries have been identified by the Ministry for special monitoring and enforcement efforts. These 17 industries include sugar, fertiliser, cement, fermentation and distilleries, aluminium, petro-chemicals, thermal power, caustic soda, oil refineries, tanneries, copper smelters, zinc smelters, iron and steel, pulp and paper, dye and dye intermediates, pesticides and pharmaceuticals.

One of the major sources of air pollution is vehicular exhaust fumes. This problems has assumed serious proportions in the metropolitan cities. The Government has laid down emission norms for automobiles under the Motor Vehicles Rules, 1989. Towards reducing the pollution effect of automobiie exhausts, the Government has also notified that all petrol-engine cars sold

in the four metropolitan cities should be fitted with catalytic converters — an efficient device to clean up exhaust emission.

The main strategy for conservation of biodiversity in the country is protection of viable habitats for wild life. The Government maintains 75 National Parks, 421 Wildlife Sanctuaries, 21 Project Tiger areas and Biosphere Reserves for conservation of wildlife species and preserving genetic diversity in representative ecosystems.

Tying up the environmental issues, the Government has drawn up an Environmental Action Programme (EAP) focusing on the following priority areas:

a) Conservation of biodiversity including forests, marine life and mountain ecosystems.

b) Conservation of soil and moisture and ensuring that water sources do not get polluted.

c) Control of industrial, pollution and wastes.

d) Access to clean technologies.

e) Tackling urban environmental issues.

f) Strengthening environmental education, training, awareness and resource management.

g) Alternative energy plan.

The underlying thrust of the EAP is to strengthen the environmental impact assessment of the above areas through an organised system of natural resource accounting and environmental statistics.

In the next part of this unit, we will familiarise you with some details of the Environment Protection Act.

Activity 8

a) Enumurate the main causes of environmental degradation. Whom would you hold responsible for such degradation? List some causes below:

S.No.	Cause of Environmental Degradation	People Responsible
(1)	(2)	(3)

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b) Arrange interviews with top managers of at least three large organisations, preferably engaged in the chemicals, pharmaceuticals or cement industry. What measures have they taken or propose to take to prevent pollution? Offer your comments

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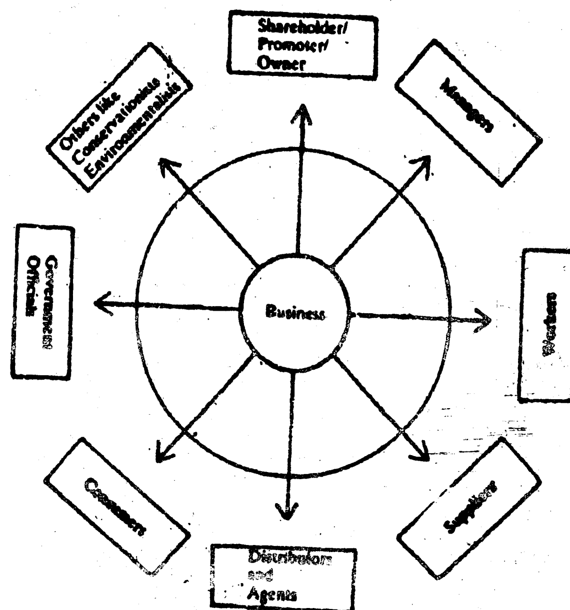
2.5 SOCIAL RESPONSIBILITIES OF BUSINESS

You have observed, how business and society interact with each other. Business exists in the context of a society. In a *(traditional) pre-industrial* society, business transactions are negligible or nil; in that society production is mainly done for self-consumption and the need for exchange is minimum. In a *modern industrial society,* business grows by leaps and bounds; production is meant for the market; the subsistence system is replaced by the commercialised system and, therefore, exchange transactions multiply. In a *post-industrial (recent) society* business gets specialised and professionalised. With growing monetisation, both primary and secondary, the complexity of business grows manifold. Business grows in variety. Business becomes more and more service-oriented from being production-oriented. Thus as transition takes place in a society through various stages, business changes in terms of size, structure, strategy and system. On the other hand, as business changes in terms of its form and organisation, society also undergoes changes. Social values, social institutions, social order, social contract, social conflict, social problems — everything changes along with a change in the business culture. In other words, business determines society as much as society determines business. Therefore, business most be socially responsible.

Over two decades ago, Peter Drucker stated in the context of American business, "If there is one development during the last ten years that stands out above all others, it is the eagerness with which business has embraced social responsibilities". This is true of Indian or any other national business today. It is no longer fashionable for business corporations the world over to take a gleeful pride in making money. What is more fashionable is to show that it is a great innovator, more specifically a great public benefactor and that it exists to serve the public.

From the standpoint of business, we have already identified each element of this public. They are: owners/shareholders, managers, workers, suppliers, distributors; consumers, Government officials and similar social groups. All these have a stake in business and can be known as stakeholders.



each and every social group as a very definite expectaion from business. The *shareholders, promoters* and *owners* expect a fair return on their investment; unless lucrative dividends are paid, they do not want to supply venture capital for business.

The *workers* expect fair wages and bonus, otherwise they feel exploited when they produce output more in value than the input. The salaried *managers* likewise expect a remunerative packet of *pay* and perks, otherwise they do not find any incentive to work hard and long for their business concern. The *consumers* expect a quality product and service at fair prices, otherwise they feel cheated. The *suppliers* expect a prompt settlement of their bills. The *distributors* expect after sales service as well as fair commission on sales, otherwise they do not find incentives to promote sales. The *Government* expects business to pay taxes and to be accountable for subsidies. And, importantly, there are others who are not directly concerned with business, yet they have a lot of expectations from it. These could be ordinary citizens forming themselves into clubs or associations of some type, expecting charitable donations for promoting education and culture; the ecologists who want business to minimise, if not avoid totally, pollution and degradation of the physical environment; the social workers who want business to adopt backward villages and undertake all round development of housing, health, and sanitation. There is no end to the expectations of these various social groups. The more you come up to their expectations, the more they expect from you and your business.

Business has to balance these manifold expectations and optimise a general social welfare function subject to the constraint of maintaining social harmony. This is a difficult and stupendous task and it involves a measure of social efficiency of business operations Normally, private business enterprises do not bother about social efficiency, they are guided by the commercial profitability criterion. For them, social responsibility is more a facade and a decoration; it is mostly a means of maximising the long-run return on investment. But, for public enterprises, social desirablility is an important consideration. Therefore, they have to attempt a detailed social *cost-benefit analysis* of their projects and operation. Such enterprises which produce public goods and services have to maximise net so return. However, social responsibility does not mean that they should continue to r losses. After all, they are not meant for supplying free or subsidised social service. Soc obligations should not eclipse their economic viability, which in itself is a social purpose. Thus, even public enterprises have social as well as commercial obligations. In fact, in India we want our public enterprises to generate surpluses for development finance. The profit of a public enterpr:ses to generate surpluses for development finance. The profit of a public enterprise is an important source of financing planned economic development. A losing public enterprise is ultimately a burden on society, and therefore is the unit is sick, even if it is a public unit, it is better to liquidate it. Such liquidation certainly would cause unemployment and hardship in the short run, but in the long run it will be good for society. Social achievements like employment creation and import substitution should never be made an alibi for an unsatisfactory economic and financial performance.

Public enterprises in a democracy like ours are accountable (a) to Parliament, (b) through audit and (c) through annual reports. Parliamentary control over public enterprises is a well established form of social control. Similarly, as an instrument of accountability; public enterprises are subject to financial audit, efficiency audit and propriety audit. Finally, a well-drafted annual report is an impotant medium of communication between the enterprises and the public.

Public accountablity of private enterprises is also statutorily required. Very often, the Annual General meeting (AGM) is an occasion where annual reports/balance-sheets can be seriously examined and the shareholders can take their public limited company to task. But this requires the shareholders' movement to be organised and strong. In fact, strong trade unionism, a strong conservationist movement, and a strong consumer movement are additional requirements to enable any business - private or public, national

or multinational, small or big - to discharge its social obligations and commitment.

Finally you must note that as society has expectations from business, so does business have from society. Society must also act responsibly. Social groups, through violent and irresponsible methods, may hold the business to ransom and ruin it. Ultimately, that will be a social loss. Business can discharge its responsibility, provided it enjoys some authority and support facilities. Social movements should support business by indicating right directions in the national interest. In Appendix-1 we present the Indian dilemma regarding the social responsibility of business.

Activity 9

An IDB sponsored study,-first of its kind in Indian industry, has figured out India's most excellent companies'

Private Sector
- Asian Paints Ltd.
- Bajaj Auto Ltd.
- Hindustan Lever Ltd.,
- ITC Ltd.,
- Larsen & Toubro Ltd.
- Reliance Industries Ltd.

Public Sector
- BHEL
- HMT Ltd.

Co-operative Sector
- Gujarat Co-operative Milk Marketing Federation Ltd. (Amul)

The study is reported in Business World. Vol. 5. Issue 20, December 23, 1985 - January5, 1986. Locate this reference and find out the criterial of 'Excellence'.

Activity 10

Pick up the Chairman's speech (normally it is published in the columns of the *Economic Times or the Financial Express* or any other newspaper) for any three lcompanies listed above, for the latest year. Read them through. Now, attempt to write two lucid paragraphs, one each on:

1. Socio-cultural Environment in India
2. Economic Environment in India

Remember, different speeches may highlight different factors. Try to work out the common factors. If you undertake this activity, you will realise how the same environment may be viewed differently by different viewers.

2.6 SUMMARY

The social environment includes a host of factors like social values, cultures, beliefs, traditions, social institutions, class structure, social group pressures, or social dynamics, etc. The nature of the social objectives and priorities along with the set of constraints, give form and content to several social movements.

The critical elements of the socio-cultural environment are: social institutions and systems, social values and attitudes, education and culture, social groups and movements, the socio-economic order, social problems and prospects, etc. Ever since the country became independent India has been witnessing changes on several fronts of the socio-cultural environment

The nation has witnessed several social movements. The trade union movement has emerged as a result of he process of industrialisation. The movement aims to protect the interests of the working classby forming organised unions. A consumer movement, to protect the consumer from the exploitation of the business community in India has emerged which in a large measure is reflected in the Consumer Protection Act. Several new trends can be discerned in the Indian management movement. In the current competitive scenario, there is more emphasis on efficiency, productivity, quality and participation in management. With the investor base becoming broad, the shareholders have become conscious of their rights. This has resulted in the Government taking several measures through legislation to protect the interests of the investing public.

Over the last two decades in particular, an environmental movement has emerged on the Indian scene. The movement aims to protect the environment for the present and future generations. In spite of remarkable advances in science and technology, unfortunately there has been tremendous degradation of the environment caused to a large extent by excessive industrialisation. Business firms cannot shirk the responsibility of minimising the polluting effect and promoting the protection of the environment. The Government has taken several policy measures to preserve the ecology and environment.

It is not merely the shareholders but several other groups who are interested in the running of a business enterprise. The management of the enterprise has therefore to strike a balance between the interests of all these groups or stakeholders. The business has therefore to be run in a socially responsible manner. This is necessary if the business has to survive and grow in the long run.

2.7 KEY WORDS

Social Environment : A subset of the environment consisting of and affected by social factors such as social institutions and systems, social structures and formations, social values and attitudes, educational and cultural influences, etc.

Ethnocentric : The practice of recruiting personnel for important positions from among the nationals of the country of the parent company.

Polycentric : The practice of recruiting personnel for important positions from among the nationals of the country of operation.

Geocentric : The practice of recruiting the best talent for important positions from any country (country of origin, host country or any third country), regardless of nationality.

Social Responsibility : Consideration of the impact of the firm's action on society.

2.8 FURTHER READING

Nadkarni, M.V., A.S. Seetharamu and Abdul Aziz, 1991, *India - The Emerging Challenges*, Sage India.

Krishna, Sumi, 1996, *Environmental Politics*, Sage India.

2.9 SELF-ASSESSMENT QUESTIONS

1. What do you understand by the socio-cultural environment of business and how is it important for business ?
2. What are the critical elements of the social environment of business ? Explain each element with examples.
3. Explain the link between social developments, the industrialisation process and the management culture. Give examples.
4. Write exhaustive notes on the following with your critical comments :
   a) The Trade Union Movement in India
   b) The Consumer Movement
   c) The Management Movement
   d) The Shareholders' Movement
   e) The Environmental Movement
5. What do you mean by the social responsibility of business? What could be some arguments for and against business assuming social responsibility?
6. "Business must be run in a socially responsible manner". Comment on the statement in the context of Indian business.

APPENDIX-1 : SOCIAL RESPONSIBILITIES OF BUSINESS-THE INDIAN DILEMMA

(Here is an extract from the writings of the late Prof. N.N. Chatterjee, *Management of Personnel in Indian Enterprises,* (Ch. 1, Pt. III), Allied Book Agency 1995, Calcutta. The piece was written about two decades ago, but is still relevant.)

"At this very mement, the environmentalists" lobby in the USA is strongly opposing the allowing of the supersonic Franco-British Concorde to fly in to American airports. The environmentalists charge that the aircraft is too noisy, burns too much fuel and is a threat to the ozone layer; the Concorde's high altitude emission of nitrogen gas could significantly affect the ozone screen that protects the earth from an overdose of the sun's ultra-violet rays and would pose a cancer risk. In the meantime the Russian TU-144, curiously enough called Concordaki, is already operating on domestic flights".

"The Rachel Carsons and Ralph Naders of 'Post-Industrial' societies have a large audience everywhere. Of late quite a few distinguished ecologists and futurologists have visited India and debated with their opposite numbers here the developing symptoms of the final collapse of human civilisation. One has even heard from eminent ecologists a wistful reference to Gandhian values of restraint of consumption and to the co-trusteeship pattern in industrial management. The pursuit of 'quality of life' rather than that of material progress is also much talked about. Prof.Dennis Meadows has found a solution in what he calls 'zero-growth'. We have been waned to avoid the kind of unplanned industrial growth and urban planning such as have polluted the air, water and vegetation in large areas of Japan, the U.S., the Mediterranean and Baltic seaboards, etc. by the discharge of industrial effluents and toxic emissions. We have been told that the 'tunnel vision' of the modern industrialist for the maximisation of profit is a menace to the human race. But this warning has been countered by citing the pollution jof the Volga river system and the Baltic seaboard and of the Caspian sea, large-scale deforestation creating dust bowl conditions in several regions, etc., by the industrial activities of the socialist society of the USSR.

"The global context kof the disturbance of the ecological balace and the predictions of the 'doom-sayers' cannot, however, produce much of an impact on the planners of developing economies. It will be extremely naive also to assume that all will be well if the affluent societies consumed less and diverted their surpluses to supporting the developing economies in their struggle for growth. In other words, the social responsibility of business in these societies is seen as a responsibility to the world community. The highly mechanised U.S. agriculture industry perhaps does play a role here, but not out of any altruistic motive. To argue that India need not intensify her programme of industrialisation in expectation of sharing substantially in the American GNP would at best provide an alibi for not being able to mobilise our national resources for growth activities".

"This is not to say that industrial pollution has not yet become much of a problem with us. Kanpur, Bombay and Calcutta conurbations have already been studied from this angle and provide startling data. Let us have a look at our river systems. The effluents from petro-chemicals, pulp-paper, textile, distilleries sugar factories, coal washeries hydrogenerated vegetable oil plants, tanneries, DDT factories, etc., have dangerously polluted long stretches of the Ganga and Bhagirathi, the Sone at Dalmianagar, the Deha

at Siwan (Bihar), the Kali at Meerut, the Gomti at Lucknow, the Yamuna at Delhi, the Damodar in the coal belt of Bihar, the Krishna at Bhadravati (Karnataka), the Godavari at Rajahmundry, the Bay of Bengal and so on. Heavy mortality of fish has been reported from many of these areas. A few years ago, a number of people died of drinking the polluted water of the Ganga below the Barauni Refinery. As for air pollution, a surgeon attached to the Coroner's Court of Bombay made this statement to a team of researchers recently:

> I have performed till now about 4000 post-mortems. The lung of every adult indicates existence of pollutants like carbon though of course the carbon contents are not fatal. The body has got used to it. But it makes people prone to cough, bronchitis and diseases of the respiratory tract. The only people in whose lungs carbon is not found are infants below the age of 3. (Sunday Standard, August 31, 1975).

The study made by the National Environmental Engineering Research Institute (NEERI) in 1974 about pollution by auto-exhaust fumes in Bombay is also revealing."

"The Delhiwalahs' growing disgust at the long plumes of smoke emitted by a thermal power station and hanging over the large parks planned round the national monuments of Rajghat, Vijayghat and Shantivan, has yet to result in the installation of any filtration device."

"Now a major Indian dilemma is that industries which have bigger pollution potential are the very industries we need most (e.g., fertilizer plants for the 'green revolution', thermal plants for electricity, DDT factories, chemicals factories for pest control, etc.). We cannot just do without them. But the Indian predicament is that the largest pollution potential industries are and have to be hereafter in the public sector and not in the profit-motivated free enterprise sector. All metropolitan transport systems which pollute the air in congested areas are now in the public sector and most of them have to be subsidised by the Exchequer".

"However, there is a ray of hope as new enterprises can be planned along with urban development and backward area development plans. Anti-pollution technology is also available and public sector enterprises can afford to invest in it".

"The country is also conscious of the nature of the problem and some significant steps have already been taken. The reconstituted National Committee on Environmental Planning and Coordination, for which the Department of Science and Technology provides the secretariat, has shown some dynamism of late. The Central Public Health Engineering Research Institute (CPHERI) at Nagpur has developed a measure of expertise in effluent disposal and control. The Central Water (Prevention and Control of Pollution) Act of 1974 has now gone off the ground. The Bombay Smoke Nuisances Act, recently extended to Delhi, if implemented with greater zeal, could produce results. A 'Clear Air Act' is also in the offing, modelled no doubt on the UK (1952) and US (1963) Acts. India, if we act in time, may not need such draconian measures as the US Federal Water Pollution (Amendment) Act, 1973, or Japan's 'Three P-Policy' (Polluters Pay for Pollution). It is hopeful sign that at last year's, Science Congress (January 1975), a number of young scientists read valuable papers based on research data on the harmful effects of insecticides and pesticides and of industrial pollution on fresh water animal life."

"But the story of the Indian dilemma does not end here. There is a much bigger dilemma

-- how to harmonise the age-long habits and cultures of profit-earning enterprises with the requirements of social responsibility and the needs of rapid growth. Till recently, the two most profitable and least arduous private sector enterprises in India were money-lending and food-adulteration. Pure milk and ghee are now mere concepts -- particularly in urban areas. Short weighment, under-invoicing, smuggling, black-marketeering, rack-renting and various other business malpractices prevail in the profit-earning business activities -- whether small, medium or large-scale. Exploitation of contract labour and bonded labour is still not under control. A large-scale private sector business enterprise may solve its conscience by 'adopting' a village or taking to landscape gardening around a new plant, or building a temple or a dharamsala but this impresses none. The roots of these maladies go deep down into the Indian soil. Modern business is supposed to be multi-allegiant -- its allegiance is to the shareholders, to the employees, to the local community and to the State. The elaborate 'Declaration on the Social Responsibilities of Business' adopted at the International Seminar held at Delhi in 1965, under the Chairmanship of the late Lal Bahadur Shastri, the then Prime Minister of India, only discussed the Indian myth of the businessman's dharma. India has a Fair Trade Practices Association at Bombay and this body has drawn up a code of Fair Trade Practices for Indian businessmen. But that was in the sixties. How many of our businessmen are even aware of this code? We have always been good at formulating excellent codes of conduct -- only the implementation has been extraordinarily feeble. One hopes and prays that at last we are beginning to make an earnest effort to implement some of them."

You may note how relevant it is even today.

PART-II POLITICO-LEGAL ENVIRONMENT

Objectives

After reading this unit, you should be able to:

* *define* the politico-legal environment of business;
* *describe* the critical elements of this environment;
* *examine* the interaction between political environment and business management;
* *overview* Indian Government philosophy with regard to our industry or business; and
* *overview* various socio-economic legislations in India which are relevant for busines management

Structure

2.10 Introduction

2.11 Some Critical Elements

2.12 Government Machinery for Jndian Industrial Economy

2.13 Understanding the Legal Environment of Business

2.14 Summary

2.15 Key Words

2.16 Further Reading

2.17 Self-assessment Questions

Appendix 2 : SEBI Guidelines for Capital Issue

Appendix 3 : OTCEI Guidelines for listing of Comany Securities

Appendix 4 : SEBI Guidelines for Issue of Shares through OTCEI

Annexure 1

2.10 INTRODUCTION

Business is an economic activity. But business managers, to be effective, must also consider the non-economic environment of business. With this assumption, we have considered the socio-cultural environment of business in the preceding unit. Now we would like you to spend some time on the politico-legal environment of business. Broadly speaking, we are still within the compass of sociology. The Government is a political institution, but it has a social purpose, it enacts and executes social policies, it exists with social consent, it provides the ways and means of maximising social benefits and minimising social costs. In other words, the Government itself has a social value and culture. You must consider the structure and style of Government and examine its impact on business. The present unit, therefore, aims to help you --

* define politico-legal environment,

* understand the parameters of this environment, and
* describe the cardinal features of India's politico-legal environment.

In the modern world, business of any type and any size is often affected by Government policies, programmes and legislations. The Government has its own form, structure, style and philosophy. Depending on the nature of the Government at work, business has to organise its activity, the businessmen have to define their respective business strategy and business tactics. In other words, business policy decisions are designed in the realm of the Government's overall policy and the system environment.

Starting with a particular ideology or philosophy, the Government of every country formulates and executes a set of policies and programmes. Quite a few of these policies are executed through legislations. These legislations and enactments, rules and regulations, systems and procedures, policies and plans, statements and announcements, directives and guidelines by the Government, constitute the politico-legal environment. If you want to become a successful manager, you must take stock of the relevant politico-legal environment of your business, and then capitalise on the opportunity available in that environment.

2.11 SOME CRITICAL ELEMENTS

The politico-legal environment of business contains a number of critical elements:

* the form of Government
* the ideology of the ruling party
* the strength of the opposition
* the role and responsibility of the bureaucracy
* political stability
* the velocity of Government policies,plans and programmes
* socio-economic legislations
* politico-legal institutions

Gone are the days of *laissez fare*. Business is no longer left alone. Government intervention to some extent in business activity all over the world is a rule rather than an exception. Therefore, the *form and structure of the Government* is a very important and decisive factor for the business sector. A couple of examples may be cited to illistrate this point. Under democracy, we have a "government of the people, by the people and for the people". People's participation is so important that even at the enterprise level, we seek workers' participation in management, i.e., industrial democracy. Similarly, under a federal form of government, we tend to confine the authority of the Central Government with the functional autonomy of the State Governments and, therefore, we allow both Central as well as State level public enterprises. In the same way, when we accept the principle of democratic decentralisation, we authorise even the local Government to collect some business taxes and spend money on local activities. Thus, the system of government and the structure of administration affects business. In its turn, in order to secure maximum favour from the existing Government, businessmen also create their own lobby and it is the strength of this lobby which partly decides whether the Government adopts pro-business or anti-business measures.

In a democratic set up, the *ideology of the ruling party* influences ownership, management

grows in a region which is politically stable. A few decade ago, many industries and businesses moved out of West Bengal because of the Naxalite movement. Similarly a few years ago when Punjab was infested with terrorism, business came to a halt. Business ethics also depend on the political situation. During the Emergency (1975-76) the standard of our business ethics and morality did improve to an extent. In the same way, President's rule or Governor's rule in a state affects business ventures. Also, you may note that whenever the nation becomes politically unstable, the flow of foreign capital and enterprise is adversely affected, and this in turn tells on business, both national and multinational. Political stability in a nation is read not only in terms of physical events and happenings but also in terms of the stability of the Government machinery and policies in relation to business. The Governemnt formulates and executes a number of *policies and programmes*. If the Government frequently changes its industrial licensing policy, tax policy or trade policy and the like, then it unnerves the business sector and thereby adversely affects business investment and related activities. If policies and programmes are stable then business can plan its activities, otherwise it faces a tremendous amount of what is called "non-market" risks and uncertainties. Stable policies build up business confidence and help corporate planning. This is one of the reasons why the Government of India has recently gone for a long-term fiscal policy statement or a quasi-long-term Expot-Import policy.

However, when policies are formulated with tremendous "speed", they come one after another though the "direction" may not be very clear. Sometimes, policies are formulated with a clear "direction" but at a snail's "speed"; we suffer on account of lack of "velocity" of such policies and this affects business unfavourably. Particularly in a country where there are so many distinct groups at work, such as policy-thinkers, policy-planners, policy-makers, policy-executers, policy-adjudicators, and so on, the business sector often views policies with suspicion, as if all policies are meant to curb and control business. Such business psychology is not conducive to business growth. Policies once formulated have to be implemented. For effective implementation we need legislations or enactments, but more than that we need political and bureaucratic will.

Policies are statutorily enfcred through laws. Various *socio-economic legislations* subject to which business operates constitute the legal environment. Today there are so may laws that at every turn a business man meets law; modern businessmen need legal advice constantly. Modern business is more in the nature of a "legal contract" than a "social contract". Business laws are many in number and various in form. The laws are enacted to protect the business interests of various groups in society. You may recall from the preceding unit that laws are needed to protect consumers, workers, managers, owners, shareholders and society at large. Subsequently, you will be exposed to details of business legislations such as MRTP, FERA, IDRA and so on. It is through this set of legislations that order is maintained in the industrial economy. Industrial order and harmony is a condition for survival and expansion of business. Laws not only protect business, sometimes they also create business. Take the example of tax laws. The more the number and the more the complications of tax laws, the more will be the business of tax consultants. Thus economic legislations and business environment interact with each other.

Last but not the least, you must also count the *politico-legal institutions* as a part of the non-echomic environment of business. The functioning of the legislative, executive and judical organs of the Government affects business environment directly and indirectly. All these organs run through organisations and institutions. For example, the judiciary runs through the Supreme Courty, the High Court, the High Courts and the lower Courts. Unless these courts function efficiently, adjudication of business matters, will be at stake. Similarly, unless the police department acts with vigilance, economic offences will increase.

The successful operation of business depends on cooperation and coordination among a number of Government departments like DGTD, DGS&D, BPE, etc., just to name a few.

Sometimes, business suffers because of inter-ministerial or inter-departmental conflict. To avoid this kind of conflict, very often coordination cells are created. If these cells work, business prospers without constraints, otherwise red-tapism, procedural delay, excessive centralisation, lack of dedication and absence of departmental coordination frustrate business activity.

Activity 11

Explain briefly the impact of the politico-legal environment on business oranisations. Illustrate your arguments with reference to the organisation you are working for. If you are not working at present, choose an organisation you would like to work for.

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Activity 12

Take a political map of India. Divide the states into four zones: North, South, East and West. Name the political party which is ruling each state. Do you observe any contrasting zonal difference with respect to political ideology or philosophy? Do you observe any contrasting zonal difference with respect to pattern of industrialisation and business culture? Would you draw any conclusion on the subject of the relationship between politics and business ?

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Activity 13

Figure out some businessmen who are active members of either the Union legislature or state legislature. What are their business interests ? Critically examine the contribution of the business loddy to the national politics of India.

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2.12 GOVERNMENT MACHINERY FOR INDIAN INDUSTRIAL ECONOMY

From the standpoint of having an idea about the non-market institutional environment within which Indian industry and business operates, we may refer here to a few selected organisational set ups.

A. The Ministry of Industry

The Ministry of Industry was constituted on August 23, 1976. It comprises two Departments:

i) Department of Industrial Development

ii) Department of Heavy Industry/Public Sector Undertakings.

The Department of Industrial Development is the primary Government agency for the formulation and implementation of Government's industrial policy including the promotion of industrialisation of the country in accordance with the Government's industrial policy the national priorities and the objectives of the five-year plans. The Department reviews from time to time the measures which are needed for the promotion of industrialisation including balanced regional development, promotion of small-scale, village and rural industries as also for securing higher employment generation and maximising production. One of the instruments employed for securing these objectives is industrial licensing which stems from the Industries (Development and Regulation) Act, 1951, and the rules made thereunder. The Act and the rules are also administered by this Department. A number of promotional, regulatory, technical and advisory functions are also discharged by this Department.

Apart from the above functions, this Department is also administering certain industries as allocated to it under the Allocation of Business rules of the Government of India.

The principal functional divisions/desks in the Department of Industrial Development are

Secretariat for Industrial Approvals

Policy Desk for the Formulation and Implementation of Industrial and Licensing Policies

Industries Division

Finance Division

Administration and General Division

Let us describe each of them separately :

The Secretariat for Industrial Approvals is functioning as an unified agency for processing applications for (a) industrial licences, (b) foreign collaboration, and (c) import of capital goods. This division is also an Entrepreneurial Assistance Unit for assisting entrepreneurs and for redressals of public grievances.

The Policy Desk for Formulation and Implementation of Industrial and Licensing Policy overses the effect of the policy measures taken from time to time and formulates the changes that may be called for in the licensing policy, procedures for industrial approvals, protective measures needed for the small-scale sector, reduction of disparities in regional development, promotion of investment in the desired channels, etc.

The Industries Division is concerned with promotion of industrial growth in the large, medium and small-scale sectors and for industrial productivity and industrial management. Besides, it deals with certain industries specifically allocated to the Department.

The Finance Division is headed by a Financial Adviser of the status of additional secretary and handles work relating to budget and accounts, financial advice, methods and work measurement studies, etc. This division also conducts internal audit to ensure both accuracy in accounts and efficiency in operation.

The Administration and General Division deals with personnel and establishment functions and allied matters such as Career Management and Training, Vigilance, Security, Welfare, etc.

The Department of Heavy Industry or what is now called the *Department of Public Sector Undertakings* is exclusively concerned with basic and capital goods industries. One of the important activities of the Department relates to coordination with other ministries and agencies responsible for the growth of the infrastructure or of producer goods industries. An impotant piece of our Government's control mechanism is the CG (Capital Goods) clearance effected through this department.

There are other developmental and promotional organisations under the Ministry of Industry. The organisational set up and functions of some of these units are described below.

The Directorate-General of Technical Development (DGTD)

The Directorate-General of Technical Development (DGTD) is the technical advisory organisation in the industrial field to various ministries/departments of the Government. It gives technical advice on matters relating to industrial technology and licensing, foreign collaboration, capital goods requirements, import and export policy, tariff structure and other related matters in respect of most of the industries excepting iron and steel, textiles, jute, sugar and vanaspati.

The organisation has two functional wings - Engineering and Non-Engineering including Chemicals. Each wing has two Deputy Directors-Generals and a number of Industrial Advisers who look after different industrial disciplines.

Regional offices of the DGTD have been established at Chennai and Calcutta. These offices render technical assistance to entrepreneurs and advise the Joint Chief Controller of Imports and Exports, the Department of Customs and other organisations regarding import of capital goods up to the value of Rs. 20 lakhs. In conjunction with the state directorates of industries, these also provide information to the headquarters on the progress of various schemes and provide feedback information on technology, quality upgradation, standardisation and development of ancillaries.

The Technology Information Centre in the DGTD collects data on technology, R&D and consultancy. Such data are utilised in processing proposals for foreign collaboration, entrepreneurial guidance, choice of technologies, etc.

The Technology Development Division of the DGTD acts as the secretariat for the Technical Evaluation Committee for examining all proposals for foreign collaboration and technical consultancy services, etc. In order to take an objective view of foreign collaboration proposals, the Technical Evaluation Committee examines thoroughly all the foreign

collaboration proposals from the angle of availability of indigenous know-how, and the feasibility for horizontal transfer of indigenous technology.

The Office of the Economic Adviser

It is an attached office under the Department of Industrial Development in the Ministry of Industry. It assists in the formulation of Industrial and Import policies and renders advice and assistance on allocation of foreign exchange for the import of raw materials and other maintenance inputs.

The Office of the Economic Adviser deals with macro-aggregates such as industrial production and trends in industrial growth and capacity utilisation. The office prepares monthly reviews of industrial production and examines and monitors trends in industrial production and capacity utilisation.

Relevant issues concerning industrial finance and resource availability and mobilisation with reference to plan targets for the industrial sector are dealt with by this office. Matters pertaining to credit policy, credit planning and availability with reference to the industrial sector and specific industries are examined in this office. Fiscal proposals in general and duty levies in particular are examined keeping in view the need for stimulating investment and industrial production in the context of overall economic development.

This office compiles and publishes the official Wholesale Price Index in India and also reviews trends in wholesale prices periodically. It brins out weekly and monthly indices of wholesale prices, a quarterly Bulletin of Industrial Statistics and a monthly Economic Review.

Additionally this office collects, compiles and analyses information on employment of Indians and non-Indians in companies with foreign majority shareholding and of non-Indians in public and private sector companies in India. Finally, the office prepares from time to time analytical notes on different aspects pertaining to the industrial sector.

Bureau of Industrial Costs and Prices (BICP)

In pursuance of a recommendation made by the Administrative Reforms Commission, the Government of India established in 1970 the Bureau of Industrial Costs and Prices (BICP). It is an attached office under the Department of Industrial Development. It advises the Government on a continuing basis on various aspects of the price structure in relation to industrial cost, cost reduction and productivity.

The Directorate-General of Industrial Contingency

The Directorate-General of Industrial Contingency (DGIC) was established in December 1976 so that industrial production in the country does not suffer on account of strikes, threats of strikes, lay-offs and lock-outs, etc. Contingency plans are drawn up on the advice of this Directorate in public sector and important private sector undertakings and the Director-General of Industrial Contingency ensures effective implementation of these plans. The Directorate keeps a close watch on the labour situation to prevent any interruption in production by getting the genuine grievances of the workers redressed by the management in time. It helps provide effective assistance from state, civil and police administrations as also from the Labour Department for the implementation of the contingency plans.

Directorate-General of Supplies and Disposals (DGS&D)

India's huge government machinery is a potentially important and growing customer. The DGS&D is the Government's central purchasing organisation. It buys all kinds of products from brooms to heavy machinery on behalf of all Central Government ministries and agencies. State, local, quasi-public, statutory, and public sector may also use DGS&D, if they so wish.

Certain products (e.g., food, leather goods, coal and wooden furniture) fall outside the scope of DGS&D, and several Government or quasi-government bodies (e g. Air India, Indian Airlines, and the Oil and Natural Gas Corporation) do their own buying.

The DGS&D uses the following four basic contract types:

1. Fixed quantity contracts, usually termed "Acceptance to Tender", call for the firm to supply a specific quantity of items at agreed-upon prices and delivery schedule.

2. Rate contracts set specified rates and a contract period but do not mention quantities. The contractor is bound to fill any order placed during the contract period.

3. Running contracts set quantity, price and a fixed term of usually a year, but the ordered quantity may vary usually by 25 per cent of the contracted quantity. Some contracts include price variation clauses.

4. Price agreements specify prices for monthly rate of supply and serve as a standing offer to the purchaser.

Development Commissioner (Small-Scale Industries)

This is an office attached to the Ministry of Industry. It is the nodal agency to coordinate the policies and programmes for the development of small-scale industries. It provides a wide range of facilities and services including consultancy in the techno- managerial aspects to small units through the network of Small Industries Service Institutions (SISI), Production Centres. Testing Centres. Product-cum-Process Development Centres, etc.

B. The Ministry of Civil Supplies

The current strategy of industrial development in India is to place heavy emphasis on heavy industry and at the same time to ensure large-scale production (or distribution) of mass-consumption goods. Production is conditioned by the availability of required inputs and, from this point of view, the purchase function is important. We have already referred to the role of the purchasing organisation which functions under the above ministry, i.e., DGS&D.

C. The Ministry of Commerce

Here is another Government organ affecting the politico-economic environment of business in India. The ministry is vested with the task of formulating and guiding India's trade policy. The ministry consists of the Department of Commerce and the Department of Textiles.

The *Department of Commerce* is the primary Government agency responsible for India's foreign trade introducing commercial relations with other countries, state trading, trade promotional measures, and regulation of certain export-oriented industries and commodities.

The functional divisions of the Deparlment of Commerce are:

(i) Administrative and General Division; (ii) Finance Division; (iii) Economic Division; (iv) Trade Policy Division; (v) Foreign Trade Territorial Division; (vi) Export Products Division; (vii) Export Industries Division; (viii) Export Services Division, and (ix) Vigilance Division.

There are a number of autonomous bodies under the Department, like Commodity Boards, Export Promotion Councils, Export Inspection Council, Trade Development Authority, Trade Fair Authority, etc.

A number of public sector undertakings are functioning under the direct administrative control of the department like the State Trading Corporation (STC), the Minerals and Metals Trading Corporation (MMTC), the Project and Equipment Corporation, The Export Credit and Guarantee Corporation, etc.

Some of the attached and subordinate offices under the Department are: (i) Office of the Chief Controller of Imports and Exports, (ii) Directorate-General of Commercial Intelligence and Statistics, (iii) Development Commissioner, Kandla Free Trade Zone, etc.

Activity 14

Suppose you are to start a new business in India. Think of any specific small-scale venture. Make a list of Government Departments, including financial institutions, which you think you may have to contact / visit. Briefly indicate the specific purpose of your visit. (In this connection, you may

consult *Guidelines to Industries, Government of India*).

Institutions	*Purpose*
1.	....
2.	....
3.	....

2.13 UNDERSTANDING THE LEGAL ENVIRONMENT OF BUSINESS

For describing and analysing the legal environment of business in India, we present here briefly an overview of some specific socio-economic legislations. Some of these legislations will be taken up for a detailed discussion in subsequent units. In this unit, you should be interested in a broad overview rather than details. We may list these legislations which define the legal environment of business in India:

- Company laws
- Laws relating to capital market
- MRTP (Monopolies and Restrictive Trade Practices Act)
- FERA (Foreign Exchange Regulation Act)
- IDRA (Industrial Development and Regulation Act)
- Trade Unions Act
- Bonus Ordinance
- Factory Legislations
- Social Security Enactment
- Laws for Consumers' Protection

This list is not exhaustive, it is just illustrative. There are many more legislations which are important from the standpoint of business and industry in India.

A. Company Laws

In the present politico-legal environment, company laws include represents the principal laws affecting the organisation and management of corporate business. Originally this law used to be concerned with joint stock companies only, but today its scope has increased. It covers different types of companies-their incorporation, their constitution, their management and even the manner of their dissolution.

The history of our company law dates back to 1850. Based on the British model, it had a modest beginning; it was only concerned with the registration of joint stock companies. Changes were introduced subsequently in 1860, 1866 and 1913 closely reflecting changes in the British law from time to time such as the introduction of limited liability. The Companies Act, 1913, had some special provision to take care of the Managing Agency System but without much success. The Act came under vehement criticism during World War II when there were serious complaints of malpractices and manipulations in company formation and management. Eventually, the advent of Independence, the adoption of the Constitution with its Directive principles of State Policy and the acceptance of the socialistic pattern of society as our goal further highlighted the need for revision of the 1913 Act. Based on the recommendations of the Bhabha Committee (1950), the Companies Act was thoroughly amended in 1956. The objectives of the Companies Act, 1956 are listed follows.

- minimum standard of business integrity and conduct in the promotion and manageme[nt of] companies
- full and fair disclosure of all reasonable information relating to the affairs of the compa[ny]
- affective participation and control by shareholders and the protection of their interests
- enforcement of proper performance of their duties by the company management

- the state's powers of intervention and investigation into the affairs of companies regarding the interests of the shareholders and the public

A number of amendments were introduced in the Act of 1956 from time to time particularly to bring an end to the Managing Agency System. Such amendments were effected in 1960, 1963, 1969 and 1970.

The word "Company" as it has come to mean in the context of the Indian Companies Act refers to a business organisation with features of a) a corporate personality, b) limited liability, and c) transferability of shares. In our law, there are three basic typed of companies: (i) Companies limited by shares, popularly known as "limited companies" (ii) Companies limited by guarantee, popular known as" guarantee companies", and iii) Companies with unlimited liability, which is more of theory than practice. Each of these three types may again be termed as either public company or private company. The general presumption in our Act is that a company is a "public company" unless it is clear from its constitution that it is a "private company". A private company is defined to be one which

i) restricts the right to transfer its shares,

ii) limits the number of its members to fifty, excluding present or past employees, and joint shareholders being counted as one member, and

iii) prohibits any invitation to the public to subscribe for any share or debenture of the company.

The Act lays down a simple procedure for conversion of a private company into a public company. Additionally, there is a category of deemed public companies: if 25% *or more* of the paid-up capital of a private company is held at any time by one or more corporate bodies, it would be "deemed" to have become a public company, subject to certain restrictions.

Then there is a classification entitled "holding" and "subsidiary" companies. The former controls the composition of the Board of Directors of the latter or it controls more than half of the voting power of the latter, or the latter is a subsidiary of another company, which itself is a subsidiary company of the holding company.

There is another concept introduced by our Companies Act. This is the concept of "Government company". i.e., a company in which not less than 50% of the paid-up capital is held by the Government, Central or state or both.

There are special provisions for foreign companies. A "foreign company" is one which is incorporated outside India, but which has an established place of business in India.

Given the definitions of various types of companies, our Companies Act seeks to provide for a certain degree of ultimate control to the shareholders, to democratise company management and also to prevent certain known malpractices in company management. For example, the Act contains provisions for Government control over the appointment and remuneration of managing directors, whole-time directors and managers. The Act also places certain restrictions on loans made or guarantees given by one company to another. The Act is thus directed against practices like interlocutory directorships and interlocking of funds. The Act also contains a few provisions for the maintenance of proper books of account.

A significant development in the context of Indian company laws was incorporated in the ***Companies (Amendment) Act, 1974.*** With this enactment, the process of gradual tightening of the Government's control over the functioning of joint stock companies seemed to have reached a climax. Some important amendments are enumerated below:

1. A large number of functions hitherto performed by High Courts are now transferred to the Central Government or the Company Law Board.
2. A new definition of "group" in Section 2(18A) has been introduced in line with a parallel amendment of Section 2(g) of the MRTP Act so as to tighten control over big business.
3. Some explanation of the definitions of managing agents, secretaries and treasurers has been suggested by which the activities of the former managing agents (as consultants or advisers) can be controlled.
4. The definition of "deemed" public limited companies has been enlarged so as to restrict the operation of private limited companies

5. The new Section 108A imposes restrictions on the transfer or acquisition of shares by groups, firms, etc. under the same management.

6. The new Sections 187C and 187D provide for investigation into the beneficial ownership of shares.

7. The new Sections 205A and 205B provide *inter alia* for unpaid dividends to be transferred to a special unpaid dividend account in a scheduled bank and after three years, if still unpaid, to the general revenue account of the Central Government.

8. Section 217 provides for the inclusion of the name of every company official drawing a Salary of Rs. 3,000 per month in the Board's Report before the annual general meeting.

9. Section 324 is amended to put a ceiling on the number of companies where a person or firm can hold appointment as auditors. This ceiling is twenty where the companies have a paid-up share capital of less than Rs. 25 lakhs each. In any other case, not more than ten out of these twenty should be companies each of which having a paid-up share capital of Rs. 25 lakhs or more.

10 Section 269, was amended to make prior approval of the Central Government to the appointment of managing directors and whole-time directors in public companies obligatory, even in the case of reappointment and not only first appointment, as previously.

11. There is a new Section 294A under which the Central Government has taken powers to prohibit the appointment of sole selling agents where the demand for the goods produced by a company is substantially in excess of the production or supply of such goods.

12. Section 314 strengthens the restrictions on the appointment of partners or relatives, etc., of directors of private companies and makes prior approval of the Central Government to such appointments obligatory.

13. The amendment inserted in Section 383 makes it obligatory for companies with a paid-up share capital of Rs. 25 lakhs to have a whole-time secretary.

14. Section 408 was amended to strengthen the Government's power of intervention to safeguard minority interests, or the public interest. Now the Government can appoint an unlimited number of directors in public companies.

A few other important changes were made through the **Companies Amendment Act of 1977**:

- it authorised the Central Government to grant exemption to companies from the operation of Section 58A which restricted the acceptance of deposits from the public
- it empowered the company to donate up to Rs. 50,000 for charitable purposes or for employees' welfare in a General Meeting
- it empowered the Company Law Board to enforce its order as the decree of a court of law

It may be mentioned that strict company enactment, with of course necessary flexibility and fairness, are consistent with the emerging trends in our socio-economic environment. These trends and tendencies may be recounted. First, the growth of big business at the national and multinational level has to be properly regulated and directed. Secondly, the growth of corporate giants such as SAIL, BHEL, ONGC, FCI and STC was created a challenging sector of Government companies. Thirdly, the social responsibility of business today is to protect the interests of all: shareholders, workers, consumers, managers, the community and the Government. In view of these factors, the new amendments in our Companies Act seem to be quite appropriate, but we must remember that amendments by themselves do not guarantee the successful operation of the law.

Recently Proposed Changes

A Working Group was constituted by the Government of India to suggest changes/modifications in the Companies Act 1956. Based on the recommendations of this group, the Government introduced in early May 1997 a Draft Companies Bill in Parliament. The main points of the Companies Bill are as follows:

- The total sections nave been compressed from 678 to 457, and the total number of Schedules from 15 to only 3.
- The bill proposes a substantial reduction in the depreciation rate of plant and machinery from 5.15 per cent to 4.75 per cent in case where the "straight line" method is followed, and from

15 per cent to 13.91 per cent where the "written down value" method is followed. This will have the effect of prolonging the lifespan of plant and machinery for depreciation purposes.

- It restricts corporates in issuing inter-corporate loans and investment up to the maximum of 60% of their paid-up capital and free reserves, or 100 per cent of free reserves, whichever is higher.
- The coporates can buy back their own shares or other specified securities out of free reserves, securities premium account, or from the proceeds of prior issues floated specifically for the purpose of buy back. Thus, a company can issue other forms of securities like debt or preference shares or even non-voting shares, to buy back the voting shares, thereby maintaining the same level of floating stock but not the voting shares.
- It proposes to reduce the period of payment of dividend from 42 days to 30 days of the rate of declaration.
- A company cannot invite deposits in case it has defaulted in the repayment of any prior deposit or part thereof or any interest thereon in accordance with the terms and conditions of such deposits.
- A director proposed for appointment will be considered to be disqualified if he is guilty of contravention of the provisions of the Securities and Exchange Board of India unless a period of 3 years has elapsed from the date of his conviction.
- The bill seeks to rationalise the classification of companies. The provision with regard to deemed companies is sought to be deleted.
- It proposes the recruitment age for whole-time directors, managing directors, or managers of a company at 60 years, and for directors at 70.

The Draft Bill has drawn widespread applause from the Chambers of Commerce and Industry for addressing contemporanous issues being faced by the corporates which it seeks to resolve in a pragmatic and result-appointed manner. It has been claimed that the bill provides for greater flexibility, self-regulation by companies and ensures transparency.

B. Capital Market

Having discussed the Companies Act, we shall now present the main points of some important laws relating to the functioning and operation of capital markets in India.

The Securities Contracts (Regulation) Act, 1956

The Securities Contracts (Regulation) Act (SCR ACt) 1956 is designed to regulate the functioning of stock exchanges in India and to prevent undesirable transactions/dealings in securities. The Act provides for: i) recognition of stock exchanges subject to fulfilment of certain conditions relating to membership and rules and bye-laws; ii) general control over trading method and practices; iii) regulation of contracts and options in securities; and iv) procedures relating to listing of securities by public companies.

A **Stock exchange** has been defined as a body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling, or dealing in securities. There are at present 21 recognised stock exchanges functioning at various places in the country. While some stock exchanges may be recognised on a permanent basis, others may be on a temporary (but extendable) basis. The 21 stock exchanges are located at: Bombay, Ahmedabad, Calcutta, Madras, Delhi, Hyderabad, Indore, Bangalore, Cochin, Kanpur, Pune, Ludhiana, Guwathati, Magalore, Patna, Jaipur, Bhubaneswar, Rajkot, Vadodara, Coimbatore, and Meerut. In addition, a National Stock Exchange of India, with headqarters in Bombay has also been set up. The National Stock exchange (NSE) has all-India jurisdiction. After the establishment of the Securities Exchange Board of India (SEBI) under the SEBI Act 1992, certain powers which were earlier exercised by the Central Government under the SCR Act have now been transferred to SEBI.

Every stock exchange must have rules approved by the Central Government/SEBI.

Securities and Exchange Board of India Act, 1992

Promulgated as an ordinance on January 30,1992 , the SEBI Bill was passed by both Houses of Parliament and became effective on April 4, 1992.

The objects of the SEBI Act are to develop the securities market on healthy and orderly lines and to provide adequate protection to investors. To this end. it is necessary to promote a market which ensures :

Fairness : The market must promote integrity in dealings, a high standard of conduct and good business practices.

Efficiency : The market should be professionalised and well informed, offering high standards of service at reasonable cost.

Confidence : The market must inspire confidence in both investors and issuers to actively participate in and rely more on the security market.

Flexibility: The market should be resilient, innovative and continuously responsive to the needs of all market participants.

The capital market in India has witnessed tremendous growth in the recent past. There is increasing participation by the investing public. It is, therefore, imperative to sustain the confidence of investors by protecting their interests. The Government has vested SEBI with necessary statutory powers to deal effectively with all matters relating to the capital market. SEBI has been established on the pattern of the Securities and Exchange Commission (SEC) of the USA. The headquarters of SEBI are located in Bombay (Mittal court, B Wing, 1st floor, 224, Nariman Point, Bombay - 400 021)

The SEBI has been constitued as a body corporate having perpetual succession and a common seal, with powers to acquire, hold and dispose of property, both movable and immovable, and to contract. It can sue or be sued in its own name. The Board consists of: i) A chairman to be appointed by the Central Government, ii) two members from among the officers of the Ministries of the of the Central Government dealing with finance and law to be nominated by the Central Government; iii) one member from among the officers of the Reserve Bank of India, to be nominated by the RBI; and iv) two other members appointed by the Central Government. Subject to the provisions of the Act, it is the duty of the Board to protect the interests of investors in securities and to promote the development of and to regulate the security market by such measures as it thinks fit. With these objects and features; the board has been entrusted with the following functions :

a) Regulating the business in stock exchanges and any other securities markets.

b) Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to public issues, trustees of trust deeds, registrars to public issues, merchant bankers underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner.

c) Registering an regulating the working of collective investment schemes including mutual funds.

d) Promoting and regulating self-regulatory organisations.

e) Prohibiting fraudulent and unfair trade practices relating to securities markets.

f) Promoting investors education and training of intermediaries of securities markets.

g) Prohibiting insider trading in securities.

h) Regulating the substantial acquisition of shares and the takeover of companies.

i) Calling for information from, undertaking inspection, conducting inquiries and audits of, the stock exchanges and intermediaries and self-regulatory organisations in the securities market.

j) Performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulations) Act, 1956, as may be delegated to it by the Central Government.

k) Levying fees or other charges for carrying out the purposes of this section.

l) Conducting research for the above purposes.

m) Performing such other functions, as may be prescribed.

SEBI Guidelines for capital Issues : With the repeal of the Capital Issues (Control) Act, 1947, the guidelines, notifications, circulars etc. issued by the office of the Controller of Capital Issues have become defunct. The companies are free to market issues of capital in any form they like, at any price, and subject to such other terms and conditions as they may decide. However, such companies are required to conform to the Guidelines issued by the SEBI on June 11, 1992, called the "Guidelines for Disclosure and Inventors' Protection". After those guidelines were issued, several clarifications have been issued on these guidelines. These guidelines are presented in Annexure-2.

Over-the-Counter Exchange of India (OTCEI)

The term "Over-the-Counter" is an anachronism. It has coined at a time when securities were traded over the counter of different dealers from their inventories. However, nowadays the over-the -counter market is a way of doing business rather than a place. It is a way of trading securities other than at an organised stock exchange. Trading of securities is carried on by brokers and dealers who are scattered over different locations and regions through a network of telephones, telegraphs, teletypewriters, telex, fax and computers. Thus, with the help of the communication network, with which every dealer-broker is linked, the prices are arrived at and investors are allowed to select among competing market makers . A market maker quotes two-way prices at which the member/dealer is willing to buy or sell a standard quantity of scripts which will be continuously quoted for a certain period, say, three months.

Thus, over-the -counter (OTC) markets are envisaged as a flood as securitey trading system equipped with an electronic or computer network through which nationally and internationally scattered buyers and sellers can conduct business more efficiently and economically.

In India, OTCEI has been promoted by the UTI, ICICI, IDBI, IFCI, LIC, GIC and its subsidiaries, SBI Capital Markets Limited and Canbank Financial Services Limited. OTCEI has been incorporated as a company under Section 25 of Companies Act, 1956, which means that it cannot distribute its income among its members by way of dividend; instead it has to use its income for furthering its objectives.

The basic objective of creating OTCEI is to provide a securities market to enable small/

start-up companies with potentially viable green field ventures to obtain their capital requirements from investors to whom such investment would be acceptable but who would also like to have some liquidity for their investment.

Need and Objectives of OTCEI : At present, the stock exchanges function as a single door market in which the securities of companies engaged in different industries and trades of varied sizes are listed with identical qualifying criteria and are traded simultaneously in the same trading hall. The result of this is that while big and important companies receive all the attention, the large bulk of companies, particularly the new and small companies, remain unnoticed and, consequently, their shares remain largely untreated. According to one estimate, only 10 per cent of the listed scrips are regularly traded on Indian stock exchanges. Thus the liquidity of the scrips of small companies tends to suffer.

The OTCEI aims at creating a stock exchange which will:

i) provide facilities to small companies to raise funds from the capital market in a cost-effective manner;
ii) provide a convenient and efficient avenue of capital market investment for small investors;
iii) strengthen investors' confidence in the market to provide the best prices to investors;
iv) ensure transparency, redress investors' complaints, unify the country's security market to cover even those places which do not have a stock exchange; and
v) provide liquidity to both shares and debt securities.

Features of OTCEI

OTCEI is remedy for investors who face problems like lack of liquidity or price information, delayed settlement, etc. The salient features of OTCEI are:

Accessibility : Counters are opened at different locations and interlinked by computer communication systems. Initially, counters were opened at Bombay and have now been opened at other places also. A public notice is given as to the availability of counters where trading takes place. Facilities for trading are available at the counters of the sponsor and the market maker whose names and addresses are given in the new issue application form attached to the offer for sale documents and with all the dealers of OTCEI.

Ready Liquidity : The compulsory market making by the sponsor for every scrip ensures that buy and sell quotes are available every day for a period of 3 years. After the initial period of 3 years, another market maker takes over.

Investor Registration : For the purchase and sale of securities, every investor has to obtain an "Invest OTC Card". Application for such a card can be made at any of the counters of OTCEI at the time of making an application for the new issue on the OTCEI. In fact, the share application form includes the necessary details to be filled in for obtaining "Invest OTC Card"

Ringless Trading : Trading does not take place on any specific floor of a stock exchange. The members and dealers open counters at various places where investors can purchase and sell the listed securities.

Price Display : In a traditional stock exchange, the investor has no means of verifying the price at which the transaction was effected by the broker. The OTCEI continuously

displays current prices on screens installed at each OTC Exchange counter to enable the investor to make on-the-spot decisions for the purchase or sale securities

Authorised Dealers : All members and dealers are authorised and approved by the OTCEI and their list is available to the public.

Instant Execution of Orders : The investors' orders are executed immediately. If there are no buyers or sellers on the OTC Exchange, the market maker shall deal with the investor.

Information About the Company : The compulsory market maker carries out research on the scrip sponsored by him and, hence, all vital information pertaining to the company is readily available.

OTCEI has prescribed certain Guidelines for listing of securities at OTCEI which are given in Annexure 3. In addition, SEBI have also issue Guidelines on issue of shares through OTCEI which given in Annexure 4.

Activity 15

a) Distinguish between a regular stock exchange (like Bombay Stock Exchange or Delhi Stock Exchange) and OTCEI. What is the rationale of establishing OTCEI?

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b) Meet at least 10 individuals, i.e., members of the public who have invested their saving/surplus money in shares, debentures or other securities which are dealt with on stock exchanges.

i) When did they feel interested in such investments for the first time?

ii) What has been their experience as investors, particularly with regard to investment in equity shares (new issues or secondary market shares).

iii) Are they aware of OTCEI? How many of them traded through OTCEI and through National Stock Exchange of India? Present your findings and discuss with your colleagues?

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c) Arrange interviews with finance managers of at least three public limited companies and discuss with the present state of the capital market in India and the prospects of improvement.

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C. Foreign Exchange Regulation Act (FERA)

In the present day Indian politico-economic environment, FERA has emerged as a very important piece of legislative control over (a) the activities of multinational businesses; (b) the flow of foreign capital, technology and managerial enterprise; and (c) foreign collaboration and joint ventures. In short, FERA regulates the and flow of foreign investment in India.

Foreign exchange control in India was introduced for the first time in the Defence of India Rules, 1939. Then came the *Foreign Exchange Regulation Act*, 1947, as the basic law of exchange control and as the main legal instrument regulating the operation of foreign controlled companies in India . This Act was in 1957 and 1965. A major change was effected through the *Foreign Exchange Regulation (Amendment) Act* 1973. The new Act came into force with effect from January 1, 1974. The main features of this Act suggesting a host of guidelines for foreign business in India.. are as follows :

1. All branches of foreign companies (except airlines and shipping companies) seeking approval under FERA have to convert themselves into Indian companies.

2. A minimum permissible foreign shareholding limit of 74 per cent will be allowed to companies which are either engaged in manufacturing of certain listed items under the 1973 Industrial Policy, or predominantly export-oriented, or using sophisticated technology, or tea plantations, or engaged in trading not exceeding 25 per cent of ex-factory value of the production or having a turnover of less than Rs.5 crores.

3. A permissible foreign shareholding of 40 per cent will be allowed for companies engaged in "other manufacturing items", construction and consultancy trading companies, plantation companies (other than tea), and other miscellaneous activities not mentioned in the guidelines.

4 The explanation to the guidelines also contains a provision that if a company is 100 per cent export-oriented, a foreign shareholding exceeding 74 per cent may be allowed depending on the merits of each case.

5. Airlines and shipping companies, which are excluded from the provision of Section 29 of the Act, will be treated on a reciprocal basis.

6. Banking companies, which are also excluded, will be governed by guidelines issued by the Reserve Bank of India and Banking Department.

The guidelines listed above were further revised in August 1976 to assist the Reserve Bank of India in administering Section 29 of FERA (1973). The main features of the revised *FERA Guidelines 1976* were as follows:

1. If the activities of a company under Appendix I, together with activities requiring sophisticated technology and exports, account for not less than 75% of its total annual turnover, such a company will be allowed to continue its activities subject to the condition that it will increase Indian participation, within a specified period, to not less than 26 per cent of the equity capital of the company.

2. If the activities of a company under Appendix I together with activities requiring sophisticated technology and exports account for not less than 60 per cent of the total annual turnover, such a company will be allowed to continue its activities, subject

to the condition that it will increase, within a specified period, Indian participation to not less than 49 per cent of the equity of the company. In such cases a condition will be stipulated that the company concerned should undertake to export a minimum 10 per cent of its total annual turnover within a period of two years commencing from the date of approval by the Reserve Bank of India.

3 If the exports of a company account for more than 40 per cent of the total annual turnover, such a company will be allowed to continue its activities subject to the condition that it will increase, within a specified period, Indian participation to not less than 49 per cent of the equity of the company.

4. Cases of companies coming with proposals for substantial exports could be considered on merits for a higher level of equity participation provided such participation is in the overall interest of the economy ~~of the country~~.

5. The limit of Rs. 5 crores for permissible trading activity by multi-activity companies will be applicable only in the case of trading activities.

6. The ceiling of 25 per cent of the ex-factory value of the annual production for permissible trading activity by multi-activity companies will be raised to 40 per cent and 60 per cent respectively in the types of cases mentioned in (2) and (3) above.

Foreign investments and enterprises which are branches or subsidiaries of foreign companies as well as joint ventures involving foreign collaboration (financial, technical or managerial) are subject to all the laws governing Indian enterprises - the MRTP Act, the Companies Act, the Income-tax Act, the Industries (Regulation and Development) Act, etc., as well as FERA. To a casual observer, it appears that control is stricter over foreign companies than on Indian companies. This observation is not quite correct. Every independent nation State has the right to design its business and industrial policies primarily in view of the national interest.

The emerging national interest of the Government has been to encourage Indianisation where feasible and attract foreign capital, technology and enterprise wherever desirable. It is realised that foreign investment does play an important role in generating income, employment and output; it helps the transfer of technology and managerial skill. In sum, foreign investment exposes the economy to what the economists term "external economy effects" as well as the domestic "multiplier effects" (both primary and secondary). While recognising these effects, the Government of India is determined to make sure that the flow of foreign capital and technology does not stand in the way of our "self-sustained economic growth"; and, therefore its basic policy has been one of strict selectivity towards private foreign investment and foreign collaboration.

The fundamental error of FERA policy has been to treat the introduction of Indian equity shareholding in foreign companies as an objective in itself. This has led to the folly of compelling them to finance their business in India with our scarce rupee capital without any increase in our power of regulation or improvement in the quantum or quality of foreign investment in India. In fact, it is argued that shareholding is not the best method of regulation; FERA survives on the platform of myth; perhaps, this is the reason why there has of late been a tendency towards liberalisation of FERA

As mentioned above the FERA Act of 1973 reflected the requirements of a highly regulatory system. The recent changes in economic policy, especially the liberalisation of the industrial sector and the moves to open up the economy through changes in trade policy and encouragement of foreign investment, have made it necessary to modify several provisions of the Act to bring them in line with current economic realities. Accordingly, it was announced in the Budget speech of 1992-93 that the Government proposed to introduce comprehensive amendments to the Foreign Exchange Regulation Act.

In pursuit of these objectives, and pending legislative changes, some important steps were taken in 1992 to reduce the rigours of FERA through certain notifications issued by the Reserve Bank of India. Various facilities were extended to foreign/FERA companies on the appointment of technical and management advisors, opening of branches, acquisition of immovable property, borrowing of money or acceptance of deposits, etc. Facilities were also extended to non-resident Indians, Indian companies and residents for the opening of foreign currency accounts in India following the introduction of partial convertibility of the rupee on current account since March 1, 1992. Notifications were also issued exempting non-resident Indians returning to the country from making a declaration on their arrival in India regarding their assets abroad and from the requirement of prior approval for the acquisition of immovable property in India

An amendment to Section 29 of FERA, effected on January 29, 1992, frees FERA companies from any limits imposed on their non-priority sector operations. This amendment also enables FERA companies to take up any trading, commercial and industrial activities, as also acquire any company in India or acquire shares of any company, without obtaining RBI permission.

Further, FERA companies have been permitted to use their trade mark, accept appointment as agent or technical or management advisers, borrow and accept deposits from the public, open branches and liaison offices, acquire and sell immovable property provided the proceeds are not remitted abroad, and export goods on a rental, hire or lease basis as long as these goods are reimported after the expiry of the contract.

They have also been granted freedom to invest and disinvest their stocks at the market price. Earlier, the price at which these companies were allowed to sell their stocks was decided by the Controller of Capital Issues.

FERA was further amended in 1993 through the Foreign Exchange Regulation (Amendment) Act 1993. Some of the important changes brought about by this amendment are as follows:

i) Restrictions regarding assets held by non-residents have been abolished.

ii) Restrictions on import and export of currency and bullion have been removed.

iii) Hospitality to non-residents on visits to India has been allowed.

iv) The power of the Central Government to acquire foreign securities for purposes of strengthening the foreign exchange position has been done away with.

v) Restrictions on the holding of immovable property outside India have been eased.

vi) Restrictions on FERA companies in the matter of borrowing funds or raising deposits by them in India as well as taking other or creating any interest in business by way of transfer from a person resident in India in their favour have been simplified.

vii) Restrictions on persons resident in India associating with themselves or participating in concerns outside India have been done away with.

viii) Restrictions on the appointment of certain persons and companies as agents or technical or management advisers in India have been done away with.

ix) Restrictions on the establishment of places of business (branch offices or a liaison office) in India have been removed.

x) Prior permission for foreign nationals before taking up employment in India has been done away with.

xi) Restrictions on the acquisitions, holding, etc., of immovable property in India have been removed.

xii) Restrictions on booking of passage outside India and restrictions on foreign travel have been done away with.

Currently, a question is being raised in several business circles whether we really need a legislation like FERA. The focus of FERA has bcSn on conserving foreign exchange and controlling its use which have lost much of their validity in the present scenario.

D. The Sick Industrial Companies (Special Provisions) Act 1985 (SICA, 1985)

It is unfortunate that many of our industrial units, both in the large and small sectors, have fallen sick. The ill effects of industrial sickness arc all-pervading Industrial sickness results into loss of production, loss of employment, and loss of revenue to the Central or Slate Governments. Besides, investible funds of banks and financial institutions get locked up. The increasing incidence of industrial sickness has drawn the attention of economic planners and industrial researchers. It is necessary to revive and rehabilitate the potentially viable sick industrial companies as quickly as possible. It is equally imperative to salvage the productive assets and realise as much money as is possible and pay back loans advanced by banks and financial institutions by liquidating the non-viable sick industrial companies. The Sick Industrial Companies (Special Provisions) Act 1985 was enacted to address the problem of industrial sickness. The objects of SICA are:

i) securing the timely detection of sick and potentially sick industrial undertakings;

ii) speedy determination, by a panel of experts, of the preventive, ameliorative, remedial and other measures which need to be taken with respect to such companies;

iii) expeditious enforcement of the measures so determined;

iv) providing for matters connected with or incidental to the above mentioned objectives.

BIFR and its functions

Under the Act, the Central Government constituted the Board for Industrial and Financial Reconstruction (BIFR) with effect from January 12, 1987. BIFR is a quasi-judicial body. It consists of experts in various relevant fields with powers to enquire into and determine the sickness in industrial companies and devise suitable remedial measures through appropriate schemes or other proposals and for proper implementation thereof.

BIFR is empowered to look into all matters relating to industrial sickness including:

i) institutional finance;

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ii) rehabilitation of sick industrial companies;

iii) revival of sick industrial companies;

iv) amalgamation of sick industrial companies with other industrial companies;

v) sale/lease of part or whole of the undertaking of sick industrial companies;

vi) liquidation/winding up of sick industrial companies; and

vii) other allied matters.

The BIFR has been vested with powers to institute the necessary enquires to determine if or not the company is sick. If the BIFR comes to the conclusion that the company has become sick it can either give reasonable time to the company concerned to make its net worth positive or it can devise suitable measures, including change of managements, reduction of share capital, sale or leasing out of a part or the whole of an undertaking or its merger with a healthy unit. By way of warning to unscrupulous managements, the Act also contains a provision that if BIFR is satisfied that a person has been responsible for diversion of funds or for managing the affairs of the company in a manner detrimental to the interests of the company then the BIFR can direct banks and financial institutions not to extend any financial assistance for a period of ten years to such a person or to a firm in which such a person is a partner or to a company in which such a person is a director.

The expression "sick industrial company" has been defined under the Act to mean an industrial company (being a company registered for not less than 5 years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

Who can make a reference in respect of a sick company?

Reference can be made to the BIFR (Board for Industrial and Financial Reconstruction) by any of the following agencies if it has sufficient reasons to believe that the industrial company under reference has become a sick industrial company:

1. The Board of Directors of the sick company
2. The Central Government
3. Reserve Bank of India
4. A State Government
5. A public financial institution
6. A State-level institution
7. A scheduled bank.

A Reference by the Board of Directors is mandatory and therefore must be made; otherwise, penal consequences are attracted. However, reference by persons listed at (2) to (7) above is optional.

Operating Agency

Operating agency means any public financial institution. State-level institution, scheduled

bank or any other person as may be specified by general or special order as its agency by the Board for Industrial and Financial Reconstruction (BIFR).

The following have been specified as operating agencies:

1. The Industrial Credit and Investment Corporation of India Limited (ICICI).
2. The Industrial Finance Corporation of India (IFCI).
3. The Industrial Development Bank of India (IDBI).
4. The Industrial Reconstruction Bank of India (IRBI).
5. The State Bank of India (SBI)
6. The Central Bank of India.
7. The Bank of India (BOI).
8. The Bank of Baroda.
9. The Punjab National Bank (PNB).
10. The Canara Bank.
11. The United Bank of India, and
12. The Indian Bank.

Potentially Sick Industrial Company

SICA 1985 for the first time provided for identification of potentially sick industrial companies to provide for timely treatment and care before they reach the stage of no return. The criterion for identifying a potentially sick industrial company has been spelt out. A potentially sick industrial company is one whose accumulated losses, as at the end of any financial year, have resulted in erosion of 50% or more of its peak net worth during the immediately preceding four financial years.

Winding up of the Sick Industrial Company

Where the Board, after making inquiry and after consideration of all the relevant facts and circumstances and after giving an opportunity of being heard to all concerned parties, is of opinion that the sick industrial company is not likely to make its net worth exceed the accumulated losses within a reasonable time while meeting all its financial obligations and that the company as a result thereof is not likely to become viable in future and it is just and equitable that the company should be wound up, it may record and forward its opinion to the concerned High Court.;

E. Monopolies and Restrictive Trade Practices (MRTP) Act 1969 (MRTP Act)

The Monopolies and Restrictive Trade Practices (MRTP) Act has its genesis in the Directive Principles of State Policy embodied in the Constitution of India. Article 39 (b) and (c) thereof lays down that the State shall direct its policy towards ensuring:

i) that the ownership and control and material resources of the community are so distributed as best to subserve the common good, and

ii) that the operation of the economic system docs not result in the concentration of wealth and means of production to the common detriment.

The Objectives of the MRTP Act are:

a) To prevent concentration of economic power to the Common detriment and control of monopolies;

b) To prohibit monopolistic trade practices; and

c) To prohibit restrictive trade practices and unfair trade practices.

Monopolies usually benefit a few and cause detriment to many. Monopolies have a tendency to restrict competition with the result that the monopolistic concerns have a hold on the prices of commodities in the market which ultimatley results in the exploitation of many at the hands of a few.

With the initiation of the market economy and the consequent liberalisation since 1991, this objective has been substantially diluted. The MRTP (Amendment) Act, 1991, has omitted provisions regarding the Central Government's permission for substantial expansion, establishment of a new undertakings, mergers, take-overs, etc. Establishments, howsoever big or small, are now free to expand, or establish new undertakings, or effect mergers. Consequently, the strategic alliance between Godrej Soap and Proctor and Gamble could not be questioned. Likewise, the merger of Hindustan Lever and TOMCO, though objected to by certain quarters including the employees of TOMCO, was allowed by the Supreme Court.

However, checking the concentration of economic power still remains one of the objectives of the MRTP Act but only in so far as a large undertaking is likely to result in the practice of monopolistic, restrictive or unfair trade practices. Sections 27 and 27A of the Act in such cases empower the Central Government to order the division of an undertaking or severance of an inter-connection on a recommendation by the MKTP Commission after due inquiry in this regard.

Under the Act MRTP Commission has been set up. The Commission is to consist of a Chairman and not less than two and not more than eight other members.

The Act empowers the Central Government to appoint a Director-General of Investigation and Registration (DGIR) and as many. Additional Joint, Deputy or Assistant Directors-General of Investigation and Registration for making investigation for the purposes of the Act and for maintaining a register of agreements as needed. The MRTP Commission acts as a body protecting the interests of the consumers. The Commission can enquire into monopolistic, restrictive or unfair trade practices. It has the powers of the civil court and can call in any person for examination, etc., can make enquiries and pass a final order in matters related to restrictive and unfair trade practices. It has the power to make an enquiry and express an opinion on matters relating to monopolistic trade practices, division and severance of inter-connection. It can grant temporary injunction and award compensation.

Monopolistic Trade Practices

Any trade practice which leads or is likely to lead to any of the following effects is regarded as a monopolistic trade practice:

i) Unreasonably high price;

ii) Unreasonably high cost of the production of goods or the provision of services;

iii) Unreasonably high profits;

iv) Prevention or reduction of competition;

v) Limited technical development;

vi) Limited capital investment; and

vii) Deterioration in the quality of goods.

The role of the MRTP Commission in regard to control of monopolistic trade practices is investigatory and advisory. The Commission, on initiation of an inquiry, merely investigates the practice and submits its report to the Central Government. It is only the Central Government which is vested with the power to pass an appropriate order on receipt of the report from the Commission.

Any inquiry into a **monopolistic trade practice** can be initiated by the Commission:

i) on a reference made to it by the Central Government;

ii) on its own motion, on receipt of any information that the owner of any undertaking is indulging in any trade practice which may be a monopolistic trade practice or upon a knowledge that monopolistic trade practices prevail in respect of any goods or services;

iii) on an application made to it by the DGIR; and

iv) if during the course of its inquiry into restrictive trade practice, the Commission finds that the owner of any undertaking is indulging in monopolistic trade practices.

Restrictive Trade Practices

The term **restrictive trade practice** is defined to mean a trade practice which has or may have the effect of preventing, distorting or restricting competition in any manner and in particular if it:

i) tends to obstruct the flow of capital or resources into the stream of production; or

ii) tends to bring about manipulation of prices or conditions of delivery or to affect the flow of supplies in the market relating to goods or services in such manner as to impose on the consumers unjustified costs or restrictions.

Every agreement falling within the one or more of the following categories is deemed to be an agreement relating to restrictive trade practices and is subject to registration under the Act:

- Refusal to deal
- Tie-up sales
- Exclusive dealing
- Concert in prices and terms and conditions of purchase or sale
- Discriminatory dealings
- Resale price maintenance
- Territorial restriction/restrictions or withholding of output or supply
- Controlling manufacturing process
- Boycott
- Agreement having the effect of eliminating competition/competitors etc.

The MRTP Commission can enquire into any restrictive trade practice whether the agreement relating to the practice has been registered or not. The Commission may enquire into the practice on its own initiative or in response to specific complaints by consumers or consumers' associations or on a reference made by the Central or State Governments, or an application made by the Director-General.

Unfair Trade Practices

An unfair trade practice has been defined under the Act to mean a trade practice which for the purpose of promoting sales, use or supply of any goods or for the provision of any services, adopts any unfair method or unfair or deceptive practice, including: i) bargain sale, ii) bait and switch selling, iii) offering gifts or prizes with the intention of not providing them and conducting promotional contests, etc.

The Commission may inquire into any unfair trade practice which may come before it for inquiry. If, after such inquiry, the Commission is of opinion that the practice is prejudicial to the public interest, or to the interest of any consumer or consumers generally it may, by order, direct that:

a) the practice shall be discontinued or shall not be repeated (that is, pass a cease and desist order);

b) any agreement relating to such unfair trade practice shall be void or shall stand modified in respect thereof in such a manner as may be specified in the order;

c) any information, statement or advertisement relating to such unfair trade practice shall be disclosed, issued or published, as the case may be, in such manner as may be specified in the order.

The Monopolies and Restrictive Trade Practices (MRTP) Commission has lost much of its teeth which were provided mainly to curb concentration of economic power. There has been a substantial increase in the number of cases taken up by the MRTP Commission on allegations of companies resorting to restrictive trade practices. But cases alleging violation of clauses relating to market dominance, etc., have been very few. A large number of companies have got deregistered following the announcement of relaxations in the Act. This deregistration trend is interpreted as a clear induction of the big houses gradually getting out of the MRTP Act's net.

F. Consumer Protection Act, 1986

There has virtually been a tradition of exploitation of consumers in India due to shortages and the sellers' markets. The consumers as buyers always had a poor bargaining power. Manufacturers and traders often follow unfair and unethical practices. Though many legislations have been enacted, they have failed to provide any effective protection to consumers due to lack of effective implementation. It is common knowledge that a number of deaths take place every year due to food adulteration, spurious liquor, and contaminated/substandard medicines, etc. Many manufactrers and traders, including multinationals, indulge in unethical practices. They make tall claims for their products which turn out to be false. The service sector is no exception to unethical practices and allurements.

To check the onslaught on consumers, a host of legislations had been enacted from time to time. These include Sale of Goods Act, 1930; Essential Commodities Act, 1955; the Prevention of Food Adulteration Act, 1954; Prevention of Black Marketing and Maintenance

of Supplies of Essential Commodities Act, 1980; Standards of Weights and Measures Act, 1956; Agricultural Products Grading and Marketing Act (AGMARK), 1937; Indian Standards Insitution Certification Act, 1952; MRTP Act, 1969, etc.

MRTP Act acquired the elements of consumer protection legislation with the amendments in 1984 when unfair trade practices were brought in its fold. However, in spite of these changes in the MRTP Act, the need was felt for a more comprehensive consumer protection legislation. As a consequence, the Consumer Protection Act, 1986 was born. It is described as a unique legislation of its kind in India to offer protection to consumers. The Act was designed after an in-depth study of consumer protection laws and arrangements in the UK the U.S.A., Australia and New Zealand. The main objective of the Act is to provide better protection to consumers. Unlike other laws which are punitive or preventive in nature, the provisions of this Act are compensatory in nature. The Act intends to provide simple, speedy and inexpensive redressal to consumers' grievances.

Other salient features of the Act are:

- It applies to all goods and services unless specifically exempted by the Central Government.
- It covers all sectors whether private, public or co-operative.
- It confers certain rights on consumers.
- It envisages establishment of consumer protection councils at the Central, state and district levels whose main objects are to promole and protect the rights of consumers.
- The provisions of this Act are in addition to and not in derogation of the provisions of any other Act.

onsumer" under the Act means any of the following persons:

A person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised or under any system of deferred payment. The term includes any other user of such goods when such use is made with the approval of the buyer.

The expression "consumer", however, does not include a person who obtains such goods for resale or for any commercial purpose.

A person who hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment. The term includes any other beneficiary of such services with the approval of the first mentioned person.

addition, the Act is understood to include the following persons as "consumers":

Persons allotted plots or houses by a housing and development board/authority (e.g., DDA).

Patients receiving medical treatment in a Government hospital. However, there is a contrary judgement also on this point.

Patients getting treatment at a private nursing home.

Persons selling/purchasing shares to/from a share broker

User of services (like electricity, telephone, telecommunications, etc.) from public/ private utility bodies or agencies.

Rights of Consumers: For the first time in the history of consumer legislation in India, the Consumer Protection Act, 1986, extends statutory recognition to the rights of consumers. The Act recognises the following six rights of consumers:

1. Right to safety, i.e., the right to be protected against the marketing of goods and services which are hazardous to life and property.
2. Right to be informed, i.e, the right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be, so as to protect the consumer against unfair trade practices.
3. Right to choose, i.e, the right of access to a variety of goods and services at competitive prices. In case of monopolies, say, railways, telephones, etc., it means right to be assured of satisfactory quality and service at a fair price.
4. Right to be heard, i.e, the consumers' interests will receive due consideration at appropriate forums. It also includes the right to be represented in various forums formed to consider consumers' welfare.
5. Right to seek redressal, i.e., the right to seek redressal against unfair practices or restrictive trade practices or unscrupulous exploitation of consumers. It also includes the right to a fair settlement of the genuine grievances of consumers.
6. Right to consumer education, i.e., the right to acquire the knowledge and skill to be an informed consumer.

Who can File a complaint

Any of the following persons may file a complaint under the Act.

1. The *consumer* to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided.

The expression "consumer" means :

A person who buys any goods or hires, avails of any services for a consideration. It is, however, not necessary that the consideration must have been paid. The person shall still be regarded as a consumer where either the whole consideration is promised to be paid in future or it has been paid partly and the balance is promised to be paid in future. The term also *includes:*

(i) a buyer under any system of deferred payments;

(ii) any other user of goods or services provided such use is made with the approval of the buver.

The expression "consumer" does not include a person who obtains such goods for resale or for any commercial purpose.

2. *Any recognised consumer association* namely, any voluntary consumer association registered under the Companies Act, 1956, or any other law for the time being in force. It is not necessary that the consumer is a member of such an association
3. *One or more consumers,* where there are numerous consumers *having the same interest,* with the permission of the District Forum, on behalf of, or for the benefit of, all consumers so interested.
4. *The Central or State Government.*

What complaints may be lodged

A complaint may relate lo one or more of the following:

(i) that an unfair trade practice or a restrictive trade practice has been adopted by any trader;

(ii) that the goods bought by him or agreed lo be bought by him suffer from one or more defects;

(iii) that the services nired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;.

(iv) that a trader has charged for the goods mentioned in the complaint a price in excess of the price fixed by or under any law for the time being in force or displayed on the goods or on any package containing such aoods:

(v) that goods which will be hazardous to life and safety when used are being offered for sale lo the public in contravention of the provisions of any law for the time being in force requiring traders to display information in regard to the contents, manner and effect of the use of such goods.

How to file a complaint

There is no fee for filing a complaint before any of the aforesaid bodies

The complainant or his authorised agent can present the complaint in person.

The complaint can also be sent by post to the appropriate forum/commission.

The complaint should be addressed to the president of the forum/commission.

A complaint should contain the following information:

(a) the name, description and address of the complainant;

(b) the name, description and address of the opposite party or parties, as the case may be, as far as they can be ascertained;

(c) the facts relating to the complaint and when and where it arose;

(d) documents, if any, in support of the allegations contained in the complaint;

(e) the relief which the complainant is seeking.

The complaint should be signed by the complainant or his authorised agent. A minimum of four copies of the complaint should be filed.

Consumer disputes and redressal agencies

To provide simple, speedy and inexpensive redressal of consumer grievances, the Act envisages a **three-ticr** quasi-judicial machinery at the district, state and national levels Consumer disputes agencies, established under the Act, have a hierarchical pattern similar to the judiciary. The following redressal agencies have been established at various levels:

a) **District Forum :** A District Forum is set up by the State Government for **each District**. Each District Forum is headed by a District Judge with two other **members. The** District Forums have jurisdiction to entertain complaints where the **value of the** goods or services and the compensation claimed does not exceed Rs. 5 **lakhs**.

b) **State Commission :** A State Commission is set up by the State Governmeni ror the respective State. The State Commission is headed by a Judge of a High Court and

has two other members. The State Commission has jurisdiction to entertain complaints where the value of goods or services and compensation, if any, claimed exceeds Rs. 5 lakhs but is less than Rs. 20 lakhs. The State Commission also hears appeals against the orders of the District Forums within the State.

c) **National Commission :** A National Commission is set up by the Central Government The National Commission is headed by a judge of the Supreme Court and consists of four other members. The National Commission has jurisdiction to hear complaints where the value of goods or services and compensation, if any, claimed exceeds Rs. 20 lakhs. It also hears appeals against the orders of any State Commission.

Liberalisation and Consumer Protection : A liberalised economic regime, it must be stated, is in itself a way of protecting the interests of consumers. Liberalisation affords the consumers an opportunity of choosing from a wide range of products and services, and this, coupled with competition, brings in sharp focus the fundamental aspects of caveate emptor. Liberalisation encourages domestic manufacturers to produce goods comparable to international standards. Unlike the protected regime of the past when manufacturers had almost the licence to charge arbitrary prices, they are now constrained to charge competitive or reasonable prices due to the greater play of market forces. With the advent of the Consumer Protection Act, 1986 and a liberalised economic regime, manufacturers and traders are expected to exercise due caution; the goods and services offered should be true to the description in terms of weight, content and quality.

G. The Environment Protection Act, 1986

The Constitution of India requires every citizen of India to protect and improve the natural environment including forests, lakes, rivers and wild life, and to have compassion for living creatures. The Directive Principles of State Policy contained in the Constitution direct the State to endeavour to protect and improve the environment and to safeguard the forests and wild life of the country.

The Environment Protection Act, 1986, came into effect in November 1986 and is in addition to the two allied Acts, viz., Water (Prevention and Control of Pollution) Act, 1974, and Air (Prevention and Control of Pollution) Act, 1981.

The objective of the Act is to provide for the protection and improvement of the environment and matters connected therewith. The law covers not only land and water or air but all aspects of the environment.

Environment includes (i) water, air and land, and (ii) the interrelationship which exists among and between water, air and land, and human beings, other living creatures, plants, micro-organisms and property. **Environment pollutant** means any solid, liquid or gaseous substance present in such concentration as may be, or tend to be, injurious to the environment. Environment pollution means the presence in the environment of any environment pollutant.

Under the Act, the Central Government has general powers to take measures for protecting and improving the quality of the environment, and preventing, controlling and abating environmental pollution. It can constitute, by order, the necessary authorities to whom it can delegate the required powers. Further, it has powers to appoint officers with such designation as it thinks fit for the purpose of the Act. It can make rules to regulate environmental pollution. The Government can call for information from any person, officer, State Government or other authority to furnish information, etc. in relation to its functions under the Act.

Environment Audit Report : As a result of introduction of Rule 14 in March 1992 in the Environment (Protection) Rules, 1992, every person carrying on an industry, operation or process requiring consent under Sec. 25 of the Water (Prevention and Control of Pollution) Act, 1974, or under Sec. 21 of the Air (Prevention and Control of Pollution) Act, 1981, or both or authorisation under the Hazardous Wastes (Management and Handling) Rules, 1989, issued under the Environment (Protection) Act, 1986, is required to submit, beginning 1993, an **Environment Audit Report** for the financial year ending March 31 to the concerned State Pollution Control Board on or before the 15th day of May every year.

H. A Few Other Legislations

Here is a reference to a few other legislations which have a direct or indirect bearing on the business environment in India.

1. The Essential Commodities (Amendment) Act, 1974. It provides for stricter enforcement of the provisions of the Act and stringent punishment for economic offenders under the Act. It is particularly directed against anti-social elements like hoarders, profiteers, smugglers and black-marketeers.
2. The Trade and Merchandise Marks Act, 1958.
3. The Patents Act, 1970.
4. The Urban Land (Ceiling and Regulation) Act, 1976.

There are other legislations relating to:

i) abolition of bonded and contract labour
ii) redemption of past indebtedness
iii) regulation of moneylenders' activities
iv) rent control
v) provision of minimum wages
vi) employees' state insurance and social security schemes
vii) settlement of industrial disputes
viii) trade union activities and organisation
ix) cooperative credit, marketing, etc.
x) control of prices and public distribution
xi) anti-pollution (of water, air, etc.)
xii) restriction on dividend payments.

Activity 16

Supppose you are a factory Manager engaged in some Manufacturing process which is highly labour intensive. Make a list of Government legislalions, other than those which have been discussed in this unit, which will be of direct relevance to you. For example, you consider **factory legislations** and social security legislations

1 .... 7 ....
2 .... 8 ....

3 .... 9 ....
4 .... 10 ....
5 .... 11 ....
6 .... 12 ....

Activity 17

Can you also briefly recall from the unit the legislations protecting workers and consumers and lsit them ? Do these legislations hamper business autonomv and efficiency ?

1 .... 1 ....
2 .... 2 ....
3 .... 3 ....
4 .... 4 ....
5 .... 5 ....
6 .... 6 ....
7 .... 7 ....
8 .... 8 ....
9 .... 9 ....

2.14 SUMMARY

The politico-legal environment of business consists of several critical elements, e.g the nature and form of government, the ideology of the ruling party, the strength of the opposition, the role and responsibility of the bureaucracy, political stability, the effectiveness of the Government, its plans and programmes, the socio-economic legislaltions, and politico-legal institutions, etc. In spite of all the policies of liberalisation followed by several countries, the need for some kind of government intervention in economic affairs will always be felt.

The policies of the Government are reflected in socio-economic legislations which have a direct bearing on the functioning of business firms. A thorough understanding of socio-political legislations therefore is imperative for business enterprises. It is also necessary for business enterprises to be fully conversant with the existing Government machinery for dealing with the industrial economy.

There are several legislations with which either business firms in general or a certain class of business firms are intimately concerned. The Companies Act is concerned with the regulation of corporate business enterprises. A thorough understanding of company laws is therefore necessary for corporate managers.

The Securities Contracts (Regulation) Act seeks to regulate the fanctionig of stock exchanges in India and prevent undesirable transactions in securities, The Securities and Exchange Board of India Act aims at developing the securities market in India on healthy and orderly lines and is meant to provide adequate protection to investors. SEBI has wide-ranging powers. It has issued Guidelines for capital issues, etc. Over the

Counter Exchange of India (OTCEI) is a floorless security trading system (or market) equipped with an electronic network through which the buyers and sellers scattered all over the nation can conduct business more efficiently and economically. The basic purpose of creating OTCEI is to provide a securities market to enable small/start-up companies with potentially viable green field ventures to obtain capital from investors who like to have liquidity for their investments.

The Foreign Exchange Regulation Act (FERA) purports to regulate dealings in foreign exchange and securities, import and export of currency and to conserve the foreign exchange resources of the country. Its primary purpose is to regulate foreign companies. The relevance of FERA in the present economic scenario is being questioned.

The Sick Industrial Companies (Special Provisions) Act (SICA) aims to secure timely detection of sick and potentially sick industrial undertakings and to provide for suitable machinery for speedy recovery of such enterprises. Under the Act a Board for Industrial and Financial Reconstruction (BIFR) has been created with powers to inquire into and determine the sickness of industrial companies and devise suitable remedial measures for their proper implementation.

The Monopolies and Restrictive Trade Practices Act (MRTP) came into force in 1969 with the objectives of preventing concentration of economic power to the common detriment and control of monopolies, and to prevent monopolistic, restrictive and unfair trade practices. With fundamental changes made in 1992, its main objective of preventing concentration of economic power has been practically done away with. It has now become more a law to regulate the undesirable practices of manufacturers and traders, and to protect the interests of the consumers.

The Consumer Protection Act is meant to provide protection to consumers. It provides for necessary machinery for speedy redressal of consumer disputes/grievances.

The Environment Protection Act is meant to provide for the protection and improvement of the environment. The law covers land, water, air and other aspects of the environment.

Thus, you will find that a comprehensive legislative framework exists in India for protecting the interests of investors, consumers and society in general. What is required is the proper enforcement and effective implementation of these laws.

2.15 KEY WORDS

Politico-legal Environment: A subset of the environment consisting of politico-legal institutions, legislations, form of government and prevailing ideologies, values, attitudes and style of functioning of the bureaucracy etc.

Companies Act: An Act to guide and regulate the organisation, functioning, and management of corporate business.

Securities Contracts (Regulation) Act: An Act designed to regulate the functioning of stock exchanges in India and to prevent undesirable transactions in securities.

Foreign Exchange Regulation Act : An Act to regulate the dealings in foreign exchange and securities, import and export of currency, and to conservation of the foreign exchange resources of the country and other related matters. It is concerned with the regulation of the foreign companies.

The Sick Industrial Companies (Special Provisions) Act, 1985 (SICA, 1985): An Act to secure timely detection of sick and potentially sick industrial undertakings and to work for their speedy recovery, etc.

Monopolies and Restrictive Trade Practices Act: An Act to prevent concentration of economic power, and to prevent monopolistic, restrictive and unfair trade practices. The objective of preventing concentration of economic power has since been significantly diluted.

Consumer Protection Act: An Act to protect the interests of consumers and to provide for consumer disputes' settlement machinery.

Environment Protection Act: An Act to provide for the protection and improvement of the environment (covering land, water, air and all aspects of the environment).

2.16 FURTHER READING

Dasgupta, A and Sengupta, N.K. 1989 *Government and Business,* Vikas Publishing House, New Delhi.

2.17 SELF-ASSESSMENT QUESTIONS

1. In what ways does the politico-legal environment in a country affect business firms? Explain.
2. Explain the critical elements of the politico-legal environment of business citing relevant examples.
3. Write a note on the Government machinery for the industrial economy in India.
4. What changes are proposed in the Draft Companies Bill 1997 in relation to the Companies Act 1956? Discuss the rationale of the proposed changes.
5. What are the objectives of MRTP Act? What fundamental changes have recently been brought about in the Act and why?
6. The "Foreign Exchange Regulation Act (FERA) has outlived its utility". Do you agree? Why or why not?
7. Write notes On the following:
   a) Sick Industrial Companies (Special Provisions) Act, 1985
   b) Consumer Protection Act, 1986
   c) The Environment Protection Act, 1986
   d) The Securities Contracts (Regulation) Act, 1956
8. What are the objectives behind the establishment of SEBI? Briefly explain the functions and powers of SEB!?
9. "The best protection to consumers is the full and fair play of market forces". Comment.

APPENDIX 2: SEBI GUIDELINES FOR CAPITAL ISSUE

Pricing, Promoters Contribution and Lock in Period

The guidelines for the purpose of pricing of issues, promoter contribution and lock in period divide the companies into the following categories.

A. New Companies

A new company is defined to mean a company:

(a) Which has not completed 12 months of commercial production, and

(b) Whose audited operative results are not available.

The new companies have been *further sub-divided* into the following categories:

(i) New companies set up by entrepreneurs (i.e. individuals) without a track record.

(ii) New companies set up by existing company/companies with a five-year track record of consistent profitability.

(iii) New companies set up by several promoting companies.

(iv) New companies set up jointly by existing private sector company/companies and a state level agency/Govemment company/foreign collaborator.

B. Existing private/closely-held/unlisted companies

The companies under this category have been further divided into five sub-heads namely:

(i) Companies without three-year record of consistent profitability.

(ii) Companies with a three-year track record of consistent profitability.

(iii) Companies without a track record but promoted by existing companies with a five-year track record of consistent profitability.

Where there are more than one promoter companies, each of them should satisfy the requirement of five-year track record of consistent profitability.

(iv) Companies without three-year track record of consistent profitability seeking disinvestment by offer to public without issuing fresh capital.

(v) Companies with a three-year track record of consistent profitability seeking disinvestment by offer to public without issuing fresh capital.

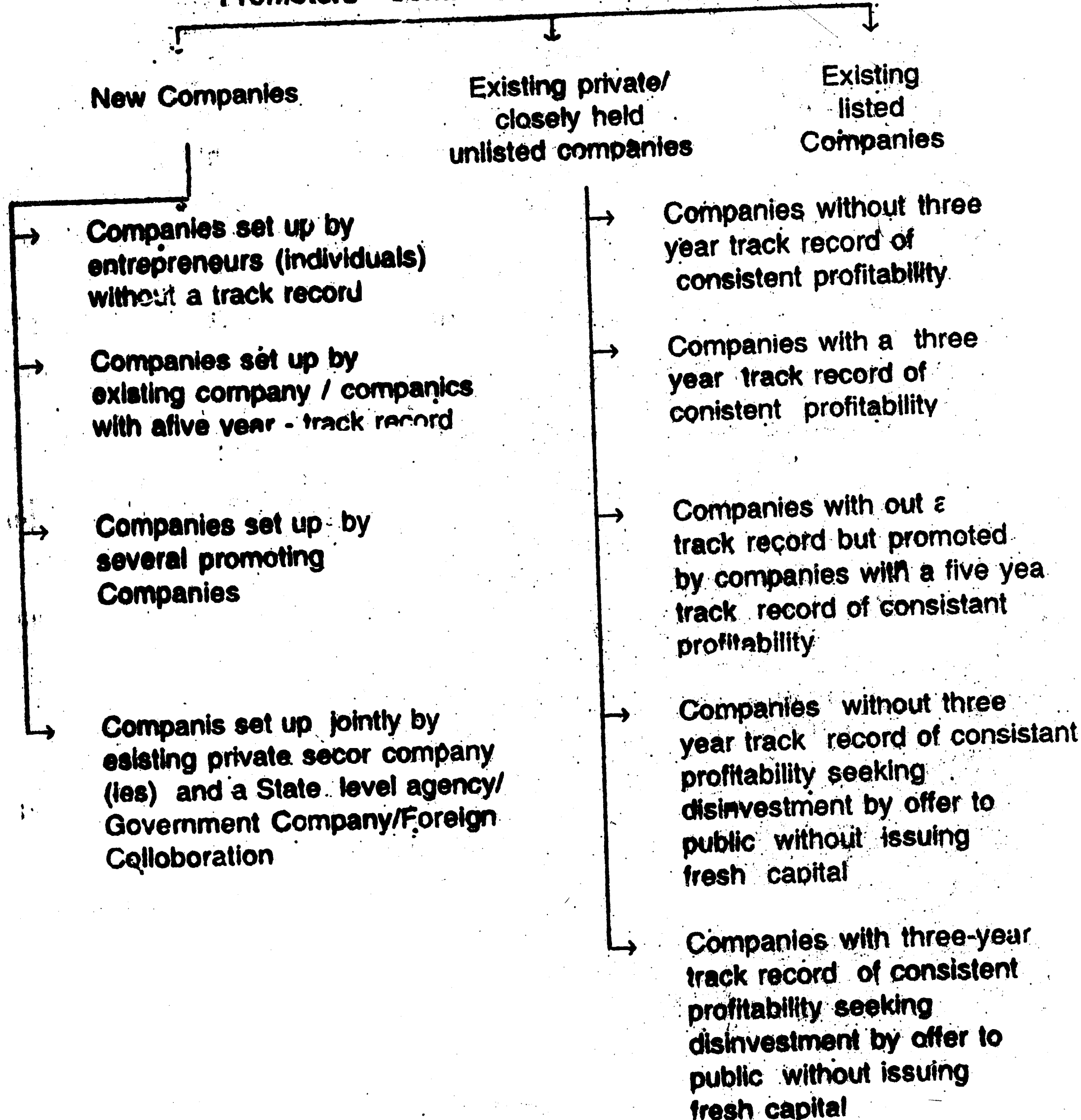
C. Existing Listed Companies i.e., companies which are already listed on one or more stock exchanges.

The aforesaid division of companies has been made for the following purposes:

(i) pricing of the issue;

(ii) promoters contribution; and

(iii) lock-in period in respect of promoters contribution.



1. Issue of new companies set up by Entrepreneurs (individuals) without a track record

A new company set-up by entrepreneurs (mdividuals) without a track record will the permitted to lsnic capital to pablic only at par.

The promoters'contribution shall not be less than 25% or 20% of the total issued capital. It shall not be less than 25%, if the total issued capital is upto Rs. 100 crorcs and 20% if the total issued capital is above Rs. 100 crores. Besides, the guidelines specify the minilaum amount to be brought in by the promoters. The amount is fixed at Rs. 50,000 by each of the friends, relatives, and associates.

Further, SBI, vide its Press *release dated 28-1-1994*, has clarified that the promoters of new companies or of those which are going public for the first time must contribute to the required extent to each class or kind of securities offered to the public. Thus, if a company issues equity shares for, say, Rs. 50 crorcs and partly convertible debentures

for Rs. 50 crores, the promoters must pick up a minimum 25% of each of these amounts.

However, the Press release of 29-4-94 suggests that it shall be sufficient if in such a can the promoters bring in the minimum required percentage of their contribution in the form of equity while 25% of each class of securities is offered to the public (Economic times, 30th April, 1994).

2. New companies set up by existing company/companies with a five-year track record of consistent profitability

Where a new company is being set up by existing companies with a five-year track record of consistent profitability, it will be free to price its issue provided:

(i) the participation of the promoting companies is not less than 50% of the equity of the new company;

(ii) the issue price is made applicable to all new investors uniformly;

(iii) the prospectus or offer document contains justification for issue price.

Clarification No. VII dated 10-8-93 provides that if the premium amount is upto face value of the share only, the participation of the promoting company must not be less than:

50% for the first 100 crores

40% for the next 200 crores

30% for another 300 crores

and 15% for the remaining portion.

In order to take advantage of the aforesaid slab system, the following conditions shall have to be satisfied:

(i) projects appraisals must be got done by financial institutions;

(ii) calculations of future earnings per share must be based on expanded equity; and

(iii) promoters' contribution shall be at the same price as other investors.

3. New companies set-up by several promoting companies

Where the new company is set up by several promoting companies, each of the companies should satisfy the criteria of five-year track record of consistent profitability as clarified above.

4. New companies set up jointly by existing private sector companies and a State level agency/Government company/foreign collaborator

Where a new company is set up by existing private sector company or companies and a State level agency/Government company/foreign collaborator, it will be sufficient if each of the promoting private sector company or companies satisfy the requirement of five-year track record of consistent profitability.

Other guidelines relevant to issue of new companies (all the aforesaid kinds) are

1. *A draft prospectus* containing the disclosures will be vetted by SEBI before a public issue is made.

2. *No private placement of the promoters' share* shall be made by solicitation of share contribution *from unrelated investors* through any kind of market intermediaries.

3. The shares of the above companies can either be *listed* on the Over the (Counter

Exchange of India (OTCEI) or any other stock exchange.

4. The *issue price* shall be applicable uniformly to all investors including promoters.

5. The promoters' contributions shall be subject to lock-in period of five years (Clarification 1, dated 17-6-92).

D. First issue by existing private/closely held companies

1. Such companies with a three-year track record[2] of consistent profitability [3] shall be permitted to freely price the issue and list their securities on the stock exchanges.

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1. The expression 'track record of consistent profitability' is to be constructed as distinct from continuous profitability. The spirit of the guidelines will be sati[illegible] e promoting companies concerned have shown profits in their respective audited profits [illegible] ounts after providing for interest, tax and depreciation in five out of seven years with pro[illegible] ne last, two years prior to the issue [Clarification II, 16.7.1992].

2 'Three-year track record' of which at least two should be completed years of 12 months each and one should be not less than 6 months [Clarification I, dated 17.6.1992].

3 The expression 'three-year track record of consistent profitability, shall mean that the concerned companies have shown profits in their respective audited profit and loss account after providing for interest, tax and depreciation in three out of 5 years with profits during the last two years prior to the issue [Clarification II, dated 16.7.1992].

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2 **Not less than 20 per cent of the equity (i.e., issued capital) should be offered.**

3. The draft prospectus will be vetted by SEBI to ensure adequacy of the disclosures.

4. The pricing would be determined by the issuer and the lead managers to the issue and would be subject to specific disclosure requirements including:

   (a) *disclosure of the net asset value* of the company as per the last audited balance-sheet, and

   (b) **justification for the issue price.**

5 An existing private/closely held/other unlisted company which *does not have three-year track record* of consistent profitability, can make an issue to public for raising additional capital *only at par* provided not less than 20 per cent of the total issued capital (expanded capital) is offered to the public (Clarification II, dated 16-7-1992).

6. *A company which does not have a three-year track record but has been promoted by other company lies with a track record of consistent profitability* will have freedom to price the shares ; provided that the participation of the promoting companies is not less than 50 per cent of the total issued capital, subject to lock-in period of 5 years. For reaching minimum percentage of 50 per cent, if the promoting company has to take additional equity out of the public issue, it will be at the same price at which the shares are offered to public (Clarification II, dated 16-7-1992).

7 Where an *issue of shares* is to be made *at a premium* for reckoning the minimum specified percentage of 50 per cent to be brought in by the promoting companies, only such portion of the issued capital as have been held by the promoting companies pursuant to the allotment made prior to 12 months of the proposed public issue would be taken into account. *Accordingly,* in case where it is not possible for the promoting companies to bring in additional equity to make up the specified percentage of 50 per cent in the issued capital after excluding the allotment of shares made within 12 months prior to the proposed public issue, such public issue

shall be made only at par (Clarification V, dated 4-11-92).

8 *A closely held company wishing to enhance its foreign share holdings upto 51 per cent* or more as permissible under the relevant guidelines of Government/Reserve Bank of India can make an issue at the price determined by the shareholders in a special resolution under Section 81 (1) (A) of the Companies Act, 1956.

9. *Where private / closely held* and unlisted companies *having three-year track record of consistent profitability* desire to get listed through disinvestment of the existing shareholding, i.e., without raising additional capital, there is *no prohibition against free pricing. Accordingly,* the existing shareholders in such companies may freely price their shares offered to the public. However, *promoters' shareholding after the disinvestment must not fall below 25 per cent* of the total issued capital of the company subject to the lock-in period of 5 years.

E. Public Issue by existing listed companies

1 These companies will be allowed to raise fresh capital by freely pricing their further issues.

2. The issue price will be determined by the issuer in consultation with the lead manager(s) to the issue.

3. The draft prospectus will be vetted by SEBI to ensure adequacy of disclosures.

4. The prospectus or offer document shall contain:

   (i) the net asset value of the company;

   (ii) a justification for the price of the issue; and

   (iii) high and low prices of the shares for the last two years.

5. Companies wishing to enhance their foreign shareholding upto 51 per cent or more as permissible under the relevant guidelines of Government/Reserve Bank of India can make issues at the price determined by the shareholders in a special resolution under Sec. 81 (1) (A) of the Companies Act.

Issue of shares through OTC Exchange of India (OTC)

Where a direct public issue is made through OTC *without the sponsor taking any share,* the normal guidelines for disclosure and investors' protection shall apply.

Where the shares of a company have been taken by the sponsor, such shares may be offered to the public at a later date at such price as the sponsor may deem fit in accordance with the regulations of OTC subject to the following conditions:

(i) the promoters after such offer retain at least 25% of the total issued capital with lock-in period of 5 years from the date of the sponsor taking up the shares;

(ii) the sponsor agrees to act as market maker for the shares at least for a period of three years on a compulsorily basis and also finds an additional market maker for such compulsory market making; and

(iii) the sponsor compulsorily gives two-way quotes based on minimum and maximum trading prices as may be stipulated by OTC in respect of the scrip. *(Clarification II dated 16-7-1992).*

Underwriting

As per the SEBI guidelines of June 1992 underwriting was *mandatory* for the full

issue. In this regard, SEBI further clarified that underwriting should be *only for issue to the public* which will exclude reserved/preferential allotment to reserved categories. *In other words,* underwriting was mandatory only to the extent of net offer to the public *(Clarification I dated 17-6-1992)*.

SEBI has now revised its aforesaid guidelines by Press release dt. 10-10-94 thereby making underwriting optional. However, it has been clarified that if the issue is not underwritten and the minimum subscription of 90% of the offer to the public is not received, the ensure amount received as subscription would have to be refunded in full.

2. Number of underwriters shall be decided by the issuers.

3. Companies shall be required to raise minimum subscription of 90% in respect of each issue and it shall be applicable for public as well as right issues.

4. If the company does not receive 90% of the issued amount from public subscriptions plus accepted development from underwriters within 120 days from the date of opening of the issue, the company shall refund the amount of subscriptions. In the case of the disputed development, The company should refund the subscriptions if the above conditions are not met.

5. The lead manager(s) must satisfy himself about the net worth of the underwriters and the outstanding commitments and disclose the same to SEBI. The intention is that the lead manager should satisfy himself in whatever manner he deems fit about the ability of the underwriters to discharge their underwriting obligations. There is no need for lead managers to furnish any certificate to SEBI in this behalf. A statement to the effect that in the opinion of the lead managers, the underwriters' assets are adequate to meet their obligations should be incorporated in the prospectus.

6. The underwriters' agreements may be filed with the stock exchanges.

G. Composite Issues

1. In case of composite issue, i.e., rights-cum-public issue, by an existing company *differential pricing shall be allowed.* In other words, issue to the public can be priced differentially as compared to issue to the rights shareholders.

However, differential pricing shall be permissible only in respect of issues made by existing listed companies. However, justification for the price differences should be given in the offer documents.

In respect of reservations to various categories, SEBI vide its guidelines *(Clarification VIII dated 11.10-1993)* has clarified that in composite issues the reservations to various categories shall be computed with reference to the amount of public issue and not the total amount of composite issue as stated in SEBI Clarification V dt. 4-11-92.

H. Reservation in Issues

1 Unreserved offer of equity or instruments convertible into equity shall not be less than the minimum required for listing purposes in case of new issues made either by the new company or by the existing closely held/private companies going public.

SEBI, has clarified that reservations and firm allotments together with the promoters' contribution should not exceed 75 per cent of the total issue amount *(Clarification VIII dated 11-10-1993)*. This clarification has been issued in the wake of the notification amending Rule 19(2) (b) of Securities Contracts (Regulation) Rules, 1957. Under these Rules, it would now suffice if at least 25 per cent of such securities were offered to public.

As per Clarification VIII dated 11-10-1993, reservations in public issue for various categories of persons may be made as follows:

S. No.	Category of persons	Maximum permissible allotment (%)
	Perma[illegible]loyees [illegible]ding working directors) of the [illegible] and in the case of a new company the perm[illegible] employees of the promoting companies	10%
(ii)	Shareholders of the promoting companies in the case of a new company and shareholders of group companies in the case of an existing company	10%
(iii)	Indian Mutual Funds	20%
(iv)	Foreign Institutional Investors (including non-resident Indians and overseas corporate bodies)	15%
(v)	Indian and Multilateral Development Financial Institutions	20%

I. The Finance Ministry has restricted this overall percentage to 15% (earlier 24%) [Economic Times, 1st. May 1994].

The aforesaid reservations shall be subject to the following:

(a) Maximum allotment per employees/shareholder shall not exceed 200 shares of Rs. 10 each.

Where the Development Financial Institutions/Central and State Industrial Development Corporations join hands with private promoters for setting up a company, no reservation may be made for allotment to the employees of such Development Financial Institutions.

(b) Reservations to Indian Financial Institutions, Indian mutual funds. Foreign Institutional Investors (including non-resident Indians and over-seas corporate bodies) shall be on a competitive basis. *'Competitive basis'* means in proportion to the shares applied for by the concerned reserved categories.

(c) The investments by Foreign Institutional Investors shall be subject to the individual and overall ceiling indicated in the Foreign Imtitutional Investors' Guidelines issued by the Government of India.

In this regard SEBI guidelines of Jan. 11, 1994 stipulate that listed companies can make private placements of shares with registered Foreign Institutional Investors (FII's) after obtaining the shareholders consent in a general body meeting under Section 81 (IA) of the Companies Act. The allotment, however, should not exceed 5% to a single FII and be subject to a maximum of 15% (including NRI's and overseas corporate bodies) of the issued capital.

In respect of pricing, guidelines stipulate that it should not be lower than the highest price during the preceding 26 weeks in the domestic markets.

(d) Any unsubscribed portion in any reserved category may be added to any other reserved category subject however to the condition that on final allotment, shares

allotted in respect of each of the categories does not exceed individual ceilings mentioned above.

(e) *There will be no lock in period* for reservations made to the category of persons mentioned above. The promoters' contribution shall, however, be subject to lock-in period.

The lock-in period for the promoters contribution shall be 5 years from the date or allotment in public issue or the date of commencement of commercial production[1] (in case of manufacturing company), whichever is later.

Reservations in Right Issue

If at the time of marketing a right issue, the company desires to make any separate reservations, such reservation shall be restricted only to the permanent employees of the issuer company, subject to a ceiling of 10% [earlier 5%] of the issue size.

Further, SEBI in its Clarification VI dated 23-12-92 allowed companies to make preferential offers in respect of their rights issues to financial institutions and other identified persons belonging to the management group subject to compliance of certain conditions.

The aforesaid guidelines with respect to reservations in right issue were modified by Clarification VIII dated 11-10-1993 by providing that **no preferential allotment shall be made along with any right issue.** If the company desires to make any preferential allotments to the employees or any identified persons they may do so independent of right issue by complying with the provisions of the Companies Act, 1956.

Reservation in Composite Issue

However, *as per Clarification No. VIII, dated 11-10-93* **reservation is to be computed with reference to the amount of public issue alone and not the amount of composite issue as stated in Clarification No. V, dated 4-11-92. This is quite consistent with the withdrawal of reservations for permanent employees in right issues.**

I Deployment of Issue Proceeds

In case of issues, where on application and on allotment an amount together exceeding Rs.500 crore S[2] is raised, the issuer will voluntarily disclose and make arrangements for the use of proceeds of the issue as per disclosure to be *monitored by one of the financial institutions.* A copy of their monitoring report shall be filed with SEBI by the institution and by the company for purpose of record.

In respect of issue of above size and beyond, the amount to be called up on application/ allotment and on various calls should not exceed 25% of the total quantum of issue.

J. Minimum Time Interval between Two Issues

SEBI has issued the following guidelines, in this regard:

(a) No bonus issue shall be made within 12 months of any public/rights issue. Issue of bonus shares after 12 months shall be subject to Section M(o) of the guidelines

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1. Date of commencement of commercial production means the last date of the month in which commercial production in a manufacturing company is expected to commence and declared in the offer documents.

2. Raised from Rs. 250 crores vide SEBI Clarification 1. dt. 17.6.92.

which states that no bonus issue shall be made which will dilute the value or rights of the holders of fully convertible debentures/partially convertible debentures.

It has been further clarified by SEBI that no company shall, pending conversion of fully or partly convertible debentures, issue any bonus shares unless a similar benefit is extended to the holders of such FCDs/PCDs through reservation of shares in proportion to such convertible part of the FCDs/PCDs. The shares so reserved may be issued at the time of conversion of such debentures on the same terms on which the bonus issues were made.

(b) The promoters shall bring capital in full before a public issue.

(c) The capital issued should be made fully paid up within 12 months from the date of issue except in cases which are subject to monitoring requirements.

K. Employees Stock Option Scheme

This is a voluntary scheme on the part of the company to encourage employees to have a higher participation in the company. Suitable percentage of reservation can be made by the issuer company for its employees or that of the promoter company. Reservation should not be more than 10% (Clarification VIII dated 11-10-93). Equitable distribution of shares among the employees will contribute to the smooth working of the scheme. The issuer may like to have non-transferability at his discretion in new issues. In other cases employees participation upto 10% subject to a maximum of 200 shares shall be non-transferable for a period of 3 years.

The Department of Company Affairs vide its Press Note dated 14-10-1992 has stated that an offer of shares to the employees on preferential basif under the employees stock option scheme was misused by some companies by allotting " to non-employees or in the joint names of employees and non-employees. Company have been advised to ensure that the shares reserved under the employees quota are allotted only to the bonafide employees, subject to the guidelines issued by SEBI and shares remaining unsubscribed by the employees may be offered to the general public through prospectus in terms of the issue, if any.

L. Promoters' Contribution and Lock-in period

The term promoters' contribution will mean contribution by promoters, directors friends, relatives and associates. In respect of further issues, if there are no promoters, the promoters' contribution will mean contribution by directors, friends, relatives, associates.

The following guidelines and clarifications have been issued by SEBI in this regard:

(a) Equity capital to be subscribed in any issue to the public by the promoters, i.e., those described in the prospectus as promoters, directors, friends, relatives and associates should not be less than 25% of the total issue of equity capital upto Rs. 100 crores and 20% for the issues above Rs. 100 crores. Minimum subscription by each of the friends/relatives and associates under promoters quota should not be less than Rs. 25,000[2] (w.e.f. 10-8-1993 - Clarification No. VII, earlier this minimum subscription under promoters' quota was Rs. 1 lakh). However, the minimum subscription of Rs. 1 lakh shall continue to apply in respect of contributions made by firms or corporate bodies not being business associates, like dealers and distributors.

(b) Where a company proposes to issue equity capital at a premium, promoters' contribution shall be 50% of the total issued capital. However, Clarification VII dated 10-8-93 has relaxed this requirement in respect of issues exceeding Rs. 100 crores. Accordingly, promoters' contribution in case of an issue of over Rs. 100

Times of India, dt. 14.4.94.

In case of new companies promoted by individuals, minimum subscription by each of the friends, relatives and associates shall be Rs. 50,000.

crores at a premium (not exceeding the face value of the shares) shall be as given in the following table:

Size of the capital Issue (including premium)	Percentage of contribution
First Rs. 100 crores of Issue	50
Next Rs. 200 crores	40
Next Rs. 300 crores	30
Balance Issue amount	15

However, the benefit of slab system mentioned in the above table shall be available only if the following conditions are satisfied:

(i) Promoters' contribution shall be at the same price as applicable to the investing public.

(ii) Lock-in period of 5 years from the date of allotment or commencement of commercial production, whichever is later, shall be applicable even in respect of equity acquired on conversion of optional instruments in future.

(iii) Projects should be appraised by the lending Development Financial Institutions.

(iv) EPS, book value, etc., given in the offer documents for future projections should be calculated with reference to the expanded capital.

(c) The promoters' contribution shall not be diluted for lock-in period of 5 years from the date of commencement of the production or date of allotment, whichever is later.

(d) Promoters must bring in their full subscription to issue in advance before the public issue.

(e) All firm allotments, preferential allotment to collaborators, shareholders or promoters companies whether corporate or individual, shall not be transferred for 3 years from the date of commencement of production or date of allotment, whichever is later.

(f) The share certificates issued to promoters, friends, relatives and associates, etc., should carry inscription "not transferable" for a period of 3 or 5 years, as may be applicable, from the date of commencement of production or date of allotment, whichever is later

Promoters' contribution in case of professionally managed companies

SEBI has clarified that in case of professionally managed companies with no identifiable promoters, the promoters' contribution should be brought in by persons in-charge of the management of the affairs of the company to the extent of the minimum specified percentage either by themselves or from other persons including their friends, relatives and associates before the public is called upon to subscribe to the issue.

Lock-in period for excess contribution by promoters

The specified percentages of promoters contribution are the minimum which the promoters are expected to take and the same shall be subject to a lock-in period of 5 years. Where, however, the promoters contribute to the proposed issue more than the minimum percentage, such additional percentage will be treated as firm allotment and will be subject to a lock-in period of 3 years from the date of allotment in public issue.

Lock-in period where promoters contribution includes holdings prior to issue

Where the aggregate percentage held by the promoters prior to the proposed issue is equivalent to or exceeds the minimum specified percentage of the promoters contribution in the post-issue capital and the promoters do not contribute in the proposed issue, the lock-in period in respect of such prior holdings shall be 5 years as reduced by the period of such prior holding except that such prior holdings to the extent of minimum specified percentage shall remain locked in at least for a minimum period of two years. The lock-in period shall commence from the date of allotment in public issue or, in case the company is a manufacturing company, from the date of such allotment or date of commencement of commercial production, whichever is later.

Promoters' contribution in case of rights issue at premium and lock-in period

Clarification VIII, dt. 11-10-1993 provides that in case of rights issue of shares at a premium, the following requirements in regard to promoters' contribution in the equity of the company must be fulfilled:

(a) If the promoters' shareholding in the equity at the time of the rights issue is more than 20 per cent of the issued capital of the company, the promoters shall ensure that their equity holdings do not fall below 20% of the expanded capital.

(b) If the promoters' existing equity holdings is less than 20 per cent of the issued capital in the event of rights issue *not being fully subscribed*, the promoters shall subscribe to the unsubscribed portion in the following manner:

(i) That the promoters' holdings are brought to the level of 20% of the expanded capital. Balance may be allotted by the Board of directors as they deem fit.

(ii) If the unsubscribed portion is not sufficient to enable the promoters reach 20% of the expanded issued capital the promoters shall take the entire issue

(c) The promoters' shareholdings under clauses (a) and (b) shall, to the extent of 20% of the post issue capital, be subject to lock-in period as follows:

(i)	Shareholdings falling under clause (a)	Two years from the date of allotment in the rights issue
(ii)	Shareholdings falling under clause (b)	
	Shareholdings falling under the rights issues	Two years from the date of allotment in the rights issue
	- Shares acquired by way of additional contribution	Three years from the date of allotment in the rights issue

(d) The aforesaid guidelines shall also apply to companies which are professionally managed.

Promoters' contribution for different classes of companies

The extent of promoters' contribution to be brought in by the promoters, directors, friends, relatives and associates and the lock-in period applicable for different categories of companies are summarised in **Annexure 1.**

M. General

1. Subscription list

(a) Subscription list for public issues should be kept open for at least 3 working days and disclosed in the prospectus.

(b) Rights issues should not be kept open for more than 60 days.

2. Certificate relating to promoters' contribution

SEBI has vide its circular dated 24-1-1992 desired that at least one day prior to the issue to the date of opening of the issue, a certificate from the Chartered Accountant/ Company Secretary in practice to the effect that the promoters' contribution on its entirety has been brought in advance before the public issue opens should be forwarded to it. The certificate should be accompanied by a list of names and addresses of friends, relatives and associates who have contributed to the promoters' quota, along with the amount of subscription made by each of them.

3. Announcement and advertisement

Announcement regarding proposed issue should be made at least 10 days before the subscription list opens. SEBI has vide its circular dated 24-12-92 provided that once 'SEBI Acknowledgement Card' is issued, no advertisement relating to the issue should be released without giving 'Risk factors' in respect of the concerned issue. Also, no advertisement should include Brand names for the issue except the normal commercial name of the company or commercial brand names of its products already in use.

4. Printing and distribution of prospectus and application forms

After the receipt of 'Acknowledgement Card' from SEBI and the intimation from the Registrar (ROC) regarding registration of prospectus, the company should take steps for the issue of the prospectus (now to be printed overleaf or to be appended through perforation) should be distributed to the brokers, under-writers, merchant bankers, lead managers, bankers, etc. to the issue.

5. Oversubscription

No retention of over subscription is permitted under any circumstances. Therefore, the quantum of issue, whether through a right or public issue, shall not exceed the amount specified in the prospectus/letter of the offer except to the extent necessary for adjust ment with respect to proportionate allotment but not exceeding 10 per cent.

6. Compliance report

Within 45 days of the closure of an issue, a report in a prescribed form with a compliance certificate from the auditor/chartered accountant/practising company secretary should be forwarded to SEBI by the lead managers.

7. Gap between closure dates of various issues, e.g., rights and Indian public should not exceed 30 days.

SEBI Guidelines for issue of Bonus Shares

(a) No bonus issue shall be made within 12 months of any public/right issue.

(b) The bonus issue shall only be made out of free reserves built out of the genuine profits or share premium collected in cash only.

(c) Reserves created bv revaluation of fixed assets are not to be capitalised.

(d) The declaration of bonus issue, in lieu of dividend. is not made.

(e) The bonus issue is not made unless the partly-paid shares, if anv. existing, are made fully paid-up.

(f) The company

(i) has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof, and

(ii) has sufficient reason to believe that it has not defaulted in respect of the paymer of statutory dues of the employees such as contribution to provident fund, gratuity bonus, etc.

(g) A company which announces its bonus issue after the approval of the Board c Directors must implement the proposal within a period of 6 months from the date o such approval and shall not have the option of changing the decision.

(h) There should be provision in the Articles of Association of the company for capitalisation of reserves, etc., and if not, the company shall pass a resolution at its general body meeting making provisions in the Articles of Association for capitalisation.

(i) Consequent to the issue of bonus shares, if the subscribed and paid-up capital exceed the authorised share capital resolution shall be passed by the company at its general body meeting for increasing the authorised capital.

(j) The company shall get a resolution passed at its general body meeting for bonus issue and in the said resolution the managements intention regarding the rate of dividend to be declared in the year immediatelv after the bonus issue should be indicated.

(k) No bonus issue shall be made which will dilute the value or rights of the holders of debentures, convertible fully or partly.

Thus, no company, may, pending conversion of FCDs/PCDs issue any snares by way of bonus, unless similar benefit is extended to the holders of such FCDs/PCDs through reservation of shares in proportion to such convertible part of FCDs/PCDs. The shares so reserved may be issued at the time of conversion of such debentures on the same terms on which the bonus issues were made *(Times of India. dt. 14-4-94)*.

(l) The company should file with SEBI a statement of the bonus issue conveying the details of the bonus issue and certifying that the bonus issue is being made as per the guidelines (As per earlier SEBI guidelines)

(m) The statement, as aforesaid, should be accompanied by a certificate from the auditors of the company as well as a practising company Secretary who shall be a member of the Institute of Company Secretaries of India to the effect that bonus guidelines have been duly complied with.

SEBI Guidelines regarding Rights Issues

1 Differential Pricing

An existing listed company while making a composite issue, may price its public and rights issue at different amounts. However, justification for price difference must be given

2 Gap between Rights and Public Issue

The gap between the closure dates of rights issue and public should not exceed **30 days**

3 Appointment of Merchant Banker

For rights issues of listed companies exceeding Rs. 50 lakhs, the issue should be managed by an authorised merchant banker.

4 Underwriting

Underwriting of rights issues which had been made compulsory by SEBI guidelines of June, 1992 has now been made optional [SEBI Press release dt. 10-10-94].

5 Issue not to be kept open beyond 60 days

A right issue should not be kept open for more than 60 days.

6 Minimum Subscription

A company making any rights issue of securities will allot the shares, debentures, etc., only if it has received a minimum of 90 per cent subscription against the entire issue. If minimum subscription is not received within 120 days from the date of opening of the subscription list, the entire money collected with applications must be returned forth with. In case the amount is not refunded within next 10 days, the company shall be liable to repay the amount alongwith interest @ 15% per annum.

7. No reservation in rights issues

SEBI, in its revised guidelines on the subject, dt. 11-10-93 has prohibited any preferential allotment in favour of its permanent employees and financial institutions (allowed earlier as per guidelines of June 1992 and 23-12-92). It now provides that if the company desires to make any preferential allotments to the employees or any identified persons they may do so independent of rights issue by complying with the provisions of the Companies Act, 1956.

8 Reservations in Composite Issue

As per Clarification No. VIII, dt. 11-10-93, in case of composite issues, reservation in ... of permanent employees is to be computed with reference to the amount of public is... alone and not the amount of composite issue.

This is quite consistent with the withdrawal of reservation for permanent employees ... rights issues.

9 Rights of FCDs / PCDs holder

The proposed rights issue should not dilute the value or rights of the fully or partly convertible debenture holders.

If the conversion of FCDs/FCDs is due within 12 months from the date of rights issue the reservation of shares out of rights issue is to be made in proportion to the convertible part of FCDs or PCDs. The shares so reserved may be issued at the time of conversion of such debentures on the same terms on which the rights issue was made.

10 Vetting of Letter of Offer by SEBI

The letter of offer pertaining to rights issue has to be vetted by SEBI and the concened lead manager has to obtain clearance from SEBI for the draft letter of offer before approaching stock exchange for fixing the date for the proposed issue. Where managers to the issue have not been appointed (in case of rights issue not exceeding Rs. 50 lakhs), a copy of the letter of offer is to be forwarded to SEBI for information.

The aforesaid procedure has not been modified w.e.f. 1-7-1995 Clarification X issued by SEBI vide Press Release, dt. 15-5-95 ,provides for vetting of offer documents by Lead Managers subject to satisfaction of certain conditions. The details as contained in classification No. X are being given hereunder.

Since a rights issue essentially affects the existing shareholders of a company unlike a public issue, it has been decided as a first step that rights issues which are not accompanied by public issues three months prior or subsequent to the date of the rights issue will not be required to be vetted by SEBI. The procedure in this behalf shall be as follows:

The lead manager will be required to file the letter of offer for a right issue with SEBI *six weeks* prior to the date on which the offer is scheduled to open. If SEBI does not ask for clarifications within 21 days (i.e. *3 weeks*) from such filing, the Issuer and the Lead Manager can go ahead with the proposed offer. If clarifications are asked for by SEBI on such a document, the proposed offer shall not open till the clarifications have been given and the draft document amended suitably. The Lead Manager would be required to file with SEBI a copy of the letter of offer alongwith a due diligence certificate at least two weeks before the issue opens for subscription.

11. New Financial Instrument

In regard to new financial instruments, whether issued by way of rights or otherwise, the disclosure requirements shall be vetted by SEBI (Clarification I, dt. 17-6-1992).

12. Compliance Report

Within 45 days of the closure of the issue, a report in the prescribed form alongwith the compliance certificate from statutory auditor / practising chartered secretary / practising chartered accountant is to be forwarded to SEBI by the lead managers. Where the right issue size is upto Rs. 50 lakhs, the compliance report / certificate shall be sent to the SEBI directly by the company.

13. Filing certificate regarding minimum subscription

Companies are also required to submit certificate to the regional recognised stock exchange, with a copy to SEBI signed by the merchant banker and the Chief Executive/ Company Secretary of the company, to the effect that the issue has been subscribed upto 90 per cent of the total for getting approval of the stock exchange for allotment

Guidelines for Prefercntial Allotments

To curb the practice followed by companeis of making preferential allotments of shares, debentures. etc. to selected person who are considered to be promoters at a price unrelated to the prevailing market price. SEBI has issued a separate set of guidelines relating to preferential issues vide Press note dt. 4.8.1994. These guidelines aim at protecting the interest of investors who do not receive preferential treatment by ensuring that the pricing of preferential allotment is market related. **These guidelines are applicable to preferential allotment to FIIs as well as promoters and other persons.** Preferential allotment to FIIs shall, in addition to these guidelines, be governed by guidelines issued by RBI. Therefore, a listed company making issue of capital by way of shares/ FCDs/PCDs/warrants and any other financial instrument on a preferential basis to any select group of persons must fulfil the following requirements as rescribed in the guidelines:

1. Preferential issue of shares have to be priced either at the average of the weekly high or low of the closing prices of the shares in the six months preceding the relevant

date or the two-weekly average of high and low of the closing prices, whichever is higher.

The same formula is to be used for calculating price for the conversion of PCDs or FCDs. The prices of shares should be taken from the stock exchange where the highest trading volume has been recorded during the 6 months prior to the relevant date. The *relevant date* for this purpose, shall be the date 30 days prior to the date on which the meeting of the general body is convened. In the case of warrants, however, the warrant holder shall have the option of fixing the relevant date at 30 days prior to the date on which the warrant holder becomes entitled to apply for the shares.

2. The promoters issuing warrants for augmenting their shareholdings in companies will have to make an upfront payment of 10% of the price fixed with a lock-in period of 5 years from the date of allotment.

3. Convertible instruments like warrants and debentures shall not have a currency of more than 18 months.

4. The upfront payment amount will be adjusted against the price to be paid by the promoters. This amount would stand forfeited if the option to acquire shares is not exercised. The warrants should be converted into equity shares within 18 months from the date of issue of such an instrument.

5. The shares allotted on preferential basis or on conversion will have non transferable lock-in period of 5 years.

6 The process of allotment of shares/warrants will have to be started within 3 months of the annual general meeting where the shareholders pass the resolution

SEBI Guidelines Pertaining to Debentures

1 Purpose of Issue

Companies can issue debentures for any purpose. However, *debentures issued by a company for financing replenishing funds or acquiring shareholding of other companies in the same group is not permitted.* It must, therefore, be ensured that the company does not issue debentures for acquisition of shares or for providing loan to any company belonging to the same group. The restriction is, however, not applicable to the issue of fully convertible debentures providing conversion within a period of 18 months.

2 Issue of Fully Convertible Debentures with a Conversion Period of more than 36 months

If the FCDs are proposed to be issued having a conversion period of more than 36 months the conversion is to be made optional with 'put' and 'call' option[1]

3 Compulsory Credit Rating

The company should obtain credit rating from CRISIL or any other recognised credit rating agency if conversion of FCDs is after 18 months or the maturity period of NCDs/PCDs exceeds 18 months. Fresh credit rating would be required when debentures are sought to be rolled over.

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1. An option to buy is called 'call option' and on option to sell is called a 'put option'. An option 'either to buy or sell' is called 'put and call option'.

4. *Pre-determination of Premium on Conversion and Time of Conversion*

The premium on conversion of FCDs and PCDs and time of conversion, in stages, if any, i to be pre-determined and stated in the prospectus.

5. *Interest rate*

The interest rate on debentures is freely determinabic.

6 *Appointment of Debenture Trustees*

The names of debenture trustees should be stated in the prospectus and the trust deed should be executed within six months of the closure of the issue. *In the case of debentures with maturity period of 18 months or less, the appointment of debenture trustees is not required.* The trustees must be vested with the requisite power for protecting the interest of debenture holders including a right to appoint a nominee director in consultation with institutional debentureholders.

7 *Debenture Redemption Reserve*

Creation of Debenture Redemption Reserve (DRR) is compulsory *except for debentures with maturity period of 18 months or less.* Creation of DRR is required to be done on the following basis:

(i) A moratorium upto the date of commercial production can be provided for creation of DRR in respect of debentures raised for project finance.

(ii) The DRR may be created in equal instalments.

(iii) In the case of PCDs, DRR should be created in respect of non-convertible portion of debenture issue on the same lines as applicable for fully non-convertible debenture issue. In respect of convertible issues by new companies, the creation of DRR should commence from the year the company earns profits for the remaining life of debentures.

(iv) Companies may distribute dividends out of general reserves in certain year if residual profits after transfer to DRR are inadequate to distribute reasonable dividends.

(v) In case of new companies, distribution of dividend shall require approval of the debenture trustee and the lead institutions, if any.

(vi) Company must create DRR equivalent to 50 per cent of debenture before debenture redemption commences. Drawal from DRR is permissible only after 10 per cent on the debenture liability has been actually redeemed by the company

(vii) In the case of existing companies, prior permission of the lead institution for declaring dividend exceeding 20 per cent or as per loan covenants is necessary if the company does not comply with institutional condition regarding interest and debt service coverage ratio.

(viii) Company may redeem debentures in greater number of instalments. The 1st instalment may start from 5th instead of 7th year.

8 *Conversion Optional*

Where the conversion of debentures (in part or whole) is to take place at or after 18 months from the date of allotment but before 36 months, such conversion should be made optional at the hands of the debentureholders.

9 Disclosure of Redemption Amount, Period of Maturity, Yield

Redemption amount, period of maturity, yield on redemption for the PCDs/NCDs are to be indicated in the prospectus.

10. Discount on Non-convertible portion of PCD

Discount on the non-convertible portion of PCD in case they are traded and procedure for their purchase on spot trading basis should be disclosed in the prospectus.

11. Roll-over of PCD/NCD

If the non-convertible portions of PCD/NCD are to be rolled over with or without change in the interest rate, a compulsory option is to be given to those debentureholders who want to withdraw and encash from the debenture programme. Roll over must be done only in cases where the debentureholders have sent their positive consent and not on the basis of the non-receipt on their negative reply.

Before roll over of any NCDs or non-convertible portion of the PCDs, fresh credit rating must be obtained within a period of six months before roll over and fresh trust deed should be made. There is, however, no need to create fresh security in the event of roll over of debentures, if the existing trust deed or the securities documents provide for continuation on the security till redemption of debentures.

Letter of information regarding roll over is required to be vetted by SEBI with regard to credit rating, debentureholders resolution, option for conversion and such other items which SEBI may prescribe from time to time.

The letter of option for roll over or conversion of debentures, value of which exceeds Rs. 50 lakhs issued by a listed company, must be forwarded to SEBI for vetting through lead manager or a merchant banker.

12. Other Disclosures

The disclosures must include the existing and future equity and long-term debt-ratio, servicing behaviour or existing debentures, payment of interest due on due dates on term loans and debentures and a certificate from a financial institution or bankers about their no objection for a second or *pari passu* charge being credited in favour of the trustees to the proposed debenture issue.

13. Creation, of Charge

Where the debentures have been issued *having a maturity period not exceeding eighteen months, it is not necessary to appoint a trustee.* If the company proposes to create a charge for such debentures, it must be filed with ROC. Where no charges is to be created, the compliance of the provisions of Deposit Rules must be ensured.

The proposal to create a charge or otherwise must be disclosed in the prospectus alongwith its implications.

14. Monitoring

The lead institution/investment institution is required to monitor the progress in respect of debentures for project finance/modernalisation /expansion / diversification / normal capital expenditure. If debentures are raised for working capital funds, the lead bank should monitor.

15. Certifate from Auditor

Institutional debentureholders and trustee should obtain from the auditors a certificate in respect of utilization of funds during the implementation period of projects. In the case of debentures for working capital, certificate should be obtained at the end of each accounting year.

16. Creation of Security

The security must be created within six months from the date of issue of debentures. If for any reason, the company is not in a position to create security within 12 months from the date of issue of debentures, the company shall be liable to pay 2 per cent penal interest to debentureholders. If security is not created even after 18 months, a meeting of the debentureholders should be called within 21 days to explain the reasons and the date by which the security would be created. The trustees are required to supervise the information of the conditions regarding creation of security and the debenture redemption reserve.

The company is also required to file with SEBI alongwith the prospectus, a certificate from the bankers that the assets on which security is to be created are free from any encumbrances and the necessary permission to mortgage the assets, has been obtained or a no objection certificate has been obtained from the financial institution or banks for a second or *pari passu* charge, if the assets are encumbered.

APPENDIX 3: OTCEI GUIDELINES FOR LISTING OF COMPANY SECURITIES

The OTCEI has prescribed the following guidelines for listing of securities on OTCEI:

1. The company must appoint one of the members of OTCEI as its sponsor. For the purpose of obtaining listing, the sponsor has to appraise the project and/or the company and certify to the OTCEI that having examined the technical, managerial, commercial, economic and financial aspects of the project and/or the company, and having satisfied that the company has or will have the necessary infrastructure as regards land, manpower, raw material, supplies, power, water, spares and market necessary for its operations, the project and/or company is viable and investment worthy.

2. The sponsor will undertake to the OTCEI that it shall make the necessary arrangements to ensure that the proposed issue of securities to the public will be fully subscribed.

   Listing will be granted on the issue being fully subscribed. In the event of the issue not being fully subscribed by the public, the sponsor will be responsible for subscribing to the unsubscribed portion of the terms envisaged by the sponsor and the company.

3. The sponsor will undertake to the OTCEI that it will ensure that the securities are offered and allotted to the public in a fair manner subject to the approval of the OTCEI, and the Government Guidelines currently in force in this regard.

4. The sponsor will undertake to the OTCEI that it will compulsorily and continuously (on all working sessions of the OTCEI) make market in the security by offering two-way quotes for buying and selling of the security. Such market-making will be subject to such rules and regulating which will be prescribed by the OTCEI from time to time. Such compulsory market making will continue for all such time as the scrips are listed provided however, that the sponsor can withdraw from such market making after a period of 3 years from the commencement of public trading, if it arranges for another member/dealer to make market compulsorily in the security.

5. The sponsor shall arrange with one member or dealer of the OTCEI for making market compulsorily in the security for a period of one year from the date of commencement of public trading.

6. The company must authorise the OTCEI or any of its nominees or agents to transfer shares (called 'small deal') upto such number of shares per day per folio as may be prescribed by OTCEI at the time of admission of a companies security for listing, with a view to expedite transactions.

7. The company will undertake to process applications for transfer of shares lodged with or its nominees or agents within 18 days (including holidays) from the date of lodgment. This period may be reduced at a future date after due notice. Failure to adhere to this time limit would lead to payment of fine as may be decided by OTCEI.

8. The OTCEI will list securities including equity shares, redeemable preference shares, convertible cumulative preference shares, convertible debentures, non-convertible debentures, bonds and warrants of companies. The face value of equity shares will be of the value of Rs. 10. The face value of any type of preference shares and non-convertible debentures will be Rs. 100. The face value of all other securities could be of any value as may be decided by the company

9. The standard lot of securities for trading will be 100. Market makers shall be obliged

to trade in non-standard lots also, but they may quote different price for such lots.

10 The company will declare to OTCEI, the portion of its share capital which is not intended to be traded. Such certificates shall be marked 'not good for trading'. If at a later date, it wishes to make those shares tradeable, the company would give a notice of 7 days before those shares are offered for trading on the OTCEI.

11 Any offer made to public either directly by the company or by the members or dealers of the OTCEI, through an offer for sale, will be accompanied by a prospectus conforming to such specification as may be laid down by OTCEI.

12. Listing on OTCEI will be permitted only after the company has obtained necessary statutory approvals and after obtaining necessary Government clearances such as the licence/registration, capital goods clearance, foreign collaboration clearance, etc., as are applicable.

The sponsors may themselves be or appoint other members/dealers of OTCEI as managers to the issue of securities for public subscriptions.

14 Publicity to an issue of security to the public will be subject to the approval of OTCEI and guidelines issued by the Government and SEBI.

15. The OTCEI will from time to time prescribe such time limit not exceeding current statutory provisions on the companies and its sponsors to complete the process of allotment of securities, compilation of the list of allottees and refunds, mailing of allotment advice/letter of allotment, mailing of refunds and mailing of share certificates.

16 The OTCEI will prescribe from time to time the interest to be paid for delay in delivery of allotment advice/letter of allotment/share certificate/refund.

17. Application for listing should be made in the prescribed format.

18. The company will pay a one-time listing fee of Rs. 6,000 and anannual listing fee of 0.05% of the paid-up equity share capital of the company in case of listing of equity shares and 0.05% of the gross amount of securities issued in case of listing of any other security.

19. (a) In case a company wishes to issue further capital, required resolution under Sec. 81 will be attached with the listing application.

(b) Due notice of clear 15 working days will be given for the purpose of fixing record date to ascertain list of members eligible for such offering of further capital. The notice would contain information on the basis and method of offer.

20 The letter of offer or prospectus or any other issue document will be subject to the clearance by the OTCEI.

21. The conditions for delisting shall be specified in the listing agreement.

22. The OTCEI's decision for granting/not granting listing will be final.

23. The OTCEI shall have the right to penalise the company, its sponsor and every officer in default for not complying with any of its guidelines, byelaws, regulations, etc.

24. The OTCEI may revise, delete or add new conditions in consultation with and subject to approval of the Government of India.

APPENDIX 4: SEBI GUIDELINES FOR ISSUE OF SHARES THROUGH OTC EXCHANGE OF INDIA (OTCEI)

Where a direct public issue is made through OTC *without the sponsor taking any shares,* the normal guidelines for disclosure and investor protection shall apply.

Where the shares of a company have been taken by the sponsor such shares may be offered to the public at a later date at such price as the sponsor may deem fit in accordance with the regulations of OTC subject to the following conditions:

(i) The promoters after such offer retain at least 25% of the total issued capital with lock-in period of 5 years from the date of the sponsor taking up the shares,

(ii) The sponsor agrees to act as market maker for the shares at least for a period of three years on a compulsory basis and also funds an additional market maker for such compulsory market making; and

(iii) The sponsor compulsorily gives two-way quotes based on minimum or maximum trading prices as may be stipulated by OTC in respect of the scrip. *Clarification II, dated 16-7-1992.*

Class of Companies	Pricing of Public Issue	Promoters Contribution	Lock-in period
Section A			
(i) New companies established by individual promoters and entrepreneurs	At par	25% or 20% of the total issued capital, as the case may be, with a minimum subscription of Rs. 50,000 by each of the relatives, friends and associates	5 years from the date of allotment in public issue or the date of commencement of commercial production (in case of a manufacturing company), whichever is earlier.
(ii) New companies set up by existing companies with a 5-year track record of consistent profitability	At Premium	50% of total issued capital [under the new Guidelines dated 10-8-93, if the premium amount does not exceed the face value the promoters' contribution shall be 50% for the first Rs. 100 crores, 40 per cent for the next Rs. 200 crores, 30% for another Rs. 300 crores and 15% for the remaining Portion]	5 years from the date of allotment in public issue or the dale of commencement of commercial productin (in case of a manufacturing company), whichever is later
Section B			
(i) Existing private/closely held and other unlisted companies without three-year track record of consistent profitability	At par	25% or 20% of the total issued capital, as the case may be, with a minimum subscription of Rs. 25,000 [w.e.f. 10-8-93] from each of the friends, relatives and associates.	(a) Subject to clause (b) below, 5 years from the date of allotment in public issue or from the date of commencement of commercial production (in case of a manufacturing company), whichever is later. (b) Where minimum specified percent- age includes shareholding held prior to the public issue, the lock-in-period referred to in clause (a) shall in respect of such prior shareholdings stand reduced by the period of such holding except that the aggregate of minimum percentage holdings shall remain locked in for a minimum period of 2 years from the date of allotment in the public issue.
(ii) Existing private/closely held and other unlisted companies will three-year track record of consistent profitability.	At Premium	[Same as (i) above]	[Same as (i) above
(iii) A company which does not have three-year track record but had been promoted by existing companies with a five-year track record of consistent profitability.	At Premium	50% of the total issued capital [undo the new guidelines dated 10-8-93 if the premium amount does not exceed the face value, the promoters contribution shall be 50% for the first 100crores, 40% for the next Rs. 200 crores, 30% for another Rs. 300	[Same as (i) above

		crores and 15% for the remaining portion]	
(iv) Existing private/closely held and other unlisted companies without three-year track record of consistent profitability - seeking disinvestment by offer to public without issuing fresh capital.	At par	Minimum stake of 25% of the total issued capital to be maintained after the public offer	5 years from the date of allotment public offer
(v) Existing private/closely held and other unlisted companies with three-year track record of consistent profitability seeking disinvestment by offer to public without issuing fresh capital.	At Premium	Minimum stake of 25% of the total issued capital to be maintained after the public offer	5 years from the date of allotment public offer
Section C			
(i) Existing listed companies marking public issue	At par or Premium	(a) 25% or 20% of the total issued capital, as the case may be, with a minimum subscription of Rs. 25,000 [w.e.f. 10-8-93] from each of the relatives, friends and associates : OR (b) 25% or 20% of the total issued capital (expanded capital), as the case may be, with a minimum subscription of Rs. 25,000 [w.e.f. 10-8-93] from each of the relatives, friends and associates.	(a) 5 years from the date of allotment in public issue or the date of commencement of commercial producing (in case of a manufacturing company) whichever is later. OR (b)The lock-in period shall subject to clause (c) below apply to the aggregate of the contribution made in the public issue and so much of the prior shareholdings as is necessary to constitute 25% of the total issued capital. (c) The lock-in period in respect of the contribution made in the public issue shall be 5 years from the date of allotment in such issue or from the date of commencement of commercial production (in case of manufacturing company), whichever is later, and in respect of the holdings prior to the date of the public issue shall be 5 years as reduced by the period of such prior holdings except that such prior holdings shall remain locked-in at least for a minimum period of 2 years from the date of the allotment in the public issue.

Note : "Date of commencement of commercial production" means the last date of month which commercial production a manufacturing company is expected to commence as declared in the documents.

UNIT 3 CHANGING ROLE OF GOVERNMENT

Objectives

- After going through this unit, you should be in a position to understand
- the different viewpoints about the rôle of the government in an economy,
- the manner in which ideas in this regard have changed over time,
- the areas of the economy where government intervention is considered desirable currently,
- the accepted manner of government intervention, and
- a brief overview of the Indian experience in this regard.

Structure

3.1 Introduction

3.2 Role of Government in Capitalist Economies

3.3 Pitfalls of Communism

3.4 Indian Experience

3.5 Emerging Consensus on the Changed Role of Government

3.6 Summary

3.7 Key Words

3.8 Further Reading

3.9 Self-Assessment Questions

3.1 INTRODUCTION

It will be an interesting exercise for you to compare the role played by the governments in two Asian countries Japan and China. These two countries differ from each other totally in terms of their political and economic ideologies. The tiny Japanese nation is considered to be a capitalist giant. The populous Chinese nation is one of the very few countries which still, by and large, practise communism.

Of course, both in Japan and China, justice, police and defence are part of the responsibilities of the Government. But as regards the economic role of the government, the situations in the two countries are strikingly different. In Japan, there are hardly any government enterprises and the means of production are almost entirely in private hands. The government at present has a very negligible role in the Japanese economy. In China the situation is almost exactly the opposite. The means of production are almost entirely in government hands and the government plays a very prominent economic role even these days.

Actually, if you scan books of economics, you will decipher two diametrically opposite viewpoints about the economic role of government. One is the *laissez-faire* view as

propounded by Adam Smith. According to this, a government that interferes least with the economy is the best. In such an economy, everyone acts according to his or her own self-interest. But the invisible hand operating through the market mechanism ensures that social interest gets promoted in this process. In striking contrast is the view held by Karl Marx and his group of scientific socialists. According to the Marxists, centralised planning with public ownership of the means of production leads to an ideal economic and social set up.

Let us now take a brief look at the economic history of the developed nations of today This is necessary to understand the prevalence of the different viewpoints on the economic role of government. It will also reveal the process of change in these viewpoints ove time. In fact there is adequate historical evidence that, basically, economic policies o *laissez-faire* helped the countries of Western Europe and the United States of America attain high levels of economic development. Actually, till the early parts of the twentieth century, scientific socialism was looked upon as something theoretically sound, but impractical and topian.

You will notice that the birth of the Soviet Union in 1917 based on scientific socialism changed all this considerably. Further, since the late 1920s the lacunae of the *laissez-faire* economies started looming larger and larger. As a result, government intervention became increasingly popular even in traditional *laissez-faire* economies. A number of countries turned communist for various reasons particularly after the Second World War. Due to all this, a number of Asian and African countries, regaining independence in the 1950s and 1960s, opted for considerable government intervention in their economies.

The pendulum has, however, swung the other way particularly since the 1970s. Many countries of Eastern Europe found central planning of the communist variety difficult to practise and hence ineffective. Many of them like Poland, Hungary and Yugoslavia started using less rigid forms of centralised planning. Private ownership of means of production also began to be allowed in some sectors of the economy in these countries. Moreover, both the Soviet Union and China started inducting market forces to supplement centralised planning. The breakup of the Soviet Union and of Yugoslavia and the pulling down of the Berlin Wall are taken as further manifestations of this wind of change. The magic formulae on everybody's lips these days are liberalisation and globalisation. It looks as if the *laissez-faire* economic philosophy has been reinstated. Almost all countries of the world, including India, have been swept off their feet as a result. The char particularly since the 1990s, of the economic role of the Government in India bear ample testimony to this.

It is, however, being increasingly realized that there are no simple panacea for improving the levels of living of the people. Most analysts agree that neither *laissez- faire* nor centralised planning of the communist variety can deliver the goods. It has, of course, been admitted for years that even in capitalist countries there are certain aspects where government intervention in the economy improves its performance. We are living in an age which is also witnessing attempts to make scientific socialism market friendly. You might have come across the popular saying that we are in the era of Karl Smith and Adam Marx these days.

In view of all this, we now embark on a more detailed analysis of the role of government in today's world.

3.2 ROLE OF GOVERNMENT IN CAPITALIST ECONOMIES

You will find that the *laissez-faire* economic philosophy underlying the capitalist economies has come in for strong analytical justification. This is done by pointing out that such policies would lead to a Pareto-optimal allocation of resources in the economy concerned. A Pareto-optimal situation exists in an economy if one person cannot be made better off without making someone else worse off in their respective opinions. Under certain assumptions the proponents of *laissez-faire* have proved that such a Pareto-optimal situation will emerge in a free market economy with no government intervention. But the assumptions made in deriving the Pareto-optimal solution from *laissez-faire* economic logic are far from reality. Further, the actual results in countries following *laissez-faire* economic policies reveal serious drawbacks. You will hence find that on both these counts, even confirmed protagonists of *laissez-faire* favour economic intervention by government. We take up these issues one by one now.

a) Unrealistic assumptions

Three basic assumptions underlie the justification of a *laissez-faire* economic philosophy. Firstly, it is assumed that markets arc characterised by perfect competition. Secondly, it is taken for granted that there are no externalities. Thirdly, not all types of goods can be taken into account in the analysis. The meanings and implications of each of these are discused below.

(i) Perfect competition : Perfect competition has a number of characteristics. There are a large number of buyers and sellers each buying and selling only a small quantity of the product. The product produced is perfectly homogeneous and both buyers and sellers are guided solely by economic considerations. There is perfect knowledge and perfect mobility of consumers and of the factors of production. The net result of all this is that there will be only one price for the commodity at one point of time in a market. Further no single buyer or seller can affect the price or the demand or the supply, as the case may be, by his independent action.

You can see by now that the a ctual situation in most markets is a far cry from this Mrs. Joan Robinson and E. Chamberlin had pointed this out even in the late 1930s. They built alternative models of market structure, namely imperfect competition and monopolistic competition. Later writers have gone on to build even more realistic models of market structure. These oligopoly models visualise the existence of a few large producers in each industry with some of these working even in collusion.

A Pareto - optimal situation in the allocation of resources even docs not emerge with *laissez-faire* policies under any of these alternative and more realistic forms of market structure. Hence we find that government intervention to prevention optimal allocation of resources, and higher prices, excessive advertising expenditure, etc., under these forms of market structures, is universally accepted.

(ii) Absence of externalities . Externalities arc defined as incidental benefits and detriments accruing out of any economic activity. If your neighbour sets up a motor cycle repair shop, the noise will bother you. The setting up of this repair shop will thus lead to a detrimental externality for the entire neighbourhood. In contrast, assume that one of your neighbours has a beautiful garden. Whenever you pass by the garden, you will feel happy and refreshed. The neighbour cannot charge you for this happiness that he, incidentally, provides you. The setting up of a beautiful garden by someone in the neighbourhood thus generates this beneficial externality.

You will certainly agree that if society interest is to be promoted, these externalities have also to be taken into account in determining economic activities. For this purpose economic activities have to be based on calculations of social cost and social benefit and not on mere private cost and private benefit.

In *laissez-faire* logic, however, we find that costs and benefits are considered without taking into account these externalities. As a result, the output of those goods and services which cause beneficial externalities will be too little. As against this, the output of those goods and services which have detrimental externalities will be too much. Government intervention to correct this anomaly is therefore an accepted practice even in capitalist economies

(iii) Public goods excluded : You find that economists make a distinction between private and public goods. According lo them, private goods possess the attributes of both depletability and excludability. On the contrary, public goods are conspicuous by the fact that they have neither of these attributes. We will now proceed to explain each of these attributes.

Assume that an item has the attribute of depletability. If so, the use of that item by an individual will reduce the total available supply for use by others, to that extent, at least temporarily. A good is excludable if a person not paying for it can be prevented from enjoying it. You notice that the goods that we buy from the market possess both these attributes. In contrast, many things that we collectively consume like street lighting are devoid of both. For a private good, market mechanism determines the price to be charged and the quantity to be produced. But the market mechanism cannot help us on both these counts in the case of public goods. Public goods are hence the responsibility of governments the world over.

b) Lacunae in performance

You will agree with the statement that the proof of the pudding is in the eating. It is indeed true that some countries following *laissez-faire* economic policies have attained very high levels of growth in tern... of per capita real income. But it has also to be admitted that the *laissez-faire* economic pudding has actually turned out to be somewhat less tasty than it was supposed to be. In fact, three serious lacunae have been noticed in the economic performance of free market economics. Firstly, these have been experiencing periodic ups and downs in national income, employment and prices. Secondly, there are huge inequalities of income and prevalence of considerable poverty. Thirdly, there is also enough reason to believe that such economies do not make adequate provision for the future at least on two counts, namely in promoting development and in making development environmentally sustainable. We now take up these three issues one by one.

(i) Cyclic fluctuations : Periodical upward and downward changes in national income, employment and prices have characterised free market economies. The *laissez-faire* economists however refused to accept this reality and went on harping on the theme that there is an automatic tendency towards full employment in a free market economy. An extreme downswing - the great depression of the 1930s - made John Maynard Keynes question the view and propound an alternative theory. According to Keynes, there will be equilibrium at less than full employment in a free-market economy. His views, with minor modifications, have come to be accepted by a large number of countries.

Hence government intervention through a combination of monetary and fiscal policies is considered essential for free market economies. The purpose of such policies is to ensure stability in national income, employment, and prices.

(ii) Inequalities : Developed free market economics are characterised by considerable interpersonal inequalities of income and wealth. This causes concern because people in the lowest income group are often found to be living in poverty. It is also seen that distribution is not equitable between different regions within a nation. Some regions are pockets of poverty. Further, there is usually a gender bias in distribution. The majority of the poor in developed free market economics are often found to be women.

A little analysis will convince you that this is not very surprising. It is true that there is a direct relationship between effort and reward in a free market economy. But the effort is judged by the means of production that an individual or a region has. If these are not initially distributed equitably, inequalities arise and are likely to get compounded over time.

Hence, we see that measures to lessen extreme inequalities in income and wealth are part of the agenda set before the governments of free market economies. And in these measures, particular attention is paid to the removal of poverty in the less developed regions and of the less advantaged groups. The last two aspects of the distributional issue have come into policy focus only in the past few years.

(iii) Inadequate provision for the future : Generally, we also find that a *laissez-faire* economic policy does not result in adequate economic provision for the future. This is so from two important points of view. Firstly, you will agree that most Third World countries cannot attain a high level of economic development without the adoption of specific policy measures in this regard by their governments. Secondly, inter generational equity in terms of attaining environmentally sustainable development is conspicuous by its absence in almost all countries of the world. These points, we believe, need to be discussed in slightly greater detail.

Developing countries need a lot of investment in areas like heavy industries and infrastructure. These areas need substantial capital and yield returns only in the long run. Further, they are often highly risky and are, often, in the form of public goods with a good deal of beneficial externalities. Moreover, the political, social and economic institutional structure in these countries is far from congenial for the promotion of economic development. It is therefore accepted that without the government playing a positive role, these institutional constraints cannot be overcome nor can heavy industries or requisite infrastructure come up.

As regards the environment, we find that in private cost-benefit calculations in free market economies, this aspect never used to be taken into consideration. This is hardly surprising because leaving a better environment for the succeding generations has become an economic policy objective only in recent years. Even centrally planned socialist economies have a miserable record on this count. It must however to be admitted that environmental impact assessment is a grey area even today. There are umpteen problems in working out the cost of the detrimental externalities on the environment resulting from economic activity. But the environmental aspect is being increasingly recognised the world over. As a result, even in free market economies, governments insist on projects getting environmental clearance.

3.3 PITFALLS OF COMMUNISM

We have, by now, discussed what are called cases of market failure in free market economies, justifying government intervention. A question that naturally would arise in your mind is whether we can go to the other extreme and leave all aspects of the economies in government hands. It may appear that ideal sometimes from the social point of view would emerge in the economy if this is done. The experience of communist economies suggests that this is simply not true. Economies practising central planning under scientific socialism have had serious difficulties on at least three counts. Firstly, there have been problems in finding out the consumer's tastes. Secondly, in a number of cases, there have been difficulties in seeing to it that adequate inputs are made available to produce planned outputs. Lastly, it has also been noticed that these economies, have lagged far behind the others in terms of technology. We shall take up these issues in greater detail one by one now.

Activity I

1. (a) Name some countries which have predominantly a capitalistic system of economy. Give some facts and figures with regard to their economic, scientific and research achievements.

....

....

....

(b) What factors could be attributed to the high levels of income leading to a higher standard of living in such countries?

....

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....

(c) Meet some people who have been for some time in any of the Western countries with capitalistic economic system and discuss the work climate that prevails in such a country and compare it with the work climate in India. What implications, if any, such contrasts have had on India's economic performance?

....

....

....

(d) What arc some of the problems which countries following the capitalistic economic system have had to face ?

....

....

....

(a) Goods produced not in line with consumer's preferences

In communist countries, the planning authorities decide the basket of commodities to be produced. Prices again are fixed not by market forces, but by these authorities. Thus the market mechanism of the type that operates in a free market economy is conspicuous by its absence in these economies.

The result is that there is often a large unsold stock of goods unwanted by consumers in shops. There are also big lines in front of shops of people wanting to buy goods which are much in demand but not produced in adequate quantity by the planners. In fact one of the major reasons for the so-called breakdown of communism is that the strong preference of consumers for VCRs, fast food, cameras, etc., had not been adequately met by the planners in these countries.

Hence, many of the former communist countries are making efforts these days to overcome this lacunae by giving the market mechanism its due place in their economies.

(b) Difficulties in attaining material balancing

The planners in a communist country have to see that adequate resources are made available at the proper time and place. This is to ensure that the production of outputs takes place according to the plan. Hence such planning for internal consistency takes care of material balancing according to which inputs supplied equal inputs demanded.

Material balancing is sought to be achieved in communist countries by the use of the input-output technique. The input-output table is worked out on the basis of the information regarding the inputs required for producing outputs in the different sectors of the economy. On the basis of such a table, the input requirements needed to produce the targeted output of all sectors together can be mathematically worked out.

The detailed information required for building such a table is seldom available. It has also to be borne in mind that if information about input requirements is collected from particular enterprises, there is always a danger of deliberate misinformation. Communist countries are often bedevilled with serious input bottlenecks. More often than not, planners in these countries are constrained to solve these problems by mere trial and error. Other such attempts to minimise input bottlenecks result in scarce inputs being diverted to "priority" sectors like spacecraft to the ultra neglect of sectors producing consumer durables. Due to all this, communist countries also witness the strange phenomenon of some enterprises keeping unusually high levels of stock of scarce raw materials to fulfil their production quotas as determined by the planning authorities.

In the light of all this, communist countries these days are attempting to make socialism market friendly. This is done by gradually introducing private ownership of means of production and using market mechanisms to bring about material balances.

(c) Outdated technologies

It is true that countries which took to communism earlier began their process of economic development by borrowing state of the art technologies from other countries. You may notice, however, that the communist system was such that there was little incentive for enterprises in these countries to go in for continuous technological upgradation. We can think of at least three important reasons for this lack of incentive. One is the fact that enterprises in communist countries are state monopolies. Secondly, there is the unpleasant reality that technological upgradation by an enterprise is often not an unmixed blessing for it. The benefits of upgradation may not necessarily accrue to that particular enterprise. We shall now briefly dwell on the reasons for the unpleasant consequences.

(i) No spur of competition : In free market economies, the enterprises compete with each other to capture the market. This enables customers to look for other producers if the quality of the product of one of the producers is not up to the mark. The producer with poor quality product is forced either to improve his quality or leave the industry.

In communist countries, since enterprises are state monopolies, the consumer has no such choice. The state decides how much each producer has to produce and there is no continuous rivalry between the producers to improve quality and capture the market. It is found that in a number of these countries, the quality of the products has instead of improving, gone down over time.

(ii) Technological improvement causes problems : In free market economies, a good deal of technological upgradations take place on shop floors. Such improvements come in for acclaim and often result in less input being used to produce the same output.

It is true that in a communist set up too such an improvement may result in a pat on the back of the concerned enterprise. It may, however, not be an unmixed blessing for it. This is so because it may often imply a much larger quota of output to be produced by it. Getting the extra volume of input in time would often cause much greater, if not insurmountable, difficulties to the management. This may act as a strong disincentive to the management to bring about technological improvements.

(iii) Profits made do not accrue to the enterprise : It is true that profits exist in an accounting sense under communism. It is also a fact that one of the factors for judging the performance of an enterprise is the profit made by it. But unlike in a free market economy there is no direct relationship between effort and reward. Enterprises in a free market economy, as you might be aware, have control over the profits made by them. They can either spend or invest these profits depending upon their discretion. This, however, is not so in a communist set up. Profits made in an accounting sense by an enterprise till recently had not been made available to the concerned enterprise to be used at its discretion. This feature also acts as a strong disincentive against technological improvements.

As a result of all these factors, countries which took to communism early are facing problems of outdated technology. This is particularly so in their non-priority sectors where government R & D efforts have not been undertaken. More or less the same is the situation in countries which took to communism later on. These countries, for political reasons, had to adopt outdated technologies prevalent in other communist countries.

Activity 2

1 (a) List below the names of the countries which till recently belonged to the communist bloc.

....

....

....

(b) Which of the above countries have changed their economic systems and which of the countries continue to tread the same path?

....

....

....

(c) What is the exact position of China in so far as its economic system/strucu and the role of the Government are concerned ? How would you describe economic system? (You may discuss this with your colleagues and ot knowledgable people).

....

....

....

3.4 INDIAN EXPERIENCE

The Indian economy has also witnessed a big change in the role of the Government over time. Ever since independence till around the 1980s, as we discussed in the previous units, our objective was to have planned economic development without adopting extreme forms of capitalism or communism.

Heavy industry and infrastructure were left in the hands of the Government to develop. Priority sectors were decided upon by the Government. In agriculture, development was encouraged along capitalistic lines. To prevent monopoly, mitigate cyclical fluctuations, lessen interpersonal inequalities of income and wealth and promote economic development, measures of command and control were frequently resorted to, though some measures operating through the market mechanism were also adopted. Little attention was however paid by the Government to prevent environmental degradation or reduce inter-regional or gender-based inequalities.

The situation in which we found ourselves by the 1980s was not a happy one. Our Government could not provide adequate infrastructural facilities. While we had some success in increasing agricultural production, the level of our per capita consumption of food was woefully low. Further, agriculture, even now, seems affected by the vagaries of the weather, causing cyclic fluctuations in the economy. You will find that there have been official statements that while the Indian economy has grown, this growth has not trickled down sufficiently. Further, Government-owned enterprises in basic and heavy industries were functioning far from efficiently and have mostly been using outdated technology. Moreover, because of resort to command and control measures, a number of private sector units of the Indian economy were also more or less in the same boat. There were hence slow rumblings of change in India's economic policy from the 80s.

It soon became clear, however, that such gradual changes will simply not work. The unprecedented crisis in the Indian economy in 1990-91 was the last straw on the camel's back. Our foreign exchange reserves fell to an all-time low level of $ 2.2 billion. Inflation rate had already crossed the double-digit figure and was actually at 14%. Fiscal deficit had risen to 8.4% of the Gross Domestic Product. The current account deficit on balance of payments was as high as $9.9 billion. International Credit Rating agencies went on to considerably downgrade India's creditworthiness.

The Government and many economists agreed that a shock therapy was immediately required to pull the Indian economy out of the woods. The World Bank agreed to bail India out, but imposed certain conditionalities for doing so. It wanted two major types of programmes to be carried out. Firstly, there were to be short-term stabilisation measures to control inflation and wipe out the balance of payments deficit. These were agreed upon. You are aware that attempts are being made to rationalise subsidies and cut

down wasteful Government expenditure to reduce the fiscal deficit. The rupee has been devalued to correct the balance of payments deficit. Secondly, there had to be structural reforms to make the Indian economy competitive and attain a high rate of growth with social justice. These have also been accepted and measures are being taken to liberalise and globalise the Indian economy.

As a result of all this, there was considerable rethinking, reinforced by the conditionalities imposed by the World bank to help India out of her difficulties. Steps began to be initiated in the 1980s and these gathered considerable momentum in the 1990s. A sea change has thus come about in the economic role of the Government in India since the 1990s. Many of the sectors reserved for the public sector have now been thrown open to the private sector. More and more physical controls are being replaced by measures to guide the economy through the market mechanism. Restraints in the way of international trade and factor movements are being gradually reduced. The seeming intention is to make the Indian economy face international competition and become efficient in performance. The Government role in the provision of public goods is not likely to increase, but as regards the protection of the environment, the Government is likely to play an increasing role

Activity 3

1 Arrange the meeting with the General Manager of one large company and one medium or small scale company and discuss with them how economic reforms since1991 have effected them. List their responses in terms of : more freedom, greater flexibility, the attitude and behaviour of the administration / bureaucrcy etc.,,

Favourable Reaction	Unfavourable reaction
....	....
....	....
....	....
....	....
....	....

3.5 EMERGING CONSENSUS ON THE CHANGED ROLE OF GOVERNMENT

You might have noted by now that the vast difference that existed between capitalist and communist countries regarding the role of government in their economies has almost disappeared. A certain consensus seems to be emerging these days on the role the government is supposed to play on the economic front.

Capitalist countries are increasingly accepting the fact that governments have to play and important role in their economies. The governments come into the picture to provide public goods and to ensure that competitive forces are not impeded in playing their role. The governments promote the production of commodities with beneficial externalities and curb the production of commodities with detrimental side effects. Measures to reduce interpersonal inequalities in income and wealth, with particular focus on the removal of poverty, especially among disadvantaged groups, are part of government agenda. So are steps to foster economic development and to prevent widespread fluctuations in national income, employment and price level.

Communist countries are similarly waking up to the fact that everything about the economy cannot be left to the state. It is, by and large, agreed that the record of these countries in overcoming cases of market failure as regards cyclic fluctuations, poverty removal and provision of public goods has been somewhat good. But there have been glaring cases of state failure in such countries regarding production of commodities wanted by the people, material balances (or stocks) and technological upgradation. To overcome these difficulties the governments of these countries are getting slowly out of the responsibility of running productive enterprises. They are also gradually introducing market forces and adopting more decentralised planning techniques.

It has also to be noted that in both sets of countries, increasing attention is being paid by governments to tackle problems of environmental degradation. As regards the modus operandi of government intervention in this and other areas, the tendency is to adopt measures operating through the market mechanism in preference to command and control measures.

3.6 SUMMARY

This unit gave you a brief overview of the change in the role of government in the economies of the world guided by different politico-economic systems.

We saw how, in capitalist economies, the economic role of government had increased over time. This is attributed to market failure on two counts. Firstly, the assumptions of perfect competition, absence of externalities and non-existence of public goods have been found to be not based on realities. Secondly, there have been lacunae in the performance of these economies in terms of cylic fluctuations of income, employment and prices, existence of inequalities, poverty and inadequate provision for future.

We went further to give you the pitfalls of communism to indicate that cases of market failure cannot be rectified by making the government responsible for everything in the economy. Three aspects of state failure in such economies were highlighted: inadequate provision of goods wanted by consumers, lack of material balances, and absence of continuous technological upgradation. It was pointed out how private ownership of means of production and market mechanism are being gradually introduced in the economies of the communist countries to overcome these lacunae. We also discussed the change over time in the role of government in the Indian economy.

In the light of whatever has been discussed, it can be inferred that the respective economic roles of government in the capitalist and communist countries of the world are becoming less and less dissimilar. As has been pointed out, we are leaving the age of **Adam Smith and Karl Marx** to enter the modern era of Adam Marx and Karl Smith. There is an emerging consensus on the economic role of government in countries of the world with totally different ideologies. It is admitted that governments have to take extra care that there are neither market nor state failures in their economies.

3.7 KEY WORDS

Adam Marx : An intentional mix-up in the names of Adam Smith and Karl Marx to indicate that the distinction between capitalism and communism is becoming blurred.

BLOCK 2 STRUCTURE OF INDIAN ECONOMY

In Block 1, we had discussed the Economic and Social Environment of Business. we had also examined the changing role of the Government. In this block we discuss the structure of the Indian Economy and its ramifications. This Block consists of six Units.

Unit 4 Structurial Dimensions of Indian Economy begins by explaining the distinction between economic growth and economic development The unit then discusses India's growth experience. The basic structural changes in the Indian economy are reviewed. The trends in India's savings and investments, and in the monetary and price spheres are examined. The unit concludes with a brief description about other structural dimensions and demographic trends.

Unit 5 Structure of Indian Industry presents an overview of India's industrial growth experience. The structural changes and ownership patterns of Indian industry are iscussed.

Unit 6 deals with **Public Sector in India.** The objectives, structure, growth, working and performance of public sector are discussed and issues are examined.

Unit 7 focuses on **Private Sector in India.** The nature, scope, growth, problems and prospects of private sector in India are discussed and issues are examined.

Unit 8 deals with **Small Scale Industry in India.** Small Scale Industry has always occupied an important place in India's economic development. The unit presents some basic definitions and data about the structure of small scale industry. The industrial policies, and programmes, institutional infrastructure, growth, problems and prospects in relation to small scale industry are discussed.

Unit 9 deals with **Sickness in Indian Industry.** The various factors responsible for sickness of Indian industry are examined and assessed. What measures can be taken to tackle the problem of industrial sickness are also discussed.

UNIT 4 STRUCTURAL DIMENSIONS OF INDIAN ECONOMY

Objectives

The main purpose of this unit is to help you to:

- understand the significance of economic growth and economic development
- analyse India's economic growth experience.
- discover and explain structural changes in the Indian economy, and
- understand the current economic situation in India.

Structure

4.1 Introduction
4.2 Economic Growth and Development
4.3 Indian Economic Growth Experience
4.4 Basic Structural Changes in the Economy
4.5 India's Saving and Investment : Trends and Components
4.6 India's Monetary and Price Trends
4.7 Other Structural Dimensions
4.8 Demographic Trends and Structure
4.9 Summary
4.10 Key Words
4.11 Self-Assessment Questions
4.12 Further Readings
Appendix 1: Statistical Tables

4.1 INTRODUCTION

The socio-economic environment of any country can be explained in terms of an institutional framework and a physical framework are the economic policy statements of the government, economic plan documents, the political constitution, economic regulations and controls; among others which define the role and status of private sector, public sector, multinationals, corporations, small business, etc. The critical elements which constitute the *institutional* framework of an economic environment. The trends in economic variables such as income, price, output, investment, foreign trade, labour supply and other factor endowments and the structural relation among these variables constitute the *physical* framework of an economic environment.

Describing and analysing the economic environment is a difficult task. Descretion and personal judgement play an important part. Difficulties arise in the context of both institutional and physical framework. Just as various interpretations of policy statements are possible various conclusions could also be drawn from the economic data.

The purpose of gathering (mainly from official sources) and analysing data is to obtain a clear picture of major economic trends and structural changes in the economy. The

trends and structural coefficients together enable us to make a quantitative assessment of the economic environment of a business/firm and thereby to outline strategies for macroeconomic management. A knowledge of economic trends and structural changes thus helps the firm to plan out a corporate strategy and policy to cope with short-run and long-run challenges of business environment. This argument is particularly valid for a developing country.

This unit attempts to present the relevant economic trends, and discuss the structural changes. It then examines the implications of growth and structural changes that have occurred. It also analyses the current economic trends, and discusses the impact of environment on business management.

In this unit, you may have to refer to additional statistical materials time and again.Of course, you are not expected to remember the details of all such data. You should only take note of such trends which are useful to the analysis of the *system-environment* of your own busines.

4.2 ECONOMIC GROWTH AND DEVELOPMENT

"Growth" and "development" are sometimes used synonymously in economic discussion. Though the two terms are used interchangeably, they have different connotations. Economic growth means more output , while economic devlopment implies both more output and changes in the technical institutional arrangements by which it is produced and distributed.

Growth may well involve not only more output derived from greater amounts of inputs but also greater efficiency, that is, an increase in productivity or an increase in output per unit of input. Development goes beyond this to imply changes in the compositon of output and in the allocation of inputs by sectors. As with human beings, to stress "growth" involves focussing on height or weight (or national income), while to emphasise development draws attention to changes in functional capacities--in physical coordination, for example, or learning capacity (or ability of the economy to adapt).

4.2.1 Economic Growth

Economic growth may be defined as a significant and sustained rise in per capita real income. One must distinguish the "level" from the rate of economic growth, though these two concepts are obviously related. The level of economic growth of a country is measured by the size of national (or per capita) real income. The percentage change in this level over a year is the annual rate of growth. That is, if we denote the level is of real income in two years Y, and Y_2, and g as the rate of growth (expressed in percentage terms), then

$$g = \frac{Y_2 - Y_1}{Y_1} \times 100$$

per capita real income is supposed to be the least imperfect measure of economic growth of a country. It takes into account changes in national income, population and price level. In this connection the following relationships are very useful ;

- Real national income = National income at current prices/General price index

  In symbols

$$Y = (Y/P) \times 100$$

- Per capita real income = $\frac{\text{Real national income}}{\text{population}}$

  In symbols

$$y_p = y/N$$

- Real income growth rate = Growth rate of national income at current prices - Inflation rate

  In symbols

$$\bar{y} = \bar{Y} - \bar{P}$$

  Bar over a symbol signifies rate of growth of that variable

- Per capita real income growth rate=real income growth rate - population growth rate
  - In symbols

$$\bar{y}_p = \bar{Y} - \bar{N}$$

Inter-temporal (over a period of time) and international (over space) comparisons of economic growth can be made. For the first (for example a country's growth experience over a period of time). we use time-series data. For the second we use cross - section data relating to different countries.

When you are interested incomparison of level of living, the per capita income measure is to be supplemented by a few other measures like per capita consumption of essential goods and services, per capita production, and availability of certain items (for example electricity per capita), etc.,

Labour productivity (output per worker) may be considered as an index of growth and standard of living. If we denote real national income by y, population by working force by W,then we can rewrite real per capita income y_p as

$$y_p = \frac{y}{N} \quad \frac{W}{N} / \frac{y}{W} / X$$

This definition suggests that the level of per capita real income (yp) is the product of 'labour force participation rate' *(W/N)* and real income per worker. From the above equation it is obvious that given the labour force participation rate *(W/N)*, the change in labour productivity *(Y/W)* reflects the growth trend in per capita income. An increase in labour productivity suggests economic growth, a decline in labour productivity suggests economic deterioration, and a constancy of labour productivity signifies stagnation of the economy.

The labour productivity measure of economic growth is of crucial significance for management in developing economies. In capital-scarce developing countries there is undoubtedly a need for optimum utilisation of plant and machinery. The preceding argument suggests that there is perhaps a more urgent need for efficient and optimum utilisation of labour in a developing country which is labour-abundant.

The task of management in this context is to maintain an industrial relations climate such that labour productivity can register rapid improvement. Thus 'productivity movement' or 'productivity revolution' is a key to improvement in the economic environment of developing countries.

4.2.2 Economic Development

onomic development' is a broader concept than 'economic growth'. As and when

the economies grow in terms of national and per capita income levels, certain structural changes accompany the process of growth. Conceptually. the trends in incomes and the structural changes together constitute economic development.

The structural changes which are quite fundamental in character are inherent in the process of economic growth. The upward trend in per capita real income (that is, economic growth) implies, given the labour force participation rate, a rise in product per worker or labour productivity. An increase in labour productivity cannont result without capital accumulation and fundamental changes in the production function (functional relationship between flows of output and corresponding flows of inputs) of the economy. A progressive shifts in the production function is the direct outcome of technological advancement, and science is the base of modern technology.

As science and technology advance, innovations (new products, new production processes and methods, new markets etc.) take place; inventions result and get spread. Such process of growth (scientific progress, invention and innovation) cannot be economically sustained for long unless it increases the productivity of labour. The inrease in the flow of material goodsend service must also be absorbed ; otherwise the process of growth gets obstructed by market limitation. In other words, the changes in production structure must be synhronised and balanced with the changes in the consumption structure. The structure of society's wants and preferences (in short, structure of demand) must change in such a way as to induce or assist changes in production and productivity and thereby .to accommodate the changes in science and technology. Similarly , the progressive development through science and technology cannot come about unless the society manages to generate capital formation (through savings and investments) and to finance research and development of science. The present day developing countries can supplement their scientific research efforts with science and technology transfer from more developed countries). Thus we find that during the process of economic growth, an economy experiences manifold changes in its structure: social, political and economic. For an understanding of the changing economic environment in a developing country, we may examine specifically the nature of some of the structural changes which are economic in character.

4.2.3 Structure of National Output

Studies of economic development of many present day "more developed countries" (a phrase suggested by Everett E.Hagen) like the U.S.A, the United Kingdom, and Japan suggest that a change in the *structure of national output* is a concomitant feature of economic growth. As an economy grows, on the one hand the level of national income increases, and on the other, composition of national income changes. The percentage contribution. of agriculture to gross domestic product declines and the contribution of industry and services to gross domestic product increases. This reflects positive income elasticity of demand for non-agriclultural output. This means that a given percentage increase in the income will result in higher percentage increase in demand for non-agricultural output. As the ratio of non-agricultural to agricultural output increases during the period of economic growth, labour productivity increases in both agricultural and non-agricultural sectors. The rate of growth of non- agricultural output is observed to be faster than that of non-agricoltral employment and therefore, the labour productivity (output per worker), is mining, manufacturing and services registers improvement during the process- of economic growth.

4.2.4 Structure of Employment

Economic growth is also associated with a change in the *structure of employment of people.* It is generally accepted that one of the structural changes that occur in the course of economic growth is a progressive shift of labour from agriculture and allied activities to secondary and tertiary sectors. Studies based on historical data of the

industrialised economies of the West have amply demonstrated the validity of this Fishr-Clark thesis. The shift in occupational pattern runs parallel to the shift in output pattern because the same factor - positive income elasticity of demand for non-primary goods and services-underlies the process of economic growth.

4.2.5 Structure of Investment and Capital Formation

A change in the structure of investment and capital formation is another development during the process of economic growth and development. With industrialisation and consequent urbanisation, the structure of industries changes. Capital and producer goods industries grow in importance, and consumer goods industries decline in relative importance. In developing countries (particularly those with planning) in the initial stage of development, resources are deliberately shifted from consumption goods to capital goods. Thus the investment structrure changes. The investment in human capital (education and health) and in social overhead capital (like irrigation, transport, etc.) increases very rapidly in the early stage of development when the infrastructure of development is laid strongly. Similarly, in the early stage of development, the dependence on foreign capital (aid, loans and grants) and foreign technology may also be very high. This means that the ratio of gross (and net) domestic capital formation to gross (and net) national capital formation is affected. The point is that different capital formation proportions reflect the nature and tempo of economic growth.

While on the subject of capital formation, we may refer to an important determinant of the rete of economic growth. This determinant is the capital-output ratio. We distinguish average capital-output ratio from marginal or incremental capital output ratio. Incremental Capital-Output Ratio (ICOR) is the additional capital required to increase output by one more unit. The following is the basic economic growth rate (g) equation.

$$g = \frac{\text{Rate of investment}}{\text{ICOR}}$$

In the above equation g is growth rate and ICOR is Incremental Capital-Output Ratio. In macro-economic planning process as well as micro-level management decisions, this ratio proves very useful. Consider, for example, the macro-economic planning process. If a planning agency wants to achieve an annual growth rate of 5% (growth rate of national income) and if the incremental capital output ratio is 4, then what should be the annual rate of investment? The above equation helps us in answering the question.

$$g = \frac{\text{Rate of investment}}{\text{ICOR}}$$

In our above example, g = 5% and ICOR = 4.

$$5\% = \frac{\text{Rate of investment}}{\text{ICOR}} = \frac{\text{Rate of investment}}{4}$$

Rearranging terms we get

Rate of investment = 5% x 4 = 20%

Changes in the capital - output ratio is a dimension of economic growth and development process.

4.2.6 Structure of Consumption

The upward trend in per capita income (economic growth in short) which initiates and accelerates changes in production, employment, factor proportion, skill and capital for-

mation directly brings about a change in the *structure of consumption.* As income changes, the pattern of income distribution (between regions, between sector and between persons) also changes. This is backed up by changes in relative price structure of the economy, the domestic terms of trade between agriculture and non-agriculture change. It is through the interaction of all these factors that the structure of consumption and the standard of living undergoes a fundamental change reflecting changes in social values, beliefs and consumer preferences.

Finally, with changes in the structure of employment, production, income distribution and consumption, there comes naturally a change in the structure of foreign trade. In the initial stage of development, an economy may have to import metals and machinery for modernisation and industrialisation. But as the industrialisation proceeds with economic growth the acceleration in the pattern of exports and imports change.

Structure of foreign trade, in short, changes (a separate block in this course is devoted to the external sector) as economy changes from primary commodity-exporting to export of manufactures.

In the next section we give an outline of the Indian economic growth experience. The remaining sections deal with major structural dimensions of India's economic development experience.

Activity 1

a) List the structural changes typical of economic development.

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....

b) If national income at current prices (Y) is Rs. 1,00,000 crores and general price index (P) is 250, find out national income at constant prices or real national income (Y)

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....

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....

c) If target growth rate is 6 per cent and ICOR is 3, find out the required rate of investment.

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Activity 2

Refer to the latest Economic Survey of the Government of India and formulate tables about (a) Net availability of cereals and pulses, (b) Net availability, procurement and public distribution of foodgrains, (c) Per Capita availability of important articles of consumption.

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4.3 INDIAN ECONOMIC GROWTH EXPERIENCE

In this section we present an overview of the Indian growth experience. The interest is to map the broad contours of the Indian growth experience for the period of little over four decades. This is to enable you to get a perspective on country's economic growth which has at the root of major structural changes in the economy

Over the period 1950-51 to 1990-91, the Net National Product (NNP) at factor cost at constant (1980-81) prices (real national income) recorded an average annual growth rate of 3.83 per cent, while per capita NNP growth rate was only 1.71 per cent. Thus during the period 1950-51 to 1990-91, the population recorded roughly a growth rate of 2.12 per cent. The per capita NNP at constant (1980-81) prices (real per capita income) increased from Rs. 1126.9 in 1950-51 to Rs.2198.6 in 1990-91. Thus during the 41 years period, the per capita income doubled itself approximately.

4.3.1 Growth Rate of NNP and NNP Per Capita

The growth rates of NNP and NNP per capita during different plan periods give an overview of the Indian growth experience. During the First Five Year Plan period (1951-56) the NNP in real terms grew at an annual compound rate of 3.36 per cent, while per capital income grew at 1.7 per cent. The performance of the economy during the Second Plan period significantly improved over the pervious Plan period. The growth rates of national income and per capita income were 3.9 per cent and 1.9 per cent respectively, higher than the first plan growth rates. The growth rates significantly fell during the Third Plan Period (1961-66). While the NNP grew at an average annual rate of 2.3 per cent, the NNP per capita grew at the rate of 0.1 per cent only. During the three annual plans (1966-69), income and per capita income growth rates picked up significantly. They were 3.7 per cent and 1.4 per cent respectively. During the Fourth plan (1969-74) the growth rates fell again. While the NNP growth rate was 3.3 per cent, the NNP per capita grew at the rate of 0.9 per cent. The growth rates improved significantly duting the Fifth Plan period (1974-79). The NNP during the Plan period grew at an annual compound rate of 4.9 per cent, while per capita NNP grew at 2.6 per cent. During the annual paln 1979-80 both NNP and per capita NNP recorded negative growth rates. The growth rates were -6.0 per cent and- 8.2 respectively. During the Sixth Plan (1980-85) period the growth rates were significantly high. The NNP and NNP per capita grew at annual compound rates of 5.4 per cent and 3.2 per cent respectively. Growth rates slightly increased during the subsequent Seventh Plan (1985-90) period. They were 5.6 per cent and 3.3 per cent respectively. In 1990-91 NNP at constant (1980-81) prices grew at 5.1 per cent, per capita income growth rate being 3.0 per cent. In the subsequent four years percentage income growth rates were -0.1,4.9,4.2 and 6.7, per capita percentage income growth during the same four years were -2.1,2.9,2.3,4.8. Thus by 1994-95, the latest year for which provisional data are available, growth rates significantly picked up and exceeded the average for the 1980s decade.

4.3.2 Income and Per Capita Rate

The above account shows that both income and per capita income growth rates fluctuat-

ed significantly. Several factors explain fluctuations in respect of growth experience during the last four and half decades. Fluctuations in weather conditions (alternating droughts and floods and periodic unfavaourable monsoons), unfavourable increase in capital- output ratio (aggregate), balance of payments problems and the consequent foreign exchange crises, wars with China and Pakistan dislocating the development efforts, international transmission of inflation through foreign trade, exogenous shocks such as oil price hikes during early part of 1970s and later, and the structural imbalances which have developed in the economy as development proceeded were some of the major factors to be noted in this connection.

While one can discern several dimensions of economic progress of the Indian economy in the post-independence period, the rate of economic growth has not been adequate enough to take care of the twin problems of unemployment and poverty. Added to this are the problems of growing inequalities in income distribution and in regional development. India's per capita income is very low relative to per capita income of more developed countries like the USA. For example, in 1992, India's per capita income was US $ 310, while that of the United States was $ 23240.

Despite low growth rate and low level of per capita income, India today has one of the most diversified industrial structures in the world.

In the remaining sections of this unit we examine the structural changes in the economy.

Activity 3

a) List the structural features of India today as a low income economy. Collect relevant data from Table 4.1 and others (Appendix 1) to substantiate each of your point.

Structural Features	Supporting data
....	....
....	....
....	....
....	....

b) From Table 4.2 (Appendix-1) identify the high growth decade and explain the reasons for high growth rates during that decade.

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4.4 BASIC STRUCTURAL CHANGES IN THE ECONOMY

Economic growth has brought about a structural change (change in sectoral shares of the national income) in the economy. This is evident in the form of a shift in the sectoral composition of production (income), diversification of activities and a gradual transformation of a feudal and Colonial economy into a modern industrial economy. The composition of gross domestic product has changed steadily during the planning era.

4.41 Historical Overview

While the share of agriculture and allied activities fell from 54.91 per cent during the First Plan period to 32.82 per cent during the Seventh Plan period, the share of manufacturing increased from 11.88 per cent during the First Plan period to 20 per cent during the Seventh Plan period. The share of tertiary or service sector increased from 28.32 per cent to 38.85 per cent. The expansion of service sector has not only been conducive for employment generation but also for better efficiency of the system and better quality of life.

Thus significant structural changes have taken place in the Indian economy during the period 1951-90 when we go by sectoral distribution of national income. Thus by income criterion structural change in the Indian economy has been very significant.

Now let us consider structural change by employment criterion. It is generally accepted (as we noted before) that one of the structural changes that occur in the course of economic development is a progressive shift of labour from agriculture and allied activities to secondary and tertiary sectors. Studies based on historical data have amply demonstratedthe validity of this Fisher-Clark thesis.

While this broad trend in sectoral reallocation of labour as development proceeded is thus firmly established, the interesting fact about these structrual shifts in economic activity for our purpose is not so much the ultimate decline in the improtance of agriculture (in relative terms) as the rate at which it occurred. To quote Paul Bairoch, " the proportion of acitve persons in agriculture diminished at a rate of less than 0.4 per cent a year till 1860, about 0.9 percent from 1860 to 1950, but at 4 per cent from 1950 to 1970. The changes in the redistribution of the active population in Western developed countries have thus been more improtant in the last twenty years."

4.4.2 Indian Experience

The above historical experience tells us that the sectoral redistribution of the active population is a time-tak in process. Unlike structural change based on income criterion, structural change based on employment is a slow process. This is demonstrated by the Indian experience also.

Table 4.4 of the Appendix gives trends in occupational structure of active population (work-force). The workforce engaged in primary sector (agriculture, livestock, forestry, fishing, hunting, plantations, etc.) decreased from 71.7 per cent in 1901 to 68.8 per cent in 1981. This percentage further declined to 66.75 per cent by 1991. If we take agriculture alone in the primary sector, the decline between 1901 and 1981 was from 66.6 per cent 66.50. By 1991 this percentage was 64.85. That is if we go by employment criterion structural chage in the Indian economy has not been significant.

The share of secondary sector (mining and quarrying, manufacturing, and construction increased from 12.6 per cent in 1901 to 13.5 per cent in 1981. The percentage was 12.75 by 1991.

The share of tertiary sector (trade and commerce, transport, storage and communications and allied services) increased from 15.7 per cent in 1901 to 17.7 per cent in 1981 The percentage was 20.50 by 1991.

4.4.3 Two Structral Features

Two structural features of the Indian economy emerge clearly from the above account:

1) Agiculture continues to be important in the Indian economy. A little more than 30 per cent of national income originates in the agricultural sector.

2) There is only slight structural change in the economy if we go by the employment

criterion. Agriculture still accounted for more than 65 per cent of workforce in early 1990s.

The underdeveloped nature of the Indian economy becomes evident when we compare the employment structure of the Indian economy with that of a more developed country U.S.A. Agriculture in USA in 1986 accounted for only 7 per cent of total workforce. The industrial sector and tertiary sector accounted for 36 per cent and 57 per cent respectively

In the remaining two sections of this unit we will consider some more structural dimensions of the Indian economy: Structure and changes in foreign trade are separately dealt within the Block dealing with "External Sector".

Activity 4

a) Take the latest Economic Survey an update Table 4.2 in the Appendix.

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b) List some reasons for the slow growth of non-agricultural employment in the Indian economy.

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4.5 INDIA'S SAVING AND INVESTMENT : TRENDS AND COMPONENTS

Given the supply of labour force and its annual rate of growth, economic growth is primarily a matter of rate of capital accumulation and resource productivity improvements. Capital accumulation in different sectors of a national economy takes place through investments in thoses sectors. To finance investment, saving from current income is necessary. Further a well developed financial system is necessary for mobilising savings from net surplus units in order to lend to the net deficit units largely to finance their investment activtity. Financial intermediation is the core function of the financial system.

4.5.1 Savings Rates

In our country, the saving rate (net domestic saving as percentage or NNP at current prices) was a mere 6.2 per cent in 1950-51. In the same year, the household sector accounted for Rs. 441.3 crores of the total net domestic savings of Rs.572.2 crores or in percentage terms for 77.1 per cent of the total net domestic saving. Of the total household saving of Rs 441.3 crores, about 96 per cent was held in the form of physical assets and about only 4 per cent was held in the form of financial assets. This is one aggregative indicator of economic underdevelopment, on the one hand, and financial underdevelopment on the other, of the country at that time.

But during the last four decades the country has experienced significant economic and financial development. The saving rate has been recording significant improvements. From 6.2 per cent in 1950-51, it rose to 9.3 per cent by 1960-61. By 1990-91 it further rose to 14 per cent. By 1993-94 it stood at 15.3 per cent.

Households, private corporate sector (including cooperatives) and public sector are three sources of saving. Let us see. What has been the trend in respect of the relative contributions to national saving of these sources? In 1960-61 , household sector accounted for 74.4 per cent of the total net domestic saving. Next in importance was the private corporate sector (including cooperatives) which accounted for 13.5 per cent of net domestic saving and public sector accounted for the remaining 12.2 per cent of the net domestic saving. By 1989-90 the picture has changed significantly. Household sector accounted for 122.3 per cent of the net domestic saving. The saving rate of the corporate sector fell significantly and was at the level of about 2.9 per cent. Public sector saving turned negative and stood at - 25.2 per cent of the net domestic saving. Thus the household sector (which includes apart from individuals, all nongovernment, non-corporate enterprises) accounts for most of the savings in the economy. The dissaving of public sector was increasing from year to year during the 1980s decade.

Household savings take broadly two forms. One is the form of physical assets. Savings in the form of physical assets comprise additions to construction' machines' and equipment and inventories. Savings in the form of financial assets comprises of currency, deposits with banks and with corporate enterprises, provident/ pension funds, claims on government, insurance and compulsory deposits. In 1960-61 financial assets accounted for 33.5 per cent of the gross savings of the household sector. The remaining 66.5 per cent savings were in the form of physical assets. By 1989-90 the saving in the form fo financial assets substantially rose and accounted for 51.3 per cent, the ramaining 48.7 per cent being accounted for by saving in the form of physical assests. Thus there took place signigicant financial development during the three decades.

4.5.2. Financial - Asset Structure of the Household Sector

Let us now look at changes in the financial asset structure of the household sector. The significant changes in the composition of assets of the household sector indicate rapid strides made by the financial system of the country. The currency component decreased in relative improtance as its share in the total gross saving decreased from 31.8 per cent in 1960-61 to 17.8 per cent in 1987-88. The important of deposits in the portfolios of household sector increased substantially during the period from 2.4 per cent in 1960-61 to 27.9 per cent in 1987-88. The phenomenal growth of banking facilities and other financial intermediation and spread of banking habit among households becomes evident from this. There is still an utapped potential in respect of government securities, investments in UTI (Unit Trust of India) and life insurance business. Evolving an appropriate structure of interest rates and through LIC rationalising its premium structure which helps in boosting its business, the potential can be realised.

Savings when invested results in capital formation. The share of the commodity sector (agriculture, forestry and fishing etc., and mining and manufacturing, construction. electricity and water supply) in gross domestic capital formation improved from 56 per cent in 1980-81 to about 60 per cent in 1989-90 and that of the non-commodity sectot (services) declined from about 44 per cent to 40 per cent during the same period. Within the commodity sector, the share of mining and manufacturing significantly rose during the period fro 37.5 per cent to 48.5 per cent. This is an indicator of the growing importance of mining and manufacturing in gross domestic capital formation.

4.5.3 Gross Domestic Capital Formation

Gross Domestic Capital Formation (GDCF) is classified on the basis of type of assret

into two commponents- (a) Gross Fixed Capital Formation (GFCF) and (b) changes in stocks or inventories. The share of the former improved from about 84 per cent in 1950-51 to 92 percent in 1990-91. This was a healthy trend because it indicated that inventory accumulation was low.

Gross Domestic Capital Formation as a percentage or Gross domestic product increased from about 81 per cent in 1960-61 to about 23 per cent in 1990-91. This shows significant improvement in investment effort. As for the division of GDCF between public sector and private-sector, in 1990-91 the percentages were 37.5 and 62.5.

The economic growth rate has not been commensurate with the rate of investment. Among many reasons for this (such as under-utiliation of productive capacity, inefficiency in resource use, etc). rising capital- output retio has been one (Table 4.7in the Appendix). The ICOR (Incremental Capital-output Ratio) rose form about 2.95 during 1951-52 to 1955-56 to 4.36 during1985-86 to 1991-92.

Activity 5

a) Read again what we have discussed in this unit so far and list the growth factors below:

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b) From the relevant Table (in the Appendix) indicate out the trend in fiancial assets of the household sector.

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c) List the financial assets and indicate the differences among them from risk and return point of trend.

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4.6 INDIA'S MONETARY AND PRICE TRENDS

A serious concern for the Indian economy since the middle of the Second Plan period has been the upward in the general price level. The price trends are related to, among others, the trends in money supply and government budget deficits. The imbalence between demand for and supply of wage goods, particularly food, triggered the price rise in early the (price rise in early) 1960s and several other factors have made inflation a persistent feature of the Indian economy.

4.6.1 Money Supply

Money supply has increased rapidly and regularly. The money supply with the public (currency plus demand depoits, plus other deposits with RBI, referred to as M_1 in RBI pubications) during the 21 year period 1970-71 to 1991-92 increased at the annual average rate of 17.7 per cent. In only one year (1977-78) it regitered a fall from Rs. 15609 crores to Rs.14388 crores. In all othr years, M_1 registered positive growth rates. One interesting fact is that while the average annual growth rate of M_1 during the 19 year period 1970-71 to 1987-88 was 13.12 per cent during the subsequent four year period from 1988-89 to 1991-92 it was 18.5 per cent. Thus, prior to the severe economic crisis in 1991, M_1 was growing at a significantly high rate, higher than the average for the period 1970-71 to 1987-88.

M_3 is defined as M_1 plus time deposits. M_3 grew at an average annual rate of 20.8 per cent durig the period 1970-71 to 1991-92. The high growth rate observable in respect of M_3 is largely accounted for by the growth rate in time deposits.

4.6.2 Growth Rate : Principal Factors

Money supply growth rate has been an important factor behind the Indian inflation experience. The three principal factors responsible for the expansion of money supply are :

a) Bank credit to commercial sector, b)Bank credit to government and (c) net foreign exchange assets of the banking sector.

Infaltion rate based on Whosesale Price Index (WPI) averaged 9 per cent during the period 1970-71 to 1991-92. It reached high level during the two years 1973-74 (20.2 per cent) and 1974-75 (23.2 Per cent).

Inflation rate based on Consumer Price Index (CPI) numbers (urban non- manual employees) averaged about 9 per cent reaching the highest level of 22.2 per cent in 1974-75. Besides the government deficits and the consequent money supply growth rate, several structural and institutional factors have been at the root of inflationary rise in prices in India beginning from mid -1950s at a slow rate, accelerating from mid- 1960s and recording considerably high rates during the first half of 1970s. The following factors have been responsible for inflation :

- The very plan strategy adopted for accelerating development and the consequent trends in the composition of domestic output and foreign trade with adverse influence on domestic output and foreign trade with adverse influence on domestic price level
- Closely related to the above is the forced pace of structural change with little regard for sectoral balance and price stability
- Role of expectations emanting from inflationany psychology.
- Plethora of Controls inspired by ideological fixation with no firm economic basis and ineffectiveness in operating them leading to the growth of parallel economy making monetary and fiscal measures almost ineffective.
- Ineffective institutional measures for redistribution of wealth and income.
- Inflationary nature of the role of distribute trade prompted by the seller's market conditions.
- Exogenous shocks such as wars oil price hikes.
- International transmission of inflationary pressures.

In the Block dealing with "Economic reforms since1991," you will learn about the" New

Economic Policy to tackle with the problems of Indian economy, including the problem of inflation.

4.7 OTHER STRUCTURAL DIMENSIONS

Some of the other strucftural dimensions of the Indian economy are :

1) As for the tax structure, heavy reliance on indirect taxes and declining importance of direct taxes, such as income tax, have been resulting in adverse consequences so far as the objectives such as price stability and reduction in inequalities in income and wealth distribution are concerned.

2) Growth in non-developmental government expenditure has been a significant factor in several economic ills facing the economy.

3) Heavy reliance on debt financing of government expenditure has been another feature of the Indian fiscal system.

4) Rapid population growth largely because of fast decline in death rate and very slow decline in birth rate is another feature of the country with adverse consequences.

Remember, from the standpoint of analysis of business environment, it isimportant for you to gain mastery over the structural dimensions we have examined in this unit.

Activity 6

a) As a student of management, how would you look at the problem of inflation. List 3 causes.

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b) Refer to *RBI Bulletin* (a monthly publication) and clearly explain M_1 and M_3

M_1 ....

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M_3 ....

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c) What is the importance of consumer price index ?
Answer in three to four sentences.

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d) With the help of the relevant Tables (in Appendix 1) answer the following questions:

i) What are the major sources of Central Government revenue ?

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ii) What are the major items of Central Government expenditure ? Compare the trend in "development" with that of "non-development" expenditure.

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iii) Explain briefly.

(i) Deficit financing

(ii) Indirect taxation

(iii) Public debt (internal)

e) Refer to C.S.O. *National Accounts Statistics* (for the latest year) and calculate growth rates in National output and consumption during the period 1991-1994.

Activity 7

Referring to Table 4.8 in the unit write a three page note on India's fiscal structure

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4.8 DEMOGRAPHIC TRENDS AND STRUCTURE

The main problem in India is the high level of birth rates of accompanying falling death rates. The rate of growth of population which was about 1.3 per cent per annum during 1941-50 rose to 2.1per cent durig 1981-91. The chief cause of the rapid growth of population was the steep fall in death rate from 49 per thouseand during 1911-20 to about 11 perthousand by the end of 1980s. But the birth rate declined from about 49 per thousand during 1911-20 to about 31 per thousand by the end of 1980s

The fast rate of growth of population, given the rate of growth of GNP implies lower pe capita GNP growth rate. For example, it GNP growth rate is 5 per cent per annum, anc population growth rate is 2 per cent, then per capital GNP growth rate is 3 per cent per annum. To maintain a rapidly growing population, the requirements of food, clothing,

shelter, medical and educational facilities and so on will be rising. Therfore a rapidly rising population imposes greater economic burdens and, consequently, the society has to make greater efforts to accelerate the process of economic growth. Moreover, rapidly rising population implies larger additions to labour force and higher dependency ratio. In 1990, for example, 36.9 per cent belonged to 0-14 age group, while 58.7 per cent belonged to age group of 15-64 in India's population. The rapid growth of labour force creates a higher supply of labour than demand for it leading to the problem of chronic unemployment.

One heartening feature is that over the last three decades there has been declining trend in population growth rates. During 1965-80 the average annual population growth was 2.3 per cent. In subsequent 1980-90 period, it declined to 2.1 per cent. With the government policies for population control and family welfare it is expected that by the end of this century population growth rate will come down to 2.7 per cent. But right now heavy population presure is causing severe hardships, particularly for the low income households.

As for the sex composition of population, the sex ratio (females per 1000 males) declined from 972 in 1901 to 926 in 1991. The explanation for a declining sex ratio lies in the poverty of the Indian people. In a country where even after more than 40 years of planned economic development nearly 35 per cent (the poverty estimates differ widely) of the population live below the poverty line, high infant mortality, extermely poor or non-existent medical facilities, extremely unhygienic conditions of living and absence of pre-natal and post-natal care, high death rate among women are all manifestations of an adject low level of living of the people. Preference for male children and attempts to avoid female children is rather a recent phenomenon which contributes to keeping sex ratio at the lower level.

Age structure of population is an important demographic dimension. As noted before, rapid population growth implies high dependency ratio. 0-14, and 60 and above, age groups constitute dependent population. In 1911, 0-14 age group constituted 38.8 per cent of population. In the same year 60 and above age group constituted 1.0 per cent of population. Together they constituted 39.8 per cent. By 1981, the first age group constituted 39.5 per cent of population and the letter age group constituted 6.4 per cent. Thus the percentage of dependent population increased from 39.8 per cent in 1911 to 45.9 per cent in 1981. A high proportion of children (0-14 age group) only reflects a large proportion of unproductive consumers. To reduce the percentage of non-productive consumers, it is essential to bring down the birth rate.

Rural-urban composition of population is an important demographic dimension, particularly from point of view of economic development. Along with economic development in general and industrialisation in particular the rural-urban composition of population has been changing in India. In 1901,89 per cent of Indian population was rural,. the remaining 11 per cent being the urban population. By 1991 the percentage of rural population declined to 74.3 per cent. while that of urban population increased to 25.7 per cent.

The quality of population can be judged from life expectancy, the level of literacy and the level of technical training attained by the people of a country. In respect of all the three indicators India achieved significant progress although the country is still to go a long way in achieving the standards of more affluent countries. The literacy rate has gone up from 18.2 per cent in 1951 to 52.2 per cent in 1991. Life expectancy at birth has gone up from 41.2 per cent in 1951 to 60.8 per cent in the early 1990s.

Activity 8

From 1991 census data, determine

a) Sex ratio giving the details about sex composition of population.

b) Rural-urban composition of population.

c) Age distribution of population.

d) Choosing suitable diagrams (bar cha[illegible] [illegible]le diagrams etc.) represent the demographic profile of India according to 1[illegible] census.

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4.9 SUMMARY

In this unit, we talked about a conceptual framework to analyse and understand economic trends. We have exposed you to the *data environment* of the Indian economy. The trends and structural features indicated by way of data environment provide a basis for describing and analysing various economic problems of India. In this unit we have given a macro-view. In the subsequent units we go into the details of sectors and subsectors.

4.10 KEY WORDS

Economic Growth and Economic Development Economic growth means more output, while economic development implies both more output and changes in the technical and institutional arrangements by which it is prouduced and distributed. The trends in income and the structural changes together constitute economic development.

Structural Changes Changes in the composition of national output, changes in the occupational pattern of labour and so on are referred to as structural changes.

4.11 SELF-ASSESSMENT QUESTIONS

1 Distinguishing economic development from economic growth, explain the major structural changes experienced by the Indian economy.

2. Keeping in mind the concept of capital intensity (capital-labour ratio), explain why structural change by employment criterion is not significant.

3. What are the major factors in India's inflation problem?

4. After carefully going through this unit, give a brief account of economic environment of business in India.

5. "From the standpoint of analysis of business environment, a large size of population is both an asset and a liability" - Explain.

4.12 FURTHER READINGS

Economic Survey, Government of India (1996 and later issue)

Report on Currency and Finance of RBI (latest issue)

Dutt, Ruddar and Sundaram, K.P.M., *Indian Economy,* (latest edition) (Chapters 1-7)

Lakshmana Rao, V. *Essays on Indian Economy,* New Delhi : Ashish Publishing House,1994 (Relevant essays about trends in money supply and price level and India's development and growth experience).

Appendix 1 : List of Statistical Tables

Table 4.1	Selected Indicators, 1950-51 to 1994-95
Table 4.2	Annual Compound Growth Rates of NNP and Per Capita NNP
Table 4.3	Sectoral Distribution of Gross Domestic Product
Table 4.4	Occupational Classification of Workers, 1901-1991
Table 4.5 (A)	Saving Rate in India
Table 4.5 (B)	Gross Domestic Savings and Investment
Table 4.5 (C)	Net Domestic Savings and Investment
Table 4.6 (A)	Gross Domestic Savings and Gross Domestic Capital Formation (at current prices)
Table 4.6 (B)	Gross Domestic Savings and Gross Domestic Capital Formation (as per cent of GDP at current market prices)
Table 4.7	GDP Growth, rate of investment and ICOR
Table 4.8 (A)	Revenue Expenditure of Government of India
Table 4.8 (B)	Budgetary Position of Government of India
Table 4.9	Revenue Receipts of Government of India

Table 4.1 : Selected Indicators 1950-51 to 1994-95

	1950-51	1960-61	1970-71	1980-81	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95
1	2	3	4	5	6	7	8	9	10	11	12	13
ECONOMIC INDICATORS												
GDP at factor cost												
(1) At current prices (Rs. crore)	8979	15254	39708	122427	294851	352706	408662	477814	552768	630182	723103	854103 #
(2) At 1980-81 prices (Rs. crore)	42871	62904	90426	122427	170322	188461	201453	212263	213983	224887	236064	251010#
Per capita net national Product at (1980-81) prices (Rupees)	1127	1350	1520	1630	1901	2059	2157	2222	2175	2239	2292	2401#
Index of industrial production (Base 1980-81)	18.3@	36.2	65.3	100.0	166.4	180.9	196.4	212.6	213.9	218.9	232.0	251.9(P)
Index of agricultural production (Base triennium ending 1981-82)	46.2	68.8	85.9	102.1	115.3	140.0	143.0	148.4	145.5	151.5(P)	156.9(P)	164.1
Gross domestic capital formation as per cent of GDP	10.2	15.7	15.6	22.7	22.9	24.5	25.6	27.0	23.4	23.1	21.6	25.2#
Gross domestic savings (as per cent of GDP)	10.4	12.7	15.7	21.2	20.9	21.4	22.2	23.6	22.8	21.2	21.4	24.4#
OUTPUT												
(a) Foodgrains (million tonnes)	50.8	82.0	108.1	129.6	140.4	169.9	171.0	176.4	168.4	179.5	184.3(P)	191.1
(b) Finished Steel (million tonnes)	1.04	2.39	4.64	6.82	11.68	12.84	13.00	13.53	14.33	15.20	15.1	17.8
(c) Cement (million tonnes)	2.7	8.0	14.3	18.6	39.6	44.3	45.8	48.8	51.7	54.7	57.8	62.4
(d) Coal (including lignite) (million tonnes)	32.3	55.2	76.3	119.0	190.9	207.0	213.7	225.5	243.8	254.9	264.1	273.1
(e) Crude oil (million tonnes)	0.3	0.5	6.8	10.5	30.4	32.0	34.1	33.0	30.4	27.0	27.0	32.2
(f) Electricity generated (utilities only) (Billion KWH)	5.1	16.9	55.8	110.8	202.1	221.4	245.4	264.3	287.0	301.1	323.5	351.0
Wholesale price index (Base 1981-82)	16.9	19.6	35.5	91.1	143.6	154.3	165.7	182.7	207.8	228.7	247.8	274.7
Consumer price index (Base 1982 = 100)@@	17	21	38	81	149	163	173	193	219	240	258	279

(Contd.)

Table 4.1 (Contd.)

	1950-51	1960-61	1970-71	1980-81	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95
1	2	3	4	5	6	7	8	9	10	11	12	13
Plan outlay (Rs. crore)	260##	1117	2524	15023	44034	48645	55630	58369	64751	72852	88081	106204(RE)
Centre's budgetary deficit (Rs. crore)	(-)33##	(-)117	285	2576	5816	5642	10592	11347	6855	12312	10960	6000 (RE)
FOREIGN TRADE												
(i) Exports												
Rs. Crore	606	642	1535	6711	15674	20232	27658	32553	44041	53688	69751	82674
US $ million	1269	1346	2031	8486	12069	13970	16612	18143	17865	18537	22238	26330
(ii) imports												
Rs. crore	608	1122	1634	12549	22244	28235	35328	43198	47851	[illegible]3375	[illegible]3101	89971
US $ million	1273	2353	2162	15869	17156	19497	21219	24075	19411	21882	[illegible]3306	28654
Foreign exchange reserves (excluding gold and SDRs):												
Rs. crore	911	186	438	4822	7287	6605	5787	4388	14578	20140	47287	86006
US $ million	1914	390	584	5850	5818	4226	3368	2236	5631	6434	15068	20809
SOCIAL INDICATORS												
Population												
Population (million)[b]	361.1	439.2	548.2	683.3	795.1	811.3	827.4	846.2	862.5	878.6	894.6*	910.7*
Birth rate (per 1000)[c]	39.9	41.7	41.2	37.2	31.5	30.6	30.2	29.5	29.2	28.	28.6P	..
Death rate (per 1000)[d]	27.4	22.8	19.0	15.0	11.0	10.3	9.7	9.8	10.1	9.3	9.2P	..
Life expectancy at birth (in years)												
(a) Male	32.4	41.9	46.4	50.9		57.7	58.1	58.6	..	60.4	..	..
(b) Female	31.7	40.6	44.7	50.0		58.1	58.6	59.0	..	61.2	..	..
Total	32.1	41.3	45.6	50.4		57.7	58.3	58.7	..	60.8	..	..

(Contd.)

Table 4.1 (Contd.)

	1950-51	1960-61	1970-71	1980-81	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95
1	2	3	4	5	6	7	8	9	10	11	12	13
EDUCATION												
Literacy rate (percentage)[e]												
(a) Male	27.16	40.40	45.95	56.37	..	..	..	64.1	..	..	..	
(b) Female	8.86	15.34	21.97	29.75	..	..	..	39.3	..	..	..	..
Total	18.33	28.31	34.45	43.56	..	..	..	52.2	..	..	..	..
HEALTH & FAMILY WELFARE[f]												
Registered medical practitioners (RMP) (thousands)	61.8	83.7	151.1	268.7	335.6	368.6	381.9	394.0	410.8		..	..
RMP per 10,000 population	1.7	1.9	2.8	3.9	4.4	4.5	4.6	4.7	4.8		..	
Beds (all types)** per 10,000	3.2	5.2	6.4	8.3	9.2	9.5	9.4	9.6	..		..	..

@ Relates to the calender year 1950.
@@ Figures for the period up to 1988-89 derived by converting indices on earlier bases into base 1982=100
\# Quick estimates.
\## Relates to 1951-52
* Figures for the period up to 1980-81 derived by converting the indices on earlier bases into base 1980-81=100
** Includes beds in hospitals, dispensaries, P.H.Cs, clinics, sanatoriums, etc.
RE Revised estimates
.. Not available
P Provisional.

Notes :

- a As on March 1, 1951 and so on up to 1980-81and 1990 to 91 as per Census of India. Figures for the period 1987 to 1990 are based on adjusted projections of the Standing Committee of Experts on Population Projections.
- b Relate to March 1. 1992, 1993, 1994 and 1995 based on annual series of the Standing Committee of Experts on population projections and adjusted to confirm to 1991 census data.
- c Data for 1950-51, 1960-61, 1970-71 and 1980-81 are census estimates and relate decades 1941-50, 1951-60, 1961-70 and 1971-80 respectively. The estimates for 1987-88 onwards are based on the SRS
- d Data for 1950-51, 1960-61, 1970-71 and 1980-81 relate to the decades 1941-50, 1951-60, 1961-70 and 1971-80 respectively, centred at mid-point of the decade, i.e. 1946, 1956, 1966 and 1976 The estimates for 1988-89, 1989-90 and 1990-91 refer to the periods, 1986-90, 1987-91 and 1988-92 respectively. For 1992-93, it is based on the extrapolated values of the Standing Committee of Experts on Population Projections centred at 1992.
- e Data for 1950-51, 1960-61, 1970-71, 1980-81 and 1990-91 relate to the years 1951, 1961, 1971, 1981 and 1991 respectively. The figures for 1951, 1961 and 1971 relate to population aged 5 years and above and those for 1981 and 1991 relate to population aged 7-years and above. All India literacy rates exclude Assam for 1981 and J&K for 1991.
- f Relate to calender year e.g., 1950-51 pertains to December 1951 and so on.

Table 4.2 : Annual Compound Growth Rates (%) of NNP at Factor cost at constant (1980-81) Prices and NNP Per Capita

Plan Period/Year		NNP at Factor Cost	NNP per capita
First Plan	(1951-56)	3.6	1.7
Second Plan	(1956-61)	3.9	1.9
Third Plan	(1961-66)	2.3	0.1
Three Annual Plan	(1966-69)	3.7	1.4
Fourth Plan	(1969-74)	3.3	0.9
Fifth Plan	(1974-79)	4.9	2.6
Annual Plan	(1979-80)	(-) 6.0	(-) 8.2
Sixth Plan	(1980-85)	5.4	3.2
Seventh Plan	(1985-90)	5.6	3.3
	1990-91	5.1	3.0
	1991-92	(-) 0.1	(-) 2.1
	1992-93	4.9	2.9
	1993-94	4.2	2.3
	1994-95	6.7	4.8

Source : *Economic Survey*

Table 4.3 : Sectoral Distribution of Gross Domestic Product

Sl. No.	Sector	1951-52 to 1955-56	1956-57 to 1960-61	1961-62 to 1965-66	1966-67 to 1970-71	1971-72 to 1975-76	1976-77 to 1980-81	1981-82 to 1985-86	1985-86 to 1989-90
1.	Primary Sector	56.06	53.04	48.00	45.21	43.42	40.21	38.17	34.58
2.	Secondary Sector	15.63	17.89	21.12	22.6	23.02	24.55	25.33	26.57
3.	Tertiary Sector	28.32	29.08	30.87	32.19	33.55	35.25	36.49	38.85
4.	Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source : Eighth Five Year Plan (1992-97) Vol. I, Government of India.

Table 4.4 : Occupational Classification of Workers, 1901-1991

(Per cent)

		1901	1951	1981	1991
A.	Primary Sector (1+2+3)	71.7	72.1	68.8	66.75
	1. Cultivators	50.6	50.0	41.6	38.41
	2. Agrl. Labourers	16.0	19.7	24.9	26.44
	3. Livestock, Forestry, fishing, hunting, plantations etc.	4.2	2.4	2.3	1.90
B.	Secondary Sector (4+5+6)	12.6	10.7	13.5	12.75
	4. Mining and Quarrying	0.1	0.6	0.6	0.62
	5. Manufacturing	11.7	9.0	11.3	10.18
	(i) Household industry				2.42
	(ii) Other than household industry				7.76
	6. Construction	0.8	1.1	1.6	1.95
C.	Tertiary Sector (7+8+9)	15.7	17.2	17.7	20.50
	7. Trade and Commerce	6.1	5.2	6.2	7.46
	8. Transport etc	1.1	1.5	2.7	2.81
	9. Other services	8.5	10.6	8.8	10.23
	Total	100.00	100.00	100.00	100.00

Source : Population Census.

Table 4.5(A) : Saving Rate in India

(Rs. Crores)

Year	Net Domestic Saving	NNP at factor cost	Saving rate (2. as % of 3.)
1	2	3	4
1960-61	1327	14242	9.3
1970-71	4566	36503	12.5
1975-76	10800	64623	16.7
1980-81	16686	110685	15.1
1985-86	27444	206133	93.3
1990-91*	58455	413943	14.1

* Provisional

Source : GOI, *Economic Survey* 1992-93

RBI, *Reprot on Currency and Finance*, for different years.

Table 4.5(B): National Income and Savings Gross Domestic Savings and Investment (At Current Prices)

(Rs. Crore)

Item	1980-81	1985-86	1987-88	1988-89P	1989-90P	1990-91P	1991-92P	1992-93P	1993-94*
1	2	3	4	5	6	7	8	9	10
1. Household Sector	21,847	35,920	58,734	69,851	86,035	1,07,815	1,20,062	1,20,552	1,57,349
(a)	16.1	13.7	17.6	17.7	18.8	20.2	19.5	17.1	19.6
Of which :									
i) Net Financial Assets	8,609	18,578	26,820	27,132	37,237	16,329	61,991	54,933	81,044
(a)	6.3	7.1	8.0	6.9	8.2	8.7	10.1	7.8	10.1
ii) Physical Assets	13,238	17,342	31,914	42,719	48,798	61,486	58,071	65,619	76,305
(a)	9.7	6.6	9.6	10.8	10.7	11.5	9.4	9.3	9.5
2. Public Sector	4,654	8,457	7,223	8,101	7,423	5,102	10,740	14,978	10,254
(a)	3.4	3.2	2.2	2.0	1.6	1.0	1.7	2.1	1.3
3. Private Corporate Sector	2,284	5,318	5,790	8,731	11,924	14,379	18,413	23,010	26,566
(a)	1.7	2.0	1.7	2.2	2.6	2.7	3.0	3.3	3.3
4. Gross Domestic Saving (1+2+3)	28,785	49,695	71,747	86,683	1,05,382	1,27,296	1,49,215	1,58,540	1,94,169
(a)	21.2	19.0	21.5	21.9	23.1	23.9	24.2	22.5	24.2
5. Net Inflow of Foreign Resources	2,253	5,655	7,773	12,101	12,791	17,960	3,679	14,062	2,149
(a)	1.7	2.2	2.3	3.1	2.8	3.4	0.6	2.0	0.3
6. Aggregate Investment (4+5)	31,038	55,350	79,520	98,784	1,18,173	1,45,256	1,52,894	1,72,602	1,96,318
(a)	22.8	21.1	23.9	25.0	25.9	27.2	24.8	24.5	24.4
7. Gross Domestic Product (GDP) at Current Market Prices	1,36,013	2,62,343	3,33,201	3,95,779	4,56,820	5,33,324	6,15,655	7,85,566	8,83,632

Note : (1) The estimates presented here may differ from those presented in the Reserve Bank's Annual Report 1993-94 as the same have been revised in the light of fresh data.

(2) There may be slight differences in the calculation of Saving (and Investment) Rates because of rounding off.

P Provisional * Tentative Estimates (a) Percentage to GDP at Current Market Prices.

Table 4.5(C) : Net Domestic Savings and Investment
(At Current Prices)

Item	1980-81	1985-86	1987-88	1988-89P	1989-90P	1990-91P	1991-92P	1992-93P	1993-94*
1	2	3	4	5	6	7	8	9	10
1. Household Sector	16,355	25,002	45,313	54,527	69,187	88,722	97,496	95,331	1,28,920
(a)	13.2	10.6	15.1	15.3	16.8	18.4	17.6	15.0	17.9
Of which :									
i) Financial Assets (Net)	8,609	18,578	26,820	27,132	37,237	46,329	61,991	54,933	81,044
(a)	6.9	7.9	8.9	7.6	9.0	9.6	11.2	8.7	11.3
ii) Physical Assets	7,746	6,424	18,493	27,395	31,950	42,393	35,505	40,398	47,876
(a)	6.3	2.7	6.2	7.7	7.8	8.8	6.4	6.4	6.7
2. Public Sector	-241	-2,931	-7,705	-9,452	-13,441	-13,683	-18,060	-18,184	-28,499
(a)	-0.2	-1.2	-2.6	-2.6	-3.3	[illegible]	-3.3	-2.9	-4.0
3. Private Corporate Sector	584	1,348	-312	1,284	3,230	5,173	5,427	7,426	9,554
(a)	0.5	0.6	-0.1	0.4	0.8	1.1	1.0	1.2	1.4
4. Net Domestic Saving (1+2+3)	16,698	23,419	37,296	46,359	58,976	75,212	84,863	84,573	1,18,275
(a)	13.5	9.9	12.4	13.0	14.3	15.6	15.3	13.3	15.3
5. Net Inflow of Foreign Resources	2,253	5,655	7,773	12,101	12,791	17,960	3,679	14,062	2,149
(a)	1.8	2.4	2.6	3.4	3.1	3.7	0.7	2.2	0.3
6. Aggregate Investment (4+5)	18,951	29,074	45,069	58,460	71,767	93,172	88,542	98,635	1,12,424
(a)	15.3	12.3	15.0	16.4	17.4	19.3	16.0	15.6	15.6
7. Net Domestic Product (NDP) at Current Market Prices	1,23,926	2,36,096	2,99,860	3,56,858	4,11,821	4,81,760	5,53,380	6,33,997	7,19,738

Note : (1) The estimates presented here may differ from those presented in the Reserve Bank's Annual Report 1993-94 as the same have been revised in the light of fresh data.

(2) There may be slight differences in the calculation of Saving (and Investment) Rates because of rounding off.

P Provisional   * Tentative Estimates   (a) Percentage To NDP at Current Market Prices.

Table 4.6 (A): Gross Domestic Savings and Gross Domestic Capital Formation

(At current prices)

(Rs. Crore)

	Gross domestic savings				Gross fixed capital formation			Change in stocks			Gross domestic capital formation					Gross domestic	
	House hold sector	Private corporate sector	Public sector	Total (2+3+4)	Public sector	Private sector	Total (6+7)	Public sector	Private sector	Total (9+10)	Public sector	Private sector	Total (12+13)	Errors & omissions	Adjusted total (14+15)	product at market prices	Year
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1950-51	718	89	168	975	224	650	874	35	125	160	259	775	1034	-80	954	9366	1950-51
1951-52	621	132	252	1005	262	702	964	41	157	198	303	859	1162	26	1188	9966	1951-52
1952-53	601	60	145	806	281	605	886	-25	-2	-27	256	603	859	-87	772	9774	1952-53
1953-54	709	86	127	922	327	566	893	-35	6	-29	292	572	864	45	909	13638	1953-54
1954-55	789	114	151	1054	394	627	1021	42	25	67	436	652	1088	-18	1070	10073	1954-55
1955-56	1128	130	172	1430	533	750	1283	-34	167	133	499	917	1416	53	1469	10258	1955-56
1956-57	1217	151	231	1599	615	1006	1621	51	219	270	666	1225	1891	68	1959	12217	1956-57
1957-58	1008	117	245	1370	643	1049	1692	190	58	248	833	1107	1940	-97	1843	125[illegible]	1957-58
1958-59	1046	136	227	1409	701	1006	1707	114	-84	30	815	922	1737	48	1785	140[illegible]	1958-59
1959-60	1349	180	236	1765	884	986	1870	16	228	244	900	1214	2114	-118	1996	14[illegible]3	1959-60
1960-61	1362	276	425	2063	1055	1101	2156	87	340	427	1142	1441	2583	-39	2544	162[illegible]1	1960-61
1961-62	1284	315	494	2093	1107	1303	2410	40	230	270	1147	1533	2680	-242	2438	1717[illegible]	1961-62
1962-63	1572	338	566	2476	1312	1352	2664	133	254	387	1445	1606	3051	-135	2916	18476	1962-63
1963-64	1730	387	709	2826	1562	1587	3149	119	261	380	1681	1848	3529	-263	3266	21237	1963-64
1964-65	1937	381	817	3135	1824	1835	3659	124	286	410	1948	2121	4069	-334	3735	24765	1964-65
1965-66	2586	396	809	3791	2046	2086	4132	170	125	295	2216	2211	4427	-37	4390	26145	1965-66
1966-67	3432	414	668	4514	2047	2554	4601	88	627	715	2135	3181	5316	121	5437	29571	1966-67
1967-68	3431	399	667	4497	2012	3072	5084	319	304	623	2331	3376	5707	-373	5334	34611	1967-68
1968-69	3412	427	858	4697	2111	3265	5376	56	108	164	2167	3373	5540	-427	5113	36674	1968-69
1969-70	4475	536	1033	6044	2190	3708	5898	69	509	578	2259	4217	6476	-191	6285	40387	1969-70
1970-71	4873	657	1253	6783	2394	3911	6305	414	660	1074	2808	4571	7379	-202	7177	43163	1970-71
1971-72	5477	753	1278	7508	2802	4282	7084	488	974	1462	3290	5256	8546	-560	7986	46257	1971-72
1972-73	[illegible]	788	1332	7833	3619	4511	8130	121	472	593	3740	4983	8723	-593	8130	51005	1972-73
1973-74	8562	1063	1807	11432	40[illegible]	5060	9069	742	1518	2260	4751	6578	11329	495	11824	62007	1973-74
1974-75	8610	1440	2676	12726	4272	[illegible]	11003	1285	2187	3472	5557	8918	14475	-1096	13379	73235	1974-75

(Contd.)

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Table 46 (A) (Contd.)

(Rs. Crore)

Year	Gross domestic savings: Household sector	Gross domestic savings: Private corporate sector	Gross domestic savings: Public sector	Gross domestic savings: Total (2+3+4)	Gross fixed capital formation: Public sector	Gross fixed capital formation: Private sector	Gross fixed capital formation: Total (6+7)	Change in stocks: Public sector	Change in stocks: Private sector	Change in stocks: Total (9+10)	Gross domestic capital formation: Public sector	Gross domestic capital formation: Private sector	Gross domestic capital formation: Total (12+13)	Gross domestic capital formation: Errors & omissions	Gross domestic capital formation: Adjusted total (14+15)	Gross domestic product at market prices	Year
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1975-76	10534	1055	3339	14928	5600	7730	13330	1983	1093	3076	7583	8823	16406	-1595	14811	78761	1975-76
1976-77	12698	1147	4185	18030	7048	8255	15303	1536	937	2473	8584	9192	17776	-1055	16721	84894	1976-77
1977-78	14686	1376	4168	20230	7697	9522	17219	149	1649	1798	7846	11171	19017	-252	18765	96067	1977-78
1978-79	17747	1611	4780	24138	8376	10500	18876	1507	2835	4342	9883	13335	23218	1048	24266	104190	1978-79
1979-80	17379	2352	4967	24698	9974	11333	21307	1844	2994	4838	11818	14327	26145	-867	25278	114356	1979-80
1980-81	21848	2284	4654	28786	11693	14583	26276	74	2103	2177	11767	16686	28453	2427	30880	136013	1980-81
1981-82	21847	2496	7254	31597	14598	16857	31455	2002	4494	6496	16600	21351	37951	-3743	34208	159760	1981-82
1982-83	23044	2908	7822	33774	18586	17183	35769	1127	3207	4334	19713	20390	40103	-3763	36340	178132	1982-83
1983-84	29341	3172	6781	39294	20450	19541	39991	337	3462	3799	20787	23003	43790	-1979	41811	207589	1983-84
1984-85	31705	3947	6526	42178	23396	22172	45568	1679	1765	3444	25075	23937	49012	-3542	45470	231343	1984-85
1985-86	38158	5318	8457	51933	27501	26754	54255	1916	7271	9187	29417	34025	63442	-5275	58167	262243	1985-86
1986-87	41587	5212	8002	54801	33254	28798	62052	888	4959	5847	34142	33757	67899	-6743	61156	292949	1986-87
1987-88	56618	5790	7223	69631	34571	37623	72194	-1512	4200	2688	33059	41823	74882	1574	76456	323201	1987-88
1988-89	68248	8319	8101	84668	39866	45803	85669	-501	11243	10742	39365	57046	96411	561	96972	395782	1988-89
1989-90	82466	11650	7423	101539	43862	58913	102775	1704	5716	7420	45566	64629	110195	3623	113818	456821	1989-90
1990-91	106276	14940	5436	126652	50176	73828	124004	1975	9177	11152	52151	83005	135156	9692	144848	535534	1990-91
1991-92	109269	19490	11888	140647	58737	77766	136503	2200	5765	3565	56537	83531	140068	3956	144024	616799	1991-92
1992-93	118704	19841	10820	149365	60[illegible]	98638	158738	2609	8201	10810	62709	106839	169548	-6367	163181	705328	1992-93
1993-94	139146	27666	4372	171184	67201	105045	172246	1548	-2785	-1237	68749	102260	171009	2322	173331	801032	1993-9
1994-95	178696	35966	15986	230648	81828	131236	213064	1417	4439	5856	83245	135675	218920	19490	238410	945615	1994

^Quick estimates.

Source: Central Statistical Organisation.

Table 4.6 (B): Gross Domestic Savings and Gross Domestic Capital Formation
(As per cent of GDP at current market prices)

Year	Gross domestic savings: Household sector	Gross domestic savings: Private corporate sector	Gross domestic savings: Public sector	Gross domestic savings: Total (2+3+4)	Gross fixed capital formation: Public sector	Gross fixed capital formation: Private sector	Gross fixed capital formation: Total (6+7)	Change in stocks: Public sector	Change in stocks: Private sector	Change in stocks: Total (9+10)	Gross domestic capital formation: Public sector	Gross domestic capital formation: Private sector	Gross domestic capital formation: Total (12+13)	Gross domestic capital formation: Errors & omissions	Gross domestic capital formation: Adjusted total (14+15)	Year
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1950-51	7.7	1.0	1.8	10.4	2.4	6.9	9.3	0.4	1.3	1.7	2.8	8.3	11.0	-0.9	10.2	1950-51
1951-52	6.2	1.3	2.5	10.1	2.6	7.0	9.7	0.4	1.6	2.0	3.0	8.6	11.7	0.3	11.9	1951-52
1952-53	6.1	0.6	1.5	8.2	2.9	6.2	9.1	-0.3	-0.0	-0.3	2.6	6.2	8.8	-0.9	7.9	1952-53
1953-54	5.2	0.6	0.9	6.8	2.4	4.2	6.5	-0.3	0.0	-0.2	2.1	4.2	6.3	0.3	6.7	1953-54
1954-55	7.8	1.1	1.5	10.5	3.9	6.2	10.1	0.4	0.2	0.7	4.3	6.5	10.8	-0.2	10.6	1954-55
1955-56	11.0	1.3	1.7	13.9	5.2	7.3	12.5	-0.3	1.6	1.3	4.9	8.9	13.8	0.5	14.3	1955-56
1956-57	10.0	1.2	1.9	13.1	5.0	8.2	13.3	0.4	1.8	2.2	5.5	10.0	15.5	0.6	16.0	1956-57
1957-58	8.0	0.9	1.9	10.9	5.1	8.3	13.4	1.5	0.5	2.0	6.6	8.8	15.4	0.8	14.6	1957-58
1958-59	7.5	1.0	1.6	10.0	5.0	7.2	12.2	0.8	-0.6	0.2	5.8	6.6	12.4	0.3	12.7	1958-59
1959-60	9.1	1.2	1.6	11.9	6.0	6.7	12.6	0.1	1.5	1.6	6.1	8.[illegible]	14.3	-0.8	13.5	1959-60
1960-61	8.4	1.7	2.6	12.7	6.5	6.8	13.3	0.5	2.1	2.6	7.0	8.9	15.9	-0.2	15.7	1960-61
1961-62	7.5	1.8	2.9	12.2	6.4	7.6	14.0	0.2	1.3	1.6	6.7	8.9	15.6	-1.4	14.2	1961-62
1962-63	8.5	1.8	3.1	13.4	7.1	7.3	14.4	0.7	1.4	2.1	7.8	8.7	16.5	-0.7	15.8	1962-6[illegible]
1963-64	8.1	1.8	3.3	[illegible]3.3	7.4	7.5	14.8	0.6	1.2	1.8	7.9	8.7	16.6	-1.2	15.4	1963-[illegible]
1964-65	7.8	1.5	3.3	12.7	7.4	7.4	14.8	0.5	1.2	1.7	7.9	8.6	16.4	-1.3	[illegible]	[illegible]964-[illegible]
1965-66	9.9	1.5	3.1	14.5	7.8	8.0	15.8	0.7	0.5	1.1	8.5	8.5	16.9	-0.1	[illegible].8	1965-[illegible]
1966-67	11.6	1.4	2.3	15.3	6.9	8.6	15.6	0.3	2.1	2.4	7.2	10.8	18.0	0.4	[illegible].4	1966-67
1967-68	9.9	1.2	1.9	13.0	5.8	8.9	14.7	0.9	0.9	1.8	6.7	9.8	16.5	-1.1	15.[illegible]	1967-68
1968-69	9.3	1.2	2.3	12.8	5.8	8.9	14.7	0.2	0.3	0.4	5.9	9.2	15.1	-1.2	13.[illegible]	1968-69
1969-70	11.1	1.3	2.6	15.0	5.4	9.2	14.6	0.2	1.3	1.4	5.6	10.4	16.0	-0.5	15.6	1969-70
1970-71	11.3	1.5	2.9	15.7	5.5	9.1	14.6	1.0	1.5	2.5	6.5	10.6	17.1	-0.5	16.6	1970-71
1971-72	11.8	1.6	2.8	16.2	6.1	9.3	15.3	1.1	2.1	3.2	7.1	11.4	18.5	-1.2	17.3	1971-72
1972-73	11.2	1.5	2.6	15.4	7.1	8.8	15.9	0.2	0.9	1.2	7.3	9.8	17.1	-1.2	15.9	1972-73
1973-74	13.8	1.7	2.9	18.4	6.5	8.2	14.6	1.2	2.4	3.6	7.7	10.6	18.3	0.8	19.1	1973-74

(Contd.)

Table 4.6 (B) (Contd.)

Year	Gross domestic saving				Gross fixed capital formation			Change in stocks			Gross domestic capital formation					Year
	House hold sector	Private corporate sector	Public sector	Total (2+3+4)	Public sector	Private sector	Total (6+7	Public sector	Private sector	Total (9+10)	Public sector	Private sector	Total (12+13)	Errors & omissions	Adjusted total (14+15)	
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1974-75	11.8	2.0	3.7	17.4	5.8	9.2	15.0	1.8	3.0	4.7	7.6	12.2	19.8	-1.5	18.3	1974-75
1975-76	13.4	1.3	4.2	19.0	7.1	9.8	16.9	2.5	1.4	3.9	9.6	11.2	20.8	-2.0	18.8	1975-76
1976-77	15.0	1.4	4.9	21.2	8.3	9.7	18.0	1.8	1.1	2.9	10.1	10.8	20.9	-1.2	19.7	1976-77
1977-78	15.3	1.4	4.3	21.1	8.0	9.9	17.9	0.2	1.7	1.9	8.2	11.6	19.8	-0.3	19.5	1977-78
1978-79	17.0	1.5	4.6	23.2	8.0	10.1	18.1	1.4	2.7	4.2	9.5	12.8	22.3	1.0	23.3	1978-79
1979-80	15.2	2.1	4.3	21.6	8.7	9.9	18.6	1.6	2.6	4.2	10.3	12.5	22.9	-0.8	22.1	1979-80
1980-81	16.1	1.7	3.4	21.2	8.6	10.7	19.3	0.1	1.5	1.6	8.7	12.3	20.9	1.8	22.7	1980-81
1981-82	13.7	1.6	4.5	19.8	9.1	10.6	19.7	1.3	2.8	4.1	10.4	13.4	23.8	-2.3	21.4	1981-82
1982-83	12.9	1.6	4.4	19.0	10.4	9.6	20.1	0.6	1.8	2.4	11.1	11.4	22.5	-2.1	20.4	1982-83
1983-84	14.1	1.5	3.3	18.9	9.9	9.4	19.3	0.2	1.7	1.8	10.0	11.1	21.1	-1.0	20.1	1983-84
1984-85	13.7	1.7	2.8	18.2	10.1	9.6	19.7	0.7	0.8	1.5	10.8	10.3	21.2	-1.5	19.7	1984-85
1985-86	14.6	2.0	3.2	19.8	10.5	10.2	20.7	0.7	2.8	3.5	11.2	13.0	24.2	-2.0	22.2	1985-86
1986-87	14.2	1.8	2.7	18.7	11.4	9.8	21.2	0.3	1.7	2.0	11.7	11.5	23.2	-2.3	20.9	1986-87
1987-88	17.0	1.7	2.2	20.9	10.4	11.3	21.7	-0.5	1.3	0.8	9.9	12.6	22.5	0.5	22.9	1987-88
1988-89	17.2	2.1	2.0	21.4	10.1	11.6	21.6	-0.1	2.8	2.7	9.9	14.4	24.4	0.1	24.5	1988-89
1989-90	18.[illegible]	2.6	1.6	22.2	9.6	12.9	22.5	0.4	1.3	1.6	10.0	14.1	24.1	0.8	24.9	1989-90
1990-91	19.8	2.8	1.0	23.6	9.4	13.8	23.2	0.4	1.7	2.1	9.7	15.5	25.2	1.8	27.0	1990-91
1991-92	17.7	3.2	1.9	22.8	9.5	12.6	22.1	-0.4	0.9	0.6	9.2	13.5	22.7	0.6	23.4	1991-92
1992-93	16.8	2.8	1.5	21.2	8.5	14.0	22.5	0.4	1.2	1.5	8.9	15.1	24.0	-0.9	23.1	1992-93
1993-94	17.4	3.5	0.5	21.4	8.4	13.1	21.5	0.2	-0.3	-0.2	8.6	12.8	21.3	0.3	21.6	1993-94
1994-95	18.9	3.8	1.7	24.4	8.7	13.9	22.5	0.1	0.5	0.6	8.8	14.3	23.2	2.1	25.2	1994-95

Note : (i) Based on Date in Table 1.

(ii) Ratios of savings and capital formation of individual sectors may not add to totals because of rounding off.

Source : Central Statistical Organisation.

Table 4.7 : GDP Growth, Rates of Investment and Incremental Capital-Output Ratio (ICOR) in Indian Economy (1951-90)

Sl. No.	Period	Growth in GDP at Factor cost	Investment Rate	ICOR
1.	1950-51 to 1955-56	3.61	10.66	2.95
2.	1956-57 to 1960-61	4.27	14.52	3.40
3.	1961-62 to 1965-66	2.84	15.45	5.44
4.	1966-67 to 1970-71	4.66	15.99	3.43
5.	1971-72 to 1975-76	3.08	17.87	5.80
6.	1976-77 to 1980-81	3.24	21.47	6.63
7.	1981-82 to 1985-86	5.06	20.98	4.15
8.	1985-86 to 1989-90	5.81	22.70	3.91
9.	1985-86 to 1991-92	5.31	23.17	4.36

Source : Eighth Five Year Plan, 1992-97, Vol. I, Government of India.

Table 4.8(A): Revenue Expenditure of Government of India

(Rs. crore)

Item	1980-81 (A/cs)	1985-86 (A/cs)	1990-91 (A/cs)	1991-92 (A/cs)	1992-93 (A/cs)	1993-94 *(R.E.)	1994-95 (B.E.)
1	2	3	4	5	6	7	8
1. Developmental expenditure (A to E)	**5,882**	**15,185**	**32,239**	**35,345**	**41,448**	**48,693**	**47,395**
A. Social and community services (1 to 5)	**877**	**1,322**	**3,027**	**3,330**	**3,750**	**4,790**	**5,039**
1. Education, art culture, scientific services and research	503	530	1,275	1,372	1,497	1,928	2,080
2. Medical, family welfare and public health	108	211	490	514	622	805	865
3. Labour and employment	64	171	278	300	329	517	481
4. Broadcasting	68	159	551	632	696	755	778
5. Other social and community services	134	251	433	512	606	785	835
B. Economic services (1 to 7)	**2,754**	**7,801**	**17,911**	**18,094**	**19,126**	**2,927**	**23,721**
1. Agriculture and allied services	1,250	2,695	5,494	6,513	6,355	7,856	6,357
of which : Food subsidy	650	1,650	2,450	2,850	2,800	5,200	4,000
2. Industries and minerals	591	912	5,083	4,855	6,759	6,225	5,785
3. Foreign trade and export promotion	427	652	2,811	1,865	907	809	407
4. Energy	@	2,188	918	947	707	1,253	1,394
5. Transport and communications	193	492	1,478	1,671	1,969	2,361	2,346
6. Science, technology and environment	@	@	1,128	1,287	1,368	1,666	1,788
7. Other economic services	293#	862	999	956	1,061	2,757	5,644
C. General services	**3**	**9**	**15**	[illegible]	**26**	**-16**	**22**
D. Grants-in-aid to States and Union Territories for developmental purpose	**2,248**	**5,428**	**9,847**	**12,302**	**16,845**	19,643	**18,001**
E. Disbursements of Union Territories	**##**	**625**	**1,439**	**1,599**	**1,701**	**1,317**	**612**
II. Non-developmental expenditure (1 to 9)	**8,954**	**19,831**	**43,973**	**50,016**	**54,699**	**66,077**	**76,553**
1. Collection of taxes and duties	133	275	543	617	724	883	951
2. Audit	37	130	243	262	303	341	360
3. Interest payments	2,748(a)	7,512	21,498	26,596	31,035	37,500	46,000
4. Administrative services (a to d)	557	1,049	2,482	2,778	3,757	3,852	3,958
a) Police	299	631	1,563	1,849	2,109	2,529	2,629
b) Public works	21	41	88	104	118	128	129
c) External affairs	65	132	445	355	478	594	579
d) Other administrative services	172	245	386	470	1052	601	621
5. Defence expenditure (Net)	3,540	7,020	10,874	11,442	12,109	14,944	16,169
6. Grants-in-aid to States and Union Territories for non-developmental purposes	518	1,598	3,446	3,503	1,098	1,872	1,842
7. Currency, coinage and mint and other general services (b)	1,296	2,053	4,556	4,457	5,449	6,333	6,940
8. Technical and economic co-operation with other countries	57	81	140	147	132	167	187
9. Postal services (Net)	68	163	191	214	92	185	146
III. Total expenditure (I+II)	**14,836**	**35,066**	**76,212**	**85,361**	**96,147**	**1,14,770**	**1,23,948**

Note : Data on Revenue Expenditure in this Statement are inclusive of Commercial Departments.

(a) Includes interest payments on deposits under Compulsory Deposit Scheme which are included in Other Fisca Services. in the Budget Document.

(b) Comprises outlay on General Services like organs of State tax collections, pension aid materials

(@) Figures are included under Social and Community Services and Industries and Minerals etc.

' Include Water and Power Development.

\# Figures are included under General Services Social and Community Services and Economic Services.

Also see 'Notes on the Statements.'

A/cs = Accounts R.E. = Revised Estimates B.E. = Budget Estimates

Source : Budget documents of the Government of India

Table 4.8(B): Budgetary Position of Government of India

(Rs. crore)

Item	1980-81 (A/cs)	1985-86 (A/cs)	1990-91 (A/cs)	1991-92 (A/cs)	1992-93 (A/cs)	1993-94 (R.E)	1994-95 (B.E.)
1	2	3	4	5	6	7	8
I. Revenue Account							
A. Receipts	12,799	29,178	57,650	69,100	77,573	80,712	91,221
B. Expenditure	14,836	35,066	76,212	85,361	96,147	1,14,770	1,23,941
C. Surplus (+)/Deficit(-)	-2,037	-5,888	-18,562	-16,261	-18,574	-34,058	-32,727
II. Capital Account							
A. Receipts	7,918	19,315	38,997	38,528	36,178	58,646	59,615
B. Disbursements	8,358	18,742	31,782	29,122	29,916	33,648	32,881
C. Surplus(+)/Deficit(-)	-440	+573	+7,215	+9,406	+6,262	+24,998	+26,727
III. Overall Surplus(+)/Deficit(-) (IC+IIC)	**-2,477**	**-5,315(a)**	**-11,347**	**-6,855**	**-12,312**	**-9,060**	**-6,000**
IV. Financing of Surplus(+)/Deficit(-)							
A. Increase(-)/Decrease(+)in Treasury Bills	-2,654	-6,562(a)	-11,769	-6,887	-11,773	-7,731	-6,000
B. Decrease(-)/Increase(+)in Cash Balances	+177	-381	+422	+32	-539	-1,329	-
i) Opening Balance	+560	+488	+1,465	+1,887	+1,919	+1,380	+51
ii) Closing Balance	+737	+107	+1,887	+1,919	1,380	+51	+51

(a) Total of financing items will not add up to overall deficit, as it excludes Rs. 1,628 crore of medium-term loans to state Governments to clear their overdrafts.

Also see 'Notes on the Statements'

A/cs = Accounts R.E. = Revised Estimates B.E. = Budget Estimates

Source : Budget documents of the Government of India

Table 4.9: Revenue Receipts of Government of India

(Rs. Crore)

Item	1980-81 (A/cs)	1985-86 (A/cs)	1990-91 (A/cs)	1991-92 (A/cs)	1992-93 (A/cs)	1993-94 *(R.E)	1994-95 (B.E.)
1	2		4	5	6	7	8
I. Taxes on Income (1 to 4)	1,905	3,530	6,666	9,930	11,996	13,319	16,454
1. Taxes on Income other than Corporation Tax (Net) (a-b)	438	665	1,250	1,627	1,831	1,729	2,720
a) Total Receipts	1,440	2,511	5,371	6,731	7,888	9,500	10,925
b) States' share	1,002	1,846	4,121	5,104	6,057	7,771	8,205
2. Corporation tax	1,377	2,865	5,335	7,853	8,899	10,500	12,480
3. Interest tax	90		-1	305	715	900	1,044
4. Expenditure tax	#	#	82	145	151	190	210
II. Taxes on property and capital transactions (1 to 3)	78	168	237	318	478	121	131
1. Estate duty (Net) (i-ii) (a)	4	3	3	3	1	1	1
i) Total receipts	16	23	3	3	1	1	1
ii) States' share	12	20	-	-	-	-	-
2. Tax on wealth	67	153	231	307	468	115	125
3. Gift tax	7	12	3	-8	9	5	5
III. Taxes on commodities and services (1 to 3)	7,150	16,945	35,020	38,651	40,526	40,023	45,971
1. Customs (Net) (a+b+c+d)	3,410	9,526	20,644	22,257	23,776	22,500	25,200
a) Imports (Gross)	3,413	9,601	20,896	21,927	24,136	23,031	25,873
b) Exprots (Gross)	121	83	36	77	55	69	83
c) Other revenue (Gross)	47	117	348	1,000	467	380	413
d) Refunds and drawbacks	171	275	636	747	882	980	1,169
2. Union excise duties (Net) (a-b)	3,723	7,330	14,100	16,017	16,367	17,277	20,511
a) Total receipts	6,500	12,956	24,514	28,110	30,832	31,750	36,700
of which : Additional excise duties in lieu of sales tax (Net)	395	928	1,490	1,868	2,177	2,435	2,701
b) States' share	2,777	5,626	10,414	12,093	14,465	14,473	16,189
3. Other taxes and duties on commodities and services (b)	17	89	276	377	383	246	260
IV. Taxes of Union Territories (c)	225	497	1,055	1,170	1,444	1,010	186
V. Total tax revenue (I to IV)	9,358	21,140	42,978	50,069	54,044	54,473	62,742
VI. Interest receipts (1 to 4)	1,794	4,595	8,730	10,933	12,488	14,537	15,975
1. State an Union Territories	889	1,872	5,174	6,565	7,843	9,724	11,163
2. Railways	110	559	938	1,080	1,489	1,299	1,372
3. Posts and telecommunications (d)	39	170	220	247	257	263	263
4. Other interest receipts	756	1,994	2,398	3,041	2,899	3,251	3,180
VII. Dividents and profits	292	515	774	1,058	2,492	2,737	2,793
of which : Profits of R.B.I.	210	210	210	350	1,500	1,500	1,500(e)
VIII. Fiscal services (1+2)	143	736	569	518	1,406	1,243	1,237
1. Currency, coinage and mint	67	206	253	265	288	443	480
2. Other fiscal services	76	530	316	253	1,118	800	757
IX. General services	266	645	1,325	1,456	2,180	2,215	2,494
X. Social and community services	180	151	361	429	495	575	577
XI. Economic services	330	842	2,179	3,407	3,294	3,432	3,843
XII. Cash grants from foreign countries and International Organisations	373	413	529	913	880	1,157	1,285
XIII. Aid material and equipment	63	72	56	35	40	143	80
XIV. Non-tax receipts of Union Territories	*	69	149	182	254	200	192
XV. Total non-tax revenue (VI to XIV)	3,441	8,038	14,672	19,031	23,529	26,239	28,479
XVI. Total revenue (V+XV)	12,799	29,178	57,650	69,100	77,573	80,712	91,221

Note: Data on Revenue Receipts in this Statement are inclusive of Commercial Departments.

(a) Estate Duty on "agricultural land" was discontinued under Estate Duty (Amendment) Act 1984 and Estate Duty in respective properites (other than agricultural land) was abolished under Estate Duty (Amendment) Act 1985. Revised Estimates for 1993-94 and Budget Estimates for 1994-95 are, therefore, represent likely collections before the above amendments.

(b) Includes foreign travel tax, foreign exchange conservation (travel) tax, water (prevention and control of pollution) cess, entertainment tax, betting tax and taxes and duties on electricity etc.

(c) Taxes of Union Teritories are shown net of assignments of U.T. taxes to local bodies.

(d) Figures from 1985-86 onwards pertain to Telecommunications only due to the sepparation of Department of Telecommunications from Posts and Telegraphs w.e.f. December 31, 1984.

(e) Net position after accounting for the provision of Rs. 5,721 crore made to meet the exchange loss liability which the government has taken over from Reserve Bank of India on account of Foreign Currency Non-Resident Account Scheme deposits maturing from July 1, 1993 onwards.

\# Expenditure tax was imposed on hotel room charges as per Expenditure Tax Act 1987.

* Figures are included under General Services, Social Services and Economic Services.

Also see 'Notes on the Statements'

A/cs = Accounts R.E. = Revised Estimates B.E. = Budget Estimates

Source : Budget documents of the Government of India

UNIT 5 STRUCTURE OF INDIAN INDUSTRY

Objectives

The main purpose of this unit is to help you:

- understand India's Industrial sector
- get an overview of India's Industrial growth experience
- analyse the various dimensions of the structure of Indian industry
- discover and explain structural changes in the industrial sector, and
- understand the ownership pattern of the industrial sector.

Structure

5.1 Introduction
5.2 Industrial Growth Experience : An Overview
5.3 Structural Changes in the Indian Industry
5.4 Ownership Pattern of the Industrial Sector
5.5 Summary
5.6 Key Words
5.7 Self-Assessment Questions
5.8 Further Readings
Appendix 2: Statistical Tables

5.1 INTRODUCTION

Before the rise of the modern industrial system in the world economy, Indian producers (largely artisan classes) had a world-wide market. Indian muslin and calicos were in great demand worldover. indian industries not only supplied all local needs but also enabled India to export its finished products. Indian exports consisted cheifly of manufactures like cotton and silk fabrics, calicos, artistic ware, silk and woollen clothing.

The impact of the British rule and the industrial revolution that took place in Britain led to the decay of the Indian handicrafts. Instead, machine-made goods started coming to India. The gap created by the decay of Indian handicrafts was not filled by the rise of modern industry in India because of the british policy of encouraging the imports of manufactures manufactured products into and export of raw materials from India.

The British Government in India provided discriminatory protection to some select industries since 1923. This protection was accompanied by the "most favoured nation" clause for British goods. Despite this factor, because of the "pioneering zeal" and "fostering care" (Prof. Lakanathan's phrases) of the early Indian entrepreneurs, some industries such as cotton textiles, sugar, paper, matches, and to some-extent, iron and steel did develop in the country. But capital goods industries were not fostered during the British period. The industrial pattern of India on the eve of planning (1950) was marked by low capital intesity, predominance of small enterprises, limited development of factory sector and imbalance between consumer goods and capital goods industries. This lop-sided pattern of industry with the predominance of consumer goods industries had to be corrected through economic planning in the post-Independence period.

5.2 INDUSTRIAL GROWTH EXPERIENCE : AN OVERVIEW

The progress of industrialisation during the four decades and more since the beginning of the planning era (1951-56 was the first plan period it is the Eighth Plan (1992-97) in progress now) has been a significant feature of the Indian economic development. The process of industrialisation, initiated as conscious and deliberate policy under Industrial Policy Resolutions of 1948 and 1956 involved heavy investments in basicd. and heavy industries besides those in consumer goods industries. As a result of efforts for rapid industrialisation, a firn industrial base has been achieved. Industrial production grew by about 5 times and India now is the tenth most industrial country in the world. India now has a well-diversified industrial sector covering the entire range of consurmer, intermediate and capital goods industries. The progress the country has made in respect of industrial sector is clearly reflected in the commodity composition of India's foreign trade. The share of imports of manufactured goods in foreign trade has steadily declined, while industrial products, particularly engineering goods have become a growing component of India's exports. Further, the rapid progress in industrialisation has been accompanied by a corresponding growth in technological and managerial know-how for efficient operation of the most modern and sophisticated industries and also for planning designing and construction of such industries.

The diversification of India's industrial capability becomes evident from Table 5.10.

India could acheive self- sufficiency in consumer goods. Growth of basic and capital goods industries has been particularly impressive. India can now sustain the future growth of key sectors of the economy primarily through domestic efforts production, with only marginal imports. Further, the infrastructure including Research and Development capability, consultancy and design engineering services, project organisation services and innovative capability to improve and adapt technologies-to suit the domestic factor endowment have shown an impressive record of progress. Now we turn to industrial growth rates.

Table 5.1 Industrial gives indusirial growth rates during various plan periods. The growth rates are annual percentage changes in general index of industrial production with 1970 as base year.

During the Third Plan period, but for the concluding year of the plan period, the annual growth rate exceeded 8 per cent.The average aninual growth rate during the 8 per cent. The average annual growth rate during the period was 8.22 per cent. During the subsequent three annual plans the growth rates fell significantly, except during 1968-69 when growth rate was 6.7 per cent.

The period was marked by low growth rates, the average growth rate for the period being 2.83 per cent. The industrial growth recovered significantly during the Fourth Plan period but the average growth rate during the period (4.4 per cent) was significantly lower than that during the Third Plan period (8.22 per cent). The industrial growth performance during the Fifth Plan was a significant improvement over the preceding years after the Third Plan period. The average growth rate during the Fifth Plan period was 6,24 per cent. During the period the highest growth rate was recorded during the year 1976-77 (9.5 per cent). Subsequent to the Fifth Plan, the growth rate recorded during the annual plan 1979-80 was negative (-1.6 per cent). During the Sixth Plan period the industrial sector not only recovered but registergd an annual growth rate of 5.92 per cent. During the subsequent Seventh Plan period (1985-90) the industrial growth proceeded at a substantial rate and the average annual growth rate during the period was 8.5 per cent. the highest growth rate acheived since the end of the Third Plan.

Table 5.2 gives trends in industrial production indicates during the period 1960 to 1994-

95. The base year for the index numbers is 1980-81. It can be seen from the Table that the general index of industrial production increased from 36.0 in 1960 to 251.9 in 1994-95. Thus in 35 years the index increased by about 7 times.

The industrial production has three components in it: mining, manufacturing and electricity. The index of production in mining increased from 45.5 in 1960 to 245.8 in 1994-95, an inerease by about 6.4 times. The index of manufacturing during the same period increased from 38.2 to 243.6, an increase by about 6.4 times. The index of electricity generation incereased from 14.6 in 1960 to 314.6 in 1994-95, an increase by about 21.5 times. The compound annual rates of growth (CARG) are also given in Table 5.2 for each of the indices.

If we take the recent period 1990-91 to 1994-95, the general index of industrial production recorded an annual growth rate of 4.3 per cent which is significantly lower than the growth rate during the 1980s decade. Mining (2.7 per cent), manufacturing (4.1 per cent) and electricity (7.4 per cent) recorded growth rates lower than the preceding 1980s decade. The severe economic crisis the economy faced in early 1990s may be kept in mind in this connection.

Now, let us look at the manufacturing sector growth record. Manufacturing is a major segment of the industrial sector. The weight of manufacturing in the general index of industrial production is 77.11 per cent. Table 5.3 gives data relating to growth of the manufacturing sector and the shares of the factory and non-factory segment of the manufacturing sector. The share of the factory sector in gross value added in manufacturing sector increased from 52.0 per cent in 1960-61 to 62.1 per cent in 1993-94, while that of the non-factory sector declined from 48.0 per cent to 37.9 per cent. Thus over the period 1960-61 to 1993-94, factory sector recorded higher growth than the non-factory sector. *(Gross value added in manufacturing is the value of output of manufacturing minus the value of intermediate inputs. Gross value added is gross of depreciation).*

Compound annual rates of growth (CARG) of factory and non-factory sectors at current and constant (1980-81) prices are also given in Table 5.3. The ongoing inflation made the current price growth rates to be significantly higher than real or constant price growth rates as can be seen from Table 5.3. We are interested in real growth rates, nominal growth rates as corrected for inflation rate. The real growth rates were the highest during the 1980s decade. They were the lowest during the recent period 1990-91 to 1993-94.

Industrial concentration inequalities among regions in respect of industrial development continue to be significant features of the industrial economy of India. Table 5.11 shows the State-wise net value added in manufacturing sector in 1992-93 (the latest-year for which data are readily available). As can be seen from the Table, Maharashtra with 22.8 per cent of manufaturing sector's net value added led the other States followed by Gujarat (11.4 per cent), Tamilnadu (10.2 per cent), and Uttar Pradesh (9.1 per cent).

Activity 1

a) Mention the components of the industrial sector.

b) From Table 5.2 compute the average percentage changes in indices of mining, manufacturing and electricity during the period 1960 to 1994-95.

c) From Table 5.2 indentify the decade of the highest growth rates and attempt an explanation.

d) From Table 5.3 compute the average percentage changes in gross value added on (i) the manufacturing sector, (ii) factory sector, and (iii) non-factory sector during the period 1960 to 1994-95. On the basis of the average percentage changes, justify the statement that factory sector grew at a higher rate than the non-factory sector.

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5.3 STRUCTURAL CHANGES IN THE INDIAN INDUSTRY

In this section we will look at several dimensions of the structure of Indian industry. As industrial development proceeds in an economy, several structural changes take place in the industrial sector. Historically, industrial development has proceeded in three stages. In the first stage,industry was concerned with the processing of primary products. Milling grain extracting oil, tanning leather; spinning vegatable fibres, prerparing timber, and smelting ores. The second stage in the evolution of secondary industry comprises the transformarion of materials making bread and confectionary, footwear, metal goods, cloth, furniture and paper. The third stage consists of the manufacture of machines and other capital equipment to be used not for the direct statisfaction of any immediate want but in order to facilitate the future process of production W.G. Hoffman (*The Growth of Industrial Economies,* Oxford, 1958) gives operational criteria of the degree of industrial development. He classified all industrial output into two categories, consumer goods and capital goods and classified various stages in terms of the ratio of consumer goods to that of capital goods output. "In the first stage the consumer goods industries are of overwhelming importance, their net output being on the average five times as large as that of capital goods industries." This ratio is 2.5:1 in the second stage and falls to 1:1 in the third stage and still lower in the fourth stage. This classification emphasises the increasing role of the capital and producer goods industries in the economy as industrial development takes place.

In the post- independence period economic planning for overall development succeeded in laying firm foundations for future economic development. The heavy-industry strategy formulated and implemented from begininng from the Second Five Year Plan helped in creating a strong industrial base. Capacities in substantial quantities have been created in basic, key and heavy industries. Tables 5.4 through 6 throw light on one dimension of structural change (changes in the composition of output) in India's industrial sector. Table 5.4 shows how the weight assigned to the basic and capital goods industries in the index of indusrial production rose from 23.3 per cent and 4.7 per cent to 39.4 per cent an 16.4 per cent respectively during the period 1956 to 1980s, while that of the consumer goods industries during the same period decreased from 48.4 per cent to 23.7 percent. Thus during the period the relative important of Basic and Capital goods increased and that of consumer goods industries decreased, signigying structural change in the industrial sector.

Activity 2

a) Refer to RBI, *Report on currency and Finance* and give the composition of each of the following categories if Industries:

1. Basic goods
2. Capital goods
3. Intermediate goods
4. Consumer goods

b) Explain the meaning if intermediate goods

Table 5.5 gives the recent trends in index number of industrial production with use-based classification. Industrial output is classified into : (i) output of basic industries such as finsihed steel, (ii) output of capital goods industries such as machinery, (iii) output of consumer goods industries such as sugar, and (iv) output of intermediate goods industries. If we take the decade 1980s, the Basic and Capital goods industries output grew at an annual compound rates of 7.86 % and 11.3%, significantly higher than the growth rate of consumer goods industries (6.57 per cent). Thus the relative improtance of basic and capital goods industries increased, signifying structural changes in the industrial sector.

Table 5.6 gives annual compound rates of growth of industrial production with use - based classification. The differences in growth rates of different kinds of output confirm structural changes revealed earlier.

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Activity 3

Study carefully Table 5.4 and answer the following questions.

a) What was the percentage of consumer goods output.......... in 1956

b) What is the percentage of consumer goods industries in total industrial output in 1980-81.

c) What is the trend in the share of intermediate goods in total industrial output during the period 1956-81.

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Activity 4

Read carefully Table 5.5 and answer the following:

a) What is the average percentage change in index of basic industries during 1981-82 to 1994-95.

b) Giving examples of consumer durables, find out the average percentage change in the index of consumer durable during 1981-82 to 1994-95.

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Activity 5

Look at the table 5.6 carefully and

a) Justify the decleration of industrial growth thesis from mid-1960s.

b) Justify the improvement of growth rates since early 1980s.

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Size of Industrial Units-Another Structural Dimension

The size of an industrial unit can be measured using different criteria. Output, total assets, fixed capital, and employment are some of the major criteria to measure size of the industrial units. Changes in the average size of the industrial units represent an important structural change of the industrial-sector in an economy. We turn to this structural dimension in this section.

As future managers you must know about this important dimension of the structure of industry. We may list the circumstances under which a large firm or a small one would be more efficient. Such synthesis provides guidance for making the proper choice of the optimum size for the firm. A large firm would be more efficient in situtations where :

a) the product is standardized and can be produced on mass scale with longer production runs such as iron and steel, sugar, industrial chemicals and fertilizers;

b) the product and / or machines used in its production are large in size such as authmobiles, ships and electricity generation.

c) the economies of linked processes are significant as in the case of pulp and paper industry and steel among others ;

d) the markets for the product are concentreated and /or transport costs are considerably low in comparison to the price of the product;

e) there are occasional indivisibilities in different units or operations of the plant which are to be balanced; and

f) research activities are essential to compete in the market such as in chemical industries.

A small firm would be more efficient if all these above conditions are not satisfied, that is, where

a) the production factors, e.g. men and machines, are "divisible"or adaptable;

b) the product is to be made an individual specification or where varieties or product differen titation are required in the market for existence, i.e., standardization and mass production is an economical. Examples are ornaments and clothing ;

c) the raw materials and markets for the products are geographically-dispersed and transport costs are quite significant, e.g., bread and brick-making;

d) the demand conditions change frequently as a result of which quick adjustments are needed to adapt to such changes, e.g., garment making;

e) the nature of work done changes frequently due to technical condition e.g., agriculture and allied industries; and

f) the supplies of the raw materials and potential market for the product are small.

Complete seperation of situation for large scale and small-scale units is not possible. There are many industries where small scale and large scale production is carried on side by side. Examples are engineering industries, cloth making , shoe making and several consumer products. In fact, if we go through the industrial structure of a country, we will find such situation in most of the industries. Small units in an industry exist along with larger ones mainly because (i) they may be relatively new and it is normal to grow large from small beginnings in due course of time, (ii) they may be supplying finished products to the larger units under some type of sub-contracting, and (iv) they may be producing a highly specific variety of products in a differentiated product industry. All such small units may be equally efficient as the bigger units.

With this background discussion about the size of industrial units, let us look at the size of the Indian industrial units. Table 5.7 gives size-wise distribution of factories using employment as criterion of size. It can be seen from the Table that in 1973-74 the smallest sized units (units employing between 0-49 workers) were 77 per cent in the total factories accounting for 14.4% of total employment, 14.9% of gross output and 8.7 per cent of value added. By 1992-93 the factories employing 0-49 workers still constituted 76.1 per cent of total factories. Thus there was a slight, almost negligible , decline in the percentage of factories belonging to the lowest size group (by employment criterion). The 50-99 employment range shows significant increase in the percentage of factories belonging to that size class (10.8 per cent\12.2 per cent between 1973-74 and 1992-93). If you carefully go through Table 5.7 you will find that the average size of industrial units has increased as industrial development proceeded. Thus structural change in Indian industrial sector is observable in repect of one dimension of the structure of the sector, namely size measured by employment.

Table 5.8 gives the structure of industrial factory sector by size of capital. Factories with gross value of plant and machinery in the range upto 2.5 lakh rupees in 1992-93 were 38.8% while the corresponding percentage was 44.0% in 1989-90, and 48.6% in 1987-88.

In 1992-93 the smallest factories accounted for 13.5 per cent of total employment in factory sector, 0.4 per cent of fixed capital and 3.1 per cent of net value added. If you carefully go through Table 5.8 you will find that the average size of factories shows increasing trend over a period of time. Thus structural change in the Indian industrial sector observable in respect of size measured by capital.

Activity 6

a) List some criteria by which the size of industrial unit could be measured.

b) Refer to Table 5.7 Reorganise the size distribution with 0-199, 200-999, and 1000 and above, as size classes and find out the shares of these classes in employment, output and value added.

c) Refer to Table 5.8 Reorganise the size distribution with 0-50, 50-1000, and 1000 and above, as size classes an find out the shares of these classes in employment, fixed capital and value added.

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5.4 OWNERSHIP PATTERN OF THE INDUSTRIAL SECTOR

After independence India wanted to adopt planned economic development. We have gone through several Five Year Plans. We opted for a mixed economy with both private and public sectors, complementing each other rather than competing. The scope of each sector was well-defined in the industrial policies announced from time to time by the Government. Industrial Policy Resolution of 1956 was the major policy announcement. We will learn about these policies in detail in the next two units. Here our interest is to describe the structure of India's industrial sector on the basis of ownership pattern.

Table 5.9 gives structure of ownership of industrial factory sector in 1992-93, the latest year for which data are available. The public sector accounted for 6.1 per cent of total number of factories, 28% of employees, 55 per cent of net fixed capital and 32.1 per cent of net value added by the industrial factory sector. Public sector includes enterprises of the Central Government, State nad local governments.

The Private sector including cooperative sector accounted for 92.3 per cent of total number of factories, 69.1% of workers, 67.2% of employees, 39.4 per cent of net fixed capital and 61.5 per cent of value added. This sector has four components: i) Corporate enterprises, ii) Partnerships, iii) Individual proprieterships, and iv) Cooperative enterprises.

Joint sector (enterprises owned jointly by private and public or government interests) accounted for 1.5 per cent of total factories, 4.4 per cent of workers. 4.7 per cent of employees, 5.6 per cent of net fixed capital and 6.4 per cent of value added.

Regional distribution of industrial activity and industrial concentration are two more dimensions of the structure of India's industrial sector. You are advised take down notes on these two aspects by going through the publications given under Further Readings.

We will learn about public and private sectors in detail in the next two units.

Activity 7

Refer to Table 5.9 and attempt the following :

a) List a few observations about the structure of public sector.

b) Comment on the size of i) cooperative sector, and ii) joint sector.

c) Explain the organizational form in the private sector.

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Activity 8

Go through Table 5.11 and write a note on inter State disparities in manufacturing sector development.

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5.5 SUMMARY

In this unit we acquainted you with several aspects of India's industrial sector. You have learnt about India's industrial growth experience. We looked at the structure of the Indian industrial sector from several dimensions: Composition of output, size, and ownership pattern.

5.6 KEY WORDS

Industrial Sector Industrial Sector has three components : Mining, Manufacturing, and Electricity.

Gross Value added in Manufacturing : It is the value of output of manufacturing minus the value of intermediate inputs. (Gross value of output of manufacturing minus the value of intermediate inputs). Gross value aided is gross of depreciation.

Structural Changes Changes in average size of the industrial units, in ownership pattern of the industrial sector and so on.

5.7 SELF-ASSESSMENT QUESTIONS

1) Explain the major structural characteristics of India's industrial sector.
2) "As industrialisation of a country proceeds, the relative important of consumer goods industries declines and that of capital goods industries increases" Justify this proposition by using the relevant data.
3) Going through the Unit carefully, Comment on the "declaration of industrial growth thesis".

5.8 FURTHER READINGS

Dutt Ruddear and Sundaram, K.P.M. *Indian Economy* Chapter 38.

Lakshmana Rao, V. *Essays on Indian Economy,* Essay No. 3 New Delhi: Ashish Publishing House, 1994.

Appendix 2 : List of Statistical Tables

Table 5.1	Industrial Growth Rates During Plan Periods.
Table 5.2	Index of Industrial production: 1961 to 1994-95.
Table 5.3	Gross Value Added in Manufacturing Sector : 1960-61 to 1993-94.
Table 5.4	Weights of Industries by Major Groups in Index of Industrial Production.
Table 5.5	Industrial Production : Use Based Classification.
Table 5.6	Annual Compound Rates of Growth of Industrial Production.
Table 5.7	Structure of Industrial Factory Sector : By size of Employment.
Table 5.8	Structure of Industrial Factory Sector : By size of Capital.
Table 5.9	Structure of Ownership of Industrial Factory Sector : 1992-93.
Table 5.10	Growth in Manufacturing Industries : 1980-81 to 1994-95.
Table 5.11	State-wise Net Value Added in Manufacturing Sector.

Table 5.1: Industrial Growth Rates During Plan Periods
(Base 1970=100)

Plan Period	Year	Index	Growth Rate	Aver[illegible]
(1)	(2)	(3)	(4)	
Third Plan	1960-61	55.8	—	3.22
	1961-62	60.4	8.2	
	1962-63	66.1	9.5	
	1963-64	72.3	9.3	
	1964-65	78.5	8.8	
	1965-66	82.6	5.3	
Annual Plans	1966-67	83.3	0.6	2.83
	1967-68	84.3	1.2	
	1968-69	89.9	6.7	
Fourth Plan	1969-70	96.8	7.6	
	1970-71	100.7	4.1	4.40
	1971-72	106.4	5.6	
	1972-73	110.6	3.9	
	1973-74	111.5	0.8	
Fifth Plan	1974-75	115.1	3.2	6.24
	1975-76	122.8	6.7	
	1976-77	134.4	9.5	
	1977-78	140.0	9.2	
	1978-79	150.7	7.6	
Annual Plan	1979-80	148.2	(-) 1.6	
Sixth Plan	1980-81	154.1	4.0	
	1981-82	167.3	8.6	5.92
	1982-83	174.3	4.1	
	1983-84	184.9	6.1	
	1984-85	197.4	6.8	
Seventh Plan	1985-86	142.1	8.7	
	1986-87	155.1	9.2	8.5
	1987-88	166.4	7.3	
	1988-89	180.9	8.7	
	1989-90	196.4	8.6	

Source : *Handbook of Industrial Statistics 1991*, Government of India, New Delhi.

Table 5.2 : Index of Industrial Production : 1961 to 1994-95

	Index 1980-81 = 100				% change over the previous year			
	Mining	Manufacturing	Electricity	General	Mining	Manufacturing	Electricity	General
(Weight)	(11.46%)	(77.11%)	(11.43%)	(100.00%)				
1960	45.5	38.2	14.6	36.0				
1961	47.9	41.6	16.9	39.3	5.3	8.9	15.8	9.2
1962	52.4	45.6	19.0	43.1	9.4	9.6	12.4	9.7
1963	56.0	49.3	22.0	46.6	6.9	8.1	15.8	8.1
1964	54.3	53.9	25.3	50.6	-3.0	9.3	15.0	8.6
1965	59.9	58.7	27.8	55.3	10.3	8.9	9.9	9.3
1966	61.9	57.9	30.3	55.1	3.3	-1.4	9.0	-0.4
1967	61.8	56.6	33.6	54.4	-0.2	-2.2	10.9	-1.3
1968	65.6	59.6	38.8	57.9	6.1	5.3	15.5	6.4
1969	67.1	63.8	43.9	62.0	2.3	7.0	13.1	7.1
1970	67.8	66.7	48.6	65.0	1.0	4.5	10.7	4.8
1971	68.5	69.7	52.1	67.9	1.0	4.5	7.2	4.5
1972	71.2	73.4	56.8	71.9	3.9	5.3	9.0	5.9
1973	72.5	74.2	55.8	72.2	1.8	1.1	-1.8	0.4
1974	76.7	74.6	60.4	73.5	5.8	0.5	8.2	1.8
1975	86.7	77.4	67.4	77.5	13.0	3.8	11.6	5.4
1976	92.7	86.9	78.0	86.9	6.9	12.3	15.7	12.1
1977	94.8	90.1	80.5	89.9	2.3	3.7	3.2	3.5
1978	96.3	96.3	89.3	96.1	1.6	6.9	10.9	6.9
1979	100.7	96.5	93.9	97.2	4.6	0.2	5.2	1.1
1980	97.7	97.5	96.0	98.0	-3.0	1.0	2.2	0.8
1980-81	100.0	100.0	100.0	100.0				
1981-82	117.7	107.9	110.2	109.3	17.7	7.9	10.2	9.3
1982-83	132.3	109.4	116.5	112.8	12.4	1.4	5.7	3.2
1983-84	147.8	115.6	125.4	120.4	11.7	5.7	7.6	6.7
1984-85	160.9	124.8	140.4	130.7	8.9	8.0	12.0	8.6
1985-86	167.5	136.9	152.4	142.1	4.1	9.7	8.5	8.7
1986-87	177.9	149.7	168.1	155.1	6.2	9.3	10.3	9.1
1987-88	184.6	161.5	181.0	166.4	3.8	7.9	7.7	7.3
1988-89	199.1	175.6	198.2	180.9	7.9	8.7	9.5	8.7
1989-90	211.6	190.7	219.7	196.4	6.3	8.6	10.8	8.0
1990-91	221.2	207.8	236.8	212.6	4.5	9.0	7.8	8.2
1991-92	221.5	206.2	257.0	213.9	0.1	-0.8	8.5	0.6
1992-93	223.7	210.7	269.9	218.9	1.0	2.2	5.0	2.3
1993-94	231.5	223.5	290.0	232.0	3.5	6.1	7.4	6.0
1994-95	245.8	243.6	314.6	251.9	6.2	9.0	8.5	8.6
CARG (%):								
1960-70					4.1	5.7	12.8	6.1
1970-80					3.7	3.9	7.0	4.2
1980-81 to 1990-91					8.3	7.6	9.0	7.8
1990-91 to 1994-95					2.7	4.1	7.4	4.3

Table 5.3: Gross Value Added in Manufacturing Sector : 1960-61 to 1993-94

	At Current prices					At 1980-81 prices					
	Rs. Crore			% share		Rs. crore			% change		
	Factory	Non-factory	Total	Factory	Non-factory	Factory*	Non-factory	Total	Factory	Non-factory	Total
1960-61	1,189	1,096	2,285	52.0	48.0	4,600	4,171	8,771	12.4	4.1	8.3
1961-62	1,306	1,214	2,520	51.8	48.2	5,020	4,500	9,500	9.1	7.9	8.5
1962-63	1,494	1,304	2,798	53.4	46.6	5,509	4,704	10,213	9.7	4.5	7.3
1963-64	1,744	1,447	3,191	54.7	45.3	6,132	5,047	11,179	11.3	7.3	9.5
1964-65	1,944	1,565	3,509	55.4	44.6	6,638	5,314	11,95[illegible]	8.3	5.3	6.9
1965-66	2,115	1,625	3,740	56.6	43.4	6,856	5,207	12,063	3.3	-2.0	0.9
1966-67	2,323	1,768	4,091	56.8	43.2	6,862	5,296	12,158	0.1	1.7	0.8
1967-68	2,418	1,953	4,371	55.3	44.7	6,638	5,567	12,205	-3.3	5.1	0.4
1968-69	2,615	2,115	4,730	55.3	44.7	7,087	5,794	12,881	6.8	4.1	5.5
1969-70	3,172	22,76	5,448	58.2	41.8	8,318	5,945	14,263	17.4	2.6	10.7
1970-71	3,406	2,540	5,946	57.3	42.7	8,516	6,082	14,598	2.4	2.3	2.3
1971-72	3,704	2,893	6,597	56.1	43.9	8,670	6,405	15,075	1.8	5.3	3.3
1972-73	4,100	3,230	7,330	55.9	44.1	8,946	6,720	15,666	3.2	4.9	3.9
1973-74	4,902	3,968	8,870	55.3	44.7	9,387	6,976	16,363	4.9	3.8	4.4
1974-75	6,360	5,039	11,399	55.8	44.2	9,481	7,359	16,840	1.0	5.5	2.9
1975-76	6,647	5,210	11,857	56.1	43.9	9,577	7,618	17,195	1.0	3.5	2.1
1976-77	7,564	5,556	13,120	57.7	42.3	10,773	7,930	18,703	12.5	4.1	8.8
1977-78	8,331	6,365	14,696	56.7	43.3	11,496	8,371	19,867	6.7	5.6	6.2
1978-79	9,625	7,298	16,923	56.9	43.1	12,750	9,571	22,321	10.9	14.3	12.4
1979-80	11,047	8,332	19,379	57.0	43.0	12,482	9,120	21,602	-2.1	-4.7	-3.2
1980-81	12,281	9,363	21,644	56.7	43.3	12,281	9,363	21,644	-1.6	2.7	0.2
1981-82	14,418	10,842	25,260	57.1	42.9	13,228	10,154	23,382	7.7	8.4	8.0
1982-83	16,558	11,515	28,073	59.0	41.0	14,501	10,407	24,908	9.6	2.5	6.5
1983-84	20,308	12,737	33,045	61.5	38.5	16,629	10,748	27,377	14.7	3.3	9.9
1984-85	23,352	13,891	37,243	62.7	37.3	18,031	11,122	29,153	8.4	3.5	6.5
1985-86	25,806	15,969	41,775	61.8	38.2	18,453	11,867	30,320	2.3	6.7	4.0
1986-87	28,254	17.912	46,166	61.2	38.8	19,521	12,924	32,445	5.8	8.9	7.0
1987-88	32,207	20,658	52,865	60.9	39.1	20,902	13,916	34,818	7.1	7.7	7.3
1988-89	39,050	23,813	62,863	62.1	37.9	23,126	14,739	37,865	10.6	5.9	8.8
1989-90	48,369	28,707	77,076	62.8	37.2	26,336	15,949	42,285	13.9	8.2	11.7
1990-91	55,553	33,607	89,160	62.3	37.7	27,657	17,206	44,863	5.0	7.9	6.1
1991-92	61,104	35,777	96,881	63.1	36.9	27,153	16,301	43,454	-1.8	-5.3	-3.1
1992-93	69,264	42,045	111,309	62.2	37.8	27,781	17,024	44,805	2.3	4.4	3.1
1993-94	75,980	46,282	122,262	62.1	37.9	28,681	17,740	46,421	3.2	4.2	3.6
CARG (%) :											
1960-61 to 1970-71	11.1	8.8	10.0			6.4	3.8	5.2			
1970-71 to 1980-81	13.7	13.9	13.8			3.7	4.4	4.0			
1980-81 to 1990-91	16.3	13.6	15.2			8.5	6.3	4.0			
1990-91 to 1993-94	11.0	11.3	11.1			1.2	1.0	1.1			

Table 5.4 : Weights of Industries by Major Groups in Index of Industrial Production

Industry Group	Base Years			
	1956	1960	1970	1980-81
(1)	(2)	(3)	(4)	(5)
Basic Industries *	23.33	25.11	32.28	39.41
Capital goods industries*	4.71	11.76	15.25	16.43
Intermediate goods Industries*	24.59	25.88	20.95	20.51
Consumer goods Industries*	48.37	37.25	31.52	23.65
Total Weight	100.00	100.00	100.00	100.00

* See RBI, *Report on Currency and Finance* for details about the composition of each category.

Source : RBI, *Report on Currency and Finance* for different years

Table 5.5: Industrial Production : Use Based Classification

	Basic Industries	Capital Goods Industries	Intermediate Goods Industries	Consumer Goods	Consumer Durables	Consumer Non-durables	General index
(Weight)	(39.41%)	(16.43%)	(20.51%)	(23.65%)	(2.55%)	(21.10%)	
			Index 1980-81 = 100				
1981-82	110.9	106.7	103.7	113.8	110.9	114.1	10.93
1982-83	118.7	110.6	104.6	112.0	121.0	110.9	112.8
1983-84	125.7	123.5	114.9	113.8	140.5	110.5	126.4
1984-85	139.7	127.2	126.1	122.0	170.8	116.1	130.7
1985-86	149.2	140.7	135.5	137.3	202.8	129.4	142.1
1986-87	163.2	166.3	140.8	145.7	241.3	134.1	155.1
1987-88	172.2	192.9	144.9	160.0	259.6	147.9	166.4
1988-89	189.2	206.6	162.0	166.0	317.4	148.0	180.9
1989-90	199.4	251.4	168.8	177.0	325.0	159.1	196.4
1990-91	213.1	291.7	176.9	189.0	359.7	168.3	212.6
1991-92	226.7	256.3	174.4	184.8	317.7	168.8	213.9
1992-93	232.9	266.5	182.4	194.3	317.7	179.4	218.9
1993-94	254.9	255.4	200.9	202.0	369.4	181.7	232.0
1994-95	264.4	319.2	211.9	219.0	405.5	196.6	251.9
			Percentage change over previous year				
1981-82	10.90	6.70	3.70	13.80	10.90	14.10	
982-83	7.03	3.66	0.87	-1.58	9.11	-2.80	
1983-84	5.90	11.66	9.85	1.61	16.12	-0.36	
1984-85	11.14	3.00	9.75	7.21	21.57	5.07	
1985-86	6.80	10.61	7.45	12.54	18.74	11.46	
1986-87	9.38	18.19	3.91	6.12	18.98	3.63	
1987-88	5.51	16.00	2.91	9.81	7.58	10.29	
1988-89	9.87	7.10	11.80	3.75	22.27	0.07	
1989-90	5.39	21.68	4.20	6.63	2.39	7.50	
1990-91	6.87	16.03	4.80	6.78	10.68	5.78	
1991-92	6.38	-12.14	-1.41	-2.22	-11.68	-0.30	
1992-93	2.73	3.98	4.59	5.14	0.00	6.28	
1993-94	9.45	-4.17	11.79	3.96	16.27	1.28	
1994-95	3.73	24.98	3.92	8.42	9.77	8.20	
CARG (%):							
1980-81 to 1990-91	7.86	11.30	5.87	6.57	13.66	5.34	
1990-91 to 1994-95	-14.18	11.73	-4.91	5.55	-2.17	9.13	

Table 5.6 : Annual Compound Rates of Growth of Industrial Production

Category	1960-65	1965-70	1970-76	1976-82	1982-87	1980-91
1. Basic goods	10.4	6.2	6.3	5.7	8.3	7.86
2. Captal goods	19.6	-1.4	6.0	4.6	10.9	11.30
3. Intermediate goods	6.9	2.6	3.3	3.5	7.8	5.87
4. Consumer goods	4.9	4.1	2.9	4.7	6.7	6.57

Source : 1. Sundaram and Dutt, *Indian Economy.*

2. CMIE, India's Industrial Sector, January 1996.

Table 5.7 : Structure of Industrial Factory Sector: By Size of Employment

Employment range (Number)		Factories (Number)	Employees (Number)	Gross Output (Rs. crore)	Net Value Added (Rs. crore)	% share: Factories	% share: Employees	% share: Gross Output	% share: Net Value Added
0-49	1973-74	49,355	837,340	2,913	402	77.0	14.4	14.9	8.7
	1979-80	74,956	1,187,660	7,485	962	78.8	15.5	14.3	8.9
	1984-85	76,072	1,164,763	13,417	1,752	78.5	14.8	12.7	8.4
	1989-90	82,646	1,426,238	31,905	3,867	76.5	17.5	13.8	8.9
	1992-93	90,954	1,509,635	49,463	5,813	76.1	17.3	13.4	8.2
50-99	1973-74	6,911	477,469	1,563	229	10.8	8.2	8.0	4.9
	1979-80	9,800	678,207	4,001	587	10.3	8.8	7.7	5.4
	1984-85	10,480	720,578	7,481	1,113	10.8	9.2	7.1	5.3
	1989-90	13,221	921,688	18,734	2,626	12.2	11.3	8.1	6.1
	1992-93	14,625	1,002,616	30,985	4,298	12.2	11.5	8.4	6.0
100-199	1973-74	3,595	547,328	1,728	341	5.6	9.4	8.8	7.4
	1979-80	4,997	691,118	4,487	761	5.7	9.0	8.6	7.0
	1984-85	4,939	686,911	8,099	1,430	5.1	8.7	7.7	6.8
	1989-90	6,192	851,577	22,224	3,586	5.7	10.5	9.6	8.3
	1992-93	7,172	995,269	39,113	6,574	6.0	11.4	10.6	9.2
200-499	1973-74	2,388	762,680	2,863	621	3.7	13.1	14.6	13.4
	1979-80	2,989	905,452	7,815	1,378	3.1	11.8	15.0	12.7
	1984-85	3,146	970,831	14,103	2,842	3.2	12.3	13.4	13.6
	1989-90	3,674	1,196,612	34,708	6,532	3.4	14.7	15.0	15.1
	1992-93	4,234	1,279,387	56,336	10,799	3.5	14.7	15.3	15.2
500-999	1973-74	963	673,344	2,690	669	1.5	11.6	13.7	14.4
	1979-80	1,152	802,112	6,763	1,500	1.2	10.4	12.9	13.8
	1984-85	1,265	883,348	15,222	3,065	1.3	11.2	14.4	14.7
	1989-90	1,310	1,091,825	37,158	6,962	1.2	13.4	16.1	16.1
	1992-93	1,554	1,085,527	58,465	12,545	1.3	12.5	15.9	17.6
1000-1999	1973-74	524	744,826	3,070	783	0.8	12.8	15.7	16.9
	1979-80	741	1,021,032	8,034	1,769	0.8	13.3	15.4	16.3
	1984-85	609	843,881	15,424	2,803	0.6	10.7	14.6	13.4
	1989-90	611	979,856	38,884	7,901	0.6	12.0	16.9	18.2
	1992-93	598	811,181	46,544	9,426	0.5	9.3	12.6	13.2
2000-4999	1973-74	322	973,485	2,831	892	0.5	16.7	14.5	19.3
	1979-80	399	1,179,866	7,329	1,961	0.4	15.4	14.0	18.0
	1984-85	333	990,632	14,758	2,968	0.3	12.6	14.0	14.2
	1989-90	284	811,731	26,740	6,501	0.3	10.0	11.6	15.0
	1992-93	286	796,291	41,438	8,800	0.2	9.1	11.2	12.4
5000 & above	1973-74	75	803,539	1,910	695	0.1	13.8	9.8	15.0
	1979-80	92	1,212,814	6,344	1,947	0.1	15.8	12.1	17.9
	1984-85	103	1,604,868	17,061	4,914	0.1	20.4	16.2	23.5
	1989-90	54	863,023	20,307	5,398	0.1	10.6	8.8	12.4
	1992-93	71	1,225,041	46,270	12,992	0.1	14.1	12.6	18.2
Total	1973-74	64,133	5,820,011	19,568	4,633	100.0	100.0	100.0	100.0
	1979-80	95,126	7,678,271	52,258	10,865	100.0	100.0	100.0	100.0
	1984-85	96,947	7,871,812	105,566	20,887	100.0	100.0	100.0	100.0
	1989-90	107,992	8,142,550	230,659	43,373	100.0	100.0	100.0	100.0
	1992-93	119,494	8,705,047	368,614	71,248	100.0	100.0	100.0	100.0

Table 5.8 : Structure of Industrial Factory Sector: By Size of Capital

Capital range (Gross value of plant and machinery)		Factories (Number)	Employees ('000)	Fixed Capital (Rs. Crore)	Gross Output (Rs. Crore)	Net Value Added (Rs. Crore)	Percentage distribution: Factories	Employees	Fixed Capital	Gross Output	Net Value Added
Upto 2.5	1989-90	47,552	1,212	685	9,892	1,770	44.0	14.9	0.6	4.3	4.1
	1992-93	46,406	1,171	812	11,534	2,198	38.8	13.5	0.4	3.1	3.1
2.5-5.0	1989-90	15,168	404	593	6,761	901	14.0	5.0	0.6	2.9	2.1
	1992-93	17,155	408	816	9,221	1,166	14.4	4.7	0.4	2.5	1.6
5.0-10.0	1989-90	12,188	421	890	8,960	1,253	11.3	5.2	0.8	3.9	2.9
	1992-93	14,398	431	1,076	11,022	1,533	12.0	5.0	0.6	3.0	2.2
10.0-20.0	1989-90	8,982	438	1,132	9,808	1,300	8.3	5.4	1.1	4.3	3.0
	1992-93	11,465	473	1,651	14,082	1,787	9.6	5.4	0.9	3.8	2.5
20.0-50.0	1989-90	8,318	595	2,381	16,911	2,448	7.7	7.3	2.2	7.3	5.6
	1992-93	10,974	650	3,514	24,874	3,294	9.2	7.5	1.8	6.7	4.6
50.0-100.0	1989-90	3,156	374	2,001	12,010	1,940	2.9	4.6	1.9	5.2	4.4
	1992-93	4,660	452	3,307	19,586	2,880	3.9	5.2	1.7	5.3	4.0
100.0-200.0	1989-90	2,176	433	2,496	12,630	2,459	2.0	5.3	2.3	5.5	5.6
	1992-93	3,051	480	4,789	19,218	3,171	2.6	5.3	2.5	5.2	4.5
200.0-500.0	1989-90	2,053	835	5,535	22,965	4,375	1.9	10.3	5.2	10.0	10.0
	1992-93	2,865	829	9,680	31,988	5,735	2.4	9.5	5.0	8.7	8.0
500.0-1000.0	1989-90	1,014	664	5,509	19,588	3,890	0.9	8.2	5.2	8.5	8.9
	1992-93	1,593	745	10,464	32,178	6,306	1.3	8.6	5.4	8.7	8.9
1000.0-2000.0	1989-90	562	588	6,319	19,590	4,387	0.5	7.2	5.9	8.5	10.0
	1992-93	891	649	11,052	32,857	6,516	0.7	7.5	5.7	8.9	9.1
2000.0-5000.0	1989-90	377	474	9,631	23,052	4,677	0.3	5.8	9.0	10.0	10.7
	1992-93	567	571	14,850	36,201	7,642	0.5	6.6	7.7	9.8	10.7
5000.0-10000.0	1989-90	153	286	7,839	15,413	3,138	0.1	3.5	7.3	6.7	7.2
	1992-93	244	312	11,691	24,686	5,646	0.2	3.6	6.1	6.7	7.9
Above 10000.0	1989-90	114	1,191	61,622	[illegible]	10,517	0.1	14.6	57.6	21.8	24.1
	1992-93	230	1,327	118,924	98,445	22,893	0.2	15.2	61.7	26.7	32.1
Unspecified	1989-90	6,179	226	294	2,752	616	5.7	2.8	0.3	1.2	1.4
	1992-93	4,995	207	245	2,722	482	4.2	2.4	0.1	0.7	0.7
Total	1989-90	107,992	8,143	106,928	230,659	43,373	100.0	100.0	100.0	100.0	100.0
	1992-93	119,494	8,705	192,871	368,614	71,248	100.0	100.0	100.0	100.0	100.0

Table 5.9 : Structure of Ownership of Industrial Factory Sector: 1992-93

	Factories (Nos.)	Employment: Workers ('000 persons)	Employment: Employees ('000 persons)	Wages per worker (Rs.)	Net Fixed Capital (Rs. crore)	Productive Capital (Rs. crore)	Emoluments (Rs. crore)	Gross Value of Output (Rs. crore)	Net Value Added (Rs. crore)
Public Sector	7,319	1,760	2,450	35,444	106,117	128,058	10,451	96,533	22,871
Central govt.	2,139	766	1,052	40,433	51,697	68,376	5,261	58,519	11,685
State local govt.	3,975	898	1,276	31,614	52,365	56,804	4,736	33,195	10,111
Central and State/ Local government Jointly	1,205	95	121	31,419	2,056	2,879	434	4,819	1,074
Private Sector	110,332	4,597	5,847	20,712	75,909	111,192	15,274	244,335	43,812
Corporate	36,827	2,754	3,621	25,963	67,683	102,966	11,751	184,251	36,371
Partnership	47,392	1,173	1,402	11,239	3,473	3,473	1,961	38,587	4,389
Individual proprietorship	23,546	397	458	9,623	976	976	490	7,635	1,106
Co-operative	2,567	272	366	24,579	3,777	3,777	1,072	13,863	1,946
Joint Sector	1,830	292	407	30,880	10,839	16,101	1,536	27,670	4,560
Central government & Private enterprises	888	172	239	32,093	6,868	10,844	938	17,099	2,874
State and/or Local government and private enterprises	942	119	168	29,123	3,971	5,257	598	10,570	1,686
Unspecified	13	1	1	17,986	6	10	3	76	6
Total	119,494	6,649	8,705	25,056	192,871	255,361	27,226	368,614	71,248
Percentage share in total									
Public Sector	6.1	26.5	28.1		55.0	50.1	38.3	26.2	32.1
Central govt.	1.8	11.5	12.1		26.8	26.8	19.3	15.9	16.4
State local govt.	3.3	13.5	14.7		27.2	22.2	17.4	9.0	14.2
Central and State/ Local government Jointly	1.0	1.4	1.4		1.1	1.1	1.6	1.3	1.5
Private Sector	92.3	59.1	67.2		39.4	43.5	56.1	66.3	61.5
Corporate	30.8	41.4	41.6		35.1	40.3	43.1	50.0	51.0
Partnership	39.7	17.6	16.1		1.8	1.4	7.2	10.5	6.2
Individual proprietorship	19.7	6.0	5.3		0.5	0.4	1.8	2.1	1.6
Co-operative	2.1	4.1	4.2		2.0	1.5	3.9	3.8	2.7
Joint Sector	1.5	4.4	4.7		5.6	6.3	5.6	7.5	6.4
Central government & Private enterprises	0.7	2.6	2.7		3.6	4.2	3.4	4.6	4.0
State and/or Local government and private enterprises	0.8	1.8	1.9		2.1	2.1	2.2	2.9	2.4
Unspecified	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0		100.0	100.0	100.0	100.0	100.0

Table 5.10 : Growth in Manufacturing Industries 1980-81 to 1994-95

	1981-82	1984-85	1990-91	1991-92	1992-93	1993-94	1994-95	CARG (%) 1980-81 to 1990-91	CARG (%) 1990-91 to 1994-95
			Index 1980-81 = 100						
Food products	113.5	120.0	169.8	166.2	175.0	161.1	182.7	5.4	1.8
Beverages & tobacco	104.3	111.7	104.8	119.1	113.7	137.8	132.6	0.5	6.1
Textiles	99.0	101.5	122.0	119.9	137.6	148.2	143.2	2.0	4.1
Cotton textiles	99.7	102.2	126.6	126.2	150.1	160.5	155.8	2.4	5.3
Jute, sannhemp & mesta	95.7	99.4	101.6	90.4	86.3	103.2	92.4	0.2	-2.4
Other textiles products	96.7	95.6	103.2	97.2	75.8	73.4	78.4	0.3	-6.6
Wood & wood Products	153.2	216.5	197.2	185.0	190.3	199.3	207.9	7.0	1.3
Paper & paper products	108.3	131.9	197.9	209.6	210.9	224.9	256.6	7.1	6.7
Leather & its products	128.1	139.7	194.3	196.6	187.7	203.0	210.9	6.9	2.1
Rubber, plastic, petroleum & coal products	119.2	147.2	174.0	172.4	175.6	176.4	184.5	5.7	1.5
Chemicals & its products	116.9	142.8	254.1	262.8	277.1	297.6	327.8	9.8	6.6
Non-metallic minerals	106.7	138.4	193.0	205.2	209.0	218.5	233.4	6.8	4.9
Basic metals	100.0	107.3	158.8	168.5	168.7	219.0	193.9	4.7	5.1
Metal products	94.6	105.0	143.1	139.9	125.1	126.6	150.8	3.6	1.3
Non-electrical machinery	111.1	127.6	186.9	184.4	180.9	188.4	204.1	6.5	2.2
Electrical machinery	103.9	148.8	563.6	493.6	483.2	453.5	597.8	18.9	1.5
Transport equipment	108.1	131.6	192.5	191.5	200.5	211.2	237.6	6.8	5.4
Other manufacturing	149.2	122.8	321.8	269.8	280.7	266.5	262.5	12.4	-5.0
			Percentage change over the previous year						
Food products	13.5	-0.9	12.5	-2.1	5.3	-7.9	13.4		
Beverages & tobacco	4.3	6.9	1.7	13.6	-4.6	21.3	-3.8		
Textiles	-1.0	4.8	8.5	-1.7	14.8	7.7	-3.3		
Cotton textiles	-0.3	2.0	12.7	-0.3	18.9	6.9	-2.9		
Jute, sannhemp & mesta	-4.3	27.1	4.3	-11.0	-4.5	19.6	-10.5		
Other textiles products	-3.3	3.8	-32.0	-5.8	-22.0	-3.2	6.9		
Wood & wood Products	53.2	29.3	12.0	-6.2	2.8	4.8	4.3		
Paper & paper products	8.3	20.7	9.0	5.9	0.6	6.7	14.1		
Leather & its products	28.1	20.1	3.2	1.2	-4.5	8.2	3.9		
Rubber, plastic, petroleum & coal products	19.2	8.2	0.3	-0.5	1.8	0.5	4.6		
Chemicals & its products	16.9	9.0	2.6	3.4	5.5	7.4	10.2		
Non-metallic minerals	6.7	13.0	1.6	6.3	1.8	4.5	6.8		
Basic metals	0.0	12.8	10.5	6.1	0.1	29.8	-11.4		
Metal products	-5.4	19.2	0.4	-2.2	-10.6	1.2	19.1		
Non-electrical machinery	11.1	6.7	8.7	-1.3	-1.9	4.2	8.3		
Electrical machinery	3.9	4.0	22.7	-12.1	-2.1	-6.2	31.8		
Transport equipment	8.1	6.6	6.3	-0.5	4.7	5.3	12.5		
Other manufacturing	49.2	17.4	-3.5	-16.2	4.0	-5.0	-1.5		

Table 5.11 : States-wise Net Value Added in Manufacturing Sector 1992-93 (Rs. crore at Current Prices)

	Manu-facturing	Electri-city	Gas & steam	Storage and ware-housing	Water work and Supply	All Indus-tries	% to All India
				0.32	5	4,298	6.0
Andhra Pradesh	3,427	865			11	830	1.2
Assam	807	17	7	2	2	3,434	4.8
Bihar	2,652	777	1	4	34	1,206	1.7
Delhi	1,166						
						253	0.4
Goa Daman & Diu	253		50	0.34	2	8,038	11.3
Gujarat	7,029	956	-7			1,609	2.3
Haryana	1,623	-7	1			442	0.6
Himachal Pradesh	219	222					
						91	0.1
Jammu & Kashmir	91				19	122	5.8
Karnataka	3,190	912			25	814	2.5
Kerala	1,497	292	2	[illegible]	4	907	5.5
Madhya Pradesh	2,918	983					
			2	29	34	16,210	22.8
Maharashtra	14,019	2,126				-3	neg.
Manipur	-3					31	neg.
Meghalaya	11	2				7	neg.
Nagaland	7						
				1		1,411	2.0
Orissa	1,104	306	3	0.47	-0.17	2,927	4.1
Punjab	1,802	1,122		0.10	-0.31	2,326	3.3
Rajasthan	1,659	667			1	7,303	10.2
Tamil Nadu	6,600	[illegible]					
					1	22	neg.
Tripura	15	6	2	15	14	6,491	9.1
Uttar Pradesh	4,961	1,500	0.23	24	17	4,174	5.9
West Bengal	3,441	692					
					1	11	neg.
Andaman & Nicobar	20	10			5	91	0.1
Chandigarh	86					59	0.1
Dadra & Nagar Haveli	59					144	0.2
Pondicherry	144		61	78	165	71,248	100.0
All India	58,796	12,149					

UNIT : 6 PUBLIC SECTOR IN INDIA

Objectives

The main purpose of this unit is to help you:

- understand the nature and importace of public sector in India
- understand the objectives of public sector
- analyse the structure and growth of public sector, and
- understand the functioning and performance of public sector.

Structure

6.1 Introduction
6.2 Objectives and Scope of Public Sector
6.3 Strucutre and Growth of Public Sector
6.4 Working of Public Sector
6.5 Performance of Public Sector
6.6 Summary
6.7 Key Words
6.8 Self-Assessment Questions
6.9 Further Readings
Appendix 3: Statistical Tables

6.1 INTRODUCTION

In India's mixed economy, public sector occupies a pivotal position. Public enterprises are expected to make significant contribution to growth in national income, creation of employment opportunities, reduction in income disparities among regions and groups, earning of foreign exchange and generation of surpluses for financing development efforts. Over a period of time, in the post-Indepdendence period, the size of the public sector has grown rapidly, and the number of public enterprises as well as the areas of their operation have recorded significant progress. Public sector was expected to achieve "commanding heights"in the economy and it did so over a period of forty years. However the quantitative growth of the public sector was not matched by qualitative performance. Many public sector enterprises were incurring losses. The performance of public sector in general was so discouraging that as part of New Economic Policy announced by, the Indian government in. 1991 the scope and role of the public sector was sought to be reduced drastically. An understanding and analysis of economic environment of business in India is not complete without an understanding and objective assessment of our public enterprises. This unit attempts to explain the objectives of India's public sector. It analyses the various aspects of structure and growth of public sector, and evaluates the performance of public sector. Finally, it discusses the shortcomings of public sector enterprises.

6.2 OBJECTIVES AND SCOPE OF PUBLIC SECTOR

The public sector exists in contrast to the private sector my owned,.controlled and managed by the government (Central State and Local) comes under public sector. After the attainment of independence and the advent of planning, there has been a rapid expansion of the scope of the public sector. The passage of Industrial Policy Resolution of 1956 and the adoption of the socialist pattern of society as our national goal further led to a deliberate enlargerment of public sector. From the standpoint of organization, structure and management four types of public sector enterprises in India:

1. Those which are departmentally managed (departmental enterprises such as the Indian Railways)
2. Those which are managed by independent boards
3. Those which are run as public corporations (which come into existence by Acts of Parliament)
4. Those which are organised as companies (registered under the CompaniesAct)

The objectives of the public sector, can be briefly described as:

1. to accelerate the economic growth and industrialisation of the country by creating the necessary infrastructure for development;
2. to promote fair distribution of income and wealth, interpersonal as well as inter-regional;
3. to promote balanced regional development;
4. to promote the growth of strategic defence-oriented industries;
5. to assist the development of small and ancillary industries;
6. to create employment opportunities;
7. to achieve socialist pattern of society;
8. to avoid and circumvent the limitations and abuses of the private sector; and
9. to generate forces of economic and technological self-reliance.

Let us elaborate these objectivcs of the public sector which inspired its rapid growth. In a developing country like India, some industries need to be brought within public ownership and control in order to achieve rapid economic growth. Public enterprises became an essential part of the economic development programme in India. The justification for public enterprises in India is based on the fact that the rate of economic development planned by the government is much higher than can be achieved by the private sector alone. In other words, the public sector is essential to acheive the objective of accelerated rate of economic development.

Heavy industry strategy initiated during the Second Plan period called for a pattern of resource allocation which necessitated expansion of the public sector. The Public sector proved to be a means for rapid development of heavy and basic industries.

The objective of economic equity, inter-regional and inter-personal, also promoted rapid growth of public sector. The anxiety for balanced regional development found a means for it in public sector growth. Public enterprises of the Central government are to be set up in those regions which are underdeveloped and where local resources are not adequate. A revealing example is the setting up of the three public sector steel plants at Bhilai, Rourkela and Durgapur which were meant to help industrialise the regions surrounding the projects.

Funds for financing development can be, generated by way of surpluses from public enterprises. The surplus of government enterprises can be reinvested in the same industries or can be used for the establishment and expansion of other industries. No doubt, private sector industries can also plough back whole or substantial amounts of their profits for expansion. However, profits in private enterprises are declared as dividends among share-holders. This would only create income inequalities among people. But surpluses of public sector enterprises can be directly used for capital formation to promote the objective of accelerated economic development.

Employment growth objective as well as the objective of promoting small and ancillary industries to achieve several other objectives can be achieved through the means of public sector expansion. The objective of earning/saving foreign exchange is also fulfilled by the growth of the public sector.

Some public sector enterprises were started specifically to produce goods which were formerly imported in order to save foreign exchange. The entry of Hindustan Antibiotics Limited and the Indian Drugs and Pharmaceuticals Limited into the manufacture of drugs and pharmaceuticals were meant to remove the monopolistic stranglehold of foreign enterprises in the field and have helped India to save foreign exchange used for importing these items. Likewise, the Oil and Natural Gas Commission and the Indian Oil Corporation are public enterprises which attempt directly to increase self-reliance of the country and reduce our dependence on imports. The Bharat Electronics Limited has saved foreign exchange by way of import substitution

Most of the public sector enterprises were started keeping in mind the requirements of the Indian economy in the fields of production and distribution. However, some public enterprises have done much to promote Indian exports. The State Trading Corporation have done a good job of export promotion in all parts of the world. Considerable success has been achieved in pushing up the exports of Indian handicrafts, light engineering goods and many other new items of exports. Hindustan Steel Ltd., the Bharat Electronics Limited, the Hindustan Machine Tools, etc. are some of the public enterprises which are exporting increasing proportion of their output and earning foreign exchange. The foreign exchange earnings of the public sector increased from about Rs. 35 crores in 1965-66 to about Rs. 9198 crores in 1991-92.

Public sector growth, it was beleived, contributes importantly to the achievement of the objective of socialistic pattern of society. The socialistic pattern of society calls for extension of public sector in two ways. Firstly, production will have to be centrally planned as regards the type of goods to be produced, the volume of output and the timing of their production. It may be comparatively easy to achieve this through public sector rather than through private sector. It is worth quoting from the Second Five Year Plan in this connection: "The adoption of the socialistic pattern of society as the national objective, as well as the need for planned and rapid development require that all industries of basic and strategic importance, or in the nature of public utility services should be in the public sector. Other industries which are essential and require investment on a scale which only the State, in present circumstances, could provide, have also to be in the public sector."

Secondly, one of the objectives under the Directive Principles of State Policy in our constitution is to bring about reduction in the inequalities of income and wealth and to establish an egalitarian society. The Five Year Plans have taken up this as a major objective. The public sector may be used as an instrument for achieving this objective for the following reasons: 1. the surpluses of public enterprises will go to the government unlike those of private enterprises which enrich private pockets 2. There can be effective regulation of income of top executives in public enterprises (with steps to ensure managerial efficiency in public enterprises) 3. The public enterprises can adopt discriminatory pricing to benefit poorer classes. 4. They make possible raising of wage income of the low-

paid workers. 5. They help to reduce income from imports for private individuals. It is worth mentioning in this connection the opinion of Prof. V.K.R.V. Rao: "sectors of economic activity which involve either monopoly conditions or strategic economic power or possession of large resources in private hands should be publicly owned and operated as public enterprises. It also means that public enterprises should make themselves responsible for the building of the economic over heads like transport, power, fuel, and basic capital goods without which increase in the production of consumption goods and services either on the required scale or necessary economic basis will not be possible, irrespective of whether it is to be in the private or public sector.... without public enterprise, there can be no private enterprise. In fact, it is the former that enables the full growth of the latter." (V.K.R.V. Rao, "The Public Sector in Indian Socialism" in P.R. Brahmananda and Other (eds.), *Indian Economic Development and Policy* (1979), pp. 26-27.

Limitations of and abuses by the private sector also necessitate public takeover or government initiative. When initial capital requirements are large, private sector fails to come forward in a big way. In such cases, public sector enterprise is the answer (example, steel industry). When risks involved are large, privatesector may be reluctant to take up the activity. For development reasons, public sector may have to fill the gap (e.g., fertilizer units). The sickness of private sector units necessitates take over by the public sector (e.g., sick textile units in Private Sector formed into National Textiles Corporation (NTC) . In the interests of workers/ employees, consumers or in the interest of society in general, nationalisation may be warranted (e.g., nationalisation of life insurance and major commercial banks).

To conclude, the establishment and expansion of public sector was aimed at the fulfilment of our national goals such as the removal of poverty, the attainment of self-reliance, redudction in income inequalities, expansion of employment opportunities, removal of regional imbalances, acceleration of the pace of economic development, reduction of concentration of economic power and of monopolitic tendencies. By acting as an effective countervailing power (a phrase of Professor Kenneth Galbraith, *American Capitalism: the Concept of Countervailing Power*) to the private sector, it would hopefully make the country self-reliance in modern technology and create professional, technological and managerial cadres so as to ultimately rid the country from dependence on foreign aid.

We have noted above the important objectives of the public sector. Now we turn to the understanding of the role of public sector in the Indian economy. To understand the role and importance of public sector in the economy, we have to get quantitative idea about it. Public sector expanded rapidly only since 1960. The size of the public sector is to be understood through several indicators such as employment, investment, and value of output. You will learn the details about public sector growth and structure in the later sections. Here it is sufficient to note the importance of public sector in the Indian economy by the size of the indicators mentioned above.

In 1992-93 (the latest year for which data are available) public sector accounted for 6.1 per cent of total number of factories. If we go by the employment criterion, public sector had 26.5 per cent of total workers in the factory sector and 28.1 per cent of total employees. Public sector accounted for 55.1 of net fixed capital, and more than 50 per cent of fixed capital in the factory sector. As for the gross output criterion, public sector accounted for 26.2 per cent of the gross value of output of the factory sector. Public sector accounted for 32.1 per cent of net value added by the factory sector. Net value added is the gross value of output minus the value of intermediate inputs minus depreciation. These figures bring out clearly the role and importance of public sector in the Indian economy. It may be noted in this connection that public sector provides many producer and capital goods to the private sector (e.g. steel. for all economic activities and fertilizers for the agricultural sectors). Public sector has entered into a wide spectrum of indus-

tries. Its operations involve basic and capital goods like steel, coal, copper, zinc, and other minerals, and heavy machinery. We find public sector important in drugs and chemicals, fertilizers, consumer goods like textiles, hotel services, watches, bread etc. Most of these industries have strategic importance in the Indian economy since they have high linkages.

Activity

In 1966, the then Prime Minister proclaimed the objectives of public sector in India as follows:

"Wc advocate a public sector for three reasons: to gain control of the commanding heights of the economy; to promote critical development in terms of social gain of strategic value rather than primarily on considerations of profit; and to provide commercial surpluses with which to finance further economic development." (Quoted in Lok Udyog, June 1976)

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Explain in about 50 words each of the objectives announced by the Prime Minister.

Activity 2

a) Classify each of the following companies by putting a (A) againt it in the appropriate box.

Company	Public Sector	Private Sector	Joint Sector
Hindustan Lever Ltd.,			
Hindustan Machine Tools			
Indian Airlines			
Maruti Udyog			
Cochin Refineries			
Andhra Paper Mills			
Hero Cycles			
National Textile Corporation			
Kundremuk Iron Ore			
Delhi Cloth Mills			
Modern Bakeries			

b) Quite a few of our public enterprises have long names. We often use abbreviations (called acronyms) to identify them. Can you spell them out? You may like to extend the list yourself.

Acronym	Full name
BHEL	
BEL	
CIL	
DVC	
HAL	
FCI	
HSL	
HMT	
IDPI	
ITI	
MMTC	
ONGC	
IOC	
NIDC	

c) Now that you know that our public enterprises produce goods (such as metals, oil, consumer goods etc.) as well as services (transport, trade, finance etc.), can you broadly classify the enterprises listed above in (a) into the two groups: as indicated below:

Goods Public Enterprises Services

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6.3 STRUCTURE AND GROWTH OF PUBLIC SECTOR

Composition of public sector output is an important structural dinmension of public sector. In 1960-61, primary output of the publice sector (enterprises in agriculture, forestry and logging, mining and quarrying) accounted for 6.4 per cent of gross domestic product originating in the public sector which secondary output (output of manufacturing, electricity, gas and water supply and construction) accounted for 11.0 per cent. Services (trade, hotels, restaurants, transport etc.) accounted for 82.6 per cent of public sector contribution to GDP. By 1989-90, the latest year for which data are available, the share of the primary output fell to 4.96 per cent (from 6.4 per cent in 1960-61), the share of secondary output rose to 23.36 per cent (from 11.0 per cent in 1960-61) the share of services output fell to 71.68 per cent (from 82.6 per cent in1960-6l). Thus the structural change in public sector during the period 1960-61 to 1989-90 consisted in the increase in the share of secondary output relative to primary and services output (See Table 6. IA to 6.IC)

Table 6.2A gives the employment structure of the public sector.

The share of public sector in total employment reveals that in transport and communic tions, electricity, gas and water supply, and construction, the share of the public sec exceeded 90 per cent. After, nationalisation of coal mines and major banks a major pa of employment in these areas is accounted for by the public sector.

Employment in the public sector increased from 107.0 lakhs in 1971 to 193.0 lakhs in 1995 (See Table 6.2). The public sector accounted for 61.1 percent of total organised sector employment in 1971. This share went up to 70.4 per cent by 1995). Thus the private sector

accounted for only 29.6 per cent of total organised sector employment. During the period 1976-1995 the average annual growth rate of employment in the public sector worked out to be 1.8 per cent. During the same period the growth rate of employment in the private sector was 1.1 per cent, significantly lower than the public sector employment growth rate. Public sector thus has been an important source of organised sector employment.

As you know, capital is an important factor of production. Capital formation takes place through investment. Net investment during a year is an addition made to the capital stock. In other words, capital stock in an economy increases through net investment. Savings out of current income when invested add to the capital stock of the economy. Let us now look at trends in savings, capital formation and capital stock of the public sector. Table 6.3 gives information on savings and capital formation in public and private sectors.

Gross domestic capital formation increased from 10.7 per cent of Gross National Product (GNP) during the First Plan period to 22.8 per cent during the Seventh Plan period. As for the capital formation in public sector, it increased from 3.5 per cent of GNP during the First Plan period to 10.7 per cent during the Seventh Plan period. The share of public sector in capital formation increased from 33 per cent during the First Plan period to 47 per cent during the Seventh Plan period. The rapid growth of public sector is evident from this.

However, the rate of savings of the public sector fell short of the rate of capital formation. The share of the public sector savings in total gross domestic savings decreased from 17per cent during the First Plan period to 11 per cent during the Seventh Plan period. The public sector has been financing its capital formation through incurring debt. This debt financing increased substantially during the 1980s decade.

Table 6.4 gives the share of the public sector in capital stock. The term 'capital stock' refers to the total stock of plant and machinery, equipment and tools and other capital goods available at a point; of time for further production. Capital stock represents produced means of production. The term investment (or gross capital formation) refers to annual flow of installation of goods partly to meet the needs of depreciation of capital stock and partly to increase the size of the total capital stock on a net basis. Table 6.4 reveals that capital stock in the public sector rose in real terms (at 1970-71 prices) from Rs. 16377 crores in 1960-61 to Rs. 68478 crores in 1979- 80. The rate of growth of capital stock in the public sector was 7.8 per cent per annum as against 4.9 per cent in the private sector. As a consequence, the share of the public sector increased from 28 per cent in 1960-61 to 37 per cent in 1979-80 in the total capital stock of the country.

In this connection it may be noted that capital intensity (capital per unit of output) of production in public sector is significantly higher than that of private sector. This is largely due to the differences in the nature of investment in the two sectors. The important differences are listed below.

1) A good part of the investment in the public sector goes into economic overheads such as roads, buildings and communications which are essential for economic development but do not contribute to output in the normal sense of the term.

2) The public sector has played a significant role in developing the key industries of the economy and these indusiries such as iron and steel and power by their very nature are areas of high capital intensity.

3) Many projects in the public sector have longer gestation periods. Capital outlays are large and take time to yielding results.

4) Areas of higher output-capital ratios fall mainly in the private sector. Examples are consumer goods industries, small-scale and cottage enterprises.

An eloquent measure of the dynamic expansion of the public sector in Inda is the growth in sales of public enterprise. The sales have grown at the rate of 1 8.2 per cent per annum during the period 1970-71 to 1987-88. During the recent period 1980-81 to 1990-91, the gross product of public sector increased from Rs. 24,171 crores to Rs. 1,24,923 crores.

Despite many criticisms against the public sector enterprises, there is no denying the fact that rapid industrialisation of the Indian economy in the post-Independence period was mainly due to the growth of the public sector. A strong and well-diversified industrial base has been laid and in many respects India has achieved self-reliance.

Public Sector in the present Scenario

Public sector which was expected to acheive "Commanding heights" of the economy did grow very rapidly during the planning era. But inefficiencies of various kinds have become the hallmark of the public sector. Debt financing of public investment became quite common during 1980s decade. In 1976-77 public saving financed 49 per cent of gross public investment. In 1981-82 the ratio came down than four-fifths of public investment thus was financed by borrowing from domestic private and external sectors. Public enterprises have shown very low rate of return on the huge capital invested. This has reduced their ability to regenerate themselves in terms of new investments and technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government.

In the national economic scenario resulting from the Economic reforms of 1991 the scope of public sector is reduced and is confined only to infrastructure and strategic industries. The priority areas for growth of public enterprises in future will be the following:

1) Essential infrastructure goods and services.

2) Exploration and exploitation of oil and mineral resources.

3) Technology development and building of manufacturing capability in areas which are crucial in the long term development of the economy where private sector investment is inadequate.

4) Manufacture of products where strategic considerations predominate such as defence equipment.

The disinvestment in the public sector units has been going on. According to the data provided by the GOI, Economic Survey 1995-96 a total amount of around Rs. 10500 crores has already been disinvested to the public sector financial institutions, mutual funds and the general public.

Activity 3

Make use of Table 6.1 and calculate annual average percentage change in products originating in public sector during the period 1960-61 to 1990-91. Find the average annual change.

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6.4 WORKING OF PUBLIC SECTOR

Working of private enterprises is largely governed by the profit motive. All managerial decisions in the working of private enterprise thus are geared to earn as much profit as possible. These decisions are, of course, constrained by the environment, within which an enterprise is to operate. The behaviour of an enterprise working in a competitive environment differs from that operating in (say) oligopolistic environment. But the prime motive in the, case of the private enterprise is maximization of profits.

In the case of public enterprises social good is the main goal and working of public enterprises is governed by this goal. Higher utilization of capacity (to produce as much output as possible given the capcity constraint), efficiency in running the enterprise, being accountable to public and following proper pricing policies are some of the norms public enterprises need to satisfy in their working. We have to pay attention to two aspects of working of public enterprises. One is public accountability. The second is pricing policies.

Public Accountability

A difficult problem faced by public enterprises is to reconcile the demands of accountability and autonomy. Autonomy in managing and running the concern is needed to ensure a high degree of efficiency. Without such a freedom to the management in choosing it policies (e.g., wage policy and the like) decision making is delayed flexibility in management is lost, and efficiency in its diverse aspects cannot be ensured. On the other hand, since public undertakings are (a) using public funds and (b) are meant to work for social good, it is necessary that the independence of the management must be subjected to the accountability constraint. It is necessary to strike a proper balance between autonomy and accountability. Three major constituents of public enterprise accountability are:

- Accountability to Parliament
- Accountability through Audit
- Accountability in Annual Reports.

Parliamentary control is essential through a number of ways such as questions, short discussions, the work of Committees on Public Undertakings (CPU), approvals and reporting about investment and loans, public enquiry based on the recommendations of CPU etc.

Auditing (financial efficiency and propriety) is an important instrument of accountability. There are also systems of Supplementary Audit and Social Audit. Each Audit has its own purpose and justification. However, sometimes too many audit objections may hinder managerial initiative and efficiency and they may come in conflict with the principle of autonomy.

Finally, there is accountability through the sytem of annual reports. The Bureau of Public Enterprises (BPE) has issued guidelines about the coverage in Annual Reports. Among other aspects, Annual Report must cover a summary of financial results, changes in

accounting methods, changes in price policy, important events affecting production and productivity, staff welfare activities etc. In parliamentary democracy these several instruments of public accountability go some way in ensuring that public enterprises serve public need in a responsible manner.

Price Policy in Public Enterprises

In public enterprises, the pricing function is "diffused over the minister, the department and the managers". Even when the government, through the minister concerned, decides about the general price-profit policy, the actual details of the price structure will have to be worked out by the management of the undertaking. In general so far as the public enterprises are concerned, the government decides the pricing policy while the managers of particular enterprises decide the price structure within the general framework of the Government's price policy

Activity 4

Of the following options for pricing products of public outer which one would you consider as the best and why?

1) Marginal Cost pricing
2) Average Cost pricing
3) Import Parity price
4) Mark-up Pricing

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6.5 PERFORMANCE OF PUBLIC SECTOR

Prior to 1991 when New Economic Policy was announced, while the government has been pushing ahead with more and more public sector undertakings, there has been considerable criticism about the poor performance, and in some cases utter failure, of government undertakings in the country.

For the reasons mentio'ned earlier the performance of public enterprises cannot be judged solely on the basis of profit criteria. Some of the public enterprises were running on profit while many others were running on losses. The over-all picture reveals that between 1960-61 and 1977-78 percentage of profit after tax to total paid-up capital and reserves has ranged between 0.2 to 4.6 per cent. Thus by the criterion of "profit after tax" the performance of the public sector was been poor.

In Table *6.5* trend of performance of the working enterprises is shown. A few points may be made about the financial performance of public enterprises.

Since 1980-81, gross profit as a ratio of capital employed (rate of return on capital) has shown a distinct improvement. It increased from 7.8 percent in 1980-81 to 13.1 per cent in 1982-83. In the subsequent years it has been in the range of 12 to 13 per cent. Reviewing the situation the *Public Enterprises Survey* (1989-90) mentioned: "In absolute terms net profits (after tax) of Central government public enterprises rose substantially from Rs. 2993 crores in 1988-89 to Rs.3781 crores in 1989-90. The rate of return, as

measured by net profits to capital employed rose to 4.5 per cent in 1989-90, which is the highest in the decade. However, as in previous years, the petroleum sector enterprises contributed the overwhelming bulk of these profits Rs. 2899 crores out of the total 3789 crores in 1989-90. (76.6% of total). Thus, the 200 odd non-petroleum enterprises contributed a meagre sum of Rs. 883 co'es. While this reflected an improvement over the net profit of Rs. 431 crores in 1988-89, the ratio of net profits to capital employed in non-petroleum sector enterprises was barely 1.3 per cent in 1989-90." Clearly there is substantial scope for improving financial performance of non-petroleum Central government enterprises.

During 1990-91 and 1991-92 gross profit as a proportion of capital employed declined to 10.9 per cent and 10.7 per cent respectively. Net profit of public enterprises declined from Rs. 3789 crores in 1989-90 to Rs. 2272 crores in 1990-91. The net rate of return declined from 4.5 per cent in 1989-90 to 2.2 per cent in 1990-91, the lowest since 1984-85. During 1991-92 it declined further to 2.1 per cent. The petroleum sector, as in the earlier years, accounted for bulk of the net profit Rs. 1779 crores out of the total of Rs. 2475 crores. But 1991-92 being a year of foreign exchange crisis, resource crunch and a year of general slackening of industrial production, the public sector also suffered the impact of overall economic deeleration.

As noted before, it is not appropriate to treat profits as the sole criterion of efficiency of the public sector. The gains to employees and welfare expenditures on employees in public enterprises are to be noted in this connection. The real emoluments per employee in the public sector went up from Rs. 11210 in 1978-79 to Rs. 17339 in 1991-92. The annual growth rate of real emoluments works out to 3.43 per cent during this period. Further, as against Rs. 420 in 1968-69, the average annual expenditure per employee on welfare activities increased to Rs. 4427 in 1988-89. A total sum of Rs. 974 crores in the form of houses, educational facilities, medical care etc., was spent in 1988-89 for the benefits of employees

The public sector by assuming responsibility of rehabilitation of sick units (example, textile mills in private sector) had to bear a burden considerable in order to save 1.6 lakh employees from the spectre of unemployment. This social responsibility explains to some extent the lower profitability of public sector.

By the criterion of capacity utilisation also, the public sector performance is founu to be better (relative to the private sector) by some studies. The foreign exchange earnings of public enterprises also constitute a performance indicator. The value of exports of central public sector enterprises increased from Rs. 502 crores in 1972-73 to Rs. 6366 crores in 1989-90. Physical productivity measures also are to be used as performance indicators.

Activity 5

a) Use data in Table 6.5 to compute a) Turnover-Employment ratio, b) Gross Profit-Turnover ratio and c) Turnover-Capital employed ratio and comment on the trends in these ratios.

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b) Graph the two rates of return (Table 6.5) measuring years on X-axis and rate of return on Y-axes, and comment on the emerging profiles.

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6.6 SUMMARY

The public sector in India has grown very rapidly. There are important reasons for promoting public sector. Public sector growth has helped in achieving infrastructural development on the one hand and a strong and well-diversified industiral base on the other. Criteria of operational efficiency show that there is need for improving substantially the performance of public sector enterprises. This is a managerial challenge, given the economic environment within which public enterprises have to function.

6.7 KEY WORDS

Public Sector Any activity owned, controlled and managed by the Government (Central, State, Local).

Autonomy and accountability Autonomy in managing and running the concern is needed to ensure a high degree of efficiency. Without such freedom to the management in choosing its policies, the decision-making processes, wage determination and the like, the flexibility for management is lost and efficiency in its diverse aspects cannot be ensured On the other hand, since public undertakings are using public funds and they are meant to work for social good, it is necessary that the independence of the management must be subjected to the accountability constraint. It is necessary to strike a proper balance between autonomy and accountability.

6.8 SELF-ASSESSMENT QUESTIONS

1) State and explain the major objectives of the public sector. In your opinion which of them are more important.
2) Give different criteria, evaluate the performance of public enterprises.
3) using different criteria, evaluate the performance of public enterprises.
4) Refer to recent *Public Enterprises Survey* and update data in Table *6.5*.
5) Explain the following concepts:

   a) Gross Investment   b) Net Investment

   c) Capital   d) Gross value added
6) As a prospective manager in a public enterprise how would you resolve the possible conflict between autonomy and public accountability of public enterprises?

6.9 FURTHER READINGS

PraBasu, sahlad Kumar, *Performance Evaluation for Perfomance Improvement*, Allied Publishers 1991.

Gouri, Geeta (Ed.) *Privatisation and Public Enterprises*, Oxford and IBH Publishing, 1991.

Mathur B.P, *Public Enterprises Management*, Macmillan, 1993

Shrivastava, M.P., *Problem of Accountability of public Enterprises in India*. Uppal Publishing, 1987.

The following are regular annual publications of the Government of India. Make sure that you get the latest issue of each. You may also update the statistics given in various tables.

CSO, National Accounts Statistics, Latest Issue.

GOI, *Economic Survey*, Latest Issue

Bureau of Public Enterprises, *Public Enterprise Survey*, Vol.1 Latest Issue.

Appendix 3: List of Statistical Tables

Table 6.IA Gross Domestic Product from Public Sector by Industry of origin

Table 6.IB Grosss Domestic Product from Public Sector by Type of Economic Activity and by Type of Institution

Table 6.IC Domestic Product in Public Sector

Table 6.2 Employment in Organised Public and Private Sectors

Table 6.2A Employment in the Public Sector by Industry in 1994

Table 6.3 Share of Public Sector in Gross Domestic Saving and Capital

Table 6.4 Share of the Public Sector in Capital Stock

Table 6.5 Performance of Central Public Enterprises.

Table 6.1A : Gross Domestic Product from Public Sector by Industry of Origin

Industry	1960-61	1961-62	1962-63	1963-64	1964-65	1965-66	1966-67	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
1. agriculture	31	42	44	55	63	81	92	100	117	117	142	164	197	210	256	288	324	382	453	488
2. forestry & logging	48	52	57	62	66	77	81	88	96	102	107	125	142	166	201	231	274	304	349	378
3. mining & quarrying	19	18	31	36	32	46	68	84	94	112	118	130	166	389	542	745	873	897	993	1432
4. manufacturing	57	75	105	153	199	221	251	303	360	463	541	535	630	841	1274	1310	1564	1742	1978	2325
5. electricity, gas & water supply	61	71	85	103	123	141	179	214	265	318	37[illegible]	411	447	472	617	774	1025	1175	1434	1658
6. construction*	50	54	62	72	73	93	99	121	140	145	154	182	199	260	345	353	429	507	585	816
7. trade, hotels & restaurants	5	6	9	7	13	23	35	32	49	74	89	134	151	189	237	424	526	626	622	726
8. transport, storage & communication	440	483	543	603	640	709	779	825	942	1009	1096	1190	1259	1296	1563	1900	2398	2533	2700	2898
8.1 railways	301	327	370	408	418	463	492	498	548	571	597	644	656	584	738	901	1113	1129	1087	1105
8.2 transport by other means & storage	74	82	92	102	115	128	150	178	214	235	261	281	327	399	468	590	741	805	914	1033
8.3 communication	65	74	81	93	107	118	137	149	180	203	238	265	276	313	357	409	544	599	699	760
9. banking & insurance	64	72	98	106	123	157	158	187	210	293	429	520	598	782	1034	1343	1639	1841	2023	2276
10. public administration & defence	564	623	702	816	934	1041	1166	1322	1446	1590	1735	1948	2114	2396	3074	3486	3727	3998	4414	4999
11. other services	185	221	243	273	309	365	424	508	569	662	[illegible]	799	887	1010	1186	1396	1623	1784	2000	2216
12. total	1524	1717	1979	2286	2575	2954	3332	3784	4288	4885		6138	6790	8011	10329	12250	14402	15789	1755	20212

* Including ownership of dwellings

Note: Contribution of fishing industry in Public Sector is negligible

Table 6.1B: Gross Domestic Product from Public Sector by Type of Economic Activity and by Type of Istitution

(at 1980-81 prices)

Industry	1980-81	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1. agriculture, forestry& fishing	1357	1498	1603	15609	1617	1595	1630
1.1 agriculture	922	1135	1150	1186	1196	1214	1234
1.1.1 departmental enterprises	838	1087	1099	1121	1144	1164	1188
1.1.2 non-departmental enterprises	64	48	51	65	52	50	46
1.2 forestry & logging	435	361	451	372	419	380	395
1.2.1 departmental enterprises	424	323	399	318	356	312	331
1.2.2 non-departmental enterprises	11	38	52	54	63	68	64
1.3 fishing		2	2	2	2	1	1
1.3.1 non-departmental enterprises		2	2	2	2	1	1
2. mining & quarrying	1715	4151	4431	4310	4746	4805	5003
2.1 non-departmental enterprises	1715	4151	4431	4310	4746	4805	5003
3. manufacturing	2823	5665	5467	6209	6614	6768	6930
3.1 depratmental enterprises	9	980	883	938	969	891	977
3.2 non-departmental enterprises	2814	4685	4584	5271	5645	5877	5953
4. electricity, gas & water supply	1878	3777	4205	4511	4974	5328	5736
4.1 administrative departments	144	322	348	366	374	395	418
4.2 departmental enterprises	87	169	185	201	219	233	251
4.3 non-departmental enterprises	1647	3286	3672	3944	4381	4700	5067
5. construction	993	1500	1797	1879	1884	1978	2011
5.1 administrative departments	372	849	1061	1143	1133	1185	1189
5.2 departmental enterprises	494	580	611	614	598	601	623
5.3 non-departmental enterprises	127	151	125	122	153	192	199
6. trade, hotels & restaurants	824	876	859	865	836	818	927
6.1 trade	797	836	801	827	803	786	890
6.1.1 departmental enterprises	15	35	19	16	10	-1	12
6.1.2 non-departmental enterprises	782	801	782	811	793	787	878
6.2 hotels & restaurants	27	40	58	38	33	32	37
6.2.1 non-departmental enterprises	27	40	58	38	33	32	37
7. transport, storage & communication	3104	4440	4671	4766	4959	5165	5393
7.1 railways	1123	1560	1623	1677	1778	1758	1746
7.2 transport by other means	1150	1541	1626	1571	1565	1627	1675
7.2.1 departmental enterprises	94	63	61	59	57	89	110
7.2.2 non-departmental enterprises	1056	1478	1565	1512	1508	1538	1565
7.3 storage	33	51	53	61	59	55	58
7.3.1 non-departmental enterprises	33	51	53	61	59	55	58
7.4 communication	798	1288	1369	1457	1557	1725	1914
7.4.1 departmental enterprises	798	944	1004	1869	1142	1265	1404
7.4.2 non-departmental enterprises	0	344	365	388	415	460	510
8. financing, insurance, real estate & business services	2931	7560	8997	9278	10907	11100	12577
8.1 banking & insurance	2892	7498	8931	9210	10836	11025	12499
8.1.1 departmental enterprises	26	35	39	47	41	38	36
8.1.2 non-departmental enterprises	2866	7463	8892	9163	10795	10987	12463
8.2 real estate & business services	39	62	66	68	71	75	78
8.2.1 administrative departments	39	62	66	68	71	75	78
9. community, social & personal services	8546	14995	16446	16956	17206	18038	18653
9.1 public administration & defence	5794	10342	11214	11328	11570	12170	12198
9.2 other services	2752	4653	5232	5628	5636	5868	6155
9.2.1 administrative departments	2671	4526	5085	5484	5478	5699	5966
9.2.2 departmental enterprises	21	30	24	37	42	38	37
9.2.3 non-departmental enterprises	60	97	123	107	116	131	152
10. total	24171	44542	48476	50334	53745	55595	58860
10.1 administrative departments	9020	16101	17774	18389	18626	19524	20149
10.2 departmental enterprises	3929	5806	5947	6097	6356	6388	6715
10.3 non-departmental enterprises	11222	22635	24755	25848	28761	29683	31996

Table 6.1C : Domestic Product in Public Sector
(at current prices)

(Rs. crores)

Item	1987-88	1988-89	1989-90	1990-91
(1)	(2)	(3)	(4)	(5)
1. Gross product of public sector	79479	94367	10961	124923
1.1 administrative departments	27663	32492	38121	44572
1.2 departmental enterprises	12996	14978	16850	19345
1.3 non-departmental enterprises	38820	46897	53990	61006
2. net product of public sector	64551	76818	88094	100848
2.1 administrative departments	25040	29438	34569	40558
2.2 departmental enteprises	9145	10515	11649	13506
2.3 non-departmental enterprises	30366	36865	41876	46784

Share of Public Sector in Domestic Product
(at current prices)

(per cent)

Item	1987-88	1988-89	1989-90	1990-91
(1)	(2)	(3)	(4)	(5)
1. Gross product of public sector	27.0	26.9	27.1	26.4
1.1 administrative departments	9.4	9.3	9.5	9.4
1.2 departmental enterprises	4.4	4.3	4.2	4.1
1.3 non-departmental enterprises	13.2	13.3	13.4	12.9
2. net product of public sector	24.7	24.6	24.7	23.9
2.1 administrative departments	9.6	9.4	9.7	9.6
2.2 departmental enteprises	3.5	3.4	3.3	3.2
2.3 non-departmental enterprises	11.6	11.8	11.7	11.1

Table 6.2 : Employment in Organised Public and Private Sectors

(In Lakhs)

Year	Public Sector	Annual Change (%)	Private Sector	Annual Change (%)	Total (2)+(4)	Public sector share ((2) as % of (6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1971	107.0		68.0		175.0	61.1
1976	133.2	4.9	68.4	0.1	201.6	66.1
1981	154.8	3.2	73.9	1.6	228.7	67.7
1986	176.8	2.8	73.7	(-) 0.2	250.5	70.6
1991	190.6	1.6	76.8	0.8	267.3	71.3
1992	192.1	0.8	78.5	2.2	270.6	71.0
1993	193.3	0.6	78.5	0.0	271.8	71.1
1994	194.5	0.6	79.3	1.0	273.8	71.0
1995*	193.0	(-) 0.1	81.1	2.3	274.1	70.4
* Annual average quick estimates		1.8		1.1		

Note : (1) Includes all establishments in the public sector irrespective of size of employment and non-agricultural establishments in the private sector employing 10 or more persons.

(2) Excludes Sikkim, Arunachal Pradesh, Dadra & Nagar Haveli and Lakshadweep.

Source: GOI, *Economic Survey* for several years.

Table 6.2(A) : Employment in the Public Sector by Industry in 1994
(Lakh persons as on March 31)

Industry	Public Sector	Private Sector	Total	(2) as % of (4)
(1).	(2)	(3)	(4)	(5)
1. Agriculture, hunting forestry and finishing	5.45	8.83	14.28	38.2
2. Mining & Quarrying	10.15	1.01	11.16	91.0
3. Manufacturing	17.84	46.30	64.14	27.8
4. Electricity, gas and water	9.38	0.40	9.78	95.9
5. Construction	11.67	0.51	12.18	95.8
6. Wholesale and retail trade	1.61	3.02	4.63	34.8
7. Transport, storage and communications	30.84	0.58	31.42	98.2
8. Finance, insurance, real estate, etc.	12.73	2.82	15.55	81.9
9. Community, social and personal services	94.78	15.85	110.63	85.7
Total	194.45	79.30	273.75	100.0

Source, GOI, *Economic Survey 1995-96*

Table 6.3 : Share of Public Sector in Gross Domestic and Capital Formation

(In Crores)

Plan Periods	Plan Period averages			% share		As % of GNP		
	Public sector	Private sector	Total	Public sector	Private sector	Public sector	Private sector	Total
GROSS DOMESTIC SAVINGS								
First Plan (1951-56)	169	874	1043	17	83	1.7	8.7	10.4
Second Plan (1956-61)	273	1368	1641	16	84	2.0	10.4	12.4
Third Plan (1961-66)	679	2185	2864	24	76	3.4	10.9	14.3
Annual Plans (1966-69)	731	3838	4569	16	84	2.4	12.5	14.9
Fourth Plan (1969-74)	1341	6579	7920	17	83	3.0	14.4	17.4
Fifth Plan (1974-79)	3830	14182	18192	21	79	4.6	17.0	21.6
Sixth Plan (1980-85)	6609	30062	36671	18	82	3.6	16.5	20.1
Seventh Plan (1985-90)	7815	62620	70435	11	89	2.3	18.1	20.4
GROSS DOMESTIC CAPITAL FORMATION								
First Plan (1951-56)	358	724	1082	33	67	3.5	7.2	10.7
Second Plan (1956-61)	871	1154	2025	43	57	6.6	8.8	15.4
Third Plan (1961-66)	1687	1662	3349	50	50	8.4	8.3	16.7
Annual Plans (1966-69)	2212	3084	5296	42	58	7.2	10.1	17.3
Fourth Plan (1969-74)	3324	4957	8281	40	60	7.2	10.9	18.1
Fifth Plan (1974-79)	7791	9799	17590	45	55	9.5	11.7	21.2
Sixth Plan (1980-85)	20122	19165	39287	51	49	11.1	10.5	21.6
Seventh Plan (1985-90)	36868	41794	78662	47	53	10.7	12.1	22.8

Source : CMIE, *Basic Statistics Relating to the Indian Economy*, Vol. I, All India, August 1991.

Table 6.4 : Share of the Public Sector in Capital Stock (At 1970-71 Prices)

As on March 31 (Rs. Crores)

Year	Public Sector	Private Sector	Total	Percentage share of Public Sector	Percentage share of Private Sector
1960-61	16377	46583	62960	26	74
1965-66	27324	53000	80324	34	66
1970-71	37896	65417	103313	37	63
1975-76	49676	93960	143636	35	65
1979-80	68478	116089	184567	37	63
Compound annual Rate of growth between 1960-61 and 1979-80	7.8	4.9	5.8		

Source : Dutt Ruddar and Sundaram K.P.M., *Indian Economy*, p. 162.

Table 6.5 Performance of Central Public Enterprises

(Rs. Crores)

Year	No. of Units	No. of employees (in lakhs)	Turnover	Capital employed	Gross Profit	Net Profit after tax	Rate of Return(%) Gross Profit to Capital 6 ÷ 3	Net Profit to Capital 7÷3
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1972-73	101	9.32	5324	4756	243	18	5.1	0.4
1973-74	114	13.44	6855	5376	334	64	6.2	1.2
1974-75	120	14.32	10185	6627	559	184	8.4	2.8
1975-76	121	15.05	11688	8824	668	129	7.6	1.5
1976-77	149	15.75	14911	10887	1028	184	9.4	1.7
1977-78	155	16.38	18020	12130	915	(-) 92	7.5	(-)0.8
1978-79	159	17.03	19061	13969	1071	(-) 40	7.7	(-)0.3
1979-80	169	17.75	23290	16182	1229	(-)147	7.6	(-)0.3
1980-81	168	18.39	28635	18207	1418	(-)203	7.8	(-)1.1
1981-82	188	19.39	36482	21935	2654	446	12.1	2.0
1982-83	193	20.24	41989	26590	3469	618	13.1	2.3
1983-84	201	20.72	47272	29856	3565	240	11.9	0.8
1984-85	207	21.07	54784	36382	4628	909	12.7	2.5
1985-86	211	21.54	62360	42965	5287	1172	12.3	2.8
1986-87	214	22.11	69080	51835	6521	1771	12.6	3.4
1987-88	220	22.94	81268	55617	6940	2030	12.5	3.6
1988-89	226	22.93	93136	67629	8572	2993	12.7	4.4
1989-90	233	23.17	106077	84760	10622	3789	12.5	4.5
1990-91	236	NA	NA	102084	11102	2272	10.9	2.2
1991-92	237	NA	NA	118492	13857	2475	10.7	2.1

Source : 1. Ruddar Dutt and Sundaram, *Indian Economy.*
2. GOI, *Handbook of Industrial Statistics.*

UNIT 7 PRIVATE SECTOR IN INDIA

Objectives

The main purpose of this unit is to help you to:

- understand the nature of private sector in India
- analyse the growth and structure of private sector
- understand the role of private sector
- examine the performance of private sector, and
- understand the problems of private sector.

Structure

7.1 Introduction

7.2 Nature and Scope of the Private Sector in India

7.3 Growth and Structure of the Private Sector in India

7.4 Problems and Prospects of the Private Sector in India

7.5 Summary

7.6 KeyWords

7.7 Self-Assessment Questions

7.8 Further Readings

Appendix 4: Statistical Tables

7.1 INTRODUCTION

In the post-Independence period, as we will discuss in greater detail in a subsequent unit, India opted for a mixed economy. In a mixed economy both private and public sector coexist. The respective spheres of private and public sectors are well defined and the two sectors function in a manner that is conducive to the achievement of overall development of the national economy. The private sector is subject to various regulations/laws so that subserves the social and economic objectives of economic planning for development. The unregulated capitalism in the western countries during the 19th century and the first quarter of the twentieth century was found to be suffering from several limitations and evils. The Keynesian Revolution clearly brought out the role of government in ensuring stability in a capitalist economy. The 19th century **police** state (in the sense that its main function was limited to maintenance of law and order) has given way to 20th century **welfare** state wherein the state plays an important regulatory and promotional role in the economic realm. The Keynesian Revolution has put the last nail into the coffin of virgin-pure-Capitalism. The regulated or controlled capitalism is an observable fact now.

In this unit we will discuss the nature and role of private sector in India, and analyse its growth and structure. Further, we will attempt to appraise the performance of the private sector, and understand its problems.

7.2 NATURE AND SCOPE OF THE PRIVATE SECTOR IN INDIA

The private sector refers to all types of individual and corporate enterprises, domestic and foreign, in any field of productive activity with the intention of making a profit. The characteristic of the private sector enterprises is that their ownership and management lies in private hands. The "enlightened self-interest" guides the running of private enterprises. Enterprise, initiative and strong profit motive are the most distinguishing features of private enterprise. Private enterprise with the above characteristics is an integral part of the capitalist economic system.

In the early stages of capitalism (during the 18th and 19th centuries) private sector enterprises were free of state interference. The private enterprises then were generally small units owned and managed by individual proprietors (proprietorship units) or a small group of individuals (partnership units). Thus the two organizational forms, proprietorship and partnership, were predominant in early capitalism. The private sector consisted largely of small enterprises with ownership and control vested in a single individual or a group of individuals in each enterprise. The *State* in those days was performing a few functions, with virtually no interference in economic matters. The *State* was a "police" state alone, in that it was concerned chiefly with law and order. The business environment at the time was one of freedom and private initiative unfettered by state control or regulation.

As part of the evolution of capitalism, an important innovation in the realm of business organisation took place. This innovation is the *company* (English usage) or Corporate (American usage) form of organization. You are familiar with this form of organisation. The nature of capitalism has thoroughly changed with this innovation. Now, with the corporate form of organisation, the private sector is qualitatively and in several other respects quite different from the private sector of the past. The main difference is that the ownership in the company form of organisation is divorced from control. Corporate enterprises (or joint stock comapnies) are owned by the shareholders and managed by professional managers. The latter may not always be interested in profit maximization. The other motives such as achieving high rate of growth, large size, social awareness, etc. may guide the professional management. But profit as a criterion of performance is still valid for the private sector.

While there were only private sector enterprises till the early years of 20th century, there is no country in the world today in which there is only private sector. The Government has been coming in a big way in economic matters with a significant government or public sector. Even in the so called capitalist countries such as USA and West European countries, the public sector is flourishing in several areas of economic activity. Defence production, multi-purpose river valley projects, aircraft production and so on are all either owned and managed by the government or are controlled directly or indirectly by the government. The economic legislation to control the working of private sector has become quite common now. What we have in the world now is regulated or controlled capitalism even in predominantly capitalist countries such as U.S.A. The American economy is usually referred to as a mixed economy. In a developing country like ours, the public sector expanded rapidly and many productive activities formerly with the private sector were taken over by the government. With expanding public sector and governmental controls the scope of the private sector became restricted due to several rules and regulations. Of course the New Economic Policy 1991, about which you will learn in detail later (in Unit 18), its hallmark is economic liberalisation. There is a greater scope, for private sector initiative and enterprise.

Since the Industrial Policy Resolutions of 1948 and *1956*, the distinction between the private sector and the public sector has become increasingly significant. The industrial policy has made Indian economy a mixed economy. The Industrial Policy Resolution, 1956

(which is considered as the 'economic constitution' of India) has clearly demarcated the scope and role of the public and private sectors. The resolution laid down three categories of industries which bear a close resemblance to the classification adopted in the 1948 Resolution but public and private sectors were more sharply defined. The role and coverage of public sector was expanded. The three categories were:

I. *Schedule A* : This consisted of industries which were to be an exclusive responsibility of the State. There were seventeen such industries : Arms and ammunition, atomic energy, iron and steel, heavy castings and forgings of iron and steel, heavy machinery required for iron and steel production, mining of iron ore and other important minerals like copper, lead and zinc; aircraft; air transport, railway transport, ship-building; telephone, telegraph and wireless equipment; generation and distribution of electricity.

II. *Schedule B:* This consisted of industries which were to be progressively state-owned and in which the state would generally set up new enterprises, but in which private enterprise would be expected only to supplement the effort of the State. Under Schedule B, 12 industries were mentioned : *viz.* mining industries, aluminium and other non-ferrous metals not included in Schedule A; machine tools, ferro-alloys and tool steels, the chemical industry; antibiotics and other essential drugs; fertilizers; synthetic rubber, carbonization of coal; chemical pulp; road transport and sea transport.

III. *Schedule C:* This consisted of all the remaining industries and their future development, in general, was to the left to the initiative and enterprise of private sector.

The New Industrial Policy announced in 1991 has significantly reduced the role and scope of the public sector. You will learn about these policy changes in a subsequent unit.

In the recent past, Joint Sector enterprises have come into existence. The Joint sector is a form of partnership between the private sector and the government.

Broadly speaking, the public sector is to assume the responsibility of developing basic and heavy industries, social and economic overheads (infrastructure) while the private sector is left with the right to develop consumer goods industries. While major banks and financial institutions (in 1969 and in 1980 major commercial banks were nationalised), railways, civil aviation, power generation and distribution etc. are in the public sector, the private sector has in its fold the whole of agriculture and allied activities, plantations, internal trade, road freight traffic etc. As the most organized component of the private sector is the corporate sector, the private sector has indeed come to mean, in common parlance, the private corporate sector. Within the private sector, however, we have a large unorganized sector.

The architects of the early industrial policy clearly made the distinction between the private and public sectors on the above line for the following reasons

1) Huge investment in public sector are necessary to initiate and accelerate the process of overall economic development;

2) Significant public investment in infrastructure and basic and key industries facilitates rapid expansion of private sector; and

3) The growth and profitability of many private enterprises would depend upon public sector activity and investments.

The protagonists of the mixed economy for India argued that as private investors were more interested in quick-yielding industries and in large profits in as short a period as possible, it is mainly the consumer goods industries involving limited risks and short gestation periods which would attract the attention of the private sector. Public sector investments were considered most suitable to low-profit yielding, long-gestation and heavy-investment sectors. The infrastructure industries were thus reserved for the public sector. Indian policy all along looked at the private and public sectors as complementary to each other and this was considered conducive for rapid development of the economy.

7.3 GROWTH AND STRUCTURE OF THE PRIVATE SECTOR IN INDIA

At the time of independence, almost the entire production and trade was in the domain of private sector. The public sector was insignificant, being confined to irrigation, power, railways, ports, posts and telegraphs and ordinance establishments. After 1951, the public sector was expanded fast both by the Central and State Governments. It has become significant in many fields in terms of investments, total turnover, capital stock, contribution to foreign exchange earnings and so on as we noted in the previous unit. Now we turn to the growth of private sector..

Table 7.1 gives trends in gross domestic product in private **sector** along with total gross domestic product and gross domestic product originating in the public sector. It can be seen from the table that in 1960-61 the public sector accounted for only8 per cent of gross domestic product at factor cost at constant (1980-81) prices. The private sector thus accounted for more than ninety per cent of GDP. By 1989-90, however, the public sector accounted for about a quarter of the Indian GDP. Rapid growth of the publio sector thus is evident as we explained in the previous unit. The predominance of the private sector is evident as it accounted for more than 75 per cent of domestic product. The growth rate of the private sector, as measured by output growth rate, during the period 1960-61 to 1989-90 was 3.2 per cent per annum.

A major segment of the *organised* private sector is the corporate sector. Let us now look at the private corporate sector. As the organised private sector is generally equated with the private corporate sector in a narrow sense, it is convenient and useful to study the growth of private corporate sector and compare it with the growth of public sector. Table 7.2 brings out clearly the growt of the corporate sector in India over the period 1957 to 1991. The public sector companies in the early 1990's occupied a major position in terms of the amount of paid up capital, even though the number of government companies was small as can be seen from Table 7.2. However, in terms of number of companies the rate of growth of public ssector companies has been faster than those of the private sector companies. Between *1957* and 1991 the number of government companies increased by nearly 16 times from 74 to 1779. During the same period, the number of non-government companies increased by about 7.5 times only, from 29283 to 219542. As can be seen from Table 7.2 the same is the trend in respect of paid-up capital.

The largest industrial activity among the private sector corporate units in terms of paid-up capital was processing and manufacture of metal products followed by chemicals, textiles, leather and leather goods, manufacture of foodstuffs, other processing and manufacture, commerce, agriculture and allied industries, construction, etc.

Selected Growth Rates

Table 7.3 gives selected growth rates in respect of organised private and public sectors. Nominal sales (value of sales at current prices) in the case of corporate private sector recorded a growth rate of 17.93 per cent during the period 1985-1995, while the corresponding growth rate for public sector was 13.18 per cent. Gross fixed assets in the case of private corporate sector recorded an annual growth rate of 18.4 per cent during the period 1985-95, the corresponding growth rate for public sector being 15.1 per cent. Profits before depreciation interest and tax (PBDIT) in the case of private sector grew at an annual average rate of 22.0 per cent during the period 1985-95, the corresponding growth rate in the case of public sector being 16.2 per cent. Thus during the recent decade all the growth rates mentioned above are higher in the case of private sector as compared with the public sector.

Employment

Table 7.4 gives estimates of employment in organised public and private sectors. In the organised sector public sector accounted for more than 70 per cent of total employment. The share of the private sector in the organised sector employment registered a slight increase from 28.7 per cent in 1989 to 29.6 per cent in 1995. As for the growth rate of employment in private sector during the recent period 1989-1995, it was 1.15 per cent per annum, slightly higher than the growth rate in public sector (0.9 per cent).

Structure of Private Sector

Agriculture and allied activities which accounted for nearly 40 per cent of the domestic GNP and nearly 65% of employment in early 1990s are completely in the private sector. Small scale and cottage industries, trading, consumer goods industries, construction etc. are some of the other areas in which the private sector has been playing a major part. As noted in the previous unit the public sector in contrast to the private sector predominates in basic, heavy and infrastructure industries.

One important structural dimension of the private sector is the predominance of the informal or unorganised sector within the private sector.

Informal or Unorganised Sector

The private sector in India has three components : 1. Corporate sector, 2. Enterprises other than corporate sector enterprises belonging to the orgnised sector, 3. Informal or unorganised sector enterprises. Within the organised private sector, the corporate sector predominates. We have already explained the structure and growth of private corporate sector. Now we briefly deal with the unorganised sector which is a large component of the private sector.

T.S. Papola ("Informal Sector: Concept and Policy," The Giri Institute of Development Studies, Lucknow, December 1979 (mimeo)) listed some prominent characteristics of the informal sector units after explaining how difficult it is to precisely define informal sector. Small size of operations, informal structure and family ownership, use of non-modern technology, lack of access to Government favours (subsidies etc.), competitive and unprotected product and labour markets are the prominent characteristics of the informal sector identified and elaborated by Papola.

A study of the informal sector in India has come up with the following conclusions:

- Informal sector both in terms of employment and income has been a predominant sector of the Indian economy. In 1981 the sector accounted for 91.1% of total national employment and *65.66* per cent of income generated in the economy. During the period 1960-61 to 1981-82, while the organised sector grew at an average annual rate of 12.57 per cent (income growth rate), the unorganised sector recorded a growth rate of 9.37 per cent. The economy as a whole recorded a higher growth rate of 11.36 per cent indicating slight declining trend of the unorganised sector.

- While in the aggregate the above trend is clear, the urban infomtal sector has been growing during the period. The share of the urban informal sector in the total income of the unorganised sector increased from *29.35* per cent to 43.56 per cent during the period 1960-61 to 1981-82.

- The average earnings per employee in the rural informal sector and urban informal sector were both less than those of the organised sector employee. The organised sector earnings per capita were several times higher than unorganised sector earnings per capita.

- While the share of wage salary income in the case of organised sector was more than two- thirds, in the case of the unorganised sector it was less than a quarter.

Table 7.5 gives recent data relating to the share of unorganised sector in the net domestic product at factor cost. In 1980-81 the share was 70 per cent. By 1989-90, it was still as high as 63.4 per cent.

With steps f6r economic liberalisation initiated in 1991, it is expected that the organised private sector will further expand resulting in the reduction of the size of the unorganised sector.

Activity I

From Table-7.1 compute the annual average change in domestic product originating in public sector and the **economy**

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Activity 2

a)On the basis of paid-up capital data given in Table 7.2, comment on the significance o pubulic sector.

b)Based on relevant tables, calculate the growth rates of NDP in organised and unro ganised sectors and compare them with the NDP growth rate during the period 1980-8 to 1989-90.

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7.4 PROBLEMS AND PROSPECTS OF PRIVATE SECTOR IN INDIA

Before dealing with the problems and prospects of private sector, we need to examine two relevant aspects namely: (i) government and private sector, (ii) role of the private sector.

Government and the Private Sector

Since independence, particularly since the process of planned development initiated ir early 1950s, government has been playing both promotional and regulatory role so far as private sector is concerned.

As for the promotional role, the government, in the planning era, has set up a network o

tor. The capital market institutions developed rapidly and have been playing an important part in the private sector exapansion. The institutions such as Industrial Finance Corportion of India (IFCI), Industrial Development Bank of India (IDBI), National Bank for Agriculture and Rural Development (NABARD) and State Financial Corporations (SFCs) have been playing significant promotional and financing role to help the private sector growth. The government has also set up a whole range of institutions to assist the private sector in the provision of infrastructure, raw materials, technology development etc. These institutions haoencouraged development of new industrial activities, new centres of industrial activity, and new entrepreneurs. Private sector growth is very much facilitated by the government's promotional role on the one hand and public sector expansion on the other. Special programmes and policies to encourage cottage and small scale industries also are worth noting in this connection.

Along with support structure, government has also implemented a regulatory framework to ensure that the working of the private sector would be in consonance with the plan objectives. and overall development strategy. The regulatory framework and the resulting mind-boggling controls, rules and regulations caused some problems for the private sector as we will see later. Here it may be noted that the 1991 economic reforms whose hallmark is economic liberalisation have liberated the private sector from unnecessary bureaucratic shackles. We will discuss these economic reforms in greater detail in a subsequent unit of this course.

Role of the Private Sector

In the western capitalist countries and in Japan, private sector enterprises were responsible for rapid economic development. The development was capitalist oriented with private initiative, enterprise and profit motive as the driving forces. The economic maladies associated with capitalism were sought to be cured through government's macroeconomic policies, thanks to the Keynesian thought and policy prescriptions. For example, the wild economic fluctuations, a feature of uncontrolled capitalism (Great Depression of 1930s being a revealing example), was almost eliminated through macroeconomic stabilisation policies in the western economies.

While that was the case with capitalist development, communist countries (the erstwhile Soviet Union and its allies, mostly the East Europen countries) relied solely on public enterprises as initiators and prime movers behind rapid industrialisation. India has attempted to combine the advantages of both capitalist and socialist lines of development and in the Industrial Policy, Resolutions, the Government alloted a specific role to the private sector in the field of industries. Public sector growth and planning were pursued with opportunities given to the private sector to develop and expand in certain spheres of the economy. As we noted before, private sector is prominent in agriculture and allied activities, small and cottage industries, trading and several consumer goods industries.

So far as the Indian economic experience during the post-independence period preceeding the 1991 economic reforms is concerned, it may be stated that private sector had not been given a significant role in economic development. The government has entrusted the basic and capital goods industries to the public sector and made it the prime mover of economic development. As a consequence, the private sector has to be satisfied with the secondary role assigned to it.

As for the problems faced by the private sector (prior to the 1991 economic reforms), the most important one was delays due to regulatory structure. There have been too many regulations imposed by the government on the private sector which often resulted in procedural delays. It is estimated that on an average it takes 7 years from the conceptual stage to the production stage for any significant investment project to materialise in India.

Unrealistic controls influenced by contradictory motives hampered private sector initiative.

goods do not give proper incentive for additional production. Capacity restrictions (with a view to prevent concentration of wealth and economic power) further aggravated the problem. Actually, the government should encourage competition among the rival firms and the resulting increase in production would automatically bring down prices. In complete contrast to this; price controls under conditions of shortage tend to perpetuate shortages, rise of black markets, and possible shifting of investment from controlled items to the production of non-controlled items.

- Reservation for small scale sector and special incentives to units in that sector made the large scale sector to stand at a disadvantage. Further the complementarityof the two sectors in the process of growth has been lost.

The decentralised sector has been facing the problem of inadequate credit facilities despite the existence of a network of financial institutions. With the economic reforms initiated in 1991, the private sector's prospects appear to be very bright.

7.5 SUMMARY

In this unit we have acquainted you with the growth and structure of private sector in India. We have noted the quantitative significance of the unorganised sector. We also discussed the problems and prospects of the private sector.

7.6 KEY WORDS

Welfare State A State where in State plays an important regulatory and promotional part in the economic realm.

Private Sector Refers to all types of individual and corporate enterprises, domestic and foreign, in any field of productive activity with the intention of making profit. Private Sector enterprises are characterised by ownership and management in private hands.

Informal or Unorganised Sector Sector of the economy characterised by small size of operations, informal structure and family ownership, use of traditional technology, lack of access to government favours (subsidies etc.), unprotected product and labour markets.

7.7 SELF-ASSESSMENT QUESTIONS

1) What is the rationale for private sector development?
2) Explain the growth of private sector in India.
3) After carefully going through the unit, mention the major differences between private and public sector.
4) Distinguish between proprietary and partnership enterprises on the one hand and corporate enterprises on the other.
5) Prior to 1991 economic reforms, which industries were exclusively reserved for public sector?
6) Explain the Components of the Private Sector in India.
7) a) Look at Table 7.1, and compute the annual average change in domestic product originating in public sector and the economy.

b) Comment on the significance of public sector on the basis of paid-up capital data given in Table 7.2.

pare them with the NDP growth rate during the period 1980-81 to 1989-90.

8) The following are said to be the major issues of the private sector in India:

   1) Emphasis of non-priority industries

   2) Emergence of monopoly power and concentration

   3) Rampant Industrial sickness

Explain the above problems.

7.8 FURTHER READINGS

Central Statistical Organisation (CSO), *National Accounts Statistics* (Annual Publication)

Centre for Monitoring of Indian Economy (CMIE), *The Indian Corporate Sector*, April 1996

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Appendix 4: List of Statistical Tables

Table 7.1	GDP at Constant (1980-81) Prices at Factor Cost in Private and Public Sectors
Table 7.2	Growth of the Corpprate Sector
Table 7.3	Indian Corporate Sector (Selected Growth Rates)
Table 7.4	Estimates of Employment in Organised Public and Private Sectors
Table 7.5	Share of Unorganised Sector in Net-Domestic Product at Factor Cost

Table 7.1 : GDP at Constant (1980-81) Prices at Factor Cost in Private and Public Sectors

Year	Total GDP	GDP in Private Sector	Annual % Change	GDP in Public Sector	(3) as % (2)
(1)	(2)	(3)	(4)	(5)	(6)
1960-61	62904	57853	--	5051	92.0
1961-62	64856	59204	2.3	5652	91.3
1962-63	66228	59631	0.7	6597	90.0
1963-64	69581	62338	4.5	7248	89.6
1964-65	74858	66672	7.0	7886	89.1
1965-66	72122	68488	(-) 5.0	8634	88.0
1966-67	72856	63683	0.3	9173	87.5
1967-68	78785	69088	8.5	9777	87.6
1968-69	80841	78244	13.3	10597	96.8
1969-70	86109	74667	(-) 5.0	11442	86.7
1970-71	90426	77957	4.4	12469	86.2
1971-72	91339	78132	0.2	13207	85.5
1972-73	91048	76993	(-) 1.0	14055	84.6
1973-74	95192	79705	3.5	15487	83.7
1974-75	96297	80458	0.9	15839	83.6
1975-76	104968	87733	9.0	17235	85.5
1976-77	106280	87236	(-) 1.0	19044	82.1
1977-78	114219	94204	8.0	20015	82.5
1978-79	120504	99029	5.1	21475	82.2
1979-80	114236	91839	(-) 8.0	22399	80.4
1980-81	122427	98256	7.0	24171	80.3
1984-85	150433	118596	5.2	31837	78.8
1985-86	156566	121724	2.6	34842	77.7
1986-87	163271	125083	2.8	38188	76.6
1987-88	170205	129281	3.4	40924	76.6
1988-89	188009	143396	10.9	44613	76.2
1989-90	199329	150840	5.2	48489	75.7
1990-91	210477	--	--	--	

Average annual change 3.2

Source : CSO, *National Accounts Statistics*, different years

Table 7.2 : Growth of the Corporate Sector

	1957	1971	1991
No. of Companies	29357	30461	220721
1. Government	74	314	1179
2. Non-government	29283	30147	219542
		Paid-up Capital (Rs. Crores)	
All Companies	1078	4423	68110
	(100.0)	(100.0)	(100.0)
1. Government	73	2074	49424
	(6.8)	(46.9)	(72.6)
2. Non-government	1005	2349	18686
	(93.2)	(53.1)	(27.4)

Note: Figures in Brackets are percentages of total paid-up capital.

Source : Dutt and Sundaram, Indian Economy, 31st revised edition, yr. *Publisher* p. 179.

Table 7.3 : Indian Corporate Sector (Selected Growth Rates)

	Nominal Sales	Gross fixed Assets	PBDIT*
1. Public Sector	13.18	15.1	16.2
2. Private Sector	17.93	18.4	22.0

*PBDIT: Profit before interest, depreciation and tax.

Source : CMIE, *The Indian Corporate Sector*, April 1996.

Table 7.4 : Estimates of Employment in Organised Public and Private Sectors (in lakhs)

Year	Public Sector	Annual Change (%)	Private Sector	Annual Change (%)	Total	Share of Private Sector (4) as % of (6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1989	185.16	1.4	74.70		259.86	28.7
1990	187.72	2.1	75.82	1.5	263.53	28.8
1991	190.57	[illegible]	76.76	1.2	267.33	28.7
1992	192.10	1.0	78.96	2.2	270.56	29.0
1993	193.26	1.0	78.51	0.06	271.77	28.9
1994	194.45	1.0	79.30	1.0	273.75	29.0
1995*	192.94	(-) 1.0	81.14.	1.0	274.09	29.6
Annual Average Change		0.9		1.15		

* Quick estimates

Source : GOI, *Economic Survey*, different years

Table 7.5 : Share of Unorganised Sector in Net-domestic Product at Factor Cost

(Rs. Crores)

Year	Net domestic product at factor cost Organised Sector	Un-organised Sector	Total	Share of Un-organised Sector %
(1)	(2)	(3)	(4)	(5)
19[illegible]	33073	77267	110340	70.0
1981-82	40527	88230	128757	68.5
1982-83	47830	94679	142509	66.4
1983-84	[illegible]	111177	167494	66.4
1984-85		121829	186442	65.3
1985-86	72952	134610	207562	64.9
1986-87	84652	145555	230207	63.2
1987-88	96755	164669	261424	63.0
1988-89	113480	198508	311988	63.6
1989-90	130461	225562	356023	63.4

Source : CSO, *National Accounts Statistics*, 1992

UNIT 8 SMALL SCALE INDUSTRY IN INDIA

Objectives

This unit aims at familiarising you with:

- characteristics of small scale enterprises
- definition and data sources of small industry in India
- review of industrial policies for SSI since independence
- description of existing institutional framework
- policies and programmes for SSI, and
- analysis of growth, problems and prospects of SSI.

Structure

8.1 Introduction
8.2 Definition of SSI
8.3 Structure of SSI and Data Sources
8.4 Industrial Policy for Small Scale Industry
8.5 Institutional Infrastructure for SSI
8.6 Policies and Programmes for SSI
8.7 Growth of Small Scale Industry in India
8.8 Small Scale Industry : Problems and Prospects
8.9 Summary
8.10 Key Words
8.11 Self Assessment Questions
8.12 Further Readings

8.1 INTRODUCTION

Small scale industry occupies a prominent place in the industrial economy of the world. Its contribution in terms of number of units, employment and industrial production is quite impressive in both developed and developing countries.

Small Scale Industry (SSI) has some significant characteristics which have been attracting increasing attention of the policy makers all over the world, particularly developing countries in recent decades. In general:

- SSI requires relatively less amount of capital per unit (i.e., it is capital light). Therefore, SSI can be developed even in capital scarce economies
- SSI generates more employment per unit of capital invested (i.e., it is labour intensive). Therefore, SSI growth will help to generate more employment
- SSI can make use of unskilled labour force
- SSI can be set up within a short period of time (i.e., short gestation period)

- SSI relies less on infrastructure and therefore can be located even in underdeveloped regions. Thus, SSI can be utilised to achieve balanced regional - industrial development
- SS1 growth promotes distribution of economic power, and
- SS1 facilitates technological experiments and innovations.

These characteristics have prompted both developed and developing countries to adopt exclusive policies and programmes to promote small scale industry.

Exclusive policies and programmes for small industry in both developed and developing countries comprise some or all of the following elements :

- Exclusive administrative body.
- Industrial extension and advisory services.
- Specialised trading and technical services.
- Infrastructure services.
- Training for entrepreneurship development.
- Measures to promot sub-contracting.
- Exclusive financial institutions.
- Fiscal and financial incentives.
- Industrial estates, etc.

Though the contents of policies and programmes for small industry appear to be similar in developing countries as compared to developed countries, the former lay more emphasis on protective growth whereas the latter emphasie development.

Among the developing countries, India is unique as it has a long standing and wide ranging policies and programmes to protect and promote small scale industry.

8.2 DEFINITION OF SSI

In general, a small scale industrial unit can be defined in terms of number of workers and/or amount of capital invested. In Indonesia, Italy, Malaysia, South Korea, Thailand and the United States, SSI is defined only in terms of labour. But in Japan, Mexico and Bangladesh, both capital and labour form the criteria for SS1 definition.

In India, SS1 unit is defined in terms of initial investment in plant and machinery. The definition of "Small Scale Units" and "Ancillary Units" is periodically changed by raising the ceiling of investment.

To begin with, to define a small scale industry and an ancillary industry, the criteria of both employment and capital investment were used (Table-1). But it was in 1960 that employment criterion was dropped. Since then, definition of SSI as well as ancillary unit has been confined to investment limits

Table 8.1 : Small scale Industry : Definitional Changes

Period	Investment Criterion: Small Scale	Investment Criterion: Ancillary	Employment Criterion
Upto 1958	Fixed capital investment upto Rs.0.5 million	Fixed capital investment upto Rs.0.5 million	Employment upto 50 workers if using power or upto 100 workers if not using power
1960	Gross value of fixed assets upto Rs.0.5 million	Gross value of fixed assets upto Rs. 1.0 million	Employment criterion dropped
1966	Investment only in plant & machinery upto Rs.0 75 million	Investment only in plant & machinery upto Rs.1.0 million	
1975	Rs.1.0 million	Rs.1.5 million	
1980	Rs.2.0 million	RL,2.5 million	
1985	Rs.3.5 million	Rs.4.5 million	
1990	Rs.6.0 million	Rs.7.5 million	
1997	Rs., 30.0 million	Rs. 30.0 million	

In India, employment criterion was dropped from the SS1 definition due to the following factors

- Employment changes seasonally and from year to year. Hence, it is difficult to administer this condition.
- An employment limit acts as an incentive to limit employment to remain within SSI.
- Using employment criterian would discriminate against industries using simple and labour intensive technologies as against sophisticated and labour savina technologies.

In 1977 the concept of tiny unit was introduced and was defined in terms of investment limit up to Rs.1 lakh. In 1980, the investment limit of a tiny unit was raised to Rs. 2 lakh. In 1990 investment limit of a tiny unit was raised upto Rs.5 lakh. In 1997, the investment limit has been enhanced, again, to Rs. 25 lakhs.

As of now, a SSI unit can increase its investment in plant and machinery upto Rs.75 lakh, provided it exports at least 75 per cent of its production from the third year of its establishment.

8.3 STRUCTURE OF SSI AND DATA SOURCES

Small scale industry is a heterogeneous group in India. It comprises household industries, unregistered workshops and small scale factories. A manufacturing unit which makes use of only household labour is a household industrial unit. A manufacturing unit which employs ten or more workers with power or twenty or more workers without power is a registered factory as per the Indian Factories Act, 1948. A manufacturing unit which employs hired labour but has less than ten workers with power or less than twenty work-

Statistics on different segments of small scale industry are available from different sources. The Development Commission for Small Scale Industry (DCSSI) publishes aggregate data at the national level - on units, employment, investment, production and exports of SSI on an annual basis. DCSSI has also conducted two census of SSI in 1972-73 and 1987-88 respectively. The census was confined to registered units of Directorate of Industries at the state level and therefore, the coverage is limited, but census data is exhaustive as it provides detailed data on units, employment, investment, production, capacity utilisation etc., industry- wise and state-wise.

Data on SSI factories could be gathered from the Annual Survey of Industries (ASI). ASI publishes data annually for units, emplovment, oroduction, investment. etc. industry-wise and state-wise.

Data on household units are available only for units and employment from the economic census.

However, for all practical purposes, tne statistics furnished by the DCSSI have been used as the yardstick for assessing he performance of SSI from time to time.

8.4 INDUSTRIAL POLICY FOR SMALL SCALE INDUSTRY

The small scale industry has always found a piace of prominence in the successive industrial policies of India. The Government of India brought out its first ever Industrial Policy Resolution (IPR) in 1948 as to give organised direction to its industrialisation. IPR 1948 made a specific reference to the role and importance of small scale industries (synonymous with village and handicrafts industries then) in India's economic development. To generate employment to the large and growing population with limited capital resources and under developed infrastructure, small scale industry growth was found to be an ideal solution. Not only does it utilise local resources and local unskilled labour force but more importantly it helps in achieving local self-sufficiency in respect of certain essential consumer goods like food, cloth and agricultural implements.

At the time of the first five year plan, small scale sector was mainly contained to cottage and village industries. To promote different segments of small scale industry, Government of India has set up six exclusive boards, *viz,* (i) Khadi and Village Industries Board, (2) Handloom Board, (3) Handicrafts Board, (4) Coir Board, (5) Sericulture Board, and (6) Small Scale Industries Board (SSIB).

The role of SSIB is to promote modern SSI whereas the rest are for promoting traditional industries. The setting up of SSIB is a land mark in the development of modern SSI in India.

The Industrial Policy Resolution(IPR) 1956 which brought out the regulatory framework for industrial growth, stressed the role of small scale industry in the development of the national economy. IPR 1956 re-emphasised that SSI provides immediate large-scale employment; it offers a method of ensuring a more equitable distribution of national income and facilitiate an effective mobilisation of resources of capilal and skill which might otherwise remain unutilised.

A significant feature of IPR, *1956* was that the entire small scale industry sector was kept outside the purview of industrial licensing. IPR 1956 also underlined the need for modernisation and technological upgradation of SSI.

A related development during this period was the launching of Industrial Estates programme. The programme was initiated in *1955.* The programme gained significant momentum during the late 50s. Industrial estates have been defined as a group of factories constructed on an economic scale in suitable sites with facilitates of water, transport, electricity, steam, bank, post office, canteen, watch and ward and first aid and provided

Alexander, P.C., *Inidustrial Estates in india,* Asia Publishing House. Bombay, 1963. Industrial estates programme had two objectives: (i) Promotion of modern small industry through provision of various infrastructural facilities and economic incentives, (ii) Dispersal of industries away from metropolitan cities through suitable location of industrial estates in rural and semi-urban centres.

The Industrial Estate programme was launched by the Central Government. However, in 1977, the responsibility of industrial estates was transferred to State Governments.

Subsequent to IPR 1956 several schemes were introduced for the protection and promotion of small industry. Important among them are : reservation of items for exclusive manufacturing in the small industry sector, reservation of SSI items for exclusive purchasing for the public sector, price preferences, excise duty concession, water and power subsidies, transport subsidies, sales tax exemptions, concessional finance. In addition to these schemes, exclusive government bodies were set up at the central, state and district level to deal with diverse activities of small industry such as marketing, finance, technology, entrepreneurship, raw materials, etc.

The Industrial Policy Statement of 1977 was significant for SSI as it substantially increased the number of items reserved for SSI manufacturing. The Industrial Policy Statement of 1980 laid guidelines for strengthening the existing facilities for credit, technology modernisation, and supply of critical raw materials.

However, it was the New Industrial Policy (NIP) 1991 which marked the watershed in India's SSI policy. It was in 1991 that the Government of India announced a separate Industrial Policy for SSI. Till then, policy measures for SSI formed a part and parcel of the general Industrial Policy of the country. Further, in all earlier industrial policies, emphasis was on protection as much as on development. The NIP, 1991 marked a departure ftom the past as the thrust was on SSI development more than anything else. Several innovative policy guidelines are introduded:

- Equity participation in SSI for large (domestic and foreign) enterprises is allowed upto) 24 per cent. This is to encourage modernisation and technology upgradation.
- Industry associations are to be encouraged to set up sub-contracting exchanges. This is to promote complementarity between large and small enterprises.
- Private industry can also set up industrial estates.
- Introduction of technology upgradation schemes called "UPTECH", in selected centres in SSI clustered regions.
- Sale of SSI products under common brand names.

Thus, in terms of policy measures, small scale industry has gained increasing importance gradually and steadily. Though all the industrial policies have underlined the importance of SSI growth for Indian economy, the NIP of 1991 for SSI is distinct as it lays more thrust on SSI development through innovative schemes for improving competitiveness in the liberalised economic environment.

Activity 1

Discuss with a small scale entrepreneur in your town -how far Government Policy is beneficial to a prospective entrepreneur? List out points of merits and demerits.

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8.5 INSTITUTIONAL INFRASTRUCTURE FOR SSI

India has evolved an extensive institutional network over a period of time for the promotion and growth of small scale industry. This network extends from the national to the state and to the district level (see Box-I).

BOX I

INSTITUTIONS FOR SSI PROMOTION

Institutions	Major Activity
A. *Central Government*	
Small Industries Development Organ isation (SIDO)	- Apex body for SSI promotion
- Small Industries Service Institutes (SISIs), branches,	- Technical Service
- Extension centres, etc.	
National Small Industrics Corporation (NISIC)	- Marketing, machinery on hire purchase
National Institute of Small Industries Extension Training (NISIET)	- Research, training, etc.
National Institue for Entrepreneurship and Small Business Development (NIESBUD) development	- Entrepreneurship
Small Industries Development Bank of India (SIDBI)	- Finance
National Research Developmeni Corporation (NRDC)	- Commercialises indigenous research for SSI
B. *State Government*.	
Directorate of Industries	- State level apex body for SSI promotion
Small Industries Development Corporation (SIDC)	- Promotion of SSI through industrial estates, etc.
Small Industries Marketing Corporation (SIMC)	- Marketing
Entrepreneurship Development Institute development	- Entrepreneurship
State Financial Corporation (SFC)	- Finance
C. *District Level*	
District Level Centre	- Provision of multiple service & support under a single roof

Central Level Institutions

The institutional network is being looked after by the Department of Small Scale Industries, Agro and Rural industries in the Ministry of Industry. Within the department there is the Development Commission for SSI, commonly called Small Industries Development Organisation (SIDO): headed by a Development Commissioner.

This is an apex body and is the Nodal Agency for formulating, coordinating and monitoring the policies and programmes for promotion and development of small scale industries in the country. It maintain close liaison with Central Ministries, Planning Commission, State Go-vernments, Financial Institutions, Voluntary Organisations and other agencies concerned with the development of small scale industries.

It provides a comprehensive range of facilities and services including consultancy in techno economic managerial aspects, training, common facility services, common processing and testing facilities, tooling facilities, marketing assistance, etc. to small scale units. SIDO provides these services through a network of institutions speciali sing in each

SIDO has 28 Small Industries Service Institutes (SISIs) 30 branch institutes, 37 extension centres, 19 field testing centres, 4 regional testing centres and 2 foot wear training centres.

SISIs and their branches and extension centres provide the following services :

- Provide technical and managerial consultancy to existing and potential small entrepreneurs.
- Organise training programmes on technical and managerial issues.
- Make techno-economic surveys in select areas and industries to identify new industrial opportunities.
- Conduct entrepreneurship development programmes to motivate new entrepreneurs.
- Provide common facility services and vocational training in the workshops and through mobile demonstration vans.
- Prepare reports for modernisation of select units in select industries, etc.

National Small Industries Corporation (NSIC) supplies machinery (both indigenous and imported) on hire purchase basis, assists SSI to get a greater share of Government purchase and provides marketing and export assistance. NSIC also undertakes assistance programmes to other developing countries.

National Institute of Small Industry Extension Training (NISIET) conducts training programmes in the areas of development, promotion and management of small, rural and artisan industries including entrepreneurship development, preparation of feasibility reports, project reports, project management, information storage and retrieval systems, training methods, etc. The Institute's services are utilised for consultancy by Central and State Government departments/organisation, financial and other promotional institutions in their programmes for small industry development.

National Institute for Entrepreneurship and Small Business Development (NIESBUD) is an apex body for co-ordinating entrepreneurial development programmes organised by various entrepreneurship development institutes in the country. The Institute organises and conducts training programmes for motivators, trainers and entrepreneurs and also co-ordinates training activities of various institutions, agencies, prepares model training syllabus for various organisations engaged in training activities, etc.

National Reserach Development Corporation (NRDC) commercialises indigenous research carried out in the laboratories of Council of Scientific and Industrial Research (CSIR) for small entrepreneurs.

Small Industries Development Bank of India (SIDBI) is the apex financial institution engaged in the devleopment of small industry. SIDBI provides both direct and indirect financial assistance to small industrial units. SIDBI renders direct assistance for specialised marketing agencies, industrial estates, acquisition of machinery both indigenous and imported, equity capital through soft loan schemes, modernisation scheme, bills rediscounting, direct discounting scheme, etc. SIDBI provides indirect assistance through commercial banks.

SIDBI has recently set up in association with Asia Pacific Centre for Technology Transfer (APCTT) a Technology Bureau for Small Enterprises.

SIDO publishes a monthly journal - Laghu Udyog Samachar - in Hindi and English to disseminate information for the benefit of existing prospective entrepreneurs and concerned official and non-official agencies.

At the state level Directorate of Industries is the apex body for co-ordinating and implementing various programmes for small industry development. The Small Industries Development Corporation (SIDCs) play a major role through the provision of industrial services, industrial estates, etc. The State Financial Corporations (SFCs) meet the term loan requirements of small industries. SFCs in turn, have branches in most of the districts in each state. Most of the states have set up their own entrepreneurship development institutes. More recently some of the states have initiated Small Industries Marketing Corporations. Thus, at the state level as well, the institutional infrastructure for SSI development is fairlv vast and diversified.

District Level Centres

To provide different services and support to village and small entrepreneurs under a single roof. District Industries Centres Programme was launched in 1978. Today, there are 422 District Industries Centres (DICs) to cover 431 districts out of the total of 436 districts in the country. The excluded districts include the four metropolitan cities, *viz.*, Delhi, Calcutta, Mumbai and Madras. DICs are jointly sponsored by the Central and State Governments.

Activity 2

Visit the District Industries Ccntre (DIC) of your district and find out the facilities that they provide to an educated unemployed youth to set up an SSI unit. Find out whether the DIC officials are well equipped to help a prospective entrepreneur?

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8.6 POLICIES AND PROGRAMMES FOR SSI.

In addition to the institutional framework, a comprehensive scheme of policies and incentives have emerged over time for the protection and growth of small scale industry (Box II).

Reservation of Items for Exclusive Manufacturing in the Small Scale Sector

The policy of reserving products for exclusive manufacturing in the small scale sector was introudced in 1967 with 47 items. Since then, the list of items reserved for SSI manufacturing has been steadily expanded. As of now, 836 items are in the reservation list. A large scale unit is allowed to manufacture a reserved item, provided it will export at least 75 per cent of its output. Statutory support has been provided to the policy of reservation of items in 1984 through an amendment of Industrial Development and Regulation Act, 1951.

As per this policy, 410 SSI items are reserved for exclusive purchasing by the Government. The full needs of Government departments for these 410 items have to be met by purchases from the small scale sector. In respect of 13 items, purchases upto 75 per cent of the requirements of the Government have to be from the small scale sector. Further, in the case of 28 other items, 50 per cent of the requirements have to be procured from the small scale sector. The Directorate General of Supplies and Disposals (DGS&D) is the agency which deals with purchases from the small scale sector.

BOX II

POLICIES AND PROGRAMMES FOR SSI

1. Reservation of items (836) for exclusive manufacturing in the small scale sector.
2. Reservation of items (410) for exclusive purchasing from the SSI for the public sector
3. Price preferences
4. Excise duty exemptions
5. Sales tax exemptions/concessions
6. Ancillary Development and Marketing Services
7. Export promotion
8. Economic Information Services
9. Collection of Statistics
10. Technical Publicity and Exhibition
11. SSI in 'Priority Sector' for Bank Advances
12. Exclusive SSI Branches by Banks
13. Assistance in imports of raw materials
14. Technology Upgradation and Modernisation

Price Preferences

For Government purchases, wherever the price of SSI products are higher than the ones offered by the medium and large scale industries, price preference to the extent of 15 per cent over and above the ones offered by the medium and large scale industries will be given to the products of SSI. The extent of price preference upto 15 per cent will be decided by DGS&D depending upon the quality of SSI product, etc.

Central Excise Duty Exemption

The excise duty exemption scheme for small scale units was introduced in 1986-87. As of now, excise duty exemption upto the value of Rs. 30 lakh is available for all small scale units whose annual turnover do not exceed Rs.2 crore.

Sales Tax Exemptions

Most of the State Governments have granted sales tax exemptions at varying degrees for a wide variety of SSI products.

Ancillary Development and Marketing Services

SIDO has an Ancillary Development Division which is the Nodal agency at the Central Government level to develop small scale, ancillary and sub-contracting units in the country through its network of 16 sub-contracting exchanges and SISIs across the country.

Central and State Governments, Department of Public Enterprises, Department of Railways, Defence, etc. for the promotion of ancillary industries.

To encourage suitable linkages between large and small scale industries both in private and public sector, the ancillary Division through SISIs brings buyers in the large scale sector in touch with sellers in the small scale sector in suitable state level Ancillary Seminars, Buyers Sellers meets, Ancillary Exhibitions, National/Regional Workshops on Ancillary Development, etc.

To promote marketing of SSI products, state level Small Industries Development Corporations (SIDCs) submit tenders on behalf of SSIs to various agencies including DGS&D, Railways, Defence and State stores purchase Authorities including public sector undertakings.

Export Promotion

Though its network of SISIs and extension centres; SIDO provides assistance throughout India for promotion of exports of SSI products.

SIDO activities in this regard include:

- dissemination of information about foreign markets,
- consultancy services in export marketing;
- organising training programmes on export marketing,
- maintaining liaison with concerned export development agencies. etc.

In addition. SIDO publishes small industry Export Bulletin comprising information export prospects, Government policy announcements and procedures relevant to small industry exports, market /commodity reports prepared by professional agencies, etc.

Economic Information Services

Eonomic information provides the basis for taking policy decisions for the promotion of SSI by the Agencies. Organisations engaged in the task. Such information [illegible] small scale entrepreneurs in making sound investment decisions.

The Economic Information Division at SIDO provides information on various aspects of small industry development and conducts studies on SSI policy issues. The Economic Information Division of SISIs provides economic information, consultancy services, guidance and assistance to small scale industrialists and prospective entrepreneurs.

Collection of Statistics

The statistics and Data Bank Division of SIDO functions as a nucleus for statistical information relating to small scale industries. It collects, compiles, and disseminates statistical information on various aspects relating to small scale industries to Government and semi-government organisations. This facilitates planning and formulation of various development programmes for the development of SSI.

Technical Publicity and Exhibition

The Publication Division of SIDO through its periodical and non-periodical publications provides infonnation on Government Policies and Programmes to existing and prospective entrepreneurs in the small scale sector. These publications comprise information on technical consultancy, modern management and production techniques, technology upgradation and training programmes, etc.

The project profiles is another publication of SIDO. These provide guidelines on manufacturing process, raw materials, machinery and equipment, investment and profitability, etc..

To encourage small industry contribution to exports, SIDO participates in inter national exhibitions.

SSI in Priority Sector

Small scale industries sector is provided term credit and working capital by commercial banks co-operative banks, regional rural banks, State financial Corporations and SIDBI.

The credit provided by banks to SSI is treated as credit to priority sector'. The commercial banks are required to lend 40 per cent of their total loans to the priority sector which comprises agriculture, small business, small transport operators apart from small scale industries. The inclusion of small-sca~e industry In tlie priority sector is one of the measures taken by the Government to ensure smooth flow of credit to the se~

Exclusive SSI Branches

The reserve Bank of India had constituted a committee to examine the adequacy of institutionaJ credit to SSI in 1991. The committee submitted its report in 1992. The committee had recoinmended, among other things, setting up of specialised SSI branches by commercial banks in SSI concentrated districts. The recommendation is under implementation. As at the end of *1995,* 50 SSI branches have come up in SSI concentrated districts across the country.

Raw Material Imports

SIDO plays a major role in assessing the needs and supplying scarce raw materials through imports to SSI. SIDO maintains close liaison with the raw materials suppliers such as primary producers and canalising agencies like Minerals and Metals Trading Corporation (MMTC), State Trading Corporation (STC), etc. Iron and Steel Meterials, non-ferrous metals like tin and nickel are some of the imported items provided by SIDO to 551.

Technology Upgradation and Modernisation

SIDO attaches considerable importnace to technology development and modernisation of SSI. The Technology Development Division of SIDO functions as an outlet for transfer of improvcd te&hnology to small industry units. SIDO has set up a variety of technology development centres for industries such as glass and ceramic, sports goods, foundry and forging industry. household electrical appliances, tool rooms for tool designing and-elec-tronic service and training centres located at different parts of the country. Some ...se centres are

1) Product and Process Development Centre for Glass and Ceramic Industries, Ranchi.
2) Process-cum-Product Development Centre for Sports Goods and Leisure time Equipment. Meerut.
3) Process-cum-Product Development Centre for Foundry and Forging Induustries, Agra.
4) Institute for Design of Electrical Measuring Instruments, Bomhav.
5) Electronic Service and Training Centre, Ramnagar (Uttar Pradesh).

The programme of modernisation of SIDO envisages uligradation of obsolete technology through identification of inout needs in SSI. Since the approval of the programme of

modernisation, more than twenty industries have been selected on an All-India basis and about 40 industries on the basis of concentration in different states, for intensive programme of modernisation.

An important development regarding technology upgradation for SSI is the setting up of Technology Bureau for Small Enterprises in *1995* by SIDBI in association with Asia Pacific Centre for Technology Transfer (APCTT). The Bureau aims at identifying suitable technology suppliers from abroad for modernising SSI technology in various industries in India, among others.

Thus India has a vast network of institutions and an extensive package of policies and programmes for the exclusive protection and promotion of small scale industry.

8.7 GROWTH OF SMALL SCALE INDUSTRY IN INDIA

Thanks to the wide network of institutions, policies. programmes and due to its own intrinsic merits, Small Scale Industry has emerged into a prominent sector in Indian economy in general and industry in particular. The growth has been consistently significant not only in terms of units but in terms of employment and production as well (Table 8.2). From about 9 lakh units in 1980-81 SSI grew to more than 22 lakn units by 1993. The cumulative employrnent generated by SSI went up from 71 lakh to more than 134 lakh. The value cf production increased from Rs.28,060 crore to Rs.209,300 during the same period.

Table 8.2: Growth of Small Scale Industry (1980-81 to 1992-93)

Year	*Number of Units (lakh)*	*Employment (Lakh No.)*	*Production (Rs. crore at current prices)*
1980-81	8.74	71.0	28.060
1981-82	9.62	75.0	32.600
1982-83	10.59	79.0	35,000
1983-84	11.55	84.2	41,620
1984-85	12.40	90.0	50,520
1985-86	13.53	96.0	61,228
1986-87	14.62	101.4	72,250
1987-88	15.83	107.0	87,300
1988-89	17.12	113.0	106,400
1989-90	18.23	119.6	132,320
1990-91	19.48	125.3	155,340
1991-92	20.80	129.8	178,699
1992-93	22.35	134.0	209,300

Average Rate of Growth			
1980-81 to 1990-91	8.3	5.8	18.7
1990-91 to 1991-92	6.8	3.0	15.0
1991-92 to 1992-93	7.3	3.3	17.1

Source: DCSSI

What is more significant is that according to some estimates. exports from the SSI sector account for about 35 per cent of the total value of exports of India.

Some of the industries in the SSI sector which contribu.ite significantly to exports are readymade garments, leather products, gems and jewellery, handicrafts, chemicals and processed foods.

Thus, the contribution of small scale industry to Indian economy in terms of employment generation, industrial production and exports is remarkable. This is specially true in the 90s. When the New Economic Policy (NEP) was introduced in 1991, there were widespread fears that economic liberalisation would adversely affect the growth of small scale industry. But contrary to all apprehensions, small scale indsutry has been growing unabatedly in the 90s. The growth in SSI production is much higher than that of the industry as a whole (Table 8.3).

Table 8.3 : Growth of Industrial Output Since 1991 (in %)

Year	Industry	Manufacturing	SSI
1991-92	0.6	0.8	15.0
1992-93	2.3	2.2	17.1
1993-94	6.0	6.1	15.5
1994-95	8.6	9.0	21.7

Source : Economic Survey, various issues.

Several factors would have contributed to the sustained growth of small industry in the 90's:

The remarkable upsurge in recent years in the growth of durable consumer goods and capital goods industries, particularly automobiles and electronics have encouraged the growth of ancillary and small scale units, directly and indirectly.

There is a renewed realisation in the 90s about the opportunities for food processing units both within the country and abroad. This had given a boost to the growth of small scale food processing units across the country.

The devaluation and depreciation of rupee in the 90s would have encouraged the

growth of export oriented small scale units particularly in garments, leather products and handicrafts sectors.

- Further, there is an emerging trend of Multi National Corporations (MNC s) sourcing products from small and medium enterprises in India.
- The setting up of Small Industries Development Bank of India (SIDBI) which has been assuming more and more development responsibilities of SSI, directly and indirectly has led to a qualitative change in the credit flow to SSI.

All these factors, among others, have collectively contributed to the unhindered high growth of small scale industry in the 90s. However, small scale industry do have problems on diverse fronts which need to be tackled to further promote their growth in the future.

8.8 SMALL SCALE INDUSTRY: PROBLEMS AND PROSPECTS

The first and foremost problem confronted by Small Scale Industry is on the technology front. Despite the establishment of wide network of SISIs, industry-specific product development centres, etc. goods produced bySSI, in general, are of poor quality and design. A study undertaken by the Entrepreneurship Development Institute of India, Ahmedabad on the Impact of New Economic Policy on SSI, has brought out that quality and productivity are the two prime areas of concern for SSI entrepreneurs in the 90s. Another study conducted by National Council of Applied Economic Research (NCAER) - Friedrich Naumann Stiftung (FNS) has revealed that SSI used outmoded technology and therefore, its products lack quality.

Financial, particularly working capital, requirements of SSI have been growing considerably due to their consistent high growth. As a result, the exisitng financial infrastructure has not been able to cope with the ever growing credit needs of the sector. The establishment of SIDBI and exclusive SSI branches by commercial banks are recent positive developments. However, non-availability of finance in right time and quantitv has remained a bottleneck for SSI growth even today.

A small scale industrial unit is subject to visits of different kinds of Government officials from different departments such as excise, labour, factory, pollution control, electricity, etc. The visits are to ensure the adherence of SSI units to the rules and regulations applicable to them. However, small scale entrepreneurs, in the process, are said to be subject to harassment and disruption of work. The visit of various inspectors to SSI units for law enforcement, commonly known as 'Inspector Raj', is said to be a major bane of SSI sector.

Shortage of power, inadequate raw materials, marketing constraints, etc. are some of the other major problems faced by different segments of the small industry sector

All these have resulted in sickness in SSI. Sickness in SSI is defined, according to Reserve Bank of India, as a unit which has:

I. Incurred cash loss in the previous accounting year and is likely to incur loss in the current accounting year leading to erosion of net worth cumulatively by 50 per cent of more.

II Defaulting to pay quarterly instalments of interest four times or two half-yearly instalments of principal on term loans.

For tiny units, one of the two conditions will suffice. For other SSI units, both conditions are to be satisfied.

Sickness in small scale industry is growing both in terms of units and outstanding bank credit (Table 8.4).

Table 8.4: Sickness in Small Scale Industry

Year	Number of sick SSI units	Percentage to total sick units in industry	Bank credit outstanding	
			Amount (Rs. billion)	Percentage to total
1982	58,551	97.3	5.7	22.2
1984	91,450	98.0	8.8	24.2
1986	145,776	98.7	13.1	26.8
1988	240,573	99.2	21.4	27.8
1990	218,828	99.0	24.3	26.0
1992	245,575	99.1	31.0	26.9

To tackle sickness in SSI, the basic causal factors such as technological obsolescence, lack of finance, raw material constraints, marketing problems, etc. have to be solved. The Reserve Bank of India (RBI) had set up a committee on the Rehabilitation of Sick Small Scale Industrial Units in 1986 and as per the report of the committee, RBI had issued guidelines to banks for early detection of sickness and prompt remedial action. However, sickness has only deteriorated since then.

Some of the following measures would go a long way in curbing sickness and promoting 'healthy' growth of SSI:

- The role of vast network of technical institutions needs to be assessed and reoriented for SSI technology development.
- Linkages between Council of Scientific & Industrial Reserach (CSIR) laboratories and small industries need to be developed and strengthened.
- Industry specific R & D centres may be set up in small industry clusters already identified. SIDBI, SFCs and respective State Governments along with small industry associations could set up such R & D Centres.
- SIDBI can set up district-wise branches to promote credit flow to SSI.
- Exclusive investment banks for SSI must be permitted to come up.
- SIDO along with NSIC may study the ways and means to promote international sub-contracting for the benefit of SSI units.
- Visits of inspectors should be monitored and curtailed to the minimum.

These measures, among others, would contribute to the development of small scale. industry.

Activity 3

Visit, at least, three SSI units in your town and list out the number of inspectors who visit them in an year and the number of taxes that they have to pay in an year. Discuss how far multiple inspections and payment of multiple taxes disturb their work schedule?

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Activity 4

Find out from the local branch of a commercial banks the procedures involved and time consumed in obtaining a loan for a small scale unit?

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8.9 SUMMARY

Small Scale Industry offers multiple benefits to an industrialising economy like India. That is why, SSI has been assuming increasing attention of the policy makers since independence. An exhaustive institutional framework and a wide range of policies and programmes have emerged for the protection and promotion of small scale industry in India. As a result, SSI has been growing impressively and contributing significantly to employment, industrial production and exports. However, SSI growth is not bereft of problems. Technology, finance, marketing, etc. are the major areas of constraints for SSI. The cumulative impact of these constraints is reflected in the growing sickness of SSI. Urgent remedial measures to overcome the constraints will boost the competitiveness of SSI and will further accelerate its growth.

8.10 KEY WORDS

Ancillary Industrial Unit: An ancillary industrial unit means an industrial undertaking which has both the following features:

(a) the investment in fixed assets in Plant and Machinery, whether held on ownership terms or by hire purchase, does not exceed Rs. 75.00 lakh; and

(b) the undertaking is engaged or is proposed to be engaged in the manufacture or production of parts, components, sub-assemblies, tooling on intermediates or the rendering of services, and the undertaking supplies or renders or proposes to supply or render at least 30 per cent of its production or services, as the case may be to one or more other industrial undertakings.

Such units shall not be subsidiary of, or owned or controlled by, any other industrial undertaking.

SSI Concentrated districts: The second All India Census of SSI (1987-8) conducted by DCSSI has revealed that 85 districts in the country have more than 2000 registered SSI Units each and account for more than 51 per cent of the total number of functioning registered SSI Units in the Country. These districts are referred to as SSI concentrated districts.

Devaluation: Reducing the value of a country's currency in terms of official exchange rate against a foreign currency.

Depreciation: Fall in the value of a country's currency against a foreign currency due to the interaction of forces of demand and supply of goods and services.

8.11 SELF-ASSESSMENT QUESTIONS

A. Discuss the role and importance of small scale industry in a developing economy like India.

B. Analyse the distinguishing features of New Industrial Policy of 1991 for SSI

C. Describe the institutional framework for SSI that emerged over the period?

D. Examine the growth of SSI in the 90s.

E. Discuss ways and means to overcome the constraints faced by SSI in the 1990s.

8.12 FURTHER READINGS

1. Development Commissioner, Small Scale Industries, *Annual Report 1988-89,* New Delhi.
2. United Nations Industrial Development Organisation (UNIDO), 1995, *INDIA: Towards Globalisation.*
3. Sandesara, J C, 1992, *Industrial Policy and Planning, 1947-1991,* Sage Publications, New Delhi.

UNIT 9 SICKNESS IN INDIAN INDUSTRY

Objectives

The main purpose of this unit is to help you to

- understand the meaning of industrial sickness
- get an overview of industrial sickness in India
- analyse the factors responsible for industrial sickness, and
- understand the measures to tackle the problem of industrial sickness

Structure

9.1 Introduction

9.2 Meaning of Industrial Sickness

9,3 Overview of Industrial Sickness in India

9.4 Factors Responsible for Industrial Sickness

9.5 Measures to Tackle Industrial Sickness

9.6 Summary

9.7 Key Words

9.8 Self-Assessment Questions

9.9 Appendix 5: Statistical Table Further Readings

9.1 INTRODUCTION

In a capitalist economy wherein competitive forces have a free play, the sickness problem usually does not invite State attention or State intervention. The Darwinian principle of the 'survival of the fittest' will apply and those who cannot stand the competition will have sickness followed by natural death or extinction. This is one important virtue of free competition in a capitalist economy. Efficiency will be rewarded (with profits and growth) and inefficiency will receive due punishment (of extinction). A system of rewards and punishments is an essential feature of capitalism. An industrial unit which falls sick and fails to rejuvenate itself will get weeded out and this is the core of the logic of competitive industry. The fear of going to the wall creates the urge among industrial units to display the entrepreneurial qualities (including innovation) not only to survive but also to excel. Thus in a competitive economy there are built-in forces to ensure efficiency in the functioning of the industrial and other sectors.

The story is different in respect of a mixed economy like ours with State Control, regulation and participation. The government in such a context cannot be indifferent to the problem of industrial sickness. In this unit we will explain the meaning of sickness, and discuss the extent or magnitude sickness, industry-wise and state-wise. We will also analyse the causes of sickness, and critically examine Government plicies to tackle the problem of industrial sickness.

9.2 MEANING OF INDUSTRIAL SICKNESS

The phenomenon of industrial sickness, both in large and small scale industry, has

become quite widespread during the last several years. This was particularly significant in the small industry sector resulting in the closure of a number of units.

Sickness may arise due to a multitude of reasons. The effects, however, are the same,e.g. financial hardships and unemployment of labour engaged in the industrial units falling sick, and wastage of national resources. It is, therefore, considered essential not only to devise suitable measures for dealing effectively with sick industrial undertakings but also to make suitable arrangements for monitoring and detecting industrial sickness at an early stage. This calls for a clear understanding of different aspects of sickness. First we shall deal with the meaning of industrial sickness.

It is generally obsered that a sick unit is one which works below 20 per cent of its installed capacity. Also a sick unit is defined as one which operates at lower than break even point. According to another viewpoint, a sick unit is one which fails to generate internal surplus on a continuing basis. A healthy unit is one which assures both a reasonable return on capital and reserves after providing for depreciation. Reasonable return on capital and reserves may be worked out from time to time by considering the lending rate of commercial banks. Units which cannot assure reasonable rate of return on capital and maintain adequate amount of reserves are defined as sick units.

The Study Team of State Bank of India in its *Report on Small Scale Industry Advances,* -1975 defined a sick unit as "one which fails to generate an internal surplus on a continuing basis and depends for its survival upon a frequent infusions of external funds".

According to R.B.I., "a sick unit is one which incurs cash losses for one year and which, in the judgement of the bank, is likely to incur losses for the current year as well as the following year, and which has an imbalance in its financial structure, such as a current ratio of less than 1:1 and worsening debt-equity ratio (total outside liabilities to net worth)"

A unit may be considered sick in which a major part, say 50 per cent, of its equity and reserves are eroded by cash losses. In the case of an entrepreneurial scheme, a sick unit is one is which there are no owned funds; a depletion of 50 per cent in the total working funds of these units may be considered indication of sickness. A persistent irregularitv in workingcapital advances (not on account of inadequacy of limits) for a period of 12 to 18 months or stoppage of production for a sufficiently long period, say, six months may be taken to signify sickness. A sick unit is also defined as one which does not yield a reasonable return, say 15 per cent on capital and reserves after providing for depreciation.

In the Sick Industrial Companies (special provisions) Act, 1985, a sick industrial company has been defined as follows: "An industrial company (being a company registered for not less than seven years) which has at the end of any financial year accumulated losses equal to or exceeding its entire networth and has also suffered cash losses in such financial year and the financial year immediately preceding such financial year". Although not covered by the Act, the Government has identified another category of units called weak units. These are the units which are at the incipient stage of sickness. A weak unit is termed as such if at the end of any accounting year, if has: (a) accumulated losses equal to or exceeding 50 per cent of its peak networth, (b)a current debt-equity ratio of less than 1:1 and (c) suffers a cash loss in the immediately preceding year. (In this unit most of our discussion is limited and to sick units as weak units are only potentially sick but not actual sick units).

Tabling into consideration the above definition of a sick industrial units, the following features may be identified with such a unit:

- A sick unit is one that has incurred cash losses in the immediately preceding two years and in the judgement of credit institutions, is expected to incur losses during the current year. This may be called the *loss criterion.*
- A sick unit is one whose networth (i.e. paid-up share capital plus reserves) has been eroded to the extent of at least 50 per cent. *This may be called the networth erosion*

- A sick unit is one whose working capital advance account with the bank was irregular and this persiste ovc a period of time, say 12 to 18 months, and likely to become more persistent. This may be. called *working capital criterion.*
- A sick unit is one which has defaulted in paying four consecutive half-yearly (or two consecutive annual) instalments of principal and interest on term loans, if any. This may be called the *loan repayment failure criterion.*
- A sick unit is one which operates below 20 per cent of its installed capacity. This may be called *low capacity utilisation criterion.*

9.3 OVERVIEW OF INDUSTRIAL SICKNESS IN INDIA

Table 9.1 non-SSI Sector give the relevant data. Among the non-SSI units, the number of sick units increased from 241 in 1976 to 1915 by 1994. Thus the incidence of sickness in non-SSI units during the period 1976-1994 increased by about 8 times. Outstanding bank credit in the case of these sick units increased from Rs. 609 crores in 1976 to Rs. 8152 crores by 1994. The bank credit locked up in non-SSI units thus increased by about 13 times.

As for the sickness in the small scale industrial sector, the number of sick units increased from 6278 in 1976 to *2,56,452* by 1994, thus an increase by 41 times. The bank credit locked up in sick units of the small scale sector increased from Rs. 134 crores in 1976 to Rs. 1601 crores in 1994, that is, an increase of about 12 times.

The total number of sick units, taking into account both small scale and non-SSI sectors, increased from 6622 in 1976 to 258367 in 1994. Numerically, thus, industrial sickness by increased by about 39 times. As for the bank credit locked up in the sick units of the two sectors, it increased from Rs. 1195 crores in 1974 to Rs. 11753 crores in 1994, i.e., by about 10 times during the period 1976-1994.

Table 9.2 (see appendix) gives State-wise and industry-wise incidence of sickness in the case of non-SSI units.

In the following Table 9.2A (based on Table 9.2) we give the industry-wise non-SSI sick units and bank credit locked up in those units as at the end of March, 1994.

Table 9.2A: **industry-wise Sickness (Non-SSI Units)**
Industry-wise sickness (1994)

Industry	No. of Units	%of Total	Bank credit outstanding (Rs. crores)	% of total
Engineering	243	12.9	1159.52	14.2
Textiles	384	20.1	18	22.3
Paper	120	6.2	314.68	3.9
Cement	52	2.7	315.02	3.0
Iron and Steel	122	6.4	569.50	7.0
Sugar	19	1.0	83.42	1.0
Chemicals	170	8.9	669.30	8.2
Metal	75	3.9	382.21	4.7
Vegetable Oil	46	2.4	106.88	1.3
Tobacco	5	0.3	14.25	0.2
Leather	29	1.5	46.88	0.6
Total**	1909		8151.52	

Source: Table 9.2. Some industries mentioned in this Table have not been included.
** inclusive of all industrial in Table 9.2.

From the above Table it can be seen that textile industrial units accounted for the highest incidence of sickness (20.1 percent of the total sick units in all industries followed by Engineering Industry (12.7 per cent), Chemicals (8.9 per cent), Iron and Steel (6.4 per cent), and Paper (6.2 per cent).

The sick units in the textile industry accounted for the largest amount of bank credit locked up in sick units (22.3 per cent), followed by Engineering Industry (14.2 percent), Chemicals Industry (8.2 per cent) and Iron and Steel Industry (7.0 per cent). Table 9.2B gives State-wise break-up of Industrial Sickness.

Table 9.2B: Industrial Sickness in Major States* (Non-SSI Units)

State	No. of Units	%in Total	Oustanding Bank Credit (Rs. crores)	% in total
Bihar	58	3.9	293.0	3.6
WestBengal	229	12.0	1138.6	14.0
Orissa	37	1.9	192.8	2.4
UttarPradesh	165	8.6	816.6	10.0
Punjab	39	2.0	95.9	1.2
Haryana	65	3.4	303.8	3.7
Rajasthan	67	3.5	188.8	2.3
Gujarat	184	9.6	758.3	9.3
Maharashtra	350	18.3	1735.6	21.3
Madhya Pradesh	87	4.6	205.4	2.5
Andhra Pradesh	209	10.9	848.9	10.4
Karnataka	108	5.7	347.8	4.3
Tamil Nadu	152	8.0	552.1	6.8
Kerala	66	3.5	374.8	4.6
Total**	1909		8151.52	

Source: Table 9.2

*selected states.

** inclusive of all States in Table 9.2.

Among the Indian States, Maharashtra topped the list with the highest incidence of industrial sickness. Of the total sick units in India, Maharashtra in 1994 had the highest percentage (18.3 per cent) followed by West bengal (12 per cent), Andhra Pradesh, (10.9 per cent), Gujarat (9.6 per cent), and Uttar Pradesh (8.6 per cent). Paradoxically, thus the relatively better off states such as Maharashtra and Gujarat had high incidence of industrial sickness.

Regarding outstanding bank credit locked up in sick units, Maharashtra again came at the top (21.3 per cent of the total outstanding bank credit), followed by West Bengal (14 percent), Andhra Pradesh (10.4 per cent), Uttar Pradesh (10 percent) and Gujarat (9.3 percent).

The problem of industrial sickness in the non-SSI sector is thus a serious one and has grave implications for the overall industrialisation process and industrial performance

Small Scale Sector

As for the incidence of industrial sickness in the small scale sector, Table 9.3A below (an abridged version ofTable 9.3) shows state-wise incidence of sickness.

Table 9.3 A: Incidence of Sickness in SSI - Major States (1994)

State	No. of Units	%of Total	Bank credit outstanding (Rs. crores)	% of total
I. Bihar	17063	6.7	113.92	3.1
2. West Bengal	56083	21.9	359.49	9.8
3. Orissa	7235	6.7	74.50	2.0
4. Uttar Pradesh	15	13.2	335.43	9.1
5. Punjab	2434	1.0	64.59	1.8
6. Haryana	1669	0.7	79.53	2.2
7. Rajasthan	14665	5.7	74.72	2.0
8. Gujarat	7812	3.0	235.47	6.4
9. Maharashtra	21350	8.3	768.47	20.9
10.Madhya Pradesh	9795	3.8	143.97	3.9
11.Andhra Pradesh	13842	5.4	262.79	7.1
12. Karnataka	15145	5.9	204.35	5.6
13. Tamil Nadu	8125	3.2	428.27	11.6
14. Kerala	10792	4.2	169.38	4.6
Total* (All India)	2,56,452		3680-37	

Source: Table 9.3 (in Appendix)

* Inclusive of all States and Union Territories.

From the above table you can see that West Bengal accounted for the highest percentage 21.9 per cent of sick units in the small scale sector in 1994, followed by Uttar Pradesh (13.2 per cent), Maharashtra (8.3 per cent), Orissa and Bihar (6.7 per cent each), Karnataka (5.9 per cent), Rajasthan (5.7 per cent), and Andhra Pradesh (5.4 per cent). The incidence of sickness in the small scale industrial sector thus has been high both in relatively high income states like Maharashtra and in low income states like Uttar Pradesh.

Interesting Maharashtra which had only 8.3 per cent of sick units accounted for 20.9 per cent of outstanding bank credit, followed by Tamil Nadu (11.6 per cent), West Bengal (9.3 per cent) and Uttar Pradesh (9.1) per cent).

Sickness of such a large number of industrial units in non-SSI and SSI sectors involving thousands of crores of rupees is a very grave matter for the Indian economy which already has a far from adequate level of industrialization and where the resources are significantly short of requirements.

These sick units adversely affect several aspects of the industrial economy of the country. The industrial capacities built by deploying large resources are not fully utilized. So, there is loss of production because of sickness. Further, because of the various backward and forward linkages of several of these industries, other industries and economic activities suffer. The finances locked up in these sick units adversely affect the loanable funds of financial agencies. The inability of the sick units to meet their statutory liabilities (e.g. provident fund contributions) impinges adversely upon labour and industrial relations. The costs to the economy of the existence of a large number of sick units is this massive.

Activity1

a) From Table 9.1, calculate

i) Average annual growth rate of industrial sickness (criterion: mimber of sick unitsy)

ii) Average annual growth rate of financial resources locked up in sick units.

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Activity 2

Calculate annual average growth rate of sickness in SSI sector for 14 major States (given in Table 9.3A) from data given in Table 9.8.

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9.4 FACTORS RESPONSIBLE FOR INDUSTRIAL SICKNESS

We shall now focus our attention on the factors in the non-SSI sector first, and then on the SSI sector.

Non-SSI Sector

The factors responsible for industrial sickness can be divided into two categories: Exogenous factors, and Endogenous factors.

Some of the exogenous factors relate to such factors as government policies pertaining to production, prices and distribution. Change in the investment pattern following new priorities in the plans is yet another factor. Further, shortage of power, transport, raw materials, deteriorating industrial relations are some other factors to be noted in this connection. Such factors are likely to affect all units in an industry. These factors may cause sickness of the industry. If state policy is the cause of sickness, then corrective action should be taken at the government policy level. An illuminating example of government policy causing industrial sickness is the controlled cloth scheme. Another is the administered coal prices beofre nationalisation of coal mines.

The most important endogenous factor causing industrial sickness has been weak management or mismanagement. In a large number of 1units, sickness was caused by bad management. In a highly protective environment (prior to 1991's new economic policy), many persons with no managerial abilities entered the field and set up industrial enterprises. Some of them indulged in malpractices. Some took a short-sighte view of development and concentrated on making quick money. Many managers found it easy to meet their cash losses through borrowed capital, rather than through efficiency improvements. In a significant number of cases, sickness has resulted from managerial failure to adapt

the production pattern and methods to the changing market onditions. Not much was done to replace the obsolete machinery or to upgrade technology. In the absence of favourable atmosphere (incentives, competition etc.), quite a number of managers preferred their units to go sick. Some did so to seek financial help from the government. According to Mr. Prem Kumar Jha ("To Nationalise or not to Nationalise" The Illustrated Weekly of India, February 18, 1979), "In fact as the take-over of sick units and textile) mills has shown in every case what the Government has inherited is a load of wornout machiney, a mountain of debts and a distraught workforce. Nationalisatioti in such circumstances has become a means of indemnifying the entrepreneur against the consequences of his misdeeds instead of punishing him - first he milks an enterprise dry, then hands it over to the government for salvage."

George Fernandes makes a similar assessment whern he "I do not want the Government to be a scavanger for the private sector. Look at the National. Textile Corporation. The NTC today has 111 textile mills. They were taken over after the private sector sucked them dry of all their money and abandoned them and 1,50,000 workers employed in them to their fate. In the Eastern States, we have Jessops, braithwaite, Burn Standard, Britannia Engineering, Arthur Buter, Gresham and Gravan and other engineering units taken over the Government after similar mismanagement."

Managerial faults and failures thus contributed a lot towards causing industrial sickness. Other endogenous factors may be summarily stated as follows:

- Diversion of funds
- Wrong dividend policy
- Excessive overheads
- Lack of sufficient provision for depreciation
- Overestimation of demand, and
- Bad planning.

SSI Sector

If we go by the number of sick units (See the earlier section), the problem of sickness is to be considered as more serious and needs greater attention of the public policy in respect of SSI Sector. In what follows, we deai with the major factors causing sickness in the small industrial sector.

1. *Lack of management expertise* is an important cause of sickness. Young entrepreneurs start enterprises with unrealistic ideas. They keep overhead costs high. They borrow funds at high interest rates. They do not care for achieving economies and reducing costs. Thus inexperienced management is one of the major causes of sickness in small industry.

2. *Scant regard for the ba&ic principles of business management* is another major cause of sickness. To start entetprises with a low equity base is a negation of healthy business management practice. In large and medium scale industries, the usual borrowings to equity ratio is 2:1 which gives them better shock- absorbing capacity. In the case of small scale industries the ratio ranges between. 5: l and 9:1. If the industries are to incur losses at the beginning they lead to serious liquidity problems which has the effect of further compounding operational problems. further, small industrial units make little effort to build internal financial resources during good years maintian high inventories, invest short-term borrowings in medium term investments etc., and all these result in developing poor internal resilence to fight difficult times.

3. *Lack of working capital, inadequate demand and non-availability of raw materials* In sufficient quantities result in underutilisation of capacity and sickness In the small scale units.

4. *Inadequate production planning and control and poor financial planning and management* in respect of small scale unit is an important reason for sickness.

5. *Inadequate assessment of market and poor marketing strategy is* another factor cc tributing to industrial sickness.

6. *Easy approval of small scale units* without adequate scrutiny by State agencies also results in sickness. This underscores the fact that assessment of viability of the project is not made with adequate care, more especially with regard to financial viability.

7. Non-payment, by the 'principles' (usually large and medium scale units) to the ancillaries (SSI unit ` has been noted as an important cause of small industry sickness.

9.5 MEASURES TO TACKLE INDUSTRIAL SICKNESS

We shall now turn over attention to the measures and policies adopted by the Government to

tackle the problem of industrial sickness in both the sectors.

Non-SSI Sector

To tackle the problem of industrial sickness two broad approaches have been suggested. The working group of Central Trade Unions (Report of the Working Group of Central Trade Unions, 1978) recommended that the two relevant statutes, namely, the Industries (Development and Regulation) Act, 1951 and the Companies Act, 1956 should be amended to provide for: (a) deterrent penalties to parties responsible for sickness of the units and for recovering all dues including compensation from their other corporatel (b) personal assets; ~) expeditious takeover of the units likely to become sick or already sick; (c) simultaneous financial and management restructuring of the unit; and (d) preparation and implementation of a revival plan for the unit with provision of the requisite funds, barring reversion of the unit to the erstwhile management.

The second approach has been suggested by some others among whom the eminent economist the late Raj Krishna was one. This approach does not favour government takeover of the sick units. In many cases it was discovered that the sickness was contrived. The private sector was successful in abandoning the sick children. Then, the public sector was called upon to pay for the sins of the private sector. Raj Krishna expressed the following view: "after basics are nationalised, public investment in my view must not be wasted on the acquisition of old plants. There are scores of new plants waiting to be created in critical sectors. I would prefer public investment to be channelled for creating new capacity in crucial sectors rather than for buying old capacity."

While one remedy for potentially viable sick units may be to do everything possible in order to revive them, the other may be to create an efficiency-oriented environment by encouraging competition and by reducing the stiffling controls over the idnustry. The New Industrial Policy seeks to bring about necessary reforms in this respect.

SSI Sector

The problem of industrial sickness in the SSI sector needs to be treated differently from the proeblm of sickness of the large units. The need is or increasing the competitive strength and viability of small units. For this purpose, the following measures may be considered.

The Reserve Bank of India should issue guidelines for the operation of small units and thuis make professional management expertise available for the guidance of small entrepreneurts in respect of financial management.

A programme of monitoring and nursing small units in the early stages is very essential. In this way, the misuse of funds for purposes other than specified, and the factors leading to low capacity utilisation can be examined and remedial action taken.

The Government (through small industry agencies) can accord priority in allocation of. raw materials, extending marketing assistance and granting certain rebates and concessions to small units and more so to such units which show better performance.

- Soft credit may be extended to small units to help them to tide over crisis situations.
- The government should take every possible measure to ensure payments by principals (large industrial units) to ancillary (SSI) units.

Government Policy

Several important changes have been brought about in the Government policy relating to sick units in recent years. Emphasis has now been pladed on the need to select only such units for revival which are viable on strictly commercial considerations. An important change in the policy has been a shift from ad hoc nursing of sick units in the past towards making available assistance under well-integrated packages to remove the causes of sickness. This policy lays stress on various reliefs and concessions to be extended not only by banks and term lending institutions but also by the promoters, government and labour. Another development has been a shift in emphasis in favour of prevention of sickness rather than undertaking remedial measures at a later stage. Who realised? the need for a selective and systematic approach towards rehabilitation of sick units, guidelines were issued to banks in November, 198[illegible] to ensure coordination between banks and term-lending institution for assessing the viability of a unit identified as sick and for framing a suitable rehabilitation package for it. Measures have also been suggested to overcome delays in the formulation and implementation of packages of remedial measures.

As recommended by the Tiwari Committee, a significant new initiative was taken through the enactment of Sick Industrial Companies (Special provisions) Act, 1985 in order to handle industrial sickness effectively. The Actprvided for the setting up of a Board for Industrial and Financial Reconstruction (BIFR). The Board which is a quasi-judicial body, has been vested with extensive powers. Under the Act it is mandatory for a unit which has become sick (as per the definition of the Act) to report to the BIFR. The BIFR, while acting through operating agencies (term-lending institutions such as IDBI, IFCI, ICICI, and IRBI), would verify the fact of sickness, ascertain its viability and, where necessary, get a package of rehabilitation prepared for the unit.

Since its inception and upto the end of December, 1995, the BIFR has received 2497 references under sick Industrial Companies Act (SICA) both in respect of private companies and public sector undertakings. Of the *1756* references registered, 383 cases were dismissed as non- maintainable, revival schemes have been sanctioned approved in 530 cases and 407 cases have been recommended to the concerned High Courts for winding up. Sale has been ordered in one case. In addition to the above, draft schemes were formulated and circulated in 57 cases and show cause notices issued for winding up of 54 companies. The proportion of cases effectively decided to those registered by the BIFR till the end of December, 1995 is 74.6 per cent.

With economic liberalisation and the new industrial policy announced in 1991. It is believed that there is a need to re-examine the role of Government in tackling the problem of industrial sickness. Meddling with the operation of inexorable economic laws in the name of reviving sick units may prove counter-productive and detrimental to the effective working of the industrial economy of the country.

Activity 3

Name and briefly describe a sick unit with which you are familiar or identify one such unit

and the following:

a) Factors which caused sickness, including management failures the present position

b) Measures, if any, initiated for ensuring its healthy functioning.

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Activity 4

Using data given in the Tables of the Unit, compare Maharashtra and Tamil Nadu in respect of industrial sickness, both in small and large scale industries.

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9.6 SUMMARY

In this unit we attempted to explain the meaninng of industrial sickness. Thereafter we examined the factors responsible for sickness of units in the non-SSI and SSI sectors. Finally, we dealt with the measures for tackling ihe problem of industrial sickness and government policy in this respect.

9.7 KEY WORDS

Sick Units Units which cannot assure reasonable rate of return on capital and maintain adequate amount of reserves.

9.8 SELF-ASSESSMENT QUESTIONS

1. Explain industrial sickness.
2. Suggest remedies for industrial sickness in Small Industry Sector.
3. A sick unit must be allowed to die a natural death - Discuss.
4. "In an uncontrolled capitalist economy, industrial sickness is not a problem that attractsthe attention of the Government". Explain .
5. Explain the following criteria for identifying industrial sickness:

   a) Networth erosion criterion

   b) Working capital criterion

   c) Loss criterion

d) Loan repayment failure criterion

e) Low capacity utilisation criterion..

6. Explain the major causes for sickness in non-SSI units.
7. Explain the major causes for sickness in SSI units.
8. Industrial sickness is essentially a managerial failure referring to important managerial decisions discuss the validity or otherwise of the statement.

9.9 FURTHER READINGS

Centre for Monitoring of Indian Economy (CMIE), *Indianindustria1 Sectors* January, 1986

RBI, *Report on Currency and Finance,* different years.

GOI, *Economic Survey,* latest publication.

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Appendix 5: List of Statistical Tables

Table 9.1:	Industrial Sickness: 1976 to 1993-94
Table 9.2:	State-wise and Industry-wise Classification of Non-SSI Sick Units and Outstanding bank Credit
Table 9.3:	State-wise classification of Sick Small-Sclae industrial units and outstanding ank credit as at the end of March, 1994.
Table 9.4:	Industry-wise Bank Credit Large Sick Units: 1978 to 1992.
Table 9.5:	Industrial Sickness: State-wise Large Scale Units: 1982 to 1994.
Table 9.6:	Industrial Sickness: Industry-by state Number of Non-SSI Sick Units: September 1992.
Table 9.7:	Industrial Sickness: Industry-by-state Outstanding Bank Credit to Non-SSI Sick Units: September 1992.
Table 9.8 :	Industrial Sickness: State-wise Small Scale Industrial Units: 1985 to 1994.

Table 9.1 : Industrial Sickness: 1976 to 1993-94

	Non-SSI units		Small-scale units		Total	
	Number	Outstanding bank credit (Rs. crore)	Number	Outstanding bank credit (Rs. crore)	Number	Oustanding bank credit (Rs. crore)
December						
1976	241	609				
1977	289	858				
1978	344	1,061	6,278	134	5,622	1,195
1979	378	1,158	20,975	262	21,353	1,420
1980	409	1,324	23,149	306	23,558	1,630
1981	422	1,479	25,342	359	25,764	1,838
1982	444	1,791	58,551	569	58,995	2,360
1983	491	2,014	78,363	72[illegible]	78,854	2,743
1984	545	2,33[illegible]	91,450	88	91,995	3,210
1985	637	2,980	117,783	1,06	118,420	4,048
1986	714	3,287	145,776	1,30[illegible]	146,490	4,593
1987	1,119	2,802	204,255	1,797	205,374	4,599
1988	1,241	3,564	240,573	2,141	241,814	5,705
March						
1989-90	1,455	4,539	218,828	2,427	220,283	6,966
1990-91	1,461	5,106	221,472	2,787	222,933	7,893
1991-92	1,536	5,787	245,575	3,100	247,111	8,887
1992-93	1,867	7,901	238,176	3,351	240,043	11,252
1993-94	1,915	8,152	256,452	3,601	258,367	11,753

Table 9.2

State-wise and industry-wise classification of non-SSI sick units and outstanding bank credit

(As at the end of March 1994)

Rs. Crore

(Amount in Rs. crore)

State/Union Territories		Engi-neering	Elec-trical	Textiles	Jute	Paper	Rubber	Cement	Iron & Steel	Sugar	Chemi-cals	Metal	Vegetable oil	Tobacco	Leather	Gem & Jewellery	Food	Vehicles etc.	Misc	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
Eastern Region																				
Assam	Units	–	–	1	–	–	–	–	–	–	3	–	–	–	–	–	–	–	6	10
	Amt.o/s	–	–	1.93	–	–	–	–	–	–	85.17	–	–	–	–	–	–	–	8.30	95.40
Meghalaya	Units	–		–		–	–	–	–	–	1	1	–	–	–	–	–	–	–	2
	Amt./os								–	–	1.14	0.67	–	–	–	–	–	–	–	1.81
Bihar	Units	9	1	4	3	4	–	3	4	4	4	1	2	–	2	–	1	1	15	58
	Amt./os	182.91	2.40	3.58	2.35	2.84	–	22.15	4.83	6.04	11.44	0.34	3.63	–	3.61	–	1.73	0.18	44.96	293.00
West Bengal	Units	32	9	17	28	14	6	2	22	1	16	13	3	–	2	–	4	3	57	229
	Amt./os	293.85	20.28	63.29	157.41	53.84	21.85	7.97	69.58	6.99	56.16	43.66	3.19	–	7.63	–	5.11	7.27	320.49	1138.58
Nagaland	Units	–	–	–	–	–	–	–	–		–	–	–	–	–	–	–	–	1	1
	Amt.o/s									–	–	–	–	–	–	–	–	–	2.35	2.35
Orissa	Units	3	–	5	1	3	1	2	2	–	8	–	4	–	–	–	–	–	8	37
	Amt./os	12.09	–	32.36	0.42	2.87	0.24	6.38	4.07	–	94.79	–	7.60	–	–	–	–	–	32.81	192.83
Sikkim	Units	–	–	–	–	–	–	–	–	–	–	–	1	–	–	–	–	–	–	1
	Amt./os								–	–	–	–	5.69	–	–	–	–	–	–	5.69
Tripura	Units	–	–	–	1	–	–	–	–	–	–	–	–	–	–	–	–	–	–	1
	Amt./os				6.88				–	–	–	–	–	–	–	–	–	–	–	6.88
Total (Eastern Region)	Units	44	10	27	33	21	7	7	28	5	32	15	10	0	4	0	5	4	87	339
	Amt./os	488.85	22.68	101.16	167.06	59.55	22.09	36.50	78.48	13.03	248.70	44.67	20 11	0.00	11.24	0.00	6.84	7.45	408.91	1736.54
% share of All India	Units	18.11	14.93	7.03	89.19	17.50	20.59	13.46	22.95	26.32	18.82	20.00	21.74	0.00	13.79	0.00	11.90	8.33	20.96	17.76
	Amt./os	42.16	3.84	5.57	97.25	18.92	19.60	11.59	13.78	15.62	37.16	11.69	18.82	0.00	23 98	0.000	7.73	1.74	31.94	21.30

(Contd.)

Table 9.2 (Contd.)

(1)	(2)	(3)		(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
Northern Region																				
Uttar Pradesh	Units		18	38	-	1	1	3	8	3	18	3	3	-	3	-	4	4	42	165
	Amt./os		146.86	223.42	-	19.96	0.69	28.40	19.03	23.27	45.25	17.19	4.23	-	2.39	-	2.43	27.60	230.56	816.99
Delhi	Units	5	-	1	-	1	-	-	2	-	-	-	-	-	-	-	-	1	7	17
	Amt./os	5.11	-	[illegible]	-	0.15	-	-	16.09	-	-	-	-	-	-	-	-	0.36	22.24	73.96
Punjab	Units	10	2	5	-	5	-	-	-	1	5	2	1	-	2	-	2	1	3	39
	Amt./os	24.84	9.71	7.50	-	9.10	-	-	-	11.28	16.25	6.13	0.41	-	2.99	-	5.40	0.17	2.07	95.86
Haryana	Units	15	-	12	-	5	1	-	7	-	4	1	-	-	1	-	1	5	13	65
	Amt./os	83.41	-	29.44	-	7.12	1.70	-	21.30	-	88.02	0.06	-	-	0.16	-	1.10	44.98	26.47	303.75
Chandigarh	Units	1	1	-	-	2	-	-	-	-	2	-	-	-	-	-	2	-	2	10
	Amt./os	1.04	0.63	-	-	0.48	-	-	-	-	0.82	-	-	-	-	-	7.20	-	4.86	15.01
Jammu and Kashmir	Units	1	-	-	-	-	-	-	1	-	-	-	-	-	-	-	-	-	2	4
	Amt./os	1.46							15.03	-	-	-	-	-	-	-	-	-	9.89	26.38
Himachal Pradesh	Units	4	1	-	-	11	1	-	4	-	2	1	-	-	-	-	-	-	2	26
	Amt./os	11.49	0.04	-	-	12.14	0.12	-	9.4	-	1.66	2.54	-	-	-	-	-	-	1.64	39.03
Rajasthan	Units	6	4	17	-	5	-	4	5	1	3	3	2	-	-	-	1	2	14	67
	Amt./os	13.28	22.70	30.54		13.61	-	8.77	47.53	1.96	5.19	12.75	7.63	-	-	-	0.66	2.71	21.44	188.77
Total Northern Region	Units	53	26	73	0	30	3	7	27	5	34	10	6	0	6	0	10	13	85	393
	Amt./os	195.95	179.94	290.90	0.00	62.56	2.51	37.17	128.39	36.51	157.19	38.67	12.27	0.00	5.54	0.00	16.79	75.82	319.17	1559.35
% share to All India	Units	21.81	38.81	19.01	0.00	25.00	8.82	13.46	22.13	26.32	20.00	13.33	13.04	0.00	20.69	0.00	23.81	27.08	20.48	20.59
	Amt./os	16.90	30.49	16.01	0.00	19.88	2.23	11.80	22.54	43.77	23.49	10.12	11.48	0.00	11.82	0.00	18.98	17.69	24.93	19.13

(Contd.)

Table 9.2 (Contd.)

(Amount in Rs. Crore)

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
Western Region																				
Gujarat	Units	19	3	87	-	6	2	5	10	-	9	6	3	-	2	-	-	3	29	184
	Amt.o/s	22.04	16.41	459.36	-	40.96	2.35	59.81	16.15	-	33.52	16.58	9.87	-	1.44	-	-	30.89	48.92	758.32
Maharashtra	Units	58	15	92	-	13	5	3	24	3	34	17	5	-	3	-	7	9	62	350
	Amt./os	238.74	115.46	611.98	-	25.91	26.73	33.90	207.85	3.22	118.76	90.92	27.00	-	1.97	-	18.40	39.96	174.75	1735.55
Daman & Diu	Units	-	-	2	-	-	1	-	-	-	-	-	-	-	-	-	-	-	-	3
	Amt./os	-	-	5.33	-	-	.79	-	-	-	-	-	-	-	-	-	-	-	-	7.12
Goa	Units	-	-	-	-	-	-	-	-	-	1	1	-	-	-	-	-	1	2	5
	Amt./os	-	-	-	-	-	-	-	-	-	0.65	0.48	-	-	-	-	-	1.82	2.45	5.40
Dadra & Nagar Haveli	Units	-	1	1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1	3
	Amt.o/s	-	1.01	0.87	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2.51	4.39
Madhya Pradesh	Units	3	2	20	-	7	2	7	4	1	5	8	4	-	-	-	2	3	19	87
	Amt./os	5.39	4.79	73.86	-	4.17	5.17	19.82	23.22	1.14	7.42	17.24	3.01	-	-	-	4.97	1.99	29.27	205.43
Total (Western Region)	Units	80	21	202	0	26	10	15	38	4	49	32	12	0	5	0	9	16	113	632
	Amt./os	266.17	137.67	1151.40	0.00	71.04	36.04	113.53	247.22	[illegible]	160.35	128.22	39.88	0.00	3.41	0.00	23.33	74.66	257.90	2716.21
% share to All India	Units	32.92	31.34	52.60	0.00	21.67	29.41	28.85	31.15	21.05	28.82	42.67	26.09	0.00	17.24	0.00	21.43	33.33	27.23	33.11
	Amt./os	22.96	23.33	63.36	0.00	22.58	31.97	36.04	43.41	10.02	23.96	32.76	37.31	0.00	7.27	0.00	26.37	17.42	20.15	33.32

(Contd.)

Table 9.2: (Contd.)

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
Southern Region																				
Andhra Pradesh	Units	30	6	21	4	12	3	13	5	1	23	7	12	5	2	-	10	7	48	209
	Amt.o/s	85.13	22.39	18.47	4.73	90.05	5.22	103.08	20.56	0.73	21.56	118.15	24.16	14.25	4.53	-	30.12	163.30	122.51	848.93
Karnataka	Units	7	2	16	-	8	5	10	9	3	3	6	2	-	-	-	6	4	27	108
	Amt./os	12.60	8.53	41.28	-	17.96	15.00	24.73	69.05	23.49	1.91	17.74	1.79	-	-	-	10.17	54.29	49.29	347.83
Tamil Nadu	Units	21	5	32	-	7	2	-	13		18	4	2	-	12	-	1	3	31	152
	Amt./os	90.71	39.53	170.26	-	8.98	2.40	-	20.41*	1.29	33.25	21.51	0.18	-	22.16	-	0.87	47.80	92.77	552.11
Kerala	Units	7	5	10	-	1	4	-	1	-	11	1	1	-	-	1	1	1	22	66
	Amt./os	19.50	179.:7	36.71	-	2.30	29.47	-	5.06	-	46.34	16.26	7.86	-	-	0.76	0.33	5.18	25.60	374.83
Pondicherry	Units	1		3	-	2	-	-	1	-	-	1	-	-	-	-	-	-	2	10
	Amt./os	0.62	-	7.18	-	3.02	-	-	0.36	-	-	0.65	-	-	-	-	-	-	3.89	15.71
Total (Southern Region)	**Units**	**66**	**18**	**82**	**4**	**30**	**14**	**23**	**29**	**5**	**55**	**18**	**18**	**5**	**14**	**1**	**18**	**15**	**130**	**545**
	Amt./os	**208.56**	**249.92**	**273.90**	**4.73**	**122.31**	**52.09**	**127.81**	**115.44**	**25.51**	**103.06**	**173.66**	**34.64**	**14.25**	**26.69**	**0.76**	**41.49**	**270.57**	**394.06**	**2139.41**
% share of All India	Units	27.16	26.87	21.35	10.81	25.00	41.18	44.23	23.77	26.32	32.35	24.00	39.13	100.00	48.28	100.00	42.86	31.25	31.33	28.55
	Amt./os	17.99	42.34	15.07	2.75	38.87	46.21	40.57	20.27	30.58	15.40	45.44	32.41	100.00	56.93	100.00	46.90	63.14	22.97	26.25
Total All India	**Units**	**243**	**67**	**384**	**37**	**120**	**34**	**52**	**122**	**19**	**170**	**75**	**46**	**5**	**29**	**1**	**42**	**48**	**415**	**1909**
	Amt./os	**1159.52**	**590.20**	**1817.35**	**171.79**	**314.68**	**112.72**	**315.02**	**569.50**	**83.42**	**669.30**	**382.21**	**106.88**	**14.25**	**46.88**	**0.76**	**88.46**	**428.52**	**1280.07**	**8151.52**

Note : 'Sick Industrial Company' means an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

* Negligible Amount.

Source : Industrial and Export Credit Department, Reserve Bank of India.

Table 9.3 : State-wise classification of Sick Small-Scale industrial units and outstanding Bank credit as at the end of March 1994

(Amount in Rs. crore)

States/Union Territories	Total Sick Units	
	No. of Units	Amount Outstanding
1	2	3
Eastern Region		
Assam	14,210	40.52
Meghalaya	317	2.11
Mizoram	119	0.66
Bihar	17,063	113.92
Arunachal Pradesh	123	0.67
West Bengal	56,083	359.49
Nagaland	1,063	4.96
Manipur	2,350	2.37
Orissa	17,235	74.50
Sikkim	77	0.44
Tripura	764	2.56
A & N Islands.	25	0.35
Total	**1,09,429**	**602.55**
	(42.67)	**(16.37)**
Northern Region		
Uttar Pradesh	33,915	335.43
Delhi	5,516	242.99
Punjab	2,434	64.59
Haryana	1,669	79.53
Chandigarh	179	10.24
Jammu & Kashmir	162	5.14
Himachal Pradesh	614	17.46
Rajasthan	14,665	74.72
Total	**59,154**	**830.10**
	(23.07)	**(22.55)**
Western Region		
Gujarat	7,812	235.17
Maharashtra	21,350	768.44
Daman & Diu	6	0.79
Goa	710	21.07
D & N Haveli	10	1.74
Madhya Pradesh	9,795	143.97
Total	**39,683**	**1,171.48**
	(15.47)	**(31.83)**
Southern Region		
Andhra Pradesh	13,842	262.79
Karnataka	15,145	204.35
Lakshadweep	—	—
Tamil Nadu	8,125	428.27
Kerala	10,792	169.38
Pondicherry	282	11.45
Total	**48,186**	**1,076.24**
	(19.00)	**(29.24)**
TOTAL (All India)	**2,56,452**	**3,680.37**

Notes: A small-scale industrial unit is considered as sick when : 1) any of its borrowal accounts has became a 'doubtful' advance i.e. principal or interest in respect of any of its borrowal accounts has remained overdue for a period exceeding 2 1/2 years, and 2) there is erosion in the net worth due to accumulated cash losses to the extent of 50 per cent or more of its peak net worth during the preceding two accounting years.

ii) Figures in brackets indicate percentage share to the all India total.

Source : Industrial Export & Credit Department, Reserve Bank of India.

Table 9.4 : Industry-wise Bank Credit to Large Sick Units 1978 to 19[illegible]

	1980	1985	1986	1987	1988	1989	1991	1992 Sept.
				Number of Units				
Textiles	89	162	186	213	227	276	268	293
Engineering and Electrical	88	153	175	326	278	299	306	348
Paper				80	97	113	114	114
Chemicals	22	34	39	122	122	140	130	149
Iron & Steel	42	39	38	45	70	91	113	115
Jute	35	44	43	36	35	35	37	40
Sugar	48	46	47	26	24	20	18	19
Rubber	9	16	16	19	16	15	21	30
Cement	3	3	5	5	10	22	28	43
Miscellaneous	53	100	140	185	293	408	426	448
Total	**389**	**597**	**689**	**1,057**	**11,72**	**1,419**	**1,461**	**1,599**
				Outstanding Amount (Rs. crore)				
Textiles	350	962	1,118	899	997	1,274	1,428	1,520
Engineering and Electrical	304	629	788	815	756	974	1,227	1,731
Paper				148	183	244	272	311
Chemicals	146	114	140	149	166	216	239	685
Iron & Steel	82	196	166	77	150	241	333	415
Jute	87	152	200	109	124	157	161	172
Sugar	78	148	177	105	99	59	101	97
Rubber	43	126	127	79	54	61	81	110
Cement	12	9	41	31	43	138	165	261
Miscellaneous	131	318	481	267	455	893	1,098	1,503
Total	**1,233**	**2,655**	**3,239**	**2,680**	**3,026**	**4,257**	**5,106**	**6,805**

Table 9.5 : Industrial Sickness: State-wise Large Scale Units: 1982 to 1994

	Number of Units				Outstanding Credit (Rs. crore)			
	June 1982	December 1985	March 1990	March 1994	June 1982	December 1985	March 1990	March 1994
Andhra Pradesh	13	37	122	209	32	103	386	849
Assam	2	2	8	16	2	7	10	95
Bihar	13	17	40	58	41	45	9[illegible]	293
Delhi	1	4	24	17	8	8	5[illegible]	74
Goa, Daman & Di	4	5	16	11	7	14	32	13
Gujarat	42	62	155	184	132	302	548	758
Haryana	6	16	46	65	12	42	83	304
Himachal Pradesh			15	26			28	39
Jammu & Kashmir			1	4			8	26
Karnataka	20	33	82	108	141	163	262	348
Kerala	17	16	32	66	74	129	155	375
Madhya Pradesh	16	22	47	87	36	89	128	205
Maharashtra	88	146	322	350	355	836	1,328	1,736
Meghalaya			1	2			1	2
Nagaland			–	1				2
Orissa	3	7	28	37	18	35	89	193
Punjab	3	4	28	39	4	6	35	96
Rajasthan	6	13	46	67	35	40	98	189
			1	1			2	6
Sikkim	35	50	133	152	216	190	273	552
Tamil Nadu		1		1		2		7
Uttar Pradesh	53	66	84	165	184	279	215	817
West Bengal	111	132	195	229	426	626	652	1,139
Andaman & Nicobar			1				2	
Chandigarh		1	23	10		2	48	15
Dadra & Nagar Haveli			2	3			1	4
Pondicherry	2	3	4	10	6	12	4	16
All India	**435**	**637**	**1,455**	**1,915**	**1,729**	**2,980**	**4,539**	**8,152**

Table 9.6 : Industrial Sickness: Industry-by-state Number of Non-SSI Sick Units: September 1992

	Textiles	Engineering	Paper	Iron & steel	Chemicals	Jute	Sugar	Rubber	Electrical	Cement	Misc. inds.	Total
Andhra Pradesh	15	32	12	4	26	4	2		4	13	54	168
Arunachal Pradesh								2			2	2
Assam		1			2						6	9
Bihar	4	11	4	4	2	1	4			3	18	51
Delhi	1	7	3	4					1		5	21
Goa, Daman & Diu								1			3	4
Gujarat	71	23	6	11	11			1	2	7	27	159
Haryana	11	20	3	6	3			1	1		15	60
Himachal Pradesh		3	9	3	3			1			4	23
Jammu & Kashmir		1									1	2
Karnataka	14	10	9	8	5			5	3	9	29	96
Kerala	7	8	1		9		4	3	3		13	44
Madhya Pradesh	15	2	6	4	3		1	2	2	4	24	63
Maharashtra	70	77	12	26	30		3	5	9	3	71	306
Meghalaya					1							1
Nagaland											1	1
Orissa	2	8	2	6	8	1		1			10	38
Punjab	4	9	4		2		1	1	2		10	33
Rajasthan	14	6	6	7	4		1		3		14	58
Sikkim											1	1
Tamil Nadu	23	26	7	9	17		1	1	2		38	124
Uttar Pradesh	24	15	9	4	10	1	1	1	9	1	38	113
West Bengal	17	38	15	19	11	33	1	5	5		58	202
Chandigarh	1	2	4		2				1		2	12
Dadra & Nagar Haveli									1		2	3
Pondicherry		1	2								2	5
All India	**293**	**300**	**114**	**115**	**149**	**40**	**19**	**30**	**48**	**40**	**448**	**1,599**

Table 9.7 : Industrial Sickness: Industry-by-state outstanding Bank Credit to Non-SSI Sick Units: September 1992

	Textiles	Engineering	Paper	Iron & steel	Chemicals	Jute	Sugar	Rubber	Electrical	Cement	Misc. inds.	Total
Andhra Pradesh	23.5	86.9	89.7	5.6	29.9	6.0	5.8		28.7	104.5	157	543
Arunachal Pradesh								5.3			11	11
Assam		0.3			71.8						6	78
Bihar	3.4	162.5	2.2	4.8	9.0	0.3	15.2			18.1	43	258
Delhi	2.2	13.7	0.8	18.2					0.3		27	62
Goa, Daman & Diu								4.1			4	8
Gujarat	346.7	52.0	44.5	33.1	18.8			0.1	1.2	58.7	63	618
Haryana	25.2	120.4	4.9	17.7	61.0			1.6	2.0		18	251
Himachal Pradesh		8.3	17.0	6.6	6.8			0.1			14	52
Jammu & Kashmir		2.0									8	10
Karnataka	55.2	46.4	21.7	38.0	3.3			14.5	12.1	28.5	110	365
Kerala	32.5	29.0	4.9		19.7		35.6	35.1	154.2		31	303
Madhya Pradesh	71.9	2.1	3.6	24.3	5.2		4.6	5.0	5.4	2.6	49	174
Maharashtra	580.9	351.6	25.6	138.2	117.7		17.7	19.5	61.1	38.0	239	1,589
Meghalaya					1.1							1
Nagaland											5	5
Orissa	6.9	13.7	7.6	19.9	59.7	0.6		0.2			57	165
Punjab	4.4	16.8	5.9		18.8		3.9	2.0	9.8		26	87
Rajasthan	38.2	8.7	11.2	15.6	5.6		2.6		31.8		38	190
Sikkim											3	3
Tamil Nadu	155.1	142.0	9.2	8.6	37.2		1.3	0.5	2.2		104	460
Uttar Pradesh	104.3	40.4	16.1	9.1	4.1	3.5	5.0	0.7	26.2	2.8	213	433
West Bengal	68.3	239.9	41.0	45.1	8.7	161.3	5.7	21.2	43.4		266	931
Chandigarh	1.3	3.4	5.3		3.4				0.6		7	196
Dadra & Nagar Haveli									1.0		2	3
Pondicherry		0.6	1.1								3	7
All India	**1,520.0**	**1,350.6**	**311.4**	**414.5**	**4.5**	**171.6**	**97.3**	**110.0**	**379.9**	**253.0**	**1,503**	**6,805**

Table 9.8 : Industrial Sickness: State-wise small Scale Industrial Units: 1985 to 1994

	Number of Units				Outstanding Credit (Rs. crore)			
	Dec. 1985	March 1990	March 1992	March 1994	Dec. 1985	March 1990	March 1992	March 1994
Andhra Pradesh	8,694	30,103	29,586	13,842	63	187	271	263
Arunachal Pradesh	11	29	50	123		neg.	neg.	1
Assam	5,683	4,512	5,317	14,210	8	26	32	41
Bihar	8,570	5,007	7,823	17,063	49	56	92	114
Delhi	2,271	4,346	4,705	5,516	64	159	206	243
Goa, Daman & Diu	811	1,217	1,071	720	9	13	13	23
Gujarat	4,045	6,174	6,581	7,812	75	185	221	235
Haryana	1,500	31,86	3,467	1,669	25	64	74	
Himachal Pradesh	413	824	1,481	614	3	8	19	17
Jammu & Kashmir	1,382	1,819	769	162	6	8	8	5
Karnataka	5,705	10,252	17,316	15,145	78	141	189	204
Kerala	2,378	15,239	14,883	10,792	46	123	157	169
Madhya Pradesh	7,843	16,716	22,333	9,795	31	86	151	144
Maharashtra	8,567	19,208	20,153	21,350	187	489	603	768
Manipur	669	771	2,277	2,350	neg.	1	1	2
Meghalaya	141	61	68	317	neg.	1	1	2
Mizoram	2		1	119	neg.	neg.	eg.	1
Nagaland	7	45	2,039	1,063	neg.	1	5	5
Orissa	5,299	7,194	8,415	17,235	29	38	54	75
Punjab	1,345	5,938	5,485	2,434	22	82	100	65
Rajasthan	5,964	9,987	14,420	14,665	29	56	67	75
Sikkim		70	75	77		neg.	neg.	neg.
Tamil Nadu	15,171	9,891	9,797	8,125	108	216	291	428
Tripura	245	465	670	764	1	1	2	3
Uttar Pradesh	12,036	27,862	34,150	33,915	82	207	258	335
West Bengal	18,620	37,448	32,022	56,083	143	263	268	359
Andaman & Nicobar		21	22	25		neg.	neg.	neg.
Chandigarh	171	290	342	179	6	8	9	10
	3	7	5	10	neg.	1	1	2
Pondicherry	24[illegible]	[illegible]				5	5	1[illegible]
All India	**117,786**	**218,801**	**245,539**	**256,456**	**1,06δ**	**2,426**	**3,098**	**3,602**

BLOCK 3 PLANNING AND POLICIES

In Block 2 we had familiarised you with the structure of the Indian economy. A Part from discussing the structural dimensions of the Indian economy, including the structure of the Indian industry, we had also discussed the structure and the role of public and private sectors in India, as well as the policies and programmes etc. of the Government regarding the small sector in India. We also dealt with sickness in Indian industry, both in the large and the small sectors.

In this Block we discuss the **Planning and Policies in India.** This Block has three Units.

Unit 10 discusses the **Planning Goals and Strategies**. First, we describe the long term goals of planning. And then we discuss briefly the strategies adopted in the various plans, right from the First Five Year Plan to the Eighth Five Year Plan. The unit concludes with a discussion about the major strategies of growth adopted in India since the industrial Policy Statement of 1956.

Unit 11 deals with **Evolution of Industrial Policy.** The Industrial Policy Statements of 1948, 1956, 1977 and 1980 in particular are explained. The major points of the policy statements and the shortcomings are highlighted.

Unit 11 spells out the **Regulatory and Promotional Policy Framework** that emerged out of the Industrial Policies persued since 1948. Topics like industrial licensing, control of large firms, control of foreign investment, preferences given to the public sector enterprises, the place of small scale industry, regulations/policy framework with regard to industrial location, administered prices, taxation etc. are discussed. Lastly, the unit examines the impact of regulatory framework on industrial structure and performance.

UNIT 10 PLANNING GOALS AND STRATEGIES

Objectives

The objectives of this unit are :

- to study the long-term goals of planning;
- to understand the strategies adopted in various plans keeping in view the short-term objectives and long-term goals; and
- to briefly outline the main trends of the strategies adopted.

Structure

10.1 Introduction
10.2 Long-term Goals of Planning
10.3 Planning Strategies Adopted in Various Plans
10.4 Three Major Strategies Adopted Since 1956
10.5 Summary
10.6 Key Words
10.7 Self-Assessment Questions
10.8 Further Readings

10.1 INTRODUCTION

During the freedom struggle, the Indian National Congress had made a commitment that after the attainment of independence, the country would work on a planned model of development. With this end in view, the Government of India set up the Planning Commission in 1950 to assess the human and material resources of the country so as to formulate a plan for their balanced and effective utilisation. The main purpose of planning was to initiate the process of industrialisation and development which had remained inhibited due to an alien government. The national government was committed to raising the level of living of the Indian people by pursuing the task of development. This task could not be completed during the short period of five years : it required sustained efforts spread over a number of plans. Neither was it possible to achieve all the objectives in one go. Each five-year plan can, therefore, be viewed as a milestone towards our progress to achieve the long-term objectives of planning.

10.2 LONG-TERM GOALS OF PLANNING

During the freedom struggle, there was a commitment made by our national leaders that soon after the attainment of independence, they would embark on a programme for the planned development of the country. In pursuance of this commitment, the Government of India set up the Planning Commission in 1950 which was assigned the task of assessing the resources of the country and thus formulate a plan.

The Planning Commission, therefore, laid down the long-term goals of planning. They were:

(i) to increase production to the maximum possible extent so as to achieve higher level of national and per capita income;

(ii) to achieve full employment;

(iii) to reduce inequalities of income and wealth; and

(iv) to establish a socialist society based on equality and socialist justice and absence of exploitation.

The First Five Year Plan released in 1952 stated the long-term economic goals of planning in the following words:

"Maximum production and full employment, the attainment of economic equality or social justice which constitute the assepted objectives of planning under present day conditions are not really so many different ideas but a series of related aims which the countr[illegible] st work for. None of these objectives can be pursued to the exclusion of others, a pla[illegible] of development must place balanced emphasis on all of them". Planning Commission, *The First Five Year Plan,* p. 28.

Genesis of Mixed Economy Framework in India

For the attainment of these objectives. It was necessary to specify the socio-economic framework in which Indian economy was to function. One choice was to move to a complete transformation to socialism in which all the means of production will be owned by the state (Soviet model). This required total nationalisation of all the spheres of economic and social life. The other choice was to follow the capitalist mode of production providing total freedom to private enterprise to undertake the task of national development . The nation, under the leadership of Prime Minister Jawaharlal Nehru, rejected the Soviet Model because it led to the emergence of totalitarian state which stifled domocratic freedoms. Since Indian society did not favour the idea of dictatorship of a party or of an individual or placing absolute power in the hands of an elite group, it rejected the 'command model' of Soviet society which is popularly described as 'Dictatorship of the Proletariat' - an euphemism for dictatorship of a political party.

At the same time, private property symbolised which is a basic tenet of the capitalist mode of production helped exploitation of the peasants and workers by the capitalist clases in theirs unbridled effort towards profit maximisation. The Directive Principles of the Indian Constitution laid it down in very clear terms:

"The State shall, in particular, direct its policy towards securing-

a) that citizens, men and women equally, have the right to an adequate means of livelihood:

b) that the ownership and control of the resources of the community are so distributed as best to subserve the common good;

c) that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.'

The Government of India, therefore, also rejected the free capitalist mode of development. It opted for the framework of mixed economy in India in which private enterprise and public enterprise were to co-exist. It could be argued that in every economy, capitalist or socialist, public and private sectors do exist side by side. But this was a very narrow view of the co-existence of the public and private sectors. The distinguishing feature of the Indian mixed economy model was that it emphasised that the private enterprise should reconcile the element of self-interest with social interest and in case, it fails to do so, the government would be left with no option but to take over the control of such sectors of the economy. This implied that in such areas where either the private enterprise fails so subordinate its self-interest in favour of the social interest or where it is not forth-

coming to promote social interest, the government would deliberately extend the area of the public sector. The state, therefore decided to limit ownership in areas wherein it was felt such ownership came in conflict with social ownership.

In agriculture, for istance, the zamindari system was abolished and surplus lands acquired by the state were transferred to farmers or landless labourers. The legislation also provided a ceiling on holdings. The whole purpose was that land being the principal source of livelihood in the rural areas its ownership be more evenly distributed. The state did not favour "collectivisation" in the form of big farms, but worked on the principle of "peasant proprietorship" with a ceiling on holdings.

In small enterprises, private ownership was accepted.

To direct investment in the desired lines of production, the state decided to control the "commanding heghts" of the economy, viz., banking and insurance. Left to the private sector, investment would be driven by market forces based on profit motive. But areas of profit maximisation may not be areas of maximising social welfare. For instance, private sector was not willing to invest in economic infrastructure such as multipurpose hydro-electric projects, irrigation, roads and communications. Similarly, private sector may not provide adequate investment in education and health facilities so that access to education and health facilities becomes available to the poor and deprived sections of the society. The state, therefore, decided to undertake the development of the economic infrastructurel energy, irrigation, transport and communication-in the public sector. It also sought to provide social infrastructure in the form of education and health so that the poor are enabled to acquire these facilities either free or at a very low and affordable cost. The network of schools, colleges, technical training centres, primary health centres, dispensaries, hospitals etc. had to be planned in the public sector.

Moreover, during the British period, defence and heavy and basic industries were not allowed to be developed. But to have an independent industrial base for the Indian economy so as to make it self-reliant, it was considered necessary that the public sector should undertake investmet in defence, heavy and basic industries. Since these industries required lump sum investment and had a long gestation period, public enterprise which sought investment in areas of short gestation and maximum profit was unwilling to undertake investment in these areas. The state, therefore, planning the development of defence, heavy and basic industries in the public sector.

The mixed economy framework in India was particularly marked with the deliberate development of the public sector in (a) Defence, heavy and basic industries, (b) the development of economic and social infrastructure and (c) in controlling the commanding heights of the economy, viz., banking and insurance.

The deliberate enlargement of the public sector was symbolised by the phrase 'the development of socialist pattern of society' in the early period of planning, which was later replaced by the phrase 'democratic socialism'. The basic philosophy of democratic socialism entailed a programme of maximising production with maximum employment and along with this, a programme of action towards reducing economic and social disparities, thus ensuring a national minimum level of living for all. In other words, growth with social justice within the framework of a democratic society were the tasks to be accomplished under democratic socialism.

Dr B.S. Minhas rightly states: "Securing rapid economic growth and expansion of employment, reduction of disparities in income and wealth, prevention of concentration of economic power and creation of values and attitudes of a free and equal society have been among the objectives of all plans." (Minhas B.S., *Planning and the Poor*, p.8).

10.3 PLANNING STRATEGIES ADOPTED IN VARIOUS PLANS

As indicated earlier, the planning goals were long-term objectives. It is not possible to achieve them with the mobilisation efforts of a single plan. Rather, planning required continuous efforts for several plans to achieve these goals. Moreover, during the process of implementation, some powerful political factors may require change of strategy and thus, priorities may require change in the prioritisation of the objectives.

Since all the objectives cannot be achieved in one go, every plan has to specify the strategy and thus indicate the priority of the objectives. In this way, as the planning process gathers momentum, in every subsequent plan a reordering of the priorities may become necessary. It would be of inerest to study the straegies adopted in the various plans.

10.3.1 Strategy in the First Five Year Plan (1951-56)

The First Five Year Plan (1951-56) was faced with three major problems : (i) Influx of refugees from Pakistan and their rehabilitation : (ii) Severe shortage of food as a result of the partition of the country and a mojor part of irrigated areas going over to Pakistan; and (iii) mounting inflation due to the prevalence of shortages in economy as a result of disequilibrium caused due to the Second World War and subsequently the partition of the country.

The strategy of the First Five Year Plan was to achieve food self- sufficiency in the shortest possible time and to control inflation. The Plan, therefore, aimed at rapid extension of irrigation so that the output of foodgrains and agricultural raw materials like cotton and jute improves. This strategy helped to boost agricultural production, especially of foodgrains and, thereby, control inflation. The First Plan, in its strategy, accorded the highest priority to agriculture. The First Plan rightly mentioned: "We are convinced that without substantial increase in the production of food and raw materials needed for industry it would be impossible to sustain a higher tempo of industrial development." Planning Commission, *The First Five Year Plan*, p. 44.

The major aim of th strategy of the First Plan was to rehabilitate the economy ravaged by war and partition. The plan did help to remove shortages that existed in the economy. By the end of the Plan, food grain imports became negligible. The general price level declined by 13 per cent, food prices also fell. Consequently the economy was stabilised and in this atmosphere of confidence generated by the success of the First Plan, it was possible to move to a programme of rapid industrialisation.

10.3.2 Strategy during the Second Five Year Plan (1956-57 to 1960-61)

For the Second Plan it was felt that economy had reached a stage at which agriculture could be assigned a low priority and a forward thrust made in the development of heavy and basic industries for a more rapid advance in future. The basic element of the strategy of the Second Plan was to give a "big push" to the economy to build an industrial base in terms of rapid expansion of iron an steel, non-ferrous metals, coal, cement, heavy chemicals and other industries of basic improtance. The Second Plan clearly stated: "Investment in basic industries creates demands for consumer goods, but it does not enlarge the supply of consumer goods in the short run; nor does it directly absorb any large quantities of labour. A balanced pattern of industrialisation, therefore, requires a well-organised effort to utilise labour for increasing the supplies of much needed consumer goods in a manner which economises the use of capital." (Planning Commission. *The Second Five Year Plan*, p.25.)

The Second Plan, while emphasising a big push for heavy industry, was conscious of the

fact that it would cause shortages of consumer goods. It was therefore, felt that it was imperative to simultaneously, develop cottage and small scale industries which are labour intensive so that on the one hand, employment could be enlarged and on the other, the shortages of consumer goods could be taken care of.

Since the Second Plan accorded a relatively low priority to agriculture, it registere unsatisfactory progress in agriculture. There was a shortfall in the achievement of targets in foodgrains, jute, cotton and oil seeds. Prices of foodgrains rose all over the country. While three public sector steel plants were erected, their, production was much behind schedule. This was the case with many industries, too. Shortages of power were experienced in every state and as a result, progress towards industrialisation remained slow.

10.3.3 Strategy during the Third Five Year Plan (1961-62 to 1965-66)

The working of the Second Plan indicated the hard reality that without a sharp increase in agricultural production, it was not possible to push for a faster rate of economic development. Thus, instead of follwing a one-legged policy of emphasising industrialisation via heavy industry, it was desirable to have a two-legged strategy of development to emphasise agriculture on the one hand and heavy industry on th other. The strategy of the Third Plan therefore emphasised that agriculture should be expanded as far as possible and rural economy may be diversified so as to reduce the pressure of population on agriculture. While giving top priority to agriculture, the Third Plan also laid equal stress on the development of heavy and basic industries such as steel, fuel and power, machine building and chemicals vitally needed for rapid economic development. The Third Plan strategy set as its goal the establishment of a self-reliant and self-generating economy.

Three major facotrs seriously jolted the implementation of the Third Plan. They were: (i) The Chinese invasion of India in 1962, (ii) The armed conflict with Pakistan in 1965, and (iii) Exceptionally bad monsoons in 1965-66 leading to serious draught which reduced foodgrains production by about 20% in a single year.

Implementaion of the Third Plan was seriously jeopardised by the abnormal facotrs which interrupted the smooth working of the Plan. Serious shortfalls in targets of agricultural and industrial production occurred. Shortfall in agricultural output particularly in raw materials led to cutback in production of consumer goods industries, especially cotton textiles, Shortages of consumer goods as also a fall in the production of foodgrains led to a sharp increase in prices. Price index of food articles rose by 48 per cent during the Third Plan and of industrial raw materials and manufactures by 33 per cent and 22 per cent respectively. Since the rate of growth of the economy suffered a setback and as against 5 per cent growth of national income per annum, actual achievement. was barely 2.5 per cent per annum, there was an increase in unemployment. The backlog of unemployment which was around 7 million at the end of the Second Plan increased to about 9 to 10 million at the end of Third Plan.

The setback to the credibility of planning was so strong that the country shifted to a period of three annual plans (1966-67 to 1968-69) which is described as the period of "Plan Holiday". It was only when the economy recovered from the recession which was with nessed during 1966-67 and thereafter, that the country launched the Fourth Plan.

10.3.4 Strategy during the Fourth Five Year Plan (1969-70 to 1973-74)

The Fourth Plan set before itself two objectives, viz., "Growth with Stability" and **"Progressive Achievement of Self-Reliance"**

To achieve the objective of growth with stability, efforts were to be made to stabilise prices of foodgrains and the price level in general. For this purpose, the Plan adopted the Intensive Agricultural Development Programme (IADP) which emphasised the applicaion of good quality seeds with adequate doses of fertilisers in areas of assured irrigation. This

was described as seed- water- fertiliser technology in selected districts under IADP. This was intended to bring a sharp increase in agricultural production to stabilise prices of foodgrains and agricultural raw materials.

To achieve the objective of self-reliance, the financing of the Fourth Plan was to be managed by a larger additional mobilisation of internal resources which would not give rise to inflationary pressures. It was planned that PL 480 imports of foodgrains would be done away with by the year1971. Besides this, foreign aid net of debt charges and interest payments was to be reduced to half by the end the Fourth Plan.

The strategy adopted in the Fourth Plan did not yield the desired results. National income measured at 1960-61 prices increased by an average by 3.3 per cent per annum and the increase in per capita income was merely 1.2 per cent per annum. Consequently, the attainment of a national minimum with this record of performance was wishful thinking. The Plan failed to bring about 5.5% increase in national income- the target fixed for the Plan.

Equally disturbing was the situation on the agricultural front. The actual growth rate of agricultural production was much less as compared to the anticipated growth of 5 per cent per annum. While evidence of a break-through in wheat crop was available, success of high yielding varieties in rice was only marginal. In respect of jute, cotton fibres as well as pulses, success could not be achieved in any meaningful manner.

Growth rate of industrial production was much less than the targeted growth of 8percent per annum. The major factors responsible for this situation were; (i) shortages and irregular supplies of raw materials, components, (ii) shortage of power, (iii) transport bottlenecks and (iv) disturbed industrial relations.

Fourth Plan did not achieve the objective of growth with stability because the achieved growth rate was far short of the target. The wholesale price index (WPI) rose by 57.3 percent during the Plan period (1969-70 to 1973-74) and the WPI for foodgrains increased by 47.3 per cent. These developments adversely affected the welfare of the poor sections of the society. However, the performance of the Plan on the self-reliance front was better. For the entire plan period, exports as a percentage of imports accounted for about 92 per cent. Export growth averaged at the rate of 12.3 per cent annum as against import growth rate of 11.2 per cent

10.3.5 Strategy during the Fifth Five Year Plan (1974-75 to 1979-80)

Two major objectives of the Fifth Plan were: **"Removal of poverty and attainment of self-reliance."** For this purpose, the main elements of the strategy were:

(i) 5.5% over-all average growth rate of GDP.

(ii) A national programme of Minimum Needs covering elementary education, drinking water, medical care in rural areas, nutrition, home sites for landless labour, rural roads, rural electrification and slum improvement.

(iii) Emphasis on agriculture, key and basic industries and industries producing goods for mass consumption.

(iv) An adequate public procurement and distribution system for assured supply of essential consumption goods. at least to poorer sections, at reasonably stable prices.

(v) Vigorous export promotion and import substitution.

(vi) Regorous restraint on inessential consumption.

At the conceptual level, the strategy of the Fifth Plan was to shift the focus from the heavy industry model of the Second Plan to wage goods model so that the welfare of the masses, more especially the poor could be taken care of. This explains its shift of emphasis to

Minimum Needs Programme to provide basis necessities such as elementary education, drinking water, medical care, home-sites for the homeles population.

But a review of the Fifth Plan indicates that the Fifth Plan allocation pattern did not result in a higher growth rate of wage goods. In fact, the Plan document did not even provide a rough estimate of employment generation under the various schemes. A review of the Fifth Plan indicates a 3.9 per cent increase in national income but the performance of the Plan in increasing the supply of foodgrains and other wage goods has not been commensurate with general price level which rose by 33.5 per cent during (1973-74 to 1977-78) the first four years of the Fifth Plan. The consumer price index shot up by 33.2 per cent during the same period. Thus lathough the Fifth Plan conceptualised to increase the supply of wage goods so that it could make a serious dent on poverty and unemployment, yet it did not work out an allocation pattern and implementation mechanism to achieve the objective. Consequently, real income of the poor did not show an increase. Neither did unemployment decline.

10.3.6 Strategy outlined in Janata's Sixth Five Year Plan (1978-83)

The Planning Commission under C. Subramanian in the document **"Towards an Approach to the Fifth Plan"** asserted way back in 1972: "The elimination of abject poverty will not be attained as a corollary to a certain acceleration in the rate of growth of the economy alone.". The Approach paper suggested a strategy that was "to launch a direct attack on the problems of unemployment, under-employment and massive low-end poverty." Following this approach the Janata's Sixth Plan (1978-83) adopted the following strategy:

a) enlargement of the employment potential in agriculture and allied activities;

b) encouragement to household and small industires producing consumer goods of massconsumption;

c) fostering area planning for integrated rural development ; and

d) raising the income of the lowest income class through a revised minimum need programme.

Janata's Sixth Plan by enlarging employment in agriculture, household and small industries intended to lower the capital-intensity of production and increase the supply of wage goods needed by the masses. In the conceptul frame, it was akin to the strategy outlined in the Fifth Plan. The Janata Party Government started the implementation of the Plan in 1978 but after hardly a year and half of its functioning, fell and was replaced by the Congress (I) Government which abandoned the Janata Plan and reformulated the Sixth Plan.

10.3.7 Strategy of the Congress (I) during Sixth Five Year Plan (1980-85)

Congress(I) Sixth Plan outlining its strategy stated: "The strategy adopted for the Sixth Plan consists essentially in moving simultaneously to strengthen the infrastructure for both agriculture and industry. as to create conditions for an accelerated growth in investments, output and exports and to provide through special programmes designed for the purpose, increased opportunities for employment especially in the rural areas and unorganised secotr and meet the minimum basic needs for the people.". Planning Commission, *The Sixth Five Year Plan* (1980-85). p.34. The main emphasis of the planners was to strengthen the infrastructural base of the economy. The planners were conscious of the weaknesses of the Nehru-Mahalanobis strategy adopted from the Second Plan onwards. They, however, attempted to remedy it by suggesting special programmer for poverty removal. The Sixth Plan. therefore, mentioned: The attack on the problem of poverty is most effective only in the conditions of an expanding economy. Since growth

by itself may not, however, suffice, other programmes and policies will need to be adopted" *Ibid.*. p.34

The strategy of the Sixth Plan of strengthening infrastructure facilities on one hand land by special programmes to remove poverty on the other was quite successful during 1980-85. National income increased on an average by 5:2 per cent during the Sixth Plan and per capita income rose by about 3.1 per cent per annum. The number of unemployed which was around 12 million at the beginning of the Plan came down to 9.2 million at the end of the Plan. The proportion of population below the poverty line declined from 48.3 per cent in 1977-78 to about 37.4 per cent in 1983-84 and further to 35.0 per cent at the end fo Sixth Plan. The country was moving towards self-reliance by reducing its dependence of imports in strategic commodities viz., foodgrains, petroleum products and fertilisers. Thus the Sixth Plan enabled the country to make faster progress towards the objectives of growth, self- reliance and social justice.

10.3.8 Strategy of Seventh Five Year Plan (1985-90)

The development strategy of the Seventh Plan aimed at a direct attack on the problem of poverty, unemployment and regional imbalances. The Seventh Plan emphasised policies which would accelerate the growth in foodgrains production, increase employment opportunities and raise productivity. These three objectives were central to the Seventh Plan. Thus the focus of the Plan was on ***Food, Work and Productivity.***

The progress of the Seventh Plan revealed that the net national product (NNP) grew at the rate of 5.5 per cent per annum, and the per capita NNP at 3.5 per cent per annum. The Indian economy thus crossed the proverbial barrier of the Hindu rate growth of about 3-3.5 per cent as indicated by Professor Raj Krishna. This was a heartening development. Agricultural production grew at an annual average rate of 3.9 per cent and industrial production at the rate of 8.6 percent. Both the targets were fulfilled.

However, balance of payments on current account continued to be under sever strain. In 1988-89, current account deficit as a percentage of GDP went up to the high level of 3 percent and in 1989-90, it was 2.4 per cent. This was much higher than the target of 1.6 per cent fixed for the plan. It was feared that it by suitable policies of import substitution and import restriction, the balance of payments deficit was not reduced, the country would be caught in a debt trap. Although Wholesale Price Index rose onan average by 6.6 per cent, the consumer price index rose by 9.4. per cent on an average much higher than WPI.This affected the welfare of the weaker sections of society.

Although modernisation and productivity upgradation are laudable objectives, yet their impact on reducing unemployment was not discernible. Obviously, the choice of technologies did not enlarge employment commensurate with the needs of the economy.

10.3.9 Planning Strategy during the Eighth Five Year Plan (1992-97)

Janata Dal Government which came to power in November 1990 fell after a short span of less than a year. It was followed by the Chandrasekhar Government which also fell in 1991 after the congres (I) withdrew its support. In June 1991, the government headed by Shri. P.V Narsimha Rao reconstituted the Planning Commission with Mr. Pranab Mukherjee as the Deputy Chairman and a new document Enghth Five Year Plan (1992-97) was finalised in May 1992.

The country at the time of the formulation of the English Plan was faced with the problem of growing fiscal deficit and sudden depletion fo foreign exchange reserves which created a serious balance of payments crisis. Due to the paucity of foreign exchange, imports had to be drastically cut. As a consequence, growth rate slumped to a low level of 2.5 per cent in 1991-92. The major challenge before the government was to initiate recovery of the economy and provide it a new dynamism

Eighth Plan set before itself the task of correcting major imbalances facing the Indian economy which were;

(i) Increasing fiscal and budgetary deficits, mounting public debt had to be restructured.

(ii) Current account deficit of the balance of payments had to be brought down from the high level of an average of 2.4 per cent reached in the Seventh Plan.

(iii) A high rate of inflation had to be controlled.

Besides meeting these challenges, the Eighth Plan targetted to achieve a growth rate of 5.6 per cent on an average and to achieve other goals, viz., improvement in the level of living, health and education of the people, full employment, elimination of poverty and planned growth of population.

Since the process of economic reforms was initiated by the government, the strategy of achieving these goals underwent a basic shift in the development paradigms.

Firstly, as against the Nehru model of development assigning a major role to the public secto the Eighth Plan redefined the role of the public sector to the following areas:

(i) the public sector should make investment only in areas where investment is of ai infrastructural nature necessary for facilitating growth.

(ii) the public sector will concetrate on meeting social needs of the society like education, health, population control or to undertake public distribution of essential commodities to protect the interests of the weaker sections of the society.

The private sector supported by market mechanism was assigned a bigger role to build a culture of high productivity and cost efficiency. The process of planning has to be indicative and the government through an appropriate mix of policy instrument should influence the decisions of various economic agencies both in the public sector and private sectors to achieve desired goals. Outlining its strategy, the Eighth Plan stated; "Planning and market mechanism should be so dovetailed that one is complementary to the other. Market mechanism must serve as an "efficiency promoting device", while planning will be the larger guiding force, keeping the long-term social goals in the perspective." Planning Commission, (1992), *The Eighth Five Year Plan* (1992-97), p.30

A review of the progress of the first 4 years of the Eighth Plan reveals that the economy has now turned the corner and the growth rate of NNP which had slumped to 2.5 per cent in 1991-92 went up to 6.3 per cent in 1995-96. This is a welcome trend. It is also gratifying to note that foreign exchange reserves which had reached a level $ 21 billion by May 1995 were around US $ 17 billion in May 1996. The position as yet is comfortable. There is no doubt that exports account for about 92 per cent of imports in the year 1995-96. These are healthy trends.

But on the front of social justice, the situation is not encouraging. Firstly, consumer price index for agricultural labourers has shown an annual average rise by 11.6 per cent and that for industrial workers by 10.3 per cent. This has adversely affected the welfare of the poor. Secondly, the number of poor which was 298 million in 1990-91 has increased to 346 million in 1993-94 - an increase of 48 million during 3 year period. The proportion of the poor which was 35.5 per cent in 1990-91 has gone up to 39.0 per cent in 1993-94

The target of employment growth fixed for the Eighth Plan was 2.6 per eent per annum, but the achievement is only 2.0 per cent. During the first 4 years of liberalisation, target of employment has lagged behind by over 9 million. This is due to the capital intensive pattern of investment pushed up by the corporate sector in the post- liberalisation period. Agricultural growth has stagnated despite the availability of seven continuous good monsoons. Besides, production of foodgrains grew by only 1.5 per cent per annum during tne fitst 4years of the Eighth Plan. Less than one-third of the foodgrains provided by

the public distribution are available to the poor, the rest are appropriated by the better-off sections. Multinationals, which have been permitted indiscriminately even in the consumer goods sector are displacing labour in traditional consumer goods and are following a highly capital- intensive pattern of production.

It may, therefore, be concluded that the record of the Eighth Plan may be considered as satisfactory on the growth front, but the market-oriented strategy has failed the people on the front of social justice.

10.4 THREE MAJOR STRATEGIES ADOPTED SINCE 1956

The three major strategies that have been adopted in India since the beginning of the Second Plan are:

- Nehru-Mahalanobis Model of Growth
- Gandhian Model of Growth
- Rao-Manmohan Model of Growth

10.4.1 Nehru-Mahalanobis Model of Growth

Prof P.C. Mahalanobis under the guidance of Prime Minister Jawaharlal Nehru developed the heavy industry model based on the Soviet experience. This model popularly known as Nehru-Mahalanobis Model formed the basis of the Second Plan. This model continued to be the principal strategy of the various Plans with minor modifications till 1977 when the Janata Party Government conceived the Gandhian Model. The chief features of the "heavy industry" model were:

1. The model emphasised the rapid development of heavy industry with the aim of creating an industrial base of the economy as also to make it more self-reliant in terms of the capital - goods sector. The Second Plan outlining the rationale of the heavy goods strategy stated :

"In long run, the rate of industrialisation and the growth of the national economy would depend upon the increasing production of coal, electricity, iron and steel, heavy machinery, heavy chemicals and heavy industries generally- which would increase the capacity for capital formation. One important aim is to make India independent as quickly as possible of foreign imports of producer goods so that the accumulation of capital would not be hampered by difficulties in securing supplies of essential producer goods from other countries. The heavy industry must, therefore, be expanded with all possible speed." Planning Commission, *The Second Five Year Plan- The Framework.*

The main argumetns providing justification for heavy industry model were:

a) The British rule deliberately denied the development of heavy industry and kept India, primarily an agrarian enonomy as an appendage of the British Colonial System.

b) Indian industrial structure had a narrow base mainly dependent on consumer goods industries. It was necessary to enlarge this base by the development of heavy industries and infrastructure. A diversified industrial structure, it was argued, could absorb a large proportion of labour and raise labour productivity. This would also reduce dependence of excessive population for its livelihood on agriculture.

c) Productivity of labour being higher in manufacturing than in agriculture, an industrialised economy promised to bring about a rapid increase in national and per capita income.

d) Rapid industrialisation was essential not only for the development of agriculture. but also for the development of all other sectors of the economy.

Role of Pubilc and private sector Since the private sector was not likely to undertake investments in heavy industry sector which had a long gestation period, but had low profitability, the government decided to give the this responsibility to the public sector. The government conceived of the public sector as the engine of growth to carry forward the establishment and expansion of heavy industries and infrastructural facilities. The role of the private sector was complementary to public sector in expanding the production of consumer goods and such other areas in which public sector investment was not directed.

Role of foreign aid Mahalanobis model admitted the use of foreign aid to facilitate the growth of capital goods and infrastructure sectors, but it emphasised the fact that the major burden of development shall have to be borne by domestic savings. Since foreign and would largely come in the form of loans, it is essential that export growth be emphasised so that bulk of imports are paid for by the increase in exports.

Role of small industries Nehru-Mahalanobis model was conscious of the fact that massive investments, though very essential in the heavy industry sector, would not enlarge employment significantly, since such investments are capital-intensive. It would, therefore be necessary that in order to encourage the production of consumer goods and generate more employment, investment be made in smal industry. The planners clearly stated ; "The test of a country's advance in industrialisation is heavy industry-not the small industries that may be put up. This does not mean that small industires should be ignored. They are highly important in themselves for production and for employment." (Government of India, *problems in the Third Plan-A Critical Miscellany,* p.51.) ;

Role of agriculture Nehru-Mahalanobis model clearly understood the role of agriculture in the process of development. Nehru, recognising the important role of agriculture mentioned ; "We shall find that this industrial progress cannot be achieved without agricultural advance and progress .... Everyone knows that unless we are self - sufficient in agriculture we cannot have the wherewithal to advance in industries. If we have to import food, then we are doomed so far as progress is concerned. We cannot import both food and machinery." *Ibid.,* pp. 35-36.

Evaluation of Nehru-Mahalanobis Strategy

The main achievements of the strategy followed during first six plans, but for the short period of two years rule of the Janata Party (1977-78 to 1979-80) are as under;

- There has been a vast expansion of the capital goods sector via the heavy industry model. Sixth Draft Plan of the Janata Party Government accepted this achievement in the following words. "It is a cause of legitimate naional pride that over this period a stagnant and dependent economy has been modernised and made more self-reliant." (Planning Commission, *Draft Five Year Plan* (1978-83), p.1.)
- There was a vast expansion in economic infrastructure in the form of irrigation, energy, transport and communications etc.
- There was an expansion of the social infrastructure in the form of health and education facilities- schools, colleges, universities, primary health centres, dispensaries and hospitals.
- A smart rise in saving and investment rates was withnessed in the country.

However, there were certain shortcomings noticed in the process fo implementation :

1. Although agriculture did progress, but with relatively small allocation for agriculture, the progress could not be considered adequate. Development of agriculture required

much greater investment in irrigation, eletricity, fertilisers, implements, pesticides etc.

2 Heavy industry model was heavily dependent on imports of capital goods. It therefore developed a capital-intensive pattern of development. This resulted in a relative neglect of small industries and industries producing consumer goods. Thus, heavy industry model created balance of payment difficulties on the one hand and failed to absorb the rapidly growing labour, on the other. This resulted in a failure to enlarge unemployment adequately.

3. The public sector expansion led to the emergence of high cost economy with much less emphasis on effeciency. Both the undertakings of the Central Government and those of the State Governments like state electrictiy boards, roads trasport undertakings and irrigation works etc.incurred losses year after year and the state exchequer was required to pay these losses out of the general tax revenues of the government.

4. Failure of exports to rise commensurate with the increase in imports (necessitated by the expansion of the capital goods sector), resulted in the persistence of trade deficits and these deficits increased in magnitude with every successive plan.

10.4.2 Gandhian Model of Development

Janata Party Draft Five Year Plan (1978-83) noted a number of weaknesses of the Nehru-Mahalanobis model: The model failed to provide a national minimum level of living despite four decades of planning. Nearly 40 per cent of the population lived below the poverty line. The number of unemployed and under-employed continued to remain high and increased with every successive plan. Inequalities of income and wealth had grown between the rural and urban areas. Thec country failed to overcome shortages of food-grains and consumer goods and suffered due to inflationary pressures.

Gandhian model of development was emphasised by the Janata Party. The model emphasised the rapid development of agriculture and small industries. Village and small industries were emphasised from the point of view of production as well as employment. The model necessitated the following changes in the pattern of planning;

(i) **Employment -oriented planning to replace production-oriented planning** - Nehru model by over-emphasising a capital- intensive pattern of development failed to generate enough employment. But unemployment and under-employment are at the root of problems of poverty and inequality. There is a strong need to demarcate areas with high employment potential and investment should be directed in such areas sc that the pattern of investment becomes employment - oriented and the economy increases its absorptive capacity of labour.

(ii) **Emphasis on development of agriculture as a means of enlarging employment** - Charan singh, an ardent advocate of the Gandhian model brought out the hard reality that while in India only 39 workers were employed per 100 acres in 1971, in Japan, South Korea and Egypt, the number of workers employed per 100 acres ranged between 87 and 71. In case, intensive cultivation is done, India can enlarge employment by 50 to 60 million in agriculture alone. It is, therefore, necessary that agricultural developmnet be taken as the foundation of the development process. The experience of the development in the states of Punjab and Haryana also corroborates the view that these states were able to achieve high growth rates via agricultural development and thus bring about a sharp reduction of population below the poverty line as well as unemployment

(iii) **Emphasis on small industries as against large industries** - The Gandhian model emphasised that " no medium or large - scale enterprise shall be allowed to come into existence in future which will produce goods or services that cottage or small-

scale enterprises can produce." The main aim of following this path was to enlarge employment, have a decentralised pattern of production which would ensure reduction in regional disparities in income and wealth.

(iv) **Heavy and basic industries to be developed by the public Sector** - The Gandhian model did recognise the need for the development of heavy and basic industries and assigned this role for the public sector.

Gandhian model intended to tackle the problem of distribution of income at the production end and not at the level of consumption by fiscal measures. It did emphasise employment as the principal means of providing 'national minimum and removal of poverty.

10.4.3 Rao-Manmohan Model of Development

Rao- Manmohan Model of Development was introduced in 1991. It emphasised privatisation and globalisation of the economy. Firstly, areas hitherto reserved for the public sector were to be opened to the private sector. Although the government failed to transfer the ownership of public sector undertakings to the private sector in view of the strong opposition by the workers and left parties, it did liberate the economy and opened areas of heavy industry and economic infrastructure to the private sector- both domestic and foreign.

Secondly, the government abolished licensing in all industries except a small list of 18 industries. In other words, it removed bureaucratic shackles on investment.

Thirdly, it freed the MRTP companies from the celling on assets. This implied that even big business was allowed to invest without any ceiling being prescribed by the Monopoly and Restrictive Trade Practices (MRTP) Commission. Obviously, considerations of growth dominated more with the government than those of monopoly control.

Fourthly, foreign direct investment was facilitated. Automatic approvals for direct foreign investment upto 51 per cent in high priority areas were granted. Government was even prepared to consider proposals involving more than 51 per cent equitv on a case-by-case basis.

Fifthly, performance of the public sector undertakings was to be improved by granting them greater autonomy. For this the Memorandum of Understanding (MOU) was devised and PSUs managements and boards were made more professional.

Lastly, to globalise the economy the government followed a policy of reducing import barriers and also one of encouraging export promotion. Such a course would facilitate the free flow of foreign capital and technology and thus help to modernise our economy.

Rao-Manmohan Model of development has also been the subject of criticism. The main points of criticism are:

(i) The model has by-passed agriculture and agro-based industries which are the major sources of emplovment generation.

(ii) The model has a very narrow focus since it emphasises the corporate sector growth which accounts for only 10 per cent of GDP.

(iii) Although in the Industrial Policy of 1991, Multinational Corporations (MNCs) were to be permitted in high priority areas, the government has been indiscriminately permitting them even in consumer goods industries. Need it be emphasised that MNCs follow a highly capital intensive pattern of production and have thus restricted the growth of employment.

(iv) MNCs after entry in various joint ventures raise their equity to 51 per cent level or even more and thus push out the Indian partner. This has led to the Indian industry asking for protection against the onslaught of multinationals.

To sum up, Rao-Manmohan model has succeeded on growth by raising GDP growth rate to more than 6 per cent level, but it has failed on equity, employment and poverty removal.

10.4.4 Reconciliation of the Models of Development

The three models of development have been addressed to solving the problems of growth, employment, removal of poverty and self-reliance by emphasising a strategy at a particular stage of development. Nehru-Mahalanobis Model was successful inlaying down the foundations of an industrial economy in India. The Gandhian Model emphasised reconciliation of the production and employment objectives. Rao - Manmohan Model emphasised the role of private sector- Indian and foreign - in the process of development. It therefore emphasised privatisation, liberalisation and globalisation.

But in the ultimate analysis, the stage of development of a society has to be measured by three parameters - (i) Impact of development on poverty removal, (ii) impact on unemployment and (iii) impact of reducing inequalities and providing social justice. Societies have to harmonise the priorities to achieve growth, employment and equity in the long-run. In the short-run, there may be different strategies.

10.5 SUMMARY

The long-term goals of planning as enunciated by the Planning Commission are :

(i) To increase production to the maximum possible extent so as to achieve higher level of national and per capita income;

(ii) To achieve full employment;

(iii) To reduce inequalities of income and wealth; and

(iv) To establish a socialist society based on equality and social justice and absence of exploitation.

To achieve these objectives, mixed economy framework was accepted in preference to either the 'Command Model' of the Soviet Society or the pure capitalist model of the private enterprise. The distinguishing feature of the Indian model was that it deliberately pushed the expansion of the public sector to build infrastructure and heavy industry and it subordinated the private sector to reconcile the element of self-interest with social interest.

The various measures taken in social interest to establish a socialist pattern of society included :

1. Abolition of Zamindari System with compensation. India did not favour collectivisation, but promoted peasant proprietorship.
2. Commanding heights of the economy viz., banking and insurance were brought under state control.
3. Education and health facilities which were denied to the people were extended by developing the social infrastructure.
4. Self-reliance in defence and heavy industry.

Planning Strategies Adopted in Various Plans.

Strategy indicates laying down of priorities within the overall objectives at a point of time. The strategy changes with progress towards the long -term goals as also depends on the prevailing situation demanding immediate action.

Strategy in the First Plan (1951-56)

The basic strategy was to achieve food self-sufficiency in the shortest possible time and to control inflation. The highest priority was, therefore, given to agriculture and irrigation.

The strategy was successful in increasing self-sufficiency in foodgrains as also controlling inflation.

Strategy during the Second Plan (1956-61)

The strategy of the First Plan intended to give a big push to `heavy industry' and relatively low priority to agriculture. However, the Plan was conscious about increasing the supply of consumer goods via. small and cottage industries.

Strategy during the Third Plan

The planners realised that without a sharp increase in agricultural production. it was not possible to push a programme of industrialisation with emphasis on heavy industry. A two-legged strategy of development with emphasis on agriculture on the one hand and heavy industry on the other, was adopted. Third plan gave top priority to agriculture with the development of heavy and basic industries. Main aim of the Plan was establishment of self-reliant and self-generating economy.

This strategy was given serious jolts by (i) Chinese invasion of India in 1962, (ii) armed conflict with Pakistan in 1965, and (iii) a serious drought in 1965.

The rate of growth of the economy suffered a serious setback, prices rose sharply and unemployment assumed high proportions.

Serious setback to the credibility of planning. Government abandoned five year plans and a period of "Plan Holiday" with three annual plans (1966-67 to 1968-69) began.

After recovery of the economy in 1968-69, the Fourth Plan was launched.

Strategy during the Fourth Plan (1969-74)

Two objectives: Growth with stability' and Progressive achievement of self-reliance.

To achieve growth with stability seed - water - fertiliser technology was started to boost production in assuredly irrigated areas.

To achieve self-reliance, a greater dependence on internally generated resources was to be achieved for financing the plan.

The strategy was to control inflation, and to reduce dependence on foreign aid.

Fourth Plan did not achieve the objective of growth with stability. Wholesale price index of foodgrains rose by 47.3 per cent during the plan. However, performance on the self-reliance front was better, since exports as a percentage of imports accounted for about 92 per cent during the plan period.

Strategy during the Fifth Plan (1974 - 79)

Main objectives: Removal of poverty and attainment of self-reliance.

Main elements of the strategy : (i) 5.5% average growth rate of GDP, (ii) National minimum needs programme, (iii) Emphasis on agriulture, key and basic industries producing goods for mass consumption, (iv) A good public distribution system (PDS) to supply essential commodities to the poor at reasonable prices, (v) Vigorous export promotion and import substitution, and (vi) Restraint on inessential consumption.

The Fifth Plan did not succeed in its objectives. No serious dent could be made on poverty and unemployment. Supply of wage goods could not be adequately increased.

Strategy during Janata Party's Sixth Plan (1978-83)

Direct attack on the problem of unemployment, under-employment and massive pover

Elements of strategy adopted:

(i) Enlargement of employment in agriculture and allied activities ;

(ii) Encouragement to household and small industries :

(iii) Fostering area planning for integrated development ; and

(iv) Revised minimum needs programme.

Janata's Plan abandoned after the fall of the Janata Government in 198(

Strategy of the Congress (I) Sixth Plan (1980-85)

To strengthen infrastructure facilities on the one hand and to remove poverty by special anti-poverty programmes on the other.

The Sixth Plan was largely successful. There was a movement towards self- reliance by reducing dependence on imports of strategic commodities.

Poverty ratio was reduced from 48.3% in 1977-78 to 37.4% in 1983-84. There was an average rate of growth of GDP by 5.3% and per capita GDP by 3.1% during the plan.

Strategy of Seventh Plan (1985-90)

Direct attack on poverty, unemployment and regional imbalances.

Food, work and productivity - the focus of the Plan.

GDP growth rate (average) was 5.5% per annum and GDP per capita by 3-3.5% per annum.

Agricultural production grew at an annual average rate of 3.9% and industrial production at 8.6%.

But this strategy failed on the following counts:

a) Current Account Deficit rose to a high figure of 3% of GDP in 1989-90

b) Consumer Price Index rose at an annual average rate of 9.4%.

c) Productivity did increase, but without a commensurate increase in employment.

Planning Strategy during Eighth Plan (1992-97)

Planning strategy redefined the role of the public sector.

a) public sector investment to be limited to areas of infrastructure development for facilitating growth; and

b) public sector to concentrate on areas to meet social needs like health and education as also to undertake public distribution system to protect the weaker sections of the society.

Strategy of the Eighth Plan was judicious use of market mechanism and planning to meet social goals.

Growth rate of the economy picked up and was around 6.3% in 1994-95.

Foreign exchange reserves peaked to $21 billion.

With these welcome developments, the situation from the point of view of social justice was not comfortable.

a) Consumer Price Index rose by 11.6% on the average

b) Number of poor and population below the poverty line did not show a marked decline.

c) Employment target lagged behind.

Eigth Plan record may be satisfactory on the growth front, but the market-oriented strategy has failed the people on the front of social justice.

THREE MAJOR STRATEGIES ADOPTED SINCE 1956:

A. NEHRU-MAHALANOBIS MODEL OF GROWTH

The model emphasised rapid development of heavy industry so as to create an industrial base so that India becomes self-reliant in the capital goods sector.

Reasons for adopting this strategy:

a) British rule deliberately denied the development of heavy industry;

b) Indian industrial structure had a narrow base mainly dependent on consumer goods industries;

c) An industrial economy will raise per capita productivity ; and

d) Rapid industrialisation was essential for agricultural development as well as the development of other sectors of the economy.

Public sector was given responsibility to develop it since private sector was not willing to invest in heavy industry which required lumpy investment, had a long gestation period and low profitability.

Role of foreign aid - Foreign aid essential for development, but to reduce the burden of foreign aid, it was essential to increase exports so as to pay for the bulk of the imports.

Role of small industries - To mitigate the effects of capital - intensive heavy industry, it was essential to encourage the production of consumer goods and generate more employment by making investment in small industry.

Role of agriculture sector - The Model recognised the importance of agriculture. It stated: unless we are self-sufficient in agriculture, we cannot have the wherewithal to advance in industries.

Achievements of Nehru-Mahalanobis Strategy

1. Legitimate pride in the development of capital goods sector via heavy industry;
2. Expansion in economic infrastructure in the form of irrigation, energy, transport and communications; and
3. A sharp rise in savings nad investment.

Shortcomings noticed in the process of implementation

1. Agricultural progress was inadequate due to insufficient investment in irrigation, electricity, fertiliser, implements etc.
2. Relative neglect of small industries and industries producing consumer goods
3. Failure to absorb rapidly growing labour resulted in unemployment.
4. Public sector expansion created the emergence of a high cost economy.
5. Failure to raise exports commensurate with import requirements led to balance of payments difficulties.

B. GANDHIAN MODEL OF DEVELOPMENT

Nehru-Mahalanobis Model failed to:

1. Provide a national minimum level of living, despite three decades of planning. Nearly 40% of the population lived below the poverty line in 1978.
2. Unemployment and under-employment remained at high levels and increased with every successive plan.
3. Rural-urban disparities increased.
4. Inflationary pressures could not be checked.

Gandhian Model emphasises :

1. Employment-oriented planning to replace production oriented planning.
2. on agriculture as a means of enlarging employment-experience of Punjab and Haryana a shining example.
3. on small- industries as against large industries.
4. that heavy and basic industries to be developed by the public sector.

Gandhian model intended to tackle the problem of distribution of income at the producion and not at the consumption level.

C. RAO-MANMOHAN MODEL OF DEVELOPMENT

i) Initiated in 1991, it emphasised privatisation and globalisation of the economy.

ii) Although the government failed to transfer ownership of public sector undertakings, it did succeed in opening hitherto reserved areas to the private sector.

iii) It abolished licensing in all industries except a small list of 18 industries.

iv) It freed MRTP companies from the ceiling limit of assets.

v) Foreign direct investment was facilitated. Automatic approvals upto 51 per cent of equity. Proposals requiring more than 51% equity could be considered on a case - by- case basis.

vi) Functioning of public sector companies to improve by granting more autonomy and making management more professional.

vii) Reducing import barriers to globalise the economy.

Criticism of Rao-Manmohan Model.

i) It has by-passed agriculture.

ii) It has a narrow focus, limited to corporate sector only.

iii) There has been indiscriminate entry of multinationals, thus generating a highly capital- intensive pattern of development , and

iv) Multinationals have started the process of swallowing Indian firms by raising their equity level above 51%.

Rao-Manmohan Model has succeeded on growth but failed on equity, employment and poverty removal.

D. RECONCILIATION OF THE MODELS OF DEVELOPMENT

The three models have been emphasising different strategies at different stages of devel-

opment to solve the problems of growth, employment, removal of poverty and self-reliance.

Societies have to harmonise the priorities to achieve growth, employment and equity.

10.6 KEY WORDS

Capitalist Model of Development : Refers to the system in which all the means of production are under the ownership and management of a class known as capitalists and who use these means of production with the sole aim of profit maximisation.

Command Model : Refers to the Soviet type of planned development where all decisions about production and distribution are centralised in a supreme authority. It is only on the dictates of the centralised supreme authority that the system operates, irrespective of the market signals.

Commanding Heights of th Economy : The term was used with reference to control of 'banking and insurance'. Left to the market forces, investment will be directed by market forces, but in case banking and insurance are nationalised, the control of investment decisions in socially desirable channels can be exercised by the State.

Democratic Socialism: Economic growth with social justice within the frame work of a democratic society, thus ensuring minimum level of living for all and a programme of maximum employment, along with a programme of action reducing economic and social disparities.

Plan Holiday : A term coined to describe the period in which the country abandoned the formulation of the five year plans and shifted to a system of annual plans. The period referred to is 1966-67 to 1968-69.

Public Distribution System: Refers to the system of fair price shops to distribute article of essential consumption to the poor at reasonable prices. The Government takes the responsibility to procure and distribute essential commodities.

Economic Infrastructure : Indicate creation of infrastructure in the form of irrigation, energy, transport and communications

Social Infrastructure : Indicates infrastructure in the form of schools, colleges, technical training institutes, primary health centres, hospitals, family planning and welfare centres etc.

10.7 SELF- ASSESSMENT QUESTIONS

1. Give the principal longterm objectives of planning as accepted by the Government of India.
2. Discuss the planning strategy adopted in the Second Plan. Why was it necessary to change it in the Fourth and Fifth Plan ?
3. Discuss the main elements of the Nehru-Mahalanobis Model of Development. What were its shortcomings? How did the model get distorted during the process of implementation ?
4. Discuss the main features of Rao-Manmohan Model of Development. Do you agree with the statement that while the model succeeded on growth, it failed on equity ?

10.8 FURTHER READINGS

Planning Commission : **The First Five Year Plan**

Planning Commission : **Second Five Year Plan**

Planning Commission : **Problems in the Third Plan**

Planning Commission : **Problems in Third Plan - A Critical Miscellany**

Planning Commission : **Draft Five Year Plan (1978-83)**

Planning Commission : **The Seventh Five Year Plan (1985-90)**

Planning Commission : **The Eighth Five Year Plan (1992-97)**

Datt Ruddar & Sundharam K.P.M. Indian Economy, (36th Edition), S. Chand & Co.,Chapters 8,9,17,18 and 19.

Chakravarty S. **Development Planning - The Indian Experience**

UNIT 11 EVOLUTION OF INDUSTRIAL POLICY

Objectives

The objective of this unit is to familiarise you with the evolution of Industrial Policy and highlight the major changes which have been brought about in India's Industrail Policy from time to time.

Structure

11.1 Introduction

11.2 Industrial Policy of 1948

11.3 Industrial Policy of 1956

11.4 Industrial Policy Statement, 1977

11.5 Industrial Policy of 1980

11.6 Summary

11.7 Key-Words

11.8 Self-Assessment Questions

11.9 Further Readings

11.1 INTRODUCTION

Industrial policy during the British period was motivated by the supreme consideration of using India as a colony of the British Empire. With the installation of the national government in 1947, it was imperative that the perspective should change in favour of industiral development of India. In the initial years, since the Government of India was bogged down with the immediate problems of partition of the country leading to rehabilitation of refugees, the integration of the states, the food problem, etc., the government did not want to push forth an industrial policy which may lead to strong opposition either from the industrial classes, or form the labouring clases. The government, therefore, decided to go slow and adopted the industrial policy of 1948 so as to bring economic stability in the industrial sector. It was only in 1956 that the government thought of giving a big push to the development of basic and heavy industries. Later in 1977, when the Janata Party came to power, it tried to correct the distortions that occurred during the last two decades of implementation of the Industrial Policy (1956). The short period for which the Janata Party ruled in the country was not enough to bring about a radical shift in favour of the small and cottage industries. But the installation of the Congress(I) government in 1980 again shifted the industrial policybasically to the 1956 policy resolution. However, the large sector was permitted the regularisation of unauthorised excess capacities. In this section, we have traced the evolution of industrial policy from 1948 to 1980

11.2 INDUSTRIAL POLICY OF 1948

The industrial policy of the British Government in India was motivated by considerations of using India as a colony of the British empire. The British were, therefore, not interested in the industrialization of India. Rather, they wanted India to export raw materials and in return, facilitate the import of British manufactures. In response to the great pressure

built up by the national movement, the British were forced to permit the establishment of some consumer goods industries. The British, however, through the managing agency system did exercise control over the ownership and management of industrial undertakings. To ensure that India remained as an appendage of the British colonial system, the British never permitted the establishment of capital goods industries in India.

After the attainment of Independence, Government of India was faced with problems of refugee rehabilitation, integration of the state in the Indian Union and shortages of foodgrains, On the industrial front, labour leaders talked of a policy of nationalisation of industries but the Indian capitalists were not in its favour. In this atmosphere of confusion and uncertainly, the government feared that investment in industry would become a casualty. To clear the foggy atmoshere, the government announced the industrial policy of 1948.

The Industrial Policy Resolution of April 1948 envisaged a mixed economy for India in which the coexistence of the public sector and the private sector was accepted as the hallmark of policy. The government classified industries into four broad categories

a) **Exclusive monopoly of the state-** The manufacture of arms and ammunition, production and control of atomic energy, ownership and management of railway transport were to be under state monopoly.

b) **New undertakings to be established by the State-** The industries included in this category were: coal, iron and steel, aircraft manufacture, shipbuilding, manufacture of telephones, telegraph and wireless apparatus and mineral oils.

c) **Industries of such basic importance that the Central Government would feel it necesary to plan and regulate them -** The industries included in this category were:automobiles, tractors, prime movers, electric engineering, heavy machinery, machine tools, heavy chemicals, fertilisers, non-ferrous metals, cotton and woollen textiles, cement, sugar and newsprint, air and sea-transport etc.

d) **Remainder of industrial field was left open to the private sector-** individuals as well co-operative.

The government announced that there would be no nationalisation for the next 10 years and in case of nationalisation, if considered necessary later, compensation would be paid.

Attitude towards foreign capital- The governent recognised the need for foreign capital in the process of industrialisaion of the economy, but insisted that while inviting foreign capital, it would be ensured that majority interest in ownership and management would remain in Indian hands.

The basic purpose of the Industrial Policy of 1948 was to bring about economic stability so that a climate favourable to investment is created. The government was successful in providing the mixed economy framework with a place for the public as well as the private sector. The resolution also helped to facilitate the process of inviting foreign capital so as to acquire technical know-how and thus pave the way for establishing such industries which had so far not been established.

Activity 1

Enumerate the factors responsible for Industrial policy of 1948 opting for economic stability rather than for economic growth.

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11.3 INDUSTRIAL POLICY OF 1956

After the successful completion of the First Five Year Plan, the Parliament felt that a stage has been set for a take- offf towards the rapid industrialisation of the country. The government also accepted the establishment of a socialist pattern of society as the goal of economic and social policy. This, necessitated the announcement of a new Industrial Policy of 1956 replacing the Industrial Policy of 1948.

Under the new policy, industries were classfied into three categories:

a) **Schedule A: Industries which were to be the exclusive monopolies of the State** - 17 industries listed in this category were : Arms and ammunition, atomic energy, iron and steel, heavy castings, heavy machinery, heavy electrical industries, coal, mineral oils, iron ore, and other important minerals like copper, lead and zinc; air-crafts, air transport, railway transport, shipbuilding, telephone, telegraph and wire-less equipment, generation and distribution of electric energy.

b) **Schedule B: Those which were to be progressively State owned and in which the State would gradally setup new undertakings** - Twelve industries were included in this category: Other mining industries, aluminium and other non-ferrous metals not included in Schedule A; machine tools, ferro-alloys and tools steels, the chemical industry, anti biotics and other essential drugs, fertilisers, synthetic rubber, carbonisation of coal. chemical pulp, road transport and sea -transport

c) **Schedule C: All other remaining industries and their development was left to the private sector.**

From the new classification of industries, certain points need to be noted.

Firstly, the new classification followed closely the pattern outlined in Industrial Policy of 1948 but it enlarged the areas of industries under state monopoly. The government also undertook the responsibility of establishing new undertakings in heavy and basic industries. This was done in view of the fact that the private sector was not willing to enter these areas which required lumpy investment and had a long gestation peiod, with low profitability. The state, therefore, declared that the public sector would be the engine of growth and industrialisation of the economy.

Secondly, the classification did not group industries into water-tight compartments and room for exceptions existed. For instance, in order to meet the requirements of an item in Schedule A or as by - products, private sector units may be engaged. Similarly, heavy industries could obtain some of their requirements of higher components from private sector. Thus, such interdependence of the private sector and public sector was not ruled out.

Thirdly, in case of private sector operating in Schedule C, if the State at any stage was convinced that an industry was not conforming to guidelines issued by the State, it could shift the industry to Schedule B or even to Schedule A. In other words, the State reserved the right to nationalise an industry in case public interests so demanded.

Fifthly, the state promised fair and non-discriminatory treatment to the private sector. In fact, the basic premise of the 1956 Industrial Policy was to foster the development of the mixed economy. It was, therefore, essential that the state should create an environment conductive to the development of the public sector. The state, an order to encourage and

facilitate the development of the private sector, ensured the development of the transport, power and financial institutions necessary for the purpose. The State decided to continue to encourage such institutions which would provide financial assistance to private sector. It even decided to take special care of the needs of enterprises organised on co-operative lines for industrial and agricultural purposes.

Sixthly, the state also provided for the encouragement and rapid growth of village and small industries. This was essential because these industries promised to provide employment to the vast sections of the poor. Support to village and small industries was to be provided by restricting the share of the large sector in production, by differential taxation or by direct subsidies. The state would concentrate on measures designed to improve the competitive strength of the small producer by constantly improving and modernising the technique of production.

Seventh, the state pledged to remove regional disparities. The Industrail Policy of 1956 stressed the need for reducing regional disparities so that industrialisation should not remain confined to a few states or regions, but should benefit the country as a whole. The balanced growth and development of the industrial and agriculture economy in each region had to be promoted so that the entire country can attain higher standards of living.

Eighth, the Industrial Policy Resolution of 1956 intended to improve the working and living conditions for labour. It recognised labour as a partner in production and thus it was expected to participate in the task of national development so that the country could build a socialist democracy. For this purpose, it was essential that labour should help to ensure industrial peace as the basic condition for rapid development. The Resolution, in return, emphasised that living and working conditions of labour should be improved and the standard of their efficiency be raised. There should be joint consultation between workers and management and wherever possible, workers should be associated with management. The Resolution stressed that the public sector enterprises should set an example in this respect.

Lastly, the Industrial Policy of 1956 maintained the same attitude towards foreign capital as enunciated in the Industrial Policy of 1948. It also emphasised the need for foreign capital, but maintained that the major interest in ownership and effective control should always remain in Indian hands.

Assessment of Industrial Policy of 1956

Industrial Policy of 1956 has been popularly referred to as the economic Constitution'. of the country based on its political counterpart the.Constitution of India. The basic objective of the Resolution was to develop a socialist democracy within the parameters of the mixed economy framework.

Private sector was treated as a junior partner and the public sector was considered as a senior partner. A leading role was assigned to the public sector to develop heavy and basic industries as well as infrastructure.

The Private sector, therefore, felt that after prescribing the areas of the public sector, the remainder was left to be taken care of by the private sector. H. Venkatasubbiah, therefore mentions : "The so-called private sector was more explicitly equated with state enterprises. Venkatasubbiah, H. (1961), *Indian Economy since Independence*, p.94. The expanding and dominant role of the public sector generated a fear that the role of the private sector would be supplanted and at a later stage, the private sector be squeezeed further. The feeling also grew because the state hung the Damocle's sword over the head of the private sector by stating that it would takeover any undertaking/industry, if it considered to be in national interest. However, this fear was based on a totally incorrect understanding of the Industrial Policy Resolution. Firstly, the new policy assigned a permanent place to the private sector in the mixed economy frame work. Secondly, since at

the stage of development, the private sector did not possess the necessary resources and expertise to undertake investment in heavy industry and infrastructure, this historic role of developing the industrial base of the economy was assigned to the public sector. The state could not afford to wait and *the imperatives* of rapid and sustained development necessitated the public sector to assume the role of the senior partner. But by building heavy industry and providing infrastructure, the public sector created a congenial environment for the private sector to develop. As later events showed, the private sector took advantage of the loopholes and exceptions provided in the Industrial Policy Resolution (IPR) 1956. Several areas which were reserved for the public sector were opened to the private sector. The grant of licences to the private sector in coal, oil, fertilisers, chemical engineering etc. is ample proof of the flexibility of the Industrial Policy Resolution (IPR) 1956. There is no doust that Nehru pushed through a programme of building steel plants, locomotives, shipbuilding yards, aircrafts and defence industries with the help of the public sector, but it is equally true, as the Industrial Licensing Policy Inquiry Committee (1969) revealed that under one pretext or another, areas reserved for the public sector were opened to the private sector. For instance, aluminimum industry was in the public sector, but in practice, the entire development was permitted in the private sector. Similarly, in the case of machine tools industry, as against 9 licences given to Hindustan Machine Tools (HMT), 226 licences were issued to the private sector. In fertilisers whereas 42 licences were granted to private sector, public sector obtained only 12 licences. In drugs and pharmaceuticals, as against 184 licences given to private sector, the public sector got only 12 licences. It is really astonishing that in the case of synthetic rubber and chemical pulp, all the licences were allotted to the private sector.

To conclude : There is no doubt that rapid expansion of the public sector took place in the core and heavy industry, but it is equally true that the private sector was able to penetrate even in the areas reserved for the public sector, not to speak of the areas left free for its opereation. Consequently, private sector investment also zoomed forward. It is, therefore, incorrect to say that private sector was threatened in any way by the programmes of the public sector expansion.

Activity 2

Give the classification of various industries into three Schedules in the Industrial Policy Resolution (IPR) 1956. Why was private sector denied a commanding role in IPR 1956?

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11.4 INDUSTRIAL POLICY STATEMENT, 1977

The defeat of the Congress (I) after emergency in the elections, resulted in the installation of the Janata Party as the ruling party at the centre. Intts critique of 20 years of the functioning of the Industrial Policy of 1956: the Janata Party Industrial Policy Statement (1977) mentioned: Despite some desirable elements, the Industrial Policy of Congress resulted in certain distortions: "Unemployment has increased, ruralurban disparities have widened and the rate of real investment has stagnated. The growth of the industrial output has been no more than three to four per cent per annum on the average. The incidence of industrial sickness has become widespread and some of the major industries are worst affected,"

Since the Janata Párty was dominated by Gandhians, the Industrial Policy of 1977 a distinctive feature of emphasising the growth of the small sector. This does not mean that the policy was not conscious about the other problems of large scale industry or sick units. The chief features of the policy were as under:

1. **The Principal Thrust of the Policy was on the Development of Small Industries** - The Janata Party accused the Congress government of over-emphasising large industries, neglecting the development of cottage and small industries. The policy statement, therefore, mentioned: "The main thrust of the new policy will be on effective promotion of cottage and small industries widely dispersed in rural areas and small towns. *It is the policy of the government that whatever can be produced by small and cottage industries must only be so produced.*" Following this, the small sector was classified into three categories:

a) Cottage and household industries which provide self-employment on a wide scale:

b) Tiny sector incorporating investment in industrial units in machinery and equipment upto Rs. 1 lakh and situated in towns with a population of less than 50,000;

c) Small-scale industries comprising industrial units with an investment upto Rs.10 lakhs and in case of ancillaries with an investment in fixed capital upto Rs. 15 lakhs.

The basic purpose of this classification was specifically to design measures to improve the small and cottage industries in these sub-sectors although the Janata Government intended to improve all the three sub-sector simultaneously.

The principal measures designed for the purpose were as under;

i) As against 180 items in the reserved list of small industries, the government expanded the list to include 807 items by May 1978.

ii) To save the small units the unnecesary botheration of getting clearances from a number of official agencies, it was decided to set up District Industries Centres (DICs) so that under a single roof, all the services and support required by small and village industries could be provided. This was a very desirable rationalisation. In the same place, a separate wing of the Industrial Development Bank of India (IDBI) was set up to provide financial assistance to small scale industries.

iii) The Janata Government intended to strengthen Khadi and Village Industries Commission (KVIC) so as to enlarge its operations. It wanted specifically to draw programmes so that the share of small scale industries in the production of footwear and soaps improves significantly.

Besides this, the government wanted to introduce Nai Khadi or Polyester Khadi so as to suit the changing tastes and fashions among the consumers. As a consequence, it hoped to increase the earnings and productivity of spinners of Khadi.

Special programmes were to be made to ensure our effective and co-ordinated aproach to develop appropriate technology for small and village industries so that the productivity and earnings of the workers and enterpreneurs in this sector improve.

Areas for Large Scale Sector- While emphasising small industries, the Janata Government was conscious of the development of large scale industries, but it stated that the role of the large scale industries would be related to the programmes for meeting minimum basic needs of the population through wide-spread dispersal of small and village industries and to the strengthening of the agricultural sector. With this end in view, Industrial Policy of 1977 prescribed the following areas for the large sector:

Basic industries, essential for providing infrastructure as well as development of small scale and village industries, such as steel, non-ferrous metals, cement, oil refi-

b) *Capital goods industries for meeting the machinery requirements of basic industries as well as small scale industries;*

c) High technology industries which required large scale production and which were related to agricultural and small- scale development such as fertilisers, pesticides petrochemicals, etc.; and

d) Other industries which were outside the list of reserved items for the small scale sector and which were considered essential for the development of the economv such as machine tools, organic and inorgnic chemicals.

3. **Approach towards Large business Houses -** The Janata's Industrial Policy criticised the earlier pattern of growth of large business houses by largely depending on the use of borrowed funds from public financial institutions and banks. This process of growth has to be reserved. The Industrial Policy of 1977, therefore , categorically stated: "Large Houses would have to rely on their own internally generated resources for financing new projects or expansion of existing ones. The funds of the public sector financial institutions would be largely available for the small sector. Further, even in the case of capital intensive fields where these large industrial houses were dominant, in the future preference would be given to medium entrepreneurs and the public sector corporations so that further concentration of economic power might be restricted. Thus, the basic thrust of the Indstrial Policy was that large scale industries should depend on their internally generated resources for their growth and that the funds of the public sector financial institutions and banks should be devoted to the growth of the small-scale and medium- scale units.

4. **Larger Role of the Public Sector -** The industrial Policy Statement(1977) clarified that the role of the public sector would not be limited to production of important and strategic goods, but would also be expanded to act as a stabilising force for maintaining essential suppiies of consumer goods. To meet this objective, the public sector would be charged with the responsibility of encouraging the development of a wide range of ancillary industries and contributing to the growth of decentralised production by making available its expertise in technology and management to small scale and cottage industries.

5. **Approach towards foreign collaboration-** The Industrial Policy of 1977 clarifying its approach towards foreign collaborations stated: " In areas where technological know-how is not needed, existing collaborations will not be renewed." Even in areas in which foreign collaborations will be permitted, the policy statement outlining the government approach clarified: " As a rule, majority interest in ownership and effective control should be in the Indian hands though the government may make exceptions in highly export- oriented and / or sophisticated technology areas. In hundred per cent export- oriented cases the government may consider even a fuliy-owned foreign company."

6. **Attitude towards Sick Units-** The industrial Policy of 1977 did express its desire to help sick units in the interest of protecting employment but did not give blanket assurance to protect all sick units. The government wanted to adopt a selective approach. It, therefore, mentioned: "While the government cannot ignore the necessity of protecting existing employment, the cost of maintaining such employment has aslo to be taken into account. In many cases, very large amounts of public funds have been pumped into the sick units which have been taken over but they continue to make losses which have to be financed by the public exchequer. This process cannot continue indefinitely".

Assessment of the Industrial Policy (1977)

The basic thrust of the Janata Party Industrial Policy of 1977 was to promote small scale industries. For this purpose:

i) list of small industries under the reservation category was to be enlarged;

ii) the large scale industry expansion was to be discouraged ; and

iii) acess on large scale industries was to be imposed.

But Janata Government failed to impose a ban either on large scale industries belonging to Indian big business or multinationals to produce ordinary items like bread, biscuits, footwear, toffees, leather products etc., which should have been reserved for the smallscale sector.

The industrial policy was not welcomed by big business because it totally denied the use of funds of public financial institutions and banks for expansion of their business. Such a blanket ban was resented.

Moreover, as the Industrial Policy Statement (1977) clarified, it was aimed at correcting the distortions of 1956 Industrial Policy so that the dominance of large industries be curtailed and small industries are encouraged in a big way. This was intended to enlarge employment on the one hand and reduce concentration of economic power on the other.

On the issue of foreign collaborations, the Janata Party's Industrial Policy more or less followed the Industrial Policy of 1956. So long as foreign collaborations were prepared to accept the rules and regulations of the government, they were permitted. In case of foreign companies they were asked to reduce the share of equity under FERA (Foreign Exchange Regulation Act). In high technology areas, even hundred per cent foreign equity was permitted.

To sum up, it may be stated that though the Janata Party intended to shift the balance of the industrial sector in favour of small scale and cottage industries, it failed to achieve this objective, but for enlarging the list of reserved items from 187 to 807. In other areas, with minor modifications, it followed more or less, the 1956 Industrial Policy. Since the Janata Party ule lasted for about two years, it failed to give concrete shape to the policy measures enunciated in the Industrial Policy Statement (1977). Despite loud talk against Indian big business and multinationals, the policy failed to restrict either Indian big business or multinationals.

Activity 3

List the major distortions noticed by Industrial Policy of 1977 in the implementaion of IPR 1956. Also catalogue the measures undertaken by Industrial Policy of 1977 to remove these distortions.

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11.5 INDUSTRIAL POLICY OF 1980

The Congress(I) Government led by Mrs. Indira Gandhi came to power in 1980 and announced its Industrial Policy in July 1980. The statement categorically asserted that it intended basically to follow the Industrial Policy of 1956. The Industrial Policy (1980) clearly stated: " In terms of this resolution (1956), the task of raising the Pillars of economic infrastructure in the country was entrusted to the public sector for reasons of its greater reliability, for the very large investmetns required and the longer gestation peri-

ods of the projects crucial for economic development. The 1956 Resolution, therefore, forms the basic of this statement." The principal elements of Industrial Policy of 1980 were:

i) **Promoting the Concept of Economic Federalism** - The policy statement intended to bring about the integrated development of the small and large sector, thus, promoting economic federalism in the country. It states: " It will be the Government's endeavour to reverse the trends of the last three years towards creating artificial divisions between small and large-scale industry under the misconception that their interests are essentially conflicting. While making all efforts towards integrated industrial development it is proposed to promote the concept of economic federalism with the setting up of a few nucleus plants in each district, identified as industrially backward, to generate as many ancillaries and small and cottage units as possible."

ii) **Redefining the Small Units** - To encourage the development of small units, the government decided:

   a) to increase the limit of investment in the case of tiny units from Rs. 1 lakh to Rs. 2 lakhs;

   b) to increase the investment limit in case of small scale units from Rs. 10 lakh to Rs. 20 lakhs; and

   c) to increase the limit of investment in the case of ancillaries from Rs. 15 lakhs to 25 lakhs,

iii) **Promotion of Industries in Rural Areas** - Industrial Policy of 1980 emphasised that in order to generate higher employment and higher per capita income in the rural areas, it was necessary to promote rural industries in the country without disturbing the ecological balance. For this purpose, handlooms, handicrafts and Khadi would receive greater attention so that a faster growth of the rural areas is made possible.

iv) **Removal of Regional Imbalances** - To correct regional imbalances, it is necessary that the state should encourage industrial units in industrially backward areas. Such a process will reduce disparity between different regions.

v) **Industrial Sickness** - The policy statement outlined clearly its approach towards sick units:

   a) Management of sick units would be taken over only in exceptional cases on grounds of public interest where other means for the revival of sick undertakings are not considered feasible.

   b) Sick units which show adequate potential for revival, would be encouraged to merge with healthy units capable of managing sick undertakings and restoring their viability. For such proposals of merger, the existing tax concessions under section 72-A of the Income Tax will be made available more liberally.

vi) **Regularisation of Unauthorised Excess Capacity-** The procedure for regularising unauthorised excess capacity in the private sector was further simplified in Industrial Policy of 1980. For this purpose, it was stated: The normal permissible capacity expansion of upto 25 per cent of the authorised capacity would become automatically available to the overall installed capacity including the regularised excess capacity.

   While regularising unauthorised excess capacities created. FERA and MRTP companies will be considered on a selective basic. This facility will not be given in respect of items reserved for the small sector.

Assessment of Industrial Policy (1980)

The Industrial Policy of 1980 claimed to follow a 'pragmatic approach'. It also endorsed the fact that it would follow the 1956 Industrial Policy. Yet, according to critics, it made several statements which were inconsistent with the 1956 Industrial Policy.

Firstly, Industrial Policy Statement of 1980 accused the Janata Party to create artificial divisions between the small and large sector and, therefore, the new dispensation proclaimed that it does not recognise the fact that the interests of the small and large sector are "essentially conflicting" One can understand thet fact that Janata Party in its over-enthusiasm to boost the small sector, may have over-emphasised in its Industrial Policy the conflict between the small and the large sector. But to say, that the existence of such conflict is based on a misconception is totally untenable. Even in the Industrial Policy of 1956, it was recognised that such conflict exists. The 1956 Resolution specifically stated: " The State has been following a policy of supporting cottage and village and small scale industries by restricting the volume of production in the large scale sector, by differential taxation or by direct subsideies." The very fact that the Congress has been encouraging labour intensive small -scale and cottage and village industries by restricting the volume of production of large scale industries, is ample proof of the emistence of the conflict between the small and the large sector. Obviously, the state intended to maximise exployment along with maximising production with the help of labour intensive industries in the cottage and small sector. It would have been more wise if the industrial Policy of 1980 should have recommended the strengthening of this trend, but to speak of reversing this trend was totally unjustified

Secondly, the government intended to regularise excess capacities. It also proposed automatic expansion of capacity to all Industries listed in the First schedule of Indian Industries (Development and Regulation) Act. The plea for doing this was the keen desire to make full use of installed capacity to maximise production. This policy was welcomed by big business because liberalisation indicated in the policy was silent endorsement of regularisation of unauthorised excess capacity. The critics feel that the government should not have given blanket liberalisation in case of all industries, but it should have acceded to the sanctioning of unauthorised capacities in case of those industries which were high priority areas for the country such as cement, paper, sugar, fertilisers, caustic soda, etc. but should have denied it to low priority areas like chocolates, baby foods, cosmetics, synthetic detergents, etc. To provide an open general licence for big business was not justified.

To sum up, the Industrial Policy of 1980 favoured a more capital-intensive pattern of development and thus it attempted various measures of liberalisation for helping the large sector. It underplayed to employment objective

Activity 4

In what respects is Industrial Policy of 1980 different from that of IPR 1956.

What is the nature of difference in the two policies initiated by the Congress Government in 1956 and 1980 respectively ?

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11.6 SUMMARY

The Industrial Policy of 1948 was aimed at clearing the foggy and uncertain environment so that investment in industry does not become a casualty.

The 1948 Industrial Policy Resolution envisaged :

i) Mixed economy for India in which the public and private sector can co-exist.

ii) The resolution announced 'no nationalisation for next 10 years'. Later, if nationalisation is constdered necessary, compensation would be paid

iii) The Resolution recognised the need for foreign capital, but insisted that majority interest in ownership and management will remain in Indian hands

The basic aim of the Industrial Policy (1948) was to bring economic stability and establish the mixed economy frame work in India.

The Industrial Policy of 1956 was motivated by considerations of rapid industrialisation within the framework of the socialist pattern of society accepted as the goal of economic and social policy.

Industries were classified into three categories :

1) Schedule A- Exclusive monopoly of the State

2) Schedule B - To be progressively owned by the State and in which new undertakings would generally be set up by the State.

3) Schedule C- All the remaining industries left to the private sector.

i) Government undertakes responsibility to set up new undertakings in heavy and basic industries. Private sector, not willing to invest in areas requiring lumpy investment, a long gestation period and low profitability.

ii) Classification not water-tight, room for exemptions existed.

iii) State reserved the right to take over industries in schedule C, if they failed to conform to guidelines issued by the State.

iv) Fair and non-discriminatory treatment for the private sector.

v) Encouragement to small and village industries to be provided so as to expand employment. This was to be done through differential taxation or by direct subsidies. Besides this, technology of the SS&1 sector to be improved and modernised.

vi) Regional disparities to be removed by encouraging balanced regional development.

vii) Improvement in working and living conditions of labour.

viii) Foreign capital to be invited as enunciated is 1948 Industrial Policy with majority ownership and control to be in the Indian hands.

The industrial Policy of 1956 is referred to as the "Economic Constitution" of the country.

Private sector, a junior partner. Public sector to play a leading role as a senior partner to develop heavy and basic industries to play a leading role as a senior partner to develop heavy and basic industries as well as infrastructure.

Private sector worked under the misconception that the Damocle's sword was hung on its head. This was an incorrect perception of IPR 1956. Rather a permanent place was provided for the private sector. By developing heavy industry and infrastructure, the State created a congenial environment for the development of the private sector.

Later development by the Industrial Licensing Policy Inquiry Comittee (1969) indicated that under one pretext or another, several areas reserves for the public sector were opened to the private sector. Private sector investment zoomed forward, along with public sector expansion.

Industrial Policy Statement, 1977- Policy drafted by the Ghanaians in the Janata Party. The main aim of the policy was to correct the distortions in the implementation of the Industrial Policy (1956). Major distortions:

a) Unemployment has increased : (b) rural-urban disparities have widened: and (c) rate of real investment has stagnated.

Chief features :

(i) Major thrust on the development of small industries. Small sector classified into three categories; (a) cottage and household industries to provide self- employment ; (b) tiny sector having investment in plant and machinery upto Rs. 1 lakh; and (c) small industries with an investment upto Rs. 10 lakhs and ancillaries with an investment upto Rs. 15 lakhs.

Main purpose of the classification was to design measures to specifically help the three sub-sectors.

Measures undertaken :

(i) Reservation list increased from 180 to 807 items.

ii) District Industries Centres to be set up so that the services and support required by SS& Is be availed under one roof.

iii) Khadi and Village Industries Commission to be strengthened. Nai Khadi or Polyester Khadi to be introduced.

iv) Appropriate technology to be developed for small and village industries.

Areas for Large Scale Sector - Large sector should be related to minimum basic needs programme via dispersal of small and village industries.

Large industries should strengthen the agricultural sector.

Approach towards Large Business Houses- Large houses to rely on internally generated resources for financing new projects or expanding existing projects. They should not depend on public financial institutions and banks.

Larger role for the Public Sector - Besides producing important and strategic goods, public sector be expanded to act as a stabilising force for maintaining supplies of essential consumer foods.

Foreign Collaborations - In areas where technological know-how is not needed, existing foreign collaborations will not be renewed.

As a rule, majority interest in ownership and control to remain in Indian hands, though the government may make exceptions in highly export- oriented and /or sophisticated technology areas.

Sick Units - Sick units to be helped in the interest of protecting employment, but no blanket assurance was given to take-over every sick unit. Units which are non-viable and continue to make losses year after year, may not be helped.

Janata Party Government failed to ban production in the large sector of items which were rserved for the small sector.

On foreign collaborations, it followed IPR (1956).

Janata Party, though it intended to shift the balance in favour of small sector, but due to

short period of its rule (about 2 years), it failed to give a practical shape to its policies. The policy failed either to restrict big business or multinationals.

Industrial Policy of 1980 - Congress (I) back to power in 1980 indicated its trust in Industrial Policy of 1956. The IP (1980) had the following elements.

(i) Promotion of the concept of economic federalism in which it proposed to set up a few nucleus plants in each district, identifies as industrially backward, to generate as many ancillaries and small and cottage industries as possible.

Based on the premise that interests of the small and large industry are not essentially conflicting.

ii) Revised definition of small units.

a) Tiny units - limit of investment raised from Rs. 1 lakh to Rs. 2 lakhs.

b) Small industries - limit of investment raised from Rs. 10 lakhs to Rs 20 lakhs.

c) Ancillaries - limit of investment raised from Rs. 15 lakhs to Rs. 25 lakhs.

iii) Promotion of rural industries to generate higher employment and higher per capita income.

iv) To remove regional imbalance, the State should encourage industrial units in backward areas.

v) Management of sick units would be taken over only in exceptional cases on grounds of public interest.

Sick units with adequate potertial for revival would be encouraged to merge with healthy units.

vi) Regularisation of unauthorised excess capacity- Capacity expansion upto 25 per cent cf installed capacity would be made automatically available to the overall capacity including regularised excess capacity.

FERA and MRTP companies will, however, be considered on a selective basis.

The Industrial Policy of 1980 has been criticised for its internal inconsistency. While swearing by Industrial Policy of 1956, the 1980 policy proclaims that the interest of the small and large sector are not essentially conflicting. This is a totally untenable proposition because the IPR 1956 intended to support small and village industries (a) by restricting the volume of production in the large scale sector, (b) by differential taxation or (c) by direct subsidies.

The main aim of IPR 1956 was to maximise employment along with maximisation of output. Reversing this policy by IPR 1980 was unjustified.

Agreeing with critics, it may be stated that regularisation of unauthorised excess capacities for all industries was not justified. The governmnet should have regularised excess capacities in high priority areas, but should have denied regularisation in low priority areas. A selective approach would have been more desirable.

IPR 1980 attempted to help large sector by various measures of liberalisation. It underplayed the employment objective.

11.7 KEY WORDS

Mixed Economy: An economic system in which both the public and private sector coexist and complement each other in the task of economic development.

Nationalisation : Take-over of ownership and management of private sector company/industry by the state.

Technical Know-How : Practical knowledge of the technique of production.

Gestation Period: The period between the initiation of an investment and its completion so as to start producion or provide a service

Differential Taxation : Charging different rates of taxation from the producers of the same product. For instance, the government imposes higher rates of excise duty on mill made cloth and may charge a lower rate from handloom weavers.

Subsidies : The grants of assistance by the State to encourage the production of a commodity or a service in a certain industry or sector of the economy.

Regional Disparities : Differences in the level of development attained by different regions.

Foreign Collaborations : Agreements made with foreign companies by the Indian Companies/ Government to undertake certain projects. The share of foreign equity is specified in such argeements.

Multinationals : Companies which have their business extended beyond the country of the origin into several other countries.

11.8 SELF-ASSESSMENT QUESTIONS

1. Compare the Industrial Policy of 1956 and the Industrial Policy of 1977 and bring out the differences of the objectives motivating the two policies.
2. Industrial Policy of 1980 indicated its tilt in favour of the large scale sector and was the first step towards liberalisation. Do you agree?

11.9 FURTHER READINGS

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UNIT 12 REGULATORY AND PROMOTIONAL POLICY FRAMEWORK

Objectives

This unit deals with the regulatory and promotional policy framework that emerged out of the industrial policies pursued since 1948. The Unit enables you to gain acquaintance with.

- The salient features of the regulatory and promotional industrial policy framework comprising industrial licensing. MRTP Act, FERA, SSI protection policy, industrial location policy, administered price mechanism, taxation etc, and
- The impact of regulatory and promotional policy framework on industrial structure and performance.

Structure

12.1 Introduction

12.2 Industrial Licensing

12.3 Control of Large or Dominant Firms

12.4 Foreign Investment Control

12.5 Public Sector Enterprise Preference

12.6 Small Scale Industry

12.7 Industrial Location

12.8 Administered Prices

12.9 Taxation

12.10 Impact of Regulatory Framework on Industrial Structure and Performance

12.11 Summary

12.12 Key Words

12.13 Self-Assessment Questions

12.14 Further Readings

12.1 INTRODUCTION

Economic activities, in general, are regulated and controlled by the Government, be it a developing country or a developed country. The Governments have invariably felt at varying degree of intensity - the need for a public policy which could direct, promote or control or regulate the economic activities in accordance with the goals and objectives of the economy.

In almost all economic, Government plays a role, major or minor, directly in economic activities and direct/ promotes/ controls/ regulates with activities of private entrepreneurs. Thus, public sector and private sector do exist with varying degrees of importance in every economy.

India has accepted the principles of a mixed economy, wherein both public and private

sectors have to co-exist with fair degrees of importance. However, it was the public sector which was assigned a major role under the Industrail Policy Resolution (IPR) 1956 for industrialisation of the country, since private sector was found to be lacking in resources and maturity or ability then to participate in a major way in the industrialisation of the economy.

To industrialise the country by assigning a major role to the public sector, Government formulated regulatory industrial policies, keeping in view the basic goals of the nation: economic growth, self-reliance and social justice. Therfore, the regulatory policy framework had four major objectives:

1. The promotion of heavy industry with an emphasis on the public sector.
2. Economic self-reliance, which translated into broad efforts at import substitution and restrictions on technology imports to promote indigenous innovation.
3. Protection to small industry sector
4. Balanced regional development

To achieve these objectives, the regulatory policy framework comprised a variety of policy instruments:

- Reseivation of vast areas of industrial activities for the public sector.
- Industrial licensing to regulate and control investments in industry and locations.
- Legislation to control large and dominant firms;
- Legislation to control foreign investment and technology inflow;
- Comprehensive policies and incentives to protect small scale industry;
- Restrictions on location of industrial units and incentives to move into backward regions;
- Price administration of infrastructural inputs; and
- Taxation.

on the whole, industrial activities were subjected to a wide variety of controls and regulations due to the emergence of regulatory industrial policy framework.

12.2 INDUSTRIAL LICENSING

To regulate the flow of investment in desired channels of industries and locations and to match supply of industrial commodities with demand on the lines of nationl priorities, the Government introduced industrial licensing for entry, in terms of quantity of production, by firm and product. A license is a written permission from the Government to an industrial undertaking to manufacture specific articles. It includes particulars of the industrial undertaking, its location, the articles to be manufactured, their capacity on the basis of maximum utilisation of plant and machinery and other appropriate conditions which are enforceable under the Act. It is also subject to a validity period within which the licensed capacity should be established.

Industrial licensing was introduced under the Industries Development and Regulation (IDR) Act. The IDR Act was passed in October 1951 and the Act came into force on 8th May, 1952. The Act applies to all the industries specified in the first schedule of the Act. Originally this schedule listed 37 industries but the scope of the Act had been enlarged from time to time to include more industries.

The IDR Act empowers the Central Government to exempt any industrial undertaking from the operation of all or any of the provisions of the Act. Exemption is granted on the

basis of investment involved, the nature of industry, foreign exchange requirements, etc. The chief objective of the Act is the development and regulation of industries in a manner befitting the policy of planning, socialistic pattern of society, and other social and economic goals of the country.

The salient fratures of the IDR Act 1951 are :

- Existing undertakings need to be registered with the Government within the prescribed time limit
- New units are permitted only through an industrial license
- Government has the power to conduct an investigation , assume management control, provide relief or control supply and distribution of products of certain industrial undertaking.

As per the IDR Act 1951 industrial licensing is mandatory:

1. to set up a new manufacturing unit.
2. for substantial expansion. Upto 1966, substantial expansion meant expansion of production by more than 10 per cent of the licensed capacity. Since 1966,

   substantial expansion means increasing production by more than 25 per cent of the licensed capacity.
3. To change the location of the unit.
4. to manufature a new product, apart from the one for which license is already obtained by an existing manufacturing unit.

Till 1960, industrial licensing was needed for all units having investment of more than Rs. 10 lakhs in land, buildings and machinery. Since then, the licensing exemption limit has been raised from time to time (see Table 12.1) Since 1988, the exemption limit has been fixed at Rs. 15 crores.

Table 12.1: Investment Limit for Industrial Licensing Exemption

Year	Investment limit (in land, building and machinery)
Upto 1964	Rs. 10 lakhs
1964	Rs. 25 lakhs
1970	Rs. 1 crore
1978	Rs. 3 crore
1983	Rs. 5 crore
1988	Rs. 15 crores

Procedures for obtaining a license

According to IDR Act 1951, all those industrial undertakings established prior to the introduction of indstrial licensing have to obtain Carry on Business (C.O.B) license. An application for an industrial license has to be made in an appropriate form prescribed under the registration and Licensing Rules 1952. From IL has to be used for licenses required for new undertakings, manufacture of new articles and for substantial expansion. Application for C.O.B. license has to be made in Form EE and application for changing the location of an existing industrial undertaking has to be made in the Form `E'. The applications have to be submitted to the Secretariat of Industrial Approvals in the Ministry of Industry.

Subsequent to the submission of applications, a Letter of Intent (L.O.I) is issued to the

applicant withind a month from the date of submission. The letter indicates the conditions subject to which Government will be prepared to consider favourably the grant of a license. The conditions may comprise furnishing details such as terms of foreign collaboration, import of capital equipment, issue of capital, etc. Once the conditions incorporated in the Letter of Intent are fulfilled, it is converted into an industrial license. The initial validity of industrial licenses is two years within which commercial production from the licensed capacity has to be established. This period can be extended by the Administrative Ministry concerned if there is good and sufficient reason for two further periods of one year each.

Since the 80's number of exemptions and relaxations were introduced in industrial licensing to promote growth and competition in industry in general and selected industries in particular. More flexibility for increasing capacity was permitted under various provisions such as "automatic growth", "unlimited growth", "regularisation of capacity", "re-endorsement of capacity", "broad-banding", and "minimum economic scale". A number of industries were exempted from licensing. However despite these relaxations, the system of capacity licensing continued to act as a significant barrier to entry and growth.

The Industrial Licensing System which was a major regulatory and controlling instrument for industrial growth, had been criticised on various fronts. The system had shortcomings and had resulted in undesirable consequences over the period.

By and large, licensing system had discouraged potential investors, dampened the overall growth of industrial investment, and inhibited the ability of firms to take advantage of economies of scale, technological progress and product specialisation.

There was no explicit economic criteria for weighing different objectives for granting or rejecting industrial licenses. This was reflected in the `poor quality' of techno-economic examination of proposed industrial investments by the Directorate General of Technical Development (DGTD), Ministry of Industry.

There was inordinate delay in the processing and clearance of applications for industrial licenses. This had also deterred entry and growth. For example, between 1982 and 1985, fewer than half of the applications for capacity licenses were decided in stipulated three months of submission, and a third required more than six months.

In many instances, industrial licensing proved `counter productive' to its objectives. Licenses were obtained by some industrial houses to pre-empt entry or expansion by competitors. Such licenses were usually not converted into installed capacity. In such cases, the most common reason for rejecting a license application was the existence of "adequate capacity". This is because, it was assumed that all sanctioned capacity was fully utilised when license applications were processed. The presence of such unutilised licenses had only facilitated the creation and sustenance of sellers' market.

In certain industries like cement, the market demand and the periodic fluctuations in it were not anticipated and judged appropriately by the licensing authorities. As a result, the efforts to balance supply with demand by licensing led to alternating periods of scarcity and excess capacity.

Licensing restrictions on exception and on producing a new product seemed to be more than those on entry. Thus, licensing had functioned as a barrier to growth, limiting specialisation and the exploitation of scale economies. Due to the bias towards a new unit, existing units tended to apply for licenses to build a new plant and produce a new product rather than expand and specialise, resulting in excessive diversification and industrial fragmentation.

There were also instances where companies did not adhere to the provisions of industrial licensing. Plans of expansion were implemented even without prior licenses. In certain cases, companies which obtained multiple licenses to produce multiple products, utilised less of the licensed capacity in one product whereas produced far in excess of

the authorised capacity in respect of some other products. Thus, there was considerable diversion of resources and raw materials obtained in the name of one license to the production of other licensed products.

Finally, industrial licensing did not succeed to curb or restrict over capitalisation in the organised industrial sector. As a result, industry was characterised by excess capacities in certain industries coupled with shortages in the rest. On the whole, the very objective of matching supply with demand in accordance with the national priorities remained a distant reality.

12.3 CONTROL OF LARGE OR DOMINANT FIRMS

An important objective of industrial policy and its important instrument of licensing is to prevent the emergence of private monopolies and the concentration of economic power in the hands of a small number of individuals. In April 1964, the Government of India appointed the Monopolies Inquiry Commission to inquire into the extent and effect of concentration of economic power in private hands and the prevalence of monopolistic and restrictive practices in important sectors of economic activity other than agriculture. The Commission submitted its report in October, 1965. On the basis of the recommendations of the Commission, the Monopolies and Restrictive Trade Practices (MRTP) Bill was enacted in 1969 and came into force in 1970.

The MRTP Act 1969 aims at controlling industrial activities of the country with a view to give effect to directive principles of state policy which states that the ownership and control of material resources of the country should be so distributed as to subserve the common good and that the operation of the economic system does not result in the concentration of wealth and means of production of to the common detriment.

The control over monopolies and restrictive trade practices is exercised through (i) setting up Monopolies and Restrictive Trade Practices Commission as a permanent body, (ii) regulation of substantial expansion, establishment of new undertakings, mergers, amalgamations, take-overs, appointment of directors and registration of dominant undertakings, and (iii) registration and control of agreements relating to restrictive trade practices.

MRTP Commission

The Commission under MRTP Act, 1969 was appointed in 1970 with a Chairman and two members. The chief function of the Commission is to review periodically the trends in ownership of industries and advise the Government on measures to prevent the concentration of economic power and on prohibition of monopolies and restrictive trade practices. The second function of the Commission is to investigate into monopolistic trade practices and to report to the Central Government its findings for necessary action. The third important function is to inquire into any restrictive trade practices prejudicial to public interest and order for its discontinuance.

Under the MRTP Act 1969, MRTP firms were originally defined as enterprises or interconnected firms that had assets of Rs. 20 crore or moreor a dominant market share (33 per cent or more). The definition of dominant market share was tightened in 1984 to 25 per cent or more. In 1985, the MRTP asset limit was raised to Rs. 100 crore.

Other Provisions of the Act

(i) Concentration of economic power: Under section 21, subsection 1(a), "dominant undertakings" shall not substantially expand their activities without prior approval. Substantial expansion means 25 per cent increase in the value of assets, volume of production or sales.

(ii) Establishment of new undertakings : No person or authority other than the Central Government shall establish a new undertaking without prior permission if such undertaking is a dominant undertaking.

(iii) Merger, amalgamation and take-over: Prior permission of the Central Government is needed if merger or amalgamation or take-over of one unit with another makes it a dominant undertaking.

(iv) Appointment of Directors : No person who is a director of a dominant undertaking shall be appointed a director of any other undertaking without the prior approval of the Central Government.

(v) Registration of agreements relating to RTP: The restrictive trade practices include exclusive dealing arrangements, minimum sale-price maintenance agreements, resale price maintenance agreements, tie-up agreements, exclusive sole distributionship agreement, any agreement for exclusion of any person from any trade association, etc.

Thus, the MRTP Act provided the Government an additional instrument for controlling large firms. In other words, large firms faced additional barriers to entering new lines of manufacturing or expanding through the MRTP-Act.

Even within the economic sphere permitted to MRTP companies, the MRTP clearance procedure was more restrictive than the procedure for companies in general. Between 1982 and 1984, the approval rate of industrial license applications involving MRTP clearnances was 25 per cent whereas it was 40 to 50 per cent for the companies in general. The processing time was usually longer. Less than half of all applications by MRTP companies were decided within one year and many took two or more years.

Further, MRTP limitations on entry and expansion of large firms prevented them from increasing competition in markets characterised by high conentration and excess profits.

Thus, the restrictions on large firms under the MRTP Act paradoxically protected firms dominant in their markets when the Act was implemented. Thus the Act, in effect divided certain industries into a series of protected monopolies, each within an assured share of the market.In machinery manufacturing for pulp and paper, earth moving equipment, packaging, cement and printing, the four biggest firms accounted for more than 70 per cent of the market in the mid 1980s. The trend only moved towards further concetration. At the beginning of 1990s, in more than half of India's industries, the market share of four large firms ranged between 80 per cent and 100 per cent.

12.4 FOREIGN INVESTMENT CONTROL

The IPR 1948 duly recognised the role of foreign investment in India's industrialisation. However, it emphasised that ownership and control of all enterprises involving foreign equity should lay in Indian hands. The objective behind encouraging foreign investment was to supplement domestic capital and to bridge technology gaps for industrialisation. A policy shift began in the mid 60s as the country opted for highly selective purchase of technology and minority foreign equity participation.

The Foreign Investment Board was set up in 1968 to scrutinise and approve foreign collaborations. Industries were classified under lists for banned and favoured sectors for technical collaboration. Royallty rates and fees were prescribed for outright purchase of technology. Separate policies were pursued for "Indianising" management and diluting foreign equity share holding.

The coming into being of Foreign Exchange Regulation Act (FERA) 1973 put further restrictions on foreign investment. FERA, with certain exceptions, put a general ceiling on foreign equity participation in the country.

FERA forced foreign equity to come down to 40 per cent or less or else withdrawal from the country altogether.

FERA emerged as a major barricade or discouraging/restrictive factor for fresh foreign investment.

The major objective of FERA limiting foreing equity upto 40 per cent was to limit the foreign exchange drain in the form of repatriation of dividends. However, FERA did not have any positive impact. New foreign investment declined and the erstwhile subsidiaries with minority equity status received a reduced flow of technology from parent companies and had to enter into collaborations for relatively minor technology transfers. Thus, there was not much improvement in the balance of payments. Royalty and technical fees increased, dividend levels remained relatively constant and new investment fell.

12.5 PUBLIC SECTOR ENTERPRISE PREFERENCES

Assigning a major role to the public sector in industrialising the country formed an important component of the regulatory framework. Vast areas of industry and infrastructure were exclusively reserved for the public sector. These included railways, telecommunications, air-transport, defence, minerals, coal etc. The objective was to enable public enterprises to reach the "commanding heights" of the economy.

Public sector enterprises were also given preference for licenses in other industries including steel, capital goods and oil refineries. Due to these deliberate policies of public sector promotion, total investment in Central Government public sector enterprises rose from Rs. 953 crore in 48 units in 1960/61 to Rs.50,300 crore in 225 units in 1985/86. The share of public sector in total manufacturing GDP went up from 7 per cent in 1960/61 to 31 per cent in 1983/84.

In addition to reservation of industries and preferences in licensing, public sector enteprises (PSEs) enjoyed low financial costs due to equity capital contributions from the Government. PSEs also had the privilege of issuing tax exempted bonds. PSEs, further, had the access to budgetary funds which reduced pressures to minimise costs and charge appropriate prices for their products. On the whole, there was all-round protection to the public sector. This is because, unlike the private sector, public sector enterprises had been burdened with multiple objectives such as employment generation, reduction in regional disparities through industrialisation of back ward areas, generation of resources for further economic development etc.

However, the all-round protection and the burden of social objectives had a telling effect on the financial performance of public sector enterprises. The overall financial performance of PSEs had been poor. In industries where both public sector and private sector co-existed, the performance in terms of capacity utilisation and profitability was generally high in the private sector than in the public sector. Thus, though public sector enlarged its presence in core as also non-core sectors due to deliberate policies, its performance was unimpressive in consideration with the huge public investments made in the sector.

12.6 SMALL SCALE INDUSTRY

Encouragement to Small Scale Industry (SSI) through exclusive policy measures of protection formed another face of the regulatory framework. Principal measures of protection for SSI comprised:

Reservation of products for exclusive manufacturing in SSI sector.

- Restrictio... n the growth of output and capacity in the large scale industry sector producing ... ns reserved for SSI sector
- Concessional credit from the banks
- Excise and sales tax exemptions/ concessions
- Exemption from many labours legislation
- Exemption from licensing
- Preferential access to raw materials, both domestic and imported
- Purchased support through Government procurement and price preferences for SSI products etc.

These policies of protection treated large and small enterprises as watertight compartments. These policies together motivated many small enterprises to stay small rather than to grow, even where a product was not reserved. They increased their operations by establishing more small units. Thus, "smallness became an end in itself".

For products in which scale economies are important, the policy of product reservation limited the scales of production to suboptimal levels. By preventing or inhibiting growth beyond the asset limits and by eliminating potential competition from medium scale and large scale firms, SSI policies have considerably reduced the pressure for small firms to improve technology, update production techniques, introduce modern product designs and reduce costs. As a result, technology upgradation and modernisation have become a major challenge today to the SSI sector towards achieving competitiveness.

12.7 INDUSTRIAL LOCATION

Balanced regional development had been a major goal of India's industrial policy. The policy instruments used to achieve this goal varied from time to time. In the 50s and 60s, public sector enterprises were used as a weapon to reduce regional disparities in development. Public sector enterprises were located in resource rich less developed states. In addition, uniform prices were ensured for basic inputs like steel, cement and coal for industries across the country.

In the 70s, policy shifted from development of backward states to development of backward regions, irrespective of states. Additional financial incentives in the form of capital subsidy, interest rate concessions, transport subsidy and tax holidays were introduced to attract industries to such regions. In the 1980s, fiscal incentives were supplemented by licensing policies to encourage MRTP and FERA companies to move towards backward ragions for further investments. Restrictions were also imposed on the entry of large firms into cities having a population of more than a million.

In addition to central level policies, there were state level incentives including sales tax exemptions, concessional finance and priority access to infrastructural facilities. These state level incentives varied from state to state. The objectives of state level incentives are two fold:

1. To attract more investments in a particular state in relation to others
2. To disperse more investments to less develped as compared to more developed districts, within the state.

However, in effect, industrial location policy emerged more as a constraint for rational investment decisions than as a facilitator of balanced regional development.

12.8 ADMINISTERED PRICES

Administered prices of certain commodities including critical industrial and infrastructural inputs by the Government represented another feature of the regulatory framework. These commodities comprised steel, fertilizer, paper, sugar , cement, drugs, coal and petroleum products, among others. During the late 80s, prices of as many as 65 individual or groups of commdities were administered by the Government.

Administered price policy had three major objectives:

1. To provide certain products at concessional prices to favoured groups such as Government, public sector units and the poor;
2. To provide subsidies through the pricing mechanism to encourage production of items such as fertilizer; and
3. To control inflation by limiting price increases that might have arisen as a result of shortages of items such as steel.

The prices of these products were set by the Ministry concerned, based on the recommendations of the Bureau of Industrial Costs and Prices (B.I.C.P) and various industry specific committees. Prices were usually calculated on a cost plus basis to provide reasonable return on capital. But the application of these principles varied from industry to industry resulting in:

- a uniform price for all plants for a given product (eg. steel)
- different prices for different plants for same product depending on the age of plant, etc. (e.g. fertilizer)
- different prices for the same product from given plant (e.g.levy and non-levy cement)

Administerd price controls had adverse effects on efficiency and growth of industry:

- Shortages emerged from time to time in consumer goods industries like paper and hydrogenated vegatable oil (vanaspati) which were subject to price controls.
- There were substantial shortages in the supply of cement until rapid investment followed the partial decontrol of prices in 1982
- Suppressed increases in steel price during the late 1960s , and 1970s reduced internal resource generation, thereby hindering modernisation which resulted in low effeciency and technological backwardness, and
- Price controls created a bias towards plants of uneconomically small scale in several sectors.

12.9 TAXATION

High rates of tax structure, both direct and indirect, formed another significant aspect of the regulatory framework. The level and incidence of direct and indirect taxation had a detrimental effect on enterpreneurial behaviour and incentives and thereby the efficiency of industraialisation. Higher rates of corporate and income taxes only encouraged tax evasion and discouraged risky and innovative manufacturing efforts by enterpreneurs.

High level of indirect taxes, especially excise and sales taxes had made India a high cost economy and hampered exports. The cascading nature of these taxes also encouraged vertical integration and discouraged product specialisation and efforts to achive economies of scale. Further, varying rates of state sales taxes and octroi have contributed to fragementation of production by hindering inter-state trade and increasing transport costs.

12.10 IMPACT OF REGULATORY FRAMEWORK ON INDUSTRIAL STRUCTURE AND PERFORMANCE

The regulatory policy framework, emerged out of the Industrial Policy Resolution of 1956 and pursued for more than three decades, had affected:

1. The structure of industry comprising structure of industrial production, size distribution of firms within industry, scale of production, market concentration of firms and product specialisation, and
2. The growth and efficiency of industry.

...ucture of Industrial Production

The primary importance assigned to the development of heavy industries produced structural changes in industrial production (Table 12.2)

Table 12.2 Changing Structure of Production in India (% share)

Industry Group	1960	1970	1980	1984
Basic Industries	26.8	32.3	35.3	40.4
Capital Goods	12.9	15.7	17.6	16.6
Intermediate Goods	24.3	20.9	19.6	17.8
Consumer Goods	36.0	31.0	28.0	25.6
Total	100.0	100.0	100.0	100.0

The basic and capital goods industries which accounted for less than 10 per cent of manufacturing value added (MVA) in 1950 and 40 per cent in 1960, accounted for 57 per cent in 1984. The share of consumer goods which accounted for more than one third of MVA in 1960 declined to about one-fourth in 1984.

Size Distribution of Firms

The regulatory policies created differential barriers to entry, growth and exit for different sizes of firms. These had a dampening effect on the gradual growth of firms, a significant characteristic of an economy attaining industrial maturity.

Production Scale

Another consequence of regulatory policies was to constrain plant size. Even large firms were often made up of many small production units. Licensing constraints, protection to small industry units, and limited size of the domestic market together had led to the growth of plants with less than economic scales of production. The average plant size of existing Indian companies is small relative to international standards in such major sectors as steel, automobiles, chemicals, aluminium, paper etc. Production costs, as a result, are higher than could be achieved with plants of minimum efficient scale.

Market Concentration

Though many Indian plants are small by international standards, production was concentrated only in a few firms in many industries. This is a paradox considering that indus-

trial licensing in general, and MRTP Act in particular, were aimed at controlling large and dominant firms. This probably reflects the small size of the domestic market. As mentioned earlier, in industries such as pulp and paper, earth moving, packaging, printing and cement, the four largest firms accounted for 70 per cent or more output in 1983/84. The concentration ratios were similarly high in other industries including basic metals, synthetic fibres and paper products.

Concentration in India was also high relative to other countries. For example, in India 55 per cent of Industrial segments had four-firm concentration ratios in the range of 80 to 100 per cent whereas in Japan only 9 per cent of industrial segments had this degree of concentration.

The important issue that needs to be noted here is that not only a few firms had a dominant share in many industries despite legislations to control monopolies, but more importantly they were protected from competition, both within the country and abroad, by not allowing other firms to enter into those 'highly concentrated' industries.

Production Specialisation

Absence of product specialisation and horizontal diversification in many industries is another outcome of regulated policy framework. The structure of production in many industries was characterised by inappropriate product mix at the firm as well as at the sub-sector level. Too many products are manufactured by one single firm in many an industry.

The insufficient industrial product specialisation was due to:

- highly protective industrial and trade policies aimed at acquiring self-sufficiency locally encouraged domestic production of any item that could be produced in the country with reasonable profits.
- many firms produced intermediate inputs for in-house consumption even if buying from other sources was more economical.
- high rate of excise duties encouraged in-house production of inputs.
- the licensing regime was less restrictive in granting licenses for new product lines than for expansion within the same product category. This prompted horizontal diversification and curtailed vertical growth of firms.

Growth and Efficiency of Industry

The regulatory industrial policies affected the overall growth and efficiency of industry as well. Though industry grew rapidly during 1950-65, the growth decelerated during 1966-1980 and therefore, slowed the process of change in the economic structure of the country.

In the process of economic development, as observed by economists, countries go through two stages of structural change. In the first stage, the share of agriculture in Gross Domestic Product (GDP) falls and that of manufacturing output increases. In the second stage, the share of agriculture continues to fall and that of manufacturing afte reaching the level of 25 to 35 per cent of GDP also starts declining combined with the increasing share of services sector.

India did experience this kind of structural change in the economy: the share of agriculture declined, the share of services increased but the increase in the share of manufacturing was not significant, both absolutely and relatively (Table 12.3).

This brings out that our restrictive industrial policies aimed at 'planned industrialisation' of the country, resulted in decelerated (below-the-potential) growth of industry and slower change in economic structure. Thus, the manufacturing sector still has the potential

for rapid growth and relative increase in the share of GDP, particularly in the light of experiences of other Asian countries.

Table 12.3 India : Structural Change in GDP 1966-83

Sector/Year	India	China	South Korea	Developing Countries	World
Agriculture					
1966	47.8	37.5	34.9	28.6	9.4
1978	38.6	29.8	20.2	21.4	7.2
1983	35.6	35.3	13.9	20.8	6.4
Mining					
1966	1.0	4.4	1.9	4.7	2.5
1978	1.4	5.5	1.4	6.2	3.5
1983	2.9	6.7	1.4	7.8	4.6
Manufacturing					
1966	14.3	30.3	18.6	21.1	27.9
1978	15.9	37.5	27.8	22.2	25.6
1983	16.7	32.5	27.4	20.6	23.0
Construction					
1966	5.1	3.2	3.7	4.5	5.8
1978	5.3	3.7	7.9	5.9	6.4
1983	5.0	4.6	8.4	5.7	5.6
Services					
1966	31.7	24.5	41.0	44.1	54.4
1978	37.7	23.6	42.7	44.3	57.3
1983	40.0	20.9	48.9	45.1	60.3

Not only was the growth of industry not as high and significant as it could have been, but more importantly the efficiency of industry did not increase, rather it only declined. This was reflected in rising capital intensity of the overall industry. The Incremental Capital Output Ratio (ICOR) in the manufacturing sector increased from 2.8 in the fifties to 4.4 in the sixties and 6.2 in the seventies. The ICORs were higher in industries: (i) where import substitution had taken place in the absence of natural comparative advantage; and (ii) which were characterised by underutilisation of capacity and technological obsolescence.

The decline in efficiency of industry could also be attributed to regional dispersal policies,

excess capacity creation, fragmentation into units of uneconomic size and rising input costs of material inputs and services from the public sector units. All these have resulted in low growth of total factor productivity. The growth of total factor productivity was around 1 per cent between 1965 and 1980 as against 2 to 5 per cent in other developing and developed countries. The slow growth of productivity and rising trend of capital intesity adversely affected the competitiveness of Indian industry in the international market and thereby affected the growth of Indian exports as well.

12.11 SUMMARY

To provide a planned direction to industrialisation, India opted for a regulatory and promotional policy framework. Industrial licensing, MRTP Act, FERA, reservation of industries for public sector, protection for small scale industry, restrictions on industrial location, administered price mechanism for infrastructural inputs and taxation formed different component of the regulatory framework

Though the regulatory framework had 'sound economic objectives', their implementation and outcome were far from satisfactory. Excess capacity on the one hand and shortage of industrial products on the other were paradoxical features of industry. Fragmented uneconomic units, high concentration of output in a few firms in strategic industries, low productivity, high capital intensity became the characteristics of Indian industry. These, factors among others, affected its competitiveness to penetrate into international market.

12.12 KEY WORDS

Administered Price : Price of a commodity or service is fixed by the Government rather than determined by the free play of market forces of demand and supply.

Commanding Heights : The prominent objective of promoting Public Enterprises (PEs) in India, as emerged out of the Industrial Policy Resolution 1956, was to enable PEs to achieve 'Commanding heights' of the economy. This means to facilitate PEs to grow and function in all strategic and core areas of the economy to produce goods and services, to generate employment, to promote balanced regional development, to generate resources to accelerate the overall economic development and thus become the pillar of India's economic prosperity.

Gross Domestic Product (GDP) : The value (at market prices) of total flow of goods produced in an economy during a year. Only goods used for final consumption or investment goods are included.

Incremental Capital Output Ratio (I.C.O.R.): I.C.O.R. is the ratio of net investment to change in output.

Manufacturing Value Added (MVA) : The difference between the value of total manufacturing output and the cost of raw materials, services and components purchased.

Monopoly : It is market structure with only a single seller of a commodity or service dealing with a large number of buyers. The seller is then said to be a monopolist

Sellers' Market : A market situation in which sellers hold the stronger strategic position of bargaining advantage because buyers are prepared to buy, at existing prices, larger amounts of goods than sellers are currently able or willing to produce and sell.

12.13 SELF-ASSESSMENT QUESTIONS

1. What were the objectives and shortcomings of industrial licensing policy in India? Discuss in detail.
2. How effective was MRTP Act in achieving its principal objective? Analyse.
3. Foreign Exchange Regulation Act, 1973 was a turning point in the fore ment policy of India. Why?
4. The promotion of public sector to achieve "commanding heights" of the my, was the most noteworthy feature of India's industrial policy. Did public sector achieve the "commanding heights" in terms of its performance?
5. Describe the salient features of the protective policy adopted by the Government for small scale industry?
6. What were the objectives and achievements of administered price mechanism?
7. Critically analyse the achievements and adverse effects of regulatory policy frame work in the course of India's industrialisation.
8. "The role of public sector is as significant and indispensable as the role of private sector in the industrialisation of a developing economy". Discuss.
9. "Industrial licensing is an instrument to channelise the limited resources of an economy in the most productive way for industrialisation". Analyse this statement on the basis of India's experience.
10. "Foreign investment is a panacea for the economic ills of a developing country" Critically evaluate this statement.
11. "Promoting competition is the best strategy to accelerate industrialisation". Do you agree?
12. "India has succeeded in preventing concentration of economic power through MRTP and protection to small scale industry". Is it true? Illustrate.

12.14 FURTHER READINGS

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BLOCK 4 EXTERNAL SECTOR

In the previous Block, you will recall, we had discussed Planning and Policies of the Government of India, particularly with regard to industrial development. We had also presented the regulatory and promotional framework which existed in India immediately before the economic reforms were initiated in 1991. In this Block, we discuss the various elements of the External Sector of the Indian economy. This block has five units.

Unit 13 **India's Foreign Trade** discusses the trends, composition and direction of India's foreign trade. The need for foreign trade is explained, and growth trends in India's foreign trade are presented. How the composition of India's exports and imports is changing, and where India's exports are destined and where imports originate are examined. Subsequently, some implications of growth inIndia's foreign trade are discussed.

Unit 14 deals with **India's Balance of Payments.** The unit begins by defining balance of payments (BOP). Thereafter components of an significance of BOP are explained. Major developments in India's BOP since 1950-51 are presented. The causes of BOP crisis in the 90s and subsequent developments are then taken up. Issues relating to *rupee convertibility* are also discussed.

Unit 15 **India's Export-Import Policy** deals with various related aspects. The backdrop of India's Exim policy is briefly presented. The changes occuring in foreign trade regime are examined/ The various phases of changes of India's Exim policy and major features of India's import regime are discussed. The various incentives provided under the export policies and also briefly dealt with. The present and future Exim policies are also examined/ presented. A brief review of the trade policy reforms is also given.

Unit 16 focuses on **Foreign Capital and Collaborations.** The rationale of foreign capital in the Indian context is examined. An overview of foreign investment policy in India is presented. Foreign investment policies till 1990 and thereafter are also described. The trends in foreign investment and collaborations till 1990 and thereafter are also presented.

Unit 17 deals with **India's External Debt.** The unit begins by explaining the scope and classification of external debt. The methodological issues relating to external debts are examined, as also the extent of utilisation of external assistance to India. Thereafter the sources of external assistance are discussed. What has been the magnitude of external debt in the 90s, and what have been the debt service payments are discussed. Some interesting comparisions with regard to external debt are also made. The unit concludes with a comment on external debt and debt servicing burden.

13 INDIA'S FOREIGN TRADE

Objectives

This Unit facilitates the understanding of the.

- need for foreign trade
- growth trends in India's foreign trade
- changing composition of India's imports and exports
- destination of India's exports and origin of India's imports, and the
- implications of India's foreign trade growth

Structure

13.1 Introduction
13.2 India's Foreign Trade : Trends
13.3 India's Foreign Trade: Composition
13.4 India's Foreign Trade : Direction
13.5 Summary
13.6 Key Words
13.7 Self-Assessment Questions
13.8 Further Readings

13.1 INTRODUCTION

Foreign trade or international trade refers to the trading of goods between countries. Thus, international trade is an extension of internal trade i.e. trade between two different regions within a country. Just like as single region within a country cannot produce everything it needs by itself, one single economy cannot produce every commodity all by itself, one single economy cannot produce every commodity all by itself. This could be due to differences in the availability of natural resources, skills of people, etc. Therefore, it would be advantageous for a country to indulge in trade with other countries, by exporting those commodities which it produces cheaper in exchange for what others can produce at a lower cost.

Foreign trade also facilitates the dissemination of technical knowledge, transmission of ideas, and import of know-how/skills, managerial talents and entrepreneurship. In addition, foreign trade encourages movement of foreign capital. In totality, foreign trade can have a profound impact on the growth of an economy in terms of production, employment, technology, resource utilisation and so on.

13.2 INDIA'S FOREGIN TRADE : TRENDS

The origin of India's foreign trade can be traced back to the age of the Indus Valley civilisation. But the growth of foreign trade gained momentum during the British rule. During that period, India was a supplier of food stuffs and raw materials to England and an importer of manufactured goods. However, organised attempts to promote foreign trade were made only after Independence, particularly with the onset of economic planning. Indian economic planning is nearing five decades, of completion. During this period, the value, composition and direction of India's foreign trade have undergone significant changes.

India's foreign trade has come a long way since 1950-51. The values of both exports and imports have increased several times over the period (Table 13.1). The value of exports rose from Rs. 606 crore in 1950-51 to Rs. 1,06465 crore in 1995-96. The value of imports, during the same period, increased from Rs. 608 crore to Rs. 1,21647 crore. With the

exception of 1971-72 and 1976-77, the value of India's imports has always been higher than that of exports. As a result, India has been a trade deficit country. Another aspect of India's foreign trade is the flucturtaing growth rates of exports and imports. The growth rate for exports ranged from as low as - 19.3 percent in 1952-53 to 42.9 percent in 1966-67. Similarly, the growth rate of import varied from -21.1 percent in 1952-53 to 58.3 percent in 1973-74.

Table 13.1 : India's Foreign Trade : Trends.

(Rs.Crore)

Year	Exports	Growth Rate	Imports	Growth Rate	Trade Balance
1950-51	606		608		-2
1951-52	716	18.2	890	46.4	-174
1952-53	578	-19.3	702	-21.1	-124
1953-54	531	-8.1	610	-13.1	-79
1954-55	593	11.7	700	14.8	-107
1955-56	609	2.7	774	10.6	-165
1956-57	605	-0.7	841	8.7	-236
1957-58	561	-7.3	1035	23.[illegible]	-474
1958-59	581	3.6	906	-12.5	-325
1959-60	640	10.2	961	6.1	-321
1960-61	642	0.3	1122	16.8	-480
1961-62	660	2.8	1090	-2.9	-430
1962-63	685	3.8	1131	3.8	-446
1963-64	793	15.8	1223	8.1	-430
1964-65	816	2.9	1349	10.3	-533
1965-66	810	-0.7	1409	4.4	-599
1966-67	1157	42.9	2078	47.5	-921
1967-68	1199	3.6	2008	-3.4	-809
1968-69	1358	13.3	1909	-4.9	-551
1969-70	1413	4.1	1582	17.1	-169
1970-71	1535	8.6	1364	3.3	-99
1971-72	1608	4.8	1825	11.7	-217
1972-73	1971	22.6	1867	2.3	-104
1973-74	2523	28.0	2955	58.3	-432
1974-75	3329	31.9	4519	52.9	-1190
1975-76	4036	21.2	5265	16.5	-1229
1976-77	5142	27.4	5074	-3.6	68
1977-78	5408	5.2	6020	18.6	-612
1978-79	5726	5.9	6811	13.1	-1085
1979-80	6418	12.1	9143	34.2	-2725
1980-81	6711	4.6	12549	37.3	-5838
1981-82	7806	16.3	13608	8.4	-5802
1982-83	8803	12.8	14293	5.0	-5490
1983-84	9771	11.0	15831	10.8	-6060
1984-85	11744	20.2	17134	8.2	-5390
1985-86	10895	-7.2	19658	14.7	-8763
1986-87	12452	14.3	20096	2.2	-7644
1987-88	15674	25.9	22244	10.7	-6570
1988-89	20232	29.1	28235	26.9	-8003
1989-90	27681	36.8	35416	25.4	-7735
1990-91	32553	17.6	43193	22.0	-10640
1991-92	44042	35.3	47851	10.8	-3809
1992-93	53688	21.9	63375	32.4	-9687
1993-94	69547	30.4	72806	15.7	-3259
1994-95	82338	18.4	88705	21.8	-6375
1995-96	106465	29.3	121647	37.1	-15182

Source 1. Economic Survey 1995-96.
2. Economic and Political Weekly. September 28, 1996

Imports : During 1950s, the value of trade increased only marginally. The value of exports, remained the same, more or less. But the value of imports, with certain fluctutations, increased by about 60 per cent during the decade. The significant rise in import was largely due to the increase in the quantum of imports of food grains, raw materials, capital equipment and machinary. The emphasis on heavy industries during the second Five Year Plan necessitated the imports of machinery and capital equipments which contributed to the increase in the value of imports.

The emphasis on heavy industries continued during the third Five Year Plan and the three Annual Plans. This resulted in increased imports of machinery and machine products. The bad weather conditions in the sixties led to more imports of food grains and agricultural raw materials. Added to these, the devaluation of the Indian rupee in 1966 further raised the value of imports. As a result, the value of imports rose by about 40 percent during 1960.

It was during the seventies that the value of imports went up sharply. This was largely due to the hike in the prices of petroleum and petroleum products effected by the Organisation of petroleum Exporting Countries (OPEC) in 1973-74 and then in 1979 and 1980. That is why the value of imports registered an increase of 58 per cent in 1973-74, 53 percent in 1974-75, 34 percent in 1979-80, and 37 percent in 1980-81. During 1970-71 to 1979-80, the value of imports increased by more than 500 percent. In addition to the oil price hike, the general inflationary trends prevailing in the international market also contributed to the increase in the value of imports.

The increase in domestic production of crude oil in the eighties slowed down the increase in the value of imports, as the relative share of petroleum products in the country's import bill marked a decline. However, during the late eighties, partly due to an increase in the quantum of petroleum products imported and partly due to a rise in the international oil prices, the value of imports once again increased sharply. The Gulf crisis' in 1990 and the currency devaluation in 1991 further pushed up the country's import bill. On the whole, in the post -Independence period, during the sixties and seventies, import of food items and capital goods contributed to the growth of imports. But since the eighties Petroleum products and capital goods determined the growth trends in the value of imports, to a large extent.

However, the growth of imports in the nineties has been characteristically different from the earlier period, especially from the policy point of view. In 1991, the Indian Government initiated a major import liberalisation programme as part of its what is now commonly known as the New Economic policy. Import liberalisation consisted of gradual reduction of import tariffs and elimination of import restrictions.

Major reductions in tariffs have been introduced in the nineties. The import-weighted average tariff for the whole economy fell from 76.7 per cent in 1990-91 to 40 per cent in 1993-94, which further fell in 1994-95. The peak rate of tariff which was as high as 220 percent in 1991 has now been brought down to 65 percent.

Import licensing has been virtually scrapped for new materials, intermediate components and capital goods. These can now be freely imported subject to a "negative list" which is under constant review and has been substantially pruned in the nineties.

Due to these policy measures, the relative share of raw material, intermediate and capital goods imports went up particularly in 1993-94. However, due to slowdown in industrial growth, capital goods imports have declined in the first quarter of 1996-97. Another aspect of import growth during the current year is that due to (i) a fall in domestic crude oil production, (ii) a sharp rise in domestic demand and (iii) the recent spurt in world oil prices, imports of petroleum products are likely to push up the import bill in a big way.

Exports Exports were more or less stagnant at around Rs. 600 crore during the fifties 'The introduction of some export promotion measures led to the rise of exports in the sixties

significant rise was seen in the exports of gems and jewellery, readymade garments and engineering goods. After the devaluation of 1966, exports of iron ore, leather and leather manufactures, chemical and allied products, etc. received a further boost. During 1960/61 - 1969/70, exports grew, on an average, by 10.2 percent.

It was in the 1970s, however, that exports grew significantly. On an average, exports grew by more than 19 per cent during 1970/71-1979/80. A sizable contribution, again came form gems and jewellery, readymade garments, engineering goods, chemicals, leather products, etc.,

The high growth rate of India's exports in the 70s were mainly due to:

- the increase in the unit value index of exports
- the increase in the quantum index of exports
- new markets for India's exports in oil producing countries with the boom in oil prices.
- increase in the price competitiveness of Indian exports as a result of a rise in the world prices of all commodities
- boom in the value of agro-based exports such as oil cakes, marine products, and sugar; and
- increase in project exports to the Middle East countries.

During the 80s, particularly in the early 80s, the growth of exports slowed down. Exports grew by about 11 percent in the first half of eighties but the growth picked up later and exports grew by almost 27 percent in the second half of eighties. The sluggishness in export growth in the early eighties was mainly due to decline in demand for Indian exports abroad - adoption of protective measures by developed countries - fall in the value of the US dollar, among others.

The reorientation of the industrial and trade policy regime in the 1980s to release the supply side constraints was combined later in the decade with a more activist policy on the exchange rate so as to attain a steady depreciation in the real effective exchange rate. The improvement in productivity performance and the loosening of the tight import control regime created a better environment for exports. New incentives for exports, notably the exemption form tax of profits on export operations, also encouraged export growth. As a result, the growth of exports went up, both in terms of value and volume.

In 1990-91, export growth once again declined but only marginally to about 18 percent. This deceleration in exports was attributed to:

(1) A slow down in the expansion of world trade. The volume of world trade decelerated from 7.3 percent in 1989 to 4.2 percent in 1990 and further to 0.9 percent in 1991.

(2) Loss of export markets in the Middle East due to the Gulf crisis.

(3) Political and economic upheavals in Eastern Europe, which earlier provided a sheltered market to Indian exports.

(4) Import curbs introduced during 1990-91 in response to foreign exchange shortage and intensified after the Gulf crisis, affecting export - related imports.

(5) Movement in the exchange rate which was broadly supportive of exports since 1986-87 becoming adverse thus affecting competitiveness of exports; and

(6) Internal law and order problems in some states.

The currency devaluation in 1991 and the subsequent liberalisation of export-import regime particularly full convertibility of rupee on current account have given a boost to the growth of exports. As a result, exports grew more significantly during the early '90s compared to the earlier decades (Table 13.2)

Table 13.2 : Growth of Exports : 1960/61-1995/96

Year	Growth Rate (%)
1960-61 to 1969-70	10.2
1970-71 to 1979-80	19.3
1980-81 to 1989-90	14.9
1990-91	17.6
1991-92	35.3
1992-93	21.9
1993-94	30.4
1994-95	18.4
1995-96	29.3

Source : 1. *India: Towards Globalization,* UNIDO, 1995.
2. *Economic & Political weekly,* September 28, 1996.

However, the trends in foreign trade in April-August in 1996-97 have been discouraging as exports have only increased modesty,. This was mainly due to a sharp fall in exports in July1996 (2.66 per cent) and in August 1996 (2.3 percent). During April - June 1996, exports grew at 26.7 percent which is quite comparable to the performances of the previous years. The rising cost of production, bottlenecks in ports and heavy rain in some regions are stated to be the factors responsible for the drop in export earnings in the months of July and August. With the easing of the latter two factors, export growth is likely to increase in the subsequent months.

Thus, India's exports have grown considerably both in terms of value and volume, over a period of time. However, a significant indicator of India's export performance is India's share in world exports. Despite the significant growth, India's share in world exports was negligible and the relative share remained more or less at the same level (Table 13.3). This is attributed to India's failure in improving its competitiveness in terms of price and quality in the international market.

Table 13.3 India's Share in world Exports

Year	Exports in US $ Million: World	Exports in US $ Million: India	India's share in World Exports (%)
1970	313706	2026	0.6
1975	875500	4355	0.5
1980	1989867	8378	0.4
1985	1932387	8750	0.5
1990	3137485	18178	0.6
1992	3218905	18145	0.6

Source : *Economic Survey, 1995-96*

13.3 INDIA'S FOREIGN TRADE : COMPOSITION

The composition of foreign trade refers to the kinds of goods imported and exported by a country. It is essential to understand the composition of imports and exports as it reveals the economic status of a country. The changes that may occur in the composition of trade over a period of time reflect the economic transformation of a country.

In general, a developing country's imports comprise mainly heavy manufacturing goods like machinery, transport equipments iron and steel, etc. whereas exports comprise mainly primary commodities like agricultural products, natural resources such as iron ore, and light manufactures consisting of textiles, leather products, processed foods etc. But in the process of industrialisation and economic development, the composition of trade undergoes a transformation. As a consequence, a developed country's imports would include mostly primary commodities and light manufactures and exports would consist mainly of heavy manufactured goods.

mports : At the beginning of the 1950s, India's imports consisted mainly of food grains, machinery, transport equipment, iron and steel, petroleum and petroleum products, etc

The announcement of the Industrial Policy Resolution, 1956 and the subsequent emphasis on the development of heavy and basic industries in the second five year plan had an impact on import composition. The policy of import substitution necessitated the setting up of a wide variety of industries to produce various manufactured goods such as machine-tools, sugar mill machinery, cement machinery, railway wagons, commercial vehicles, automobile tyres and tubes, etc. All these led to an increase in the import of capital goods and equipment in the late fifties.

The relatively underdeveloped agriculture and the demand - supply gap for food grains caused the import of food items, particularly cereals and cereal preparations. Food items accounted for about 15 percent of the Import bill in 19950-51. Since then food imports ranged between 15 percent and 17 percent for almost two decades. However, since the eighties, the relative share of food imports has declined considerably. This largely reflects the near self-sufficiency in food grains attained by India over the period.

A significant portion of India's imports comprised raw materials and intermediates (Table 13.4). These accounted for Rs 527 crore out of the total imports of Rs. 1122 crore in 1960-61, thereby accounting for 47 per cent of the value of imports. In 1970-71, raw materials and intermediates accounted for more than 50 percent of the value of imports. In 1980-81, their relative share peaked to about 78 percent. This was largely due to a rise in the quantum and prices of petroleum products. In 1985-86, the share of raw materials and intermediates relatively declined to 71 percent.

Table 13.4 : Structure of India's Imports : 1960/61 - 1994-95

(% Share in value).

Major Items	1960/61	1970/71	1980/81	1990/91	1994/95
I Food and related items	19.0	14.8	3.0	N.A	N.A
II Raw materials and Intermediate manufactures of which :	47.0	54.4	77.8	N.A	N.A
a: Petroleum, oil and lubricants (POL)	6.1	8.3	41.9	25.0	20.7
b: Fertilisers and chemical products	7.8	13.2	11.9	N.A	N.A
c: Pearls, precious and semi-precious stones	0.1	1.5	3.3	8.7	5.7
d: Iron and steel	11.0	9.0	6.8	4.9	4.1
e: Non-ferrous Metals	4.2	7.3	3.8	2.6	3.3
III Capital Goods	31.7	24.7	15.2	24.2	22.2
IV Other Items (unclassified)	2.3	6.1	4.0	N.A	N.A
Total	100.0	100.0	100.0	100.0	100.0

Source : Economic Survey, 1995-96.

Of the raw materials and intermediates, (i) Petroleum, oil and lubricants (P.O.L) (ii) Fertilisers and chemical products (iii) Pearls, precious and semi-precious stones (vi) Iron and steel (v) Non-ferrous metals are the major items of imports. The very composition of raw material and intermediate imports has undergone a change since the fifties. In 1960-61, iron and steel and non-ferrous metals formed a significant part of the value of imports However, their importance has declined steadily and gradually since then. POL formed about 1/8 of the value of imports in 1960-61. But their relative share has risen considerably both due to a consistent rise in the quantum imported and in the prices of petroleum products in the international market. Since the late '80s, POL imports account for about quarter of the import bill of the country. The recent liberalisation measures introduced with respect to the automobile industry in the country will further push up the domestic demand for petroleum products. The scope for increased domestic production being limited, increased quantum of P.O.L imports will become indispensable. As a result, the relative share of P.O.L imports might go up further in the coming years.

The process of agricultural development necessitated a gradual increase in fertiliser imports chemical imports comprised mainly of chemical elements and compounds.

The import of pearls, precious and semi-precious stones is done mail as a raw material for the gems and jewellery industry, which was/is a significant export item of India.

The capital goods imports comprise electrical and non-electrical machinery and transport equipments. The growing industrialisation has only led to increased demand for capital goods of various kinds. The policy of import substitution has little impact on the growth of

capital goods imports. In faster the industrial liberalisation of the nineties, has further pushed up these imports in the first half of nineties. However, there is a remarkable fall in the capital goods imports during April-June, 1996 which is attributed to a likely slow down in the industrial growth of the country, On an average, capital goods have been accounting for about a quarter of the value of imports. Unless and until, India develops its own technology base, its capital goods import requirements will only go up in the future.

Thus, P.O.L and capital goods, which together form about a half of the total import would determine the future growth of India's imports.

Exports : The structure of India's exports has undergone a considerable change since independence. Exports started growing considerably only since the sixties. India's exports are broadly classified under.

(i) agriculture and allied items which includes coffee, tea, oil cakes, tobacco, cashew kennels, spices, sugar, raw cotton, rice, fruits and vegetable, etc.

(ii) Ores and minerals which include mica and iron ore, among others,

(iii) manufactured goods consisting of gems and jewellery, ready made garments, engineering goods, chemicals, leather products, jute manufactures, etc.

(vi) Mineral fuels and lubricants (including coal); and

(v) Others.

The major value of India's exports emanated from agricultural products on the one hand, and manufactured goods on the other (Table 13.5). Among the agricultural items, tea was a prominent foreign exchange earner for the country. In 1960-61, tea exports earned about. Rs.124 crore out of the total exports revenue of Rs. 643 crore (thereby it accounted for about 20 percent of the total value of exports). However, the relative contribution of tea exports to total exports amounted to only 3.3 percent. Some of the major agricultural items whose exports have increased over the period, are cashew kernels, spices, rice, fish and fish preparation, tobacco, oil cakes and more recently, fruits and vegetables.

Though the export value of agriculture and allied products has consistently increased since the '60 s their relative share in the total value of exports declined steadily. This could be broadly attributed to two factors:

- Despite agricultural development (which has been confined to certain regions within the country) commercialisation of agriculture has not taken place on a significant scale. Subsistence farming, which largely, prevails in India constrains the scope for export growth.
- Exports from the manufacturing sector have grown more significantly.

However, in the '90s agricultural development has been gaining increased attention from the policy markers:

1. The government of India has brought out an Agricultural policy (which has not been enacted) which lays more thrust on agricultural development and exports.
2. The food processing industry has been accorded a 'sun rise industry' status for its promotion, in order to prevent the wastage of fruits and vegetables due to lack of processing facilities and to promote exports of processed foods.
3. The export obligation of Export Oriented Units (EOUs) related to agriculture and allied products has been brought down to 50 percent., This enables these EOUs to sell the remaining 50 percent of the production in the domestic market thereby enabling them to settle down quickly.

4. Some of the state governments have taken policy decision to enable food processing units to acquire agricultural land for cultivating the required raw materials for in house consumption.
5. Even 'contract farming' is encouraged to promote agriculture industry linkages.

All these are aimed at giving a new turn to agriculture development and exports in the nineties. However, the relative, share of agriculture and allied items in total exports has declined further in the nineties. If the potential of Indian agriculture is harnessed appropriately, agriculture and allied items exports could be stepped up more significantly in the future.

The exports of manufactured goods have grown at a much faster rate than that of agriculture (Table 13.6). As a result, the relative share of manufactured goods in the total value of exports has gone up steadily from 45 percent in 1960-61 to 78 percent in 1994-95. This reflects a positive outcome of India's industrial development.

Table 13.5 : Structure of India's Exports : 1960/61 - 1994-95

(% share in value).

	Major Items	*1960/61*	*1970/71*	*1980/81*	*1990/91*	*1994/95*
I	Agricultural and allied products	44.2	31.4	30.7	19.4	16.6
II	Ores and Minerals	8.0	10.7	6.2	4.6	3.1
III	Manufactured Goods	45.3	50.3	55.8	72.9	78.2
	- Gems & Jewellary	0.1	2.8	9.6	16.1	17.1
	- Readymades	0.1	1.9	8.4	12.3	12.5
	- Engineering Goods	2.0	12.0	13.0	11.9	13.2
	- Chemicals	1.1	2.3	3.5	6.5	9.2
	- Leather Products	3.0	4.7	5.0	8.0	6.1
	- Jute manufactures	21.0	12.3	4.9	0.9	0.6
	- Other manufactures	21.0	14.2	11.3	17.2	
IV	Minerals/ Fuels and Lubricants	1.1	0.8	0.4	2.9	2.0
V	Others	1.4	6.5	6.9	0.2	0.1
	Total	100.0	100.0	100.0	100.0	100.0

Source : *Economic Survey, 1995-96.*

Even within manufacturing exports, the composition has changed over the period. In 1960-61, jute manufactures was the most prominent manufactured items of exports (by contributing more than 46 percent of the total value of manufactured exports which amounted to 21 percent of the total value of exports). However, with the emergence of substitute for jute goods in the international market and the decline of jute industry domestically, the share of jute goods in the total value of exports decreased continuously. In 1990-91, jute manufactures' exports accounted for hardly 1 percent of the total value of exports decreased continuously. In 1990-91, jute manufactures' exports accounted for hardly 1 percent of the

total value of exports and in 1994-95 it declined further to 0.6 percent.

The export of (1) readymade garments, (2) leather and leather products (3) gems and jewellery (4) engineering goods and (5) chemical has increased gradually. In 1994-95, these five items together had a share of more than 58 percent of the total value of exports. In 1960-61, these same items contributed hardly 8 percent of the total value of exports.

This brings out the fact that the export composition of India has grown more in terms of non-traditional items than traditional items. But non-traditional items are largely confined to light manufacture. The share of only light manufactures went up from year to year. Thus, though the export composition got diversified in terms of faster growth of non traditional items, these are largely confined to light manufactures. The near absence of heavy manufactures in India's exports reflects the inadequate indigenous technology base for the development of heavy manufactured goods. Unlike industrialising countries like South Korea and Singapore, India's export composition has not yet started diversifying in the form of significant emergence of heavy manufactured goods and consumer durables.

Table 13.6 : Growth of Exports : 1960-90.

Period	Agriculture & Allied Products	Manufactures
1960-61 to 1969-70	5.5	10.3
1970-71 to 1979-80	15.5	17.1
1980-81 to 1989-90	8.7	17.7

Source : *India : Towards Globalisation, UNIDO, 1995.*

Activity 1

Prepare a chart describing the major stages in the transformation of India's export and import compositions during the planning period.

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13.4 INDIA'S FOREIGN TRADE : DIRECTION

India's foreign trade relations cover the countries all around the world. To understand the regional direction of India's foreign trade and its progress, countries of the world are classified under five broad groups:

I. Organisation for Economic Co-Operation & Development (OECD) Countries which, in turn, comprise

(1) The European Economic Community (EEC): United Kingdom, Germany, France, Belgium, etc.

(2) North America : Canada, USA

(3) Asia and Ocean a : Australia, Japan

II. Organisation of Petroleum Exporting Countries (OPEC)

III. Eastern Europe

IV. Developing countries

V Others

Imports : Most of India's imports originate from the industrialised (OECD) countries (Table 13.7). In 1960-61, about four - fifths of the imports were from the OECD countries. Of these, the UK and the USA together accounted for as much as 50 percent of the total value of India's imports. However, since then, the relative importance of OECD countries in India's imports has declined to some extent (though it has increase marginally in the '90s). This is reflected in the gradual fall in the share of UK and USA in the value of Indian imports. In 1993-94, UK and USA together accounted for hardly 19 percent of the total value of imports. But countries like Belgium and Japan have become more important trading partners as far as India's imports are concerned. By and large, India imports capital goods, raw materials and intermediates from OECD countries.

India imports mainly petroleum, oil and lubricants (P.O.L.) from the OPEC. Both in terms of value and value and volume, POL has a minor presence in India's import structure in the 60s 70s. OPEC accounted for hardly 5 percent of the value of imports in 1960-61 and hardly 8 percent in 1970-71. But thereafter, due to the sharp rise in oil prices as well as increase in the quanitty of India's imports, the share of OPEC in the value of India's imports went up steeply. As a result, imports in 1980-81 from OPEC accounted for almost 28 percent of the Import bill. the subsequent fall in international oil prices resulted in a relative fall but went up again as a result of the Gulf crisis in 1991.

Table 13.7 : Direction of India's Imports 1960-61 - 1993-94

(% Share in value).

Countries	1960-61	1970-71	1980-81	1990-91	1993-94
I OECD :	78.0	63.7	45.7		
1. EEC :	37.1	19.6	21.0	29.4	30.1
- Belgium	1.4	0.7	2.4	6.3	8.1
- East Germany	10.9	6.6	5.5	8.0	7.7
- UK	19.4	7 8	5.8	6.7	6.6
2. North America	31.0	34.9	14.7	13.4	12.7
- USA	29.2	27.7	12.9	12.1	11.7
3. Asia & Oceania	7.1	7.4	7.4	11.2	9.7
Japan	5.4	5.1	6.0	7.5	6.6
II OPEC :	4.6	7.7	27.8	16.3	22.5
III Eastern Europe	3.4	13.5	10.3	7.8	1.7
- USSR	1.4	6.5	8.1	5.9	1.1
IV Developing Countries	3.4	13.5	10.3	7.8	1.7
-Asia	5.7	3.3	11.4	14.0	
V Others :	2.2	0.5	0.5	3.5	4.3
Total	100.0	100.0	100.0	100.0	100.0

Source : *India : Towards Globalisation, UNIDO, 1995.*

The growing domestic demand for P.O.L. and increasing oil prices in the internation market will make OPEC all the more important in terms of India's imports in the guture.

Eastern Europe, particularly, the former USSR was a significant source of Indias imports for nearly two decades: mid-'sexties to mid-'eighties. The main items of imports from these countries were iron and steel, non-ferrous metals, chemicals, capital equipment, pharmaceuticals and petroleum products. However, with the transformation of the economic systme of East-European countries and disintegration of the USSR, imports from Eastern Europe declined Europe declined drastically., In 1993-94, Eastern Europe accounted for hardly 2 percent of the value of India's imports (as against about 14 percent in 1970-71 and 10 percent in 1980-81).

A significant deveioonment in the direction of India's imports is with reference to developing countries, particualry Asia. the imports generated from Asian countries have increased significantly since the 80s. This could be attributed to (i) rapid economic development of many Asian countries, specially South East Asian countries and (ii) greater trade co-operation among the members of SAARC (South Asian Association for Reqioonal Co-operation).

On the whole, India has exoerienced increaseing regional diversification in the process of the growth of imports.

Exports : A major share of India's exports goes to industrialised (OECD) countries (Table 13.8) In 1960-61, more than 66 percent of the value of exports were absorbed by OECD countries. But the relative share of OECD countries in India's exports declined in 1970-71 and again in 1980-81. Thereafter, the share has increased again. In the '90s, the exports to OECD countries sttod at around 57 percent. Within the OECD countries, Uk and USA were the major destinations for India's exports, which accounted for as much as 43 per cent of the value of exports in 1960-61. However, the pre-eminent position fothese two countries, particularly the UK has declined considerably since themn. Of course, in the nineties, the USA is emerging as a major trade partner in terms of India's export destination. In 1990-91, exports to the USA accounted for almost 15 percent of the value of exports. This further went up to 18.1 percent in 1993-94.

Table 13.8 : Direction of India's Exports : 1960-61 - 1993-94

(% Share in value).

Countries	1960-61	1970-71	1980-81	1990-91	1993-94
I OECD :	66.2	50.1	46.6	53.5	57.0
1. EEC :	36.2	18.4	21.6	27.5	26.1
- Belgium	0.8	1.3	2.2	3.9	3.0
- Germany	3.1	2.1	5.7	7.8	6.9
- UK	26.9	11.1	5.9	6.5	6.2
2. North America	18.7	15.2	12.0	15.6	19.1
- USA	16.0	13.5	11.1	14.7	18.1
3. Asia & Oceania	10.1	15.2	10.6	10.4	9.1
Japan	5.5	13.3	8.9	9.3	7.8
II OPEC :	4.0	6.4	11.1	5.6	0.7
III Eastern Europe	7.0	21.0	22.1	17.9	3.8
USSR	4.5	13.7	18.3	16.1	2.9
IV Developing Countries	14.8	19.9	19.2	16.8	24.1
Asia	7.0	10.8	13.4	14.3	
V. Others	8.0	2.6	1.0	6.2	4.4
Total	100.0	100.0	100.0	100.0	100.0

Source *: India : Towards Globalisation, UNIDO, 1995.*

Today, India's exports within OECD are not confined to only UK and USA but more evently spread among other countries such as Belgium, France, Germany, Japan, the Netherlans, etc. This implies that India's export penetration Has been diversified among the OECD countries over the period.

The snare of OPEC in India's exports has always been minimum and showed no definite trends over time.

India's export trade with Eastern Europe like that of imports peaked during the '70s and 80s. But since then, due to the factors descibed earlier, exports to the region have declined rapidly. In 1993-94, India exported hardly 4 percent of the value of its exports to Estern Europe, including Russia.

A significant development in the direction of Indias exports, Is the emergence of Asian Coutries as the major buyers, Since 1960-61, the share of Asian coutries inIndia's exports has steadily gone up. the growing economic prosperity in south East Asia and greater trade Co-operation among Asian Countries, particularly South Asian countries, may have contibuted largely to this development

The destination of India's exports and imports has some important implications:

- Deposite relative decline in importance, OECD countries are the majro destination for Indian exports and major source of imports.
- Among the OECD countries, the USA has emerged as the leading trade partner of India.
- The importance of developing coutries, particularly Asia countries as trade partners is growing gradually.
- The trade relations with East European countries incluind Russia have declined drastically since 1990-91.
- Due to P.O.L. imports, the OPEC is an indispensable trade partner but its importance in terms of trade exports is not too disgnificant.
- India's trade relations with South American and african countries are negligible.

Activity 2 -

Develop a bar diagram for India's trade balance on the basis of date provided in Table 13.1 Analyse the factors for its fluctuation.

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13.5 SUMMARY

India's foreign trade has grown remarkably, both in terms of valuae and quantity, since the beginning of economic planning. The policy of industrial and trade liberalisation introduced in 1991 has given a new turn to the growth of both imports and exports. However, imports have always exceeded exports which means that India has become a perennially trade deficit country. India's imports mainly comprise capital goods like machinery and equipment; raw materials and intermediates like P.O.L, iron and steel non-ferrous metals, precious stones, etc. Thuys, India's export composition has transformed with the faster growth of

manufactured goods and the relative decline of agricultural and allied products. But manufactured exports are largely confined to light manufactures. India's imports as well exports have also undergone diversification in terms of destination.

As a result of all these, the share of foreign trade in India's Gross National Product (GNP) has been increasing steadily. But it is still lower than that of East Asian and Latin American countries. The share of foreign trade in GNP in India accounted for 17 percent in 1992 whereas it was 54 percent in South Korea, 36 percent in China and 23 percent in Maxico. Further, the share of India's exports in world exports has been negligible which is the outcome of the lack of competitiveness of Indian goods in the international market. All these show clearly that, despite remarable growth, India has to go a long way in:

- attaining economic self-sufficiency in the form of paying for imports through exports.
- improving the competitiveness of its goods in terms of price and quality to increasingly penetrate the world market
- Diversificaiton of exports, specially in terms of hkeavy manufacturers
- relating foreign trade as major sector of the economy in terms of GNE

13.6 KEY WORDS

(i) **Import Substitution** The process of developing industries to produce those goods which are currently imported with the objective to acquire indigenous capability to produce imported goods and curtail imports.

(ii) **Balance of Trade** (of trade balance Refers to the difference between the values of exports and imports. If the value of imports, the trade balance is said to be positive or favourable. If the value of of imports is more than the value of exports, the trade balance is said to be unfavourable or negative.

(iii) **Negative List** Refers to list of items whose imports are totally banned.

13.7 SELF-ASSESSMENT QUESTIONS

1. Write an essay on why a developing country should engage in foreign trade.
2. Discuss the role and significance of foreign trade for a developing economy.
3. Analyse the major trands in the growth of India's foreign trade
4. "India's imports are more critical and indispensable than exports. Do you agree? Why ?
5. Exporting minerals and agricultural raw materials in the long run may prove counter - productive for the economic development of a country. Do you agree with this statement ? Give reasons to suport your argument.

13.8 FURTHER READINGS

(1). UNIDO, 1995: *India: Towards Globalisaiton*

(2). Government of India: *Economic Society*. Ministry of Finance, 1990-91, 1991-92, 1992-93, 1993-94, 1994-95, 1995-96.

(3) Ministry of Commerce: *Annual Reports*

Reserve Bank of Inida: *Annual Reports.*

UNIT 14 INDIA'S BALANCE OF PAYMENTS

Objectives

This unit familiarises with the

- Definition of Balance of Payments (BOP)
- Components of BOP
- Significance of BOP
- Developments in India's BOP since 1950-51
- BOP crisis in the 90s and subsequent developments, and the
- Issues of Rupee convertibility

Structure

14.1 Introduction

14.2 Financing Payments Deficits: The International Monetary System and Special DrawingRights.

14.3 Importance of Balance of Payments

14.4 India's Balance of Payments : 1950 - 51 to 1996-97

14.5 Exchange Rate and Balance of Payments : Rupee Convertibility

14.6 India's Balance of Payments: Viable or Vulnerable?

14.7 Summing Up

14.8 Key Words

14.9 Self -Assessment Questions

14.10 Further Readings

14.1. INTRODUCTION

The balance of payments of a country is a systematic record of all economic transactio[ns] between the residents of a country and the rest of the world. It is composed of all receip[ts] on account of goods exported, services rendered and capital received by residents an[d] payments made by them on account of goods imported, services received and capit[al] transferred to non-residents or foreigners.

A balance of payments table is designed to summarise a nation's transactions with th[e] outside world. The balance of payments of a country consists of (i) current account, (ii) capital account and (iii) cash account/official reserve assets account. The current accou[nt] component portrays the flow of goods and services in the form of exports and imports fo[r] country during a given year. The capital account shows the volume of private forei[gn] investment and public grants and loans from individual nations and multilateral donor agenc[ies] such as the IMF, World Bank, etc.

The official reserve assets accounts comprise its gold stock, holding of its convertible fore[ign] currencies, and Special Drawing Rights (SDRs). This account is the balancing item [in] response to current and capital accounts transactions. The account will see a declin[e in] terms of foreign exchange reserves i.e., a net outflow of foreign exchange, whenever [total] disbursements on the current and capital accounts exceed total receipts. Thus, the bal[ance] on current account plus the balance on capital account must always be offset by the bal[ance]

on official reserves assest account. If the balance on current and capital accounts is negative, it would represent balance of payments "deficit". But if the balance on current and capital accounts is positive, it would be called a balance of payments "surplus".

14.2. FINANCING PAYMENTS DEFICITS: THE INTERNATIONAL MONETARY SYSTEM AND SPECIAL DRAWING RIGHTS

A balance of payments table for a hypothetical country is presented in Table 14.1. The country has a net negative balance of Rs. 1500 crore on current account. Commodity imports plus payments to foreign shipping firms exceed commodity exports plus payments to Indian Shipping firms by Rs. 1500 crore. On the capital account front, the country experiences a net inflow of Rs.1300 crore. This comprises a net private foreign investment of Rs. 800 crore and a net government and multilateral flows of Rs.700 crore. Thought the gross inflow of government and multilateral assistance was Rs. 1000 crore, this is partly offset by the capital outflow of Rs.300 crore representing debt repayments, consisting of amortisation and interest payment on former loans.

Table 14.1 Balance of Payments : A Hypothetical case.

	Item	Amount (Rs.crore)	
A.	Current Account		
	-- Commodity Exports		2500
	i) Primary Products	1500	
	ii) Manufactured goods	1000	
	- Services (e.g : Shipping costs)		1000
	-- Commodity Imports		1500
	i) Primary Products	500	
	ii) Manufactured goods	3000	
	-- Services		1500
	Balance on Current Account		-1500
B	Capital Account		
	-- Private foreign investment (net)		+800
	-- Government and multilateral flow (net)		+700
	i) Loans	+800	
	ii) Grants	+200	
	iii) Debt repayments	-300	
	Private transfer payment (net)		-200
	Balance on Capital Account		+1300
	Balance on Current and Capital Account		-200
C	Official Reserve Asset. Account		
	Net decrease in official monetary reserves		+200
	Balance on Official Reserves Asset Account		+200

But the net private transfer payment of Rs. 200 crore - monetary outflow of private individuals such as friends and relatives living overseas - bring the balance on capital account to Rs. 1300 crore.

The combined net balance on current and capital accounts is a negative Rs.200 crore. This amount represents the balance of payments deficit of our hypothetical economy.

How to finance this negative balance on combined current and capital accounts?

To offset the negative balance our hypothetical economy can rely on its Central Bank holdings of official monetary reserves. Such reserves consist of gold, convertible foreign currencies (such as US dollar and British pounds) and Special Drawing Rights. International reserves serve for countries the same purpose that bank accounts serve for individuals. They can be drawn on to pay bills and debts; they may increase due to current account or capital account surplus or both.

The balance on current account plus the balance on capital account must always be offset by the balance on official reserves asset account. In the present case of our hypothetical economy, there is a net outflow of Rs.200 crore and accordingly the official monetary reserves declined by the same amount.

A country which is faced with exiting or projected balance of payments deficits on combined current and capital accounts has a variety of policy options. It can seek to improve the balance on current account by promoting export expansion/or limiting imports. A second alternative, though often not exclusive of the first, is to improve the balance on their capital account by encouraging more private foreign investment and seeking more public foreign assistance. Finally, a country can also seek to modify the detrimental impact of chronic balance of payments deficits by expanding their stocks of official monetary reserves. Generally, under the workings of the international monetory system, countries with deficits in their balance of payments are required to pay for these deficits by drawing down on their official reserves comprising gold U.S.Dollars and SDRs.

The SDR owe its origin to the phenomenal growth in the volume and value of world trade. The remarkable expansion of internationalo trade necessitated a new international asset to supplement the limited stock of gold and dollars. Consequently, in 1970 the International Monetary Fund (IMF) was given the authority to create $10 billion of these SDRs. These new international assets perform many of the functions of gold and dollars in settling balance of payments accounts

14.3. IMPORTANCE OF BALANCE OF PAYMENTS

A country's balance of payments reveals various aspects of a country's international economic position. It presents the international financial position of the country. It Helps the Government in taking decisions on monetary and fiscal policies on the one hand, and on external trade and payments issues on the other.

In the case of a developing country, the balance of payments shows the extent of dependence of the country's economic development on the financial assistance by the developed countries.

The greatest importance of balance of payments lies in its serving as an indicator of changing international economic position of a country. The balance of payments is the economic barometer which can be used to appraise a nation's short-term international economic prospects, to evaluate the degree of its international solvency, and to determine the appropriateness of the exchange rate of country's currency.

However, a country's favourable balance of payments cannot be taken as an indicator of economic prosperity nor its adverse or unfavourable balance of payments is a reflection of

bankruptcy. A balance of payments deficit *per se* is not the proof of competitive weakness of a nation in foreign markets. However, the longer the balance of payments deficit continues, the more it would imply some fundamental problems in that economy. Similarly, a favourable balance of payments should not always make a country complacent. A poor country may have a favourable balance of payments due to large inflow of foreign loans and equity capital. A developed country may have adverse balance of payments due to massive assistance given to developing countries.

Thus, a deficit or surplus of balance of payments of a country *per se* should not be taken as an index of economic bankruptcy of prosperity of the country. The balance of payments deals only with the transactions of the period under review. It does not provide data about assets and liabilities that relate one country to others. However, despite all these short comings, the significance of balance of payments lies in the fact that it provides vital information to understand a country's economic dealings with other countries.

Activity 1:

Developing a table of statistics for a hypothetical economy for three consecutive years showing:

(i) Trade surplus, current account deficit, capital account surplus and a decline in forex reserves - in the first year.

(ii) Trade deficit, current account surplus, capital account deficit and a decline in forex reserves - in the second year, and

(iii) Trade surplus, current account surplus, capital account deficit, and an increase in forex reserves - in the third year.

14.4. INDIA'S BALANCE OF PAYMENTS : 1950-51 TO 1996-97

The BOP in the 50s: In the early 1950s when India launched its economic planning, the balance of payments position was more or less comfortable. But in 1951-52, there was a large trade deficit and as a result, despite net surplus invisible transfers and capital account surplus (which was due to long term loans), there was overall deficit on the current and capital accounts, which was met by the official reserves account. In 1952-53 and 1953-54 the net surplus invisible transfers more than offset the trade deficit and capital account deficit. As a result, India experienced current account surplus and net surplus on combined current and capital accounts resulting in an increase in the official reservies position.

In 1954-55, though there was surplus on both current and capital accounts, due to repayments to the IMF, there was outflow from the official reserves account. In 1955-56, there was an inflow into the official reserves account due to surplus current and capital accounts, despite

repayments in the I.M.F (For year by year statistics on India's Balance of Payments see. *Reserve Bank of India: India's Balance of Payments. 1948-49 to 1988-89*. Bombay, July 1993).

But the scenarios changed substantially since then. In the second five year plan, India laid emphasis on the development of heavy and basic industries which necessitated large scale imports of machinery and capital equipments. The consequent trade deficit was much more than the net surplus invisible transfers and surplus capital account. As a result, India resorted to borrowing from the I.M.F. to some extent and and the remaining deficit was met from the official reserves account. Throughout the late 50s, India experience an outflow from the official reserves account towards meeting the balance of payments requirements. As a result, the foreign exchange reserves of the country declined sharply.

The BOP in the 60s : In the early 60s, the situation did not improve. The trade and current account deficits increased sharply due to large scale imports of food grains, machinery and equipments. India sought external assistance in a big way under capital account. I.M.F. borrowings supplemented the loans to meet the current account deficit. On the whole, there was a net outflow from the official reserves account during the first-half of 60s.

Heavy trade deficits, debt obligations and a sharp fall in foreign exchange reserves led to the devaluation of the rupee in 1966. The rupee was devalued against the US dollar by 57.5 per cent. This exchange rate adjustment enabled India to curtail imports and encouraged the growth of exports, However, India continued to have deficits both on trade account and current account. Asa result, there was a substantial increase in external assistance. This enabled, among others, an increase in the foreign exchange reserves of the country in the latter half of 1960s. Throughout the 60s, India had current account deficits and thanks to long term loans, among others, surpluses on capital account front. The foreign exchange reserves could increase at the end of the decade due to these long term loans.

The BOP in the 70s : In the earlym 70s though exports grew more significantly, the larger increase in imports led to continued trade deficits and India had deficits and in terms of invisible transfers (Table 14.2). The combined deficit on the current account forced the country to continue to seek external assistance. In 1973-74, however, the country had a substantial current account surplus.(about Rs. 1135 crore), despite a trade deficit of Rs. 510 crore. This was due to large surplus in terms of invisible transfers. However, amortisation (Rs.2000 crore) caused the country to have large capital account deficit and as a result. there w an outflow fom the feign exchange rserves account to thextent-ofRs. 84 crore.

In 1973-74, the International economy, particularly oil importing countries. experienced the first oil-price hike-shock. This put a severe pressure on the balance of payments of these countries by raising the import bill dramatically. India's trade deficit more than doubled in 1974-75 (Rs. 128 crore) as compared to 1973-74 (Rs, 510 crore). The surplus invisible transfers (Rs.331 crore) could reduce the current account deficit only to Rs.956 crore. As a result, India went for huge external assistance (Rs. 1214 crore) to tide over the balance of payments problems, Substantial external assistance became a regular feature thereafter.

On the whole, the adjustments to the first oil shock of 1973-74 was rendered smooth by a combination of buoyant exports, spurt in private transfer receipts and increased inflow of external aid. Exports, benefited by the expansion in global trade, rose at an annual rate of 6.8 percent in volume terms and by 15.6 percent in US dollar terms during the decade. PRivate transfers rose substantially and in fact, in the post first oil shock period, financed roughly 80 percent of the trade deficit. The utilisation of external assistance was significant and was substantially higher than the financing requirement for the decade allowing for a build up of foreign exchange reserves

	1960-61	1970-71	1980-81
	Rs. Crore	Rs. Crore	Rs. Crore
1. Imports (c.i.f)	1105.7	11826.1	12543.6
a) PL 480 Title I	185.1	49.9	-
b) Others	920.6	1776.2	12543.6
2. Exports (f.o.b)	630.5	1404.5	6576.4
3. Trade balance (2-1)	-475.2	-421.6	-5967.2
4. Non-monetory gold movement (Net)		13.1	
5. Invisibles			
a) Receipts	259.9	496.1	5980.2
b) Payments (of which: Interest and service paymets on loans & Crdits)	177.1 (33. 8)	533.0 (203.8)	1579.6 (282.4)
c) Net	82.8	-36.9	4310.6
6. Current account (net)	-392.4	-455.4	-1656.6
7. Capital transactions			
a) Private			
i) Receipt	51.5	79.9	162.6
ii) Payments	35.0	59.6	65.5
iii) Net	16.5	20.3	97.1
b) Government miscellaneous			
i) Receipt	147.0	323.7	1010.9
ii) Payments	42.0	353.3	1246.8
iii) Net	105.0	-29.6	-235.9
c) Amortisation Payments (Gross)	-37.6	-231.8	-691.3
d) Repurchase from IMF	-10.7	-154.0	-7.5
e) Banking capital (net)	9.7	0.1	12.7
8 Errors & Omissions	-6.3	-66.9	-158.0
9. Total Surplus (+)/Deficit (-) (6 to 8)	-315.8	-907.3	-2639.5
FINANCED B:			
10. External Assistance loans	256.6	743.3	1728.7
11 Drawings from IMF (Gross)			274.3

1960-61	1970-71	1980-81	
	Rs. Crore	Rs. Crore	Rs. Crore
12. Allocation of SDRs		75.4	120.5
13. Decline (+) / increase (-) in Reserves	59.2	88.6	516.0
Total (10 to 13)	315.8	907.3	2639.5

Source : Economic Survey, Part II, 1991-92.

The BOP in the early 80s : During the 80s, issues relating to the balance of payments came to occupy the centre stage in terms of India's macro economic management. The second oil-price hike-shock in 1979 had a far more severe impact on the economy's balance of payments than that of the first shock in 1973-74. The full effects of the second oil shock spilled over into the 80s. Between 1978-79 and 1981-82, imports almost doubled. The increase in petroleum, oil, lubricants (POL) imports accounted for a little over half the increase in the overall imports. This was followed by the second round effects on non-POL imports.

Export performance was depressed by the severe international recesion of 1980-83. Exports grew by about 3 percent, in terms of volume. Net invisible receipts were substantially higher and continued to provide support to the balance of payments. However, the sharply widening trade deficit resulted in an increased current account deficit which reached almost Rs. 3006 crore in 1981-82. External assistance and I.M.F. borrowings together enabled the country to control the balance of payments position.

However, in tthe subsequent three years, the balance of payments pressure eased to some extent, due to a number of factors. There was a decline in the volume growth of imports from an average rate of 11 percent during 1978-82 to a little over 2 percent during 1982-85. This was largely due to a decline in net oil imports which in turn, was due to the discovery of crude oil in Bombay High and the subsequent domestic crude oil production.

However, exports did not grow substaintially due to adverse internal and external conditions. The invisibles account deteriorated as the interest payments to service external borrowing acquired a steady rising trend. Private transfers stagnated with the arrest in labour migration boom. due to all these factors, current account deficit hovered around Rs. 3000 crore during 1982-85. External assistance, I.M.F. forrowings and commercial borrowings together enabled the country to manage the balance of payments position.

The BOP during 1985-90: The latter half of the 80s saw the building up of strains on the balance of payments. Trade deficits and consequently current account deficits increased substantially and remained at high levels throughout (Table 14.3).

Recovering from the stagnation in 1985-86, the volume growth of exports in the subsequent four years ranged between 10 to 12 percent per annum. But imports rose more sharply. The volume of net POL imports increased from 12.4 million tonnes in 1984-85 to 23.5 million tonnes in 1989-90. The fall in international crude oil prices during the period helped to some extent, to contain the oil import bill. On the other hand, non-oil imports increased significantly due to large imports of food grains in 1988-89. Imports of capital goods, defence imports, imports of ships and air crafts etc. and export-related imports also went up.

At the same time, support from invisible receipts fell due to steadily growing interest payments

and outgo on account of profits, dividends, royalolty, technical fees and professional fe[illegible]
The current account deficit averaged around Rs. 7800 crore during 1985-90. The repayme[illegible]
to the I.M.F. during the period put added pressure on the balance of payments. Exter[illegible]
assistance, commercial borrowings and non-resident deposits together made up the balan[illegible]
However, as a result, India's external debt doubled and the debt service ratio rose from 1[illegible]
per cent in 1984/85 to almost 31 per cent in 1989-90.

Table 14.3 : Balance of Payments: 1985-86 to 1989-90

	1985-86 Rs. Crore	1986-87 Rs. Crore	1987-88 Rs. Crore	1988-89 Rs. Crore	1989-[illegible] Rs. Crore
1. Imports (c.i.f)	21163.6	22668.9	25692.5	34202.3	40642.
a) PL 480 Title I					
b) Others	21163.6	22668.9	25692.5	34202.3	40642.4
2. Exports (f.o.b)	11577.6	13315.0	16396.4	20646.7	28229.[illegible]
3. Trade balance (2-1)	-9586.0	-9353.9	-9296.1	-13555.6	-1241[illegible]
4. Non-monetary gold movement (net)	28.5				
5. Invisibles					
a) Receipts	7872.5	8274.[illegible]	9278.5	10926.3	12483.[illegible]
b) Payments (of which Interest & service payments on loans & credits)	4245.0	4750.[illegible]	6275.0	7780.7	9900.[illegible]
	(1371.5)	(1533.3)	(1948.8)	(2560.2)	(3536.2
c) Net	3630.2	3523.9	3003.5	3145.6	
6. Current account (net)	-5927.3	-5830.0	-6292.6	-10410.0	-9823.[illegible]
7. Capital transactions					
a) Private					
i) Receipts	2566.9	3141.4	3880.5	6261.4	9816.2
ii) Payments	2[illegible]2.6	514.2	966.3	2520.7	6191.4
iii) Net	2354.3	2627.2	2914.2	3740.7	3624.[illegible]
b) Government miscellaneous					
i) Receipts	2233.2	5386.9	8499.1	9462.5	12015
ii) Payments	895.8	2060.9	4837.9	3571.[illegible]	615[illegible]
iii) Net	1337.4	3326.0	3661.2	5893.8	58[illegible]
c) Amortisation payments (Gross)	1465.3	-3039.9	-3611.0	-392[illegible]	-3773.
d) Repurchases from IMF	-253.0	-672.3	209.0	1547.[illegible]	-1459.6
e) Banking capital (net)	186.1	-70.1	74.8	-2[illegible]5.2	59.2

		1985-86 Rs. Crore	1986-87 Rs. Crore	1987-88 Rs. Crore	1988-89 Rs. Crore	1989-90 Rs. Crore
8.	Errors and Omissions	580.1	-129.3	947.7	203.4	-720.0
9.	Total Surplus (+)/ Deficit (-) (6 to 8)	-3187.1	-3788.4	-5410.1	-6308.9	-6230.8
FINANCED BY						
10.	External Assistance loans	2481.2	3056.2	4453.9	4859.6	4998.4
11.	Drawing from IMF (Gross)					
12.	Allocations of SDRs					
13.	Decline (+)/ increase (-) in Reserves	706.5	732.2	956.2	1449.3	1232.4
	Total (10 to 13)	3187.7	3788.4	5410.1	6308.9	6230.8

Source: *Economic Survey* 1995-96

The BOP crisis : 1990-92: In 1990, the Gulf crisis led to a sharp increase in oil prices. This led to an increase in the import bill of POL. From an average of Rs. 499 crore per month in June- August, 1990 POL imports rose sharply to Rs. 1221 crore per month in the subsequent six months. There was a steep rise in world oil prices on the annexation of Kuwait, and spot purchases were very costly, which were made to prevent shortages in the domestic market The rise in the cost of Prise imports more than ccounted for the in trade deficit from an average of Rs., 619 crore per month in June-August 1990 to Rs. 1229 crore per month in the subsequent six months.

The situation was aggravated when Indian workers employed in Kuwait had to be airlifted back to India, and their remittances stopped flowing in. The UN trade embargo on Iraq led to the cessation of exports to Iraq and Kuwait.

The Problems on the trade account were compounded further by the developments on the capital account. There was a loss of confidence in the Governments ability to manage the situation. Commercial loans began to dry up. This was accompanied by a net outflow of NRI deposits, which began in October 1990, continued in 1991. The situation got reversed only in January 1992.

All these led to a dwindling of India's foreign exchange reserves. They declined from a level of Rs. 5480 crore at the end of August 1990 to Rs.1666 crore on 16th January 1991. Though emergency borrowings from the I.M.F. provided some temporary relief, the decline in reserves continued unabated. By June 1991, the level of foreign exchange reserves dropped so precipitously that they were barely sufficient to finance imports for a fortnight. A default on payments for the first time in Indian history had become a serious possibility in June 1991.

It was at this juncture that the Government of India introduced measures of fiscal correction and structural reform through radical changes in trade and industrial policies. To finance the balance of payments requirements, Government resorted to borrowings from the I.M.F the World Bank, the Asian Development Bank as well as from bilateral donors In July-

September 1990, it withdrew the reserve tranche (RT) of SDR 490 million. In December 1990, it applied for the first credit tranche (FCT) of SDR 552 million, and negotiated drawals under the contingency compensatory finance facility (CCFF) which totalled SDR 1.352 billion between January and September 1991.

In addition, the Government drew a total of SDR 270 million under the upper credit tranche standby arrangement and a further SDR 461 million by April 1992. A structural adjustment loan of 500 million was drawn from the World Bank. Additional fast disbursing assistance was tied up with the Asian Development Bank and with some bilateral donors. The loss of reseves was thus stopped and from October 1991 onwards there was a steady build up.

With the sharp decline in imports (not in rupee terms but in dollar terms because of rupee currency devaluation) and increase in exports (in rupee terms and not in dollar terms, due to devaluation), trade deficit declined from Rs. 16934 crore/US $ 9438 million in 1990-91 to Rs.6495 crore / US $ 2798 million in 1991-92 (Table 14.4). Due to external assistance and drawals from the IMF, the foreign exchange reserves position improved from 1991-92 onwards. In fact, the dip in foreign exchange reserves was the worst ever experienced by India since independence, particularly in terms of its ability to meet the country's imports and current payments (Table 14.5)

Table 14.4 : Balance of Payments : 1990-91 to 1992-93

	1990-91 Rs. Crore	1191-92 Rs. Crore	1992-93 Rs. Crore
1. Imports (c.i.f)	50086	51418	68863
a) PL 480 Title I	--	--	--
b) Others	50086	51418	68863
2. Exports (f.o.b)	33153	44923	54762
3. Trade balance (2-1)	-16934	-6495	-141(
4. Invisibles			
a) Receipts	13394	23449	23901
b) Payments (of which; interest and service payments on loans & Credits)	13829 (4958)	19191 (6346)	22564 (7395)
c) Net	-435	4258	1337
5. Current account (net)	-17369	-2237	-12764
6. Capital transactions			
a) Private			
i) Receipt	15064	30512	32087
ii) Payments	10710	18490	24599
iii) Net	4354	12022	7488
b) Government miscellaneous			
i) Receipt	18594	13087	19374

	1990-91 Rs. Crore	1191-92 Rs. Crore	1992-93 Rs. Crore
ii) Payments	7383	14963	16250
iii Net	11211	-1876	3124
c) Amortisation miscellaneous (Gross)	-5725	-7365	-9100
d) Rupee Debt Service	-2140	-2785	-2335
e) Repurchase from IMF	-1156	-1127	-868
e) Banking capital (net)	-11[illegible]	-405	2859
Errors & Omissions	237	-301	-246

	1990-91 Rs. Crore	1191-92 Rs. Crore	1992-93 Rs. Crore
8. Total surplus (+)/Deficit (+) (5 to 7) FINANCED BY:	-11721	-4073	-11842
9. External Assistance loans	6095	10715	10173
10. Drawings from IMF (Gross)	3334	3205	4231
11. Allocation of SDRs			
13. Decline (+) / increase (-) in Reserves	2293	-9845	-2563
Total (9 to 12)	11721	4075	11841

Source : Economic Survey, 1995-96.

The BOP : 1992-95 : During 1992-93, with the lift of import curbs, import growth picked up. Since the growth in exports was not that significant, trade deficit, once again, increased both in rupee and dollar terms. The invisibles account recorded a deterioration as travel receipts suffered due to decline in travel arrivals. Private transfers remained more or less stable. On the other hand, there was a rise in the outgo on interest payments, royalties, technical fees and miscellaneous payments. As a result, current account deficit increased from Rs. 2237 crore/US $ 1178 million in 1991-92 to Rs. 12764 crore / US $ million in 1992-93.

Table 14.5 : India's Foreign Exchange Rserves : Historical Perspective

(US & million)

Year	Forex Reserves[1]	Import cover (No. of months)[2]	Current Payments Cover (No. of months)[2]
1950-51	1914	16.8	14.6
1955-56	1648	12.2	10.6
1960-61	390	2.0	1.7
1965-66	383	1.6	1.3
1970-71	584	2.9	2.2
1975-76	1657	3.3	2.9
1980-81	5850	4.5	4.0
1985-86	5972	4.2	3.5
1990-91	2236	1.0	0.8
1991-92	5631	3.2	2.3
1992-93	6484	3.3	2.5
1993-94	15068	7.5	5.4
1994-95	20809	8.0	5.7
1995-96	16317[3]	5.0[4]	3.8[4]

1. a) Excluding Gold and SDRs

   b) Year end level

2. Based on foreign exchange reserves of respective year end levels

3. End January 1996

4. Estimates

Source : *Economic Survey, 1995-96*

During 1993-94. there was a distinct improvement in the balance of payments position . A significant growth in exports the fall in international prices of crude oil and the slack in the growth of non-POL imports resulted in a sharp contraction in trade deficit. The decline in international interest rates also provided a measure of saving in the invisibles account. The market determined exchange rate led to strong growth in remittances. As a result of all these, the current account deficit declined significantly

By this time, thanks to liberalised foreign investment policy, the flow of foreign investment has started increasing. The total foreign investment (which includes direct foreign investment. Foreign institutional investment and Euro equities) Went ukp to US $ 4110 million in 1993-94 from US $ 68 million in 1990-91. US $ 154 million in 1991-92 and US $ 585 million in 1992-93. These, among others, led to substaintial incrase in the foreign exchange reseves

Table 14.6: Balance of payments : 1990-91 to 1994-95.

	1990-91	1991-92	1992-93	1993-94	1994-95
1. Exports	18477	18266	18869	22700	26763
2. Imports	27914	21064	23237	23985	31269
of which : POL	6028	5364	6100	5650	5882
3. Trade Balance	-9437	-2798	-4368	-1285	-4506
4. Invisibles (Net)	-243	1620	842	970	2191
Non Factor Services	979	1207	1128	777	-494
Investment Income.	-3752	-3830	-3422	-4002	-3905
Pvt. Transfers	2069	3783	2773	3825	6200
Official Grants	461	460	363	370	390
5. Current Account Balance	-9680	1178	-3526	-315	-2315
6. External Assistance (Net)	2210	3037	1859	1700	1250
7. Commercial Borrowings (Net)	2249	1456	-358	1252	1029
8. IMF (Net)	1214	786	1288	191	-1146
9. NRI Deposits (Net)	1536	290	2001	940	847
10. Rupee Debt Service	-1193	-1240	-878	-745	-1050
11. Foreign Investment of which	68	154	585	4110	4895
(i) DFI	68	154	344	620	1314
(ii) FII	0	0	1	1665	1503
(iii) Euro equities	0	0	240	1460	1839
12. Other flows	2318	271	-243	1735	1247
13. Capital account total (Net)	8402	754	4254	9183	7072
14. Reserve Use (+decline/ increase)	1278	-3576	-728	-8868	-4757
As per cent of GDP					
Exports	6.2	7.3	7.8	8.9	8.9
Imports	9.4	8.3	9.8	9.4	10.4
Trade Balance	-3.2	-1.1	-2.0	-0.5	-1.5
Invisible Balance	-0.1	0.7	0.2	0.4	0.7
Current Account Balance	-3.2	-0.4	-1.8	-0.1	-0.8

Source : *Economic Survey, 1995-96*

During 1994-95, both exports and imports grew significantly: exports grew by 18.4 percent in US dollar terms and imports by 22.9 percent. The growth in imports was in the line with the expansion in industrial growth and investment activities. The higher grow in imports led to an increase in total deficit from US $ 1285 million in 1993-94 to US $ 4506 million in 1994-95. Invisible payments also rose considerably. As a result, the current account deficit widened from the abnormally low level of US $ 315 million in 1993-94 to US $ 2315 million in 1994-95 (Table 14.6).

The rise in the current account deficit was expected due to the recovery of the Indian economy from recession and there were no financing problems of this deficit either. Total capital flows in 1994-95 were much in excess of financing needs and thus contributed to the foreign exchange reserves buildup. Foreign currency assets of the Reserve Bank of India (R.B.I) increased from US $ 15.07 billion at the end of March 1994 to a historical peak of US $ 20.81 billion at the end of March 1995. Total foreign exchange reserves, including gold and special Drawing Rights (SDRs), amounted to US $ 25.19 billion at the end of March 1995 equivalent to about ten months of imports in 1994-95.

The BOP : Recent Developments : In 1995-96, the buoyancy in export growth was maintained. But import growth was much higher. This led to a further increase in trade deficit which exceeded US $ 8900 million. Thanks to a significant increase in private transfers, the invisible payments increased substantially., Howeever, current account deficit increased to US $ 5434 million in 1995-96.

On the capital account, there was deterioration as the net inflow declined due to I.M.F. repayments, among others. On the whole, there was an outflow of foreign exchange reserves to the extent of almost US $ 3000 million. The foreign currency assets of the R.B.I. stood at US $17.0 billion at the end of March 1996.

The developments in 1996-97 in the balance of payments indicated an easing of pressure on the current account and the buoyancy in capital inflow. There has been not worthy slow down in the growth of both imports and exports. The trade deficit in 1996-97 is expected to be lower than in 1995-96, largely because of a sharp deceleration in the growth of non-petroleum (non-POL) imports. This improvement in trade deficit would be partly offset by an anticipated decline in invisible receipts, reflecting an increase in payments for factor services and some decline in private transfers.

Net Capital inflows in 1996-97 are expected to rise nearly three-fold over the pr[illegible]ear, largely because of buoyant inflows under non resident deposits and foreign investment flow, and a sizable decline in repayments to the I.M.F. The easing of pressure o[illegible] account and buoyant capital flows in 1996-97 resulted in a sizable build up of forei[illegible] reserves. The foreign currency assets of the R.B.I. rose by over US $ 2.8 bil[illegible] $ 19.8 billion at the end of January, 1997.

Activity 2:

Construct a bar diagram showing India's current account balance, capital account balance and forex reserves for the period 1990-95. List the major features.

14.5. EXCHANGE RATE AND BALANCE OF PAYMENTS : RUPEE CONVERTIBILITY

An important factor which influences the Balance of Payments of an economy is the exchange rate of its currency vis-a-vis other major currencies. Therefore, influencing the exchange rate movement is one of the instruments available for correcting the imbalances in the current account. Obviously, besides exchange rate, there are a host of other factors such as world demand, quality of products, marketing skills and supply availabilities which have a bearing on export growth particularly of developing countries. Nevertheless, real effective exchange rate is an important explanatory factor of export growth.

In the 90s. India introduced several measures which have a significant bearing on the exchange rate regime. In July 1991, a correction for over - valuation of rupee through two steps downward adjustment of the rupee was undertaken. Simultaneously, the EXIM Scrip scheme was introduced under which certain imports were permitted only against export entitlement. The Scheme aimed at providing additional incentives to exporters through premium on the scrips as well as establishing a quantitative link between imports and exports.

This was followed by a dual exchange rate management, which entailed the surrender of 40 percent of the exchange earnings at the official rate hereby facilitating the import of Exchange Rate Management System (LERMS). the market performed well equilibrating 60 percent of current receipts which were realised at the market rate of exchange obtained from the market. The market exchange obtained from the market. The market exchange rate remained stable, the gap between official and market rates remained, more or less, around 17 percent. The overall stability in market conditions witnessed during this period enabled the unification of exchange rates later.

Current Account Convertibility

In March 1993 India moved from the earlier dual exchange rate regime to a single. market -determined exchange rate system. Under this system. There is no officially fixed exchange. rate of rupee. Instead. The rate is determined by the demand and supply conditions in the foreign exchange market. The role of R.B.I. is confined to intervening to maintain orderly market condition and to curb excessive speculation.

Despite the shift to market determined system, the rupee-dollar rate remained stable at about Rs. 31.4 for over two years since March 1993. This was mainly due to the large inflow of foreign investments. In fact, if the rupee would have appreciated sharply against dollar in this period. This would have hurt exports and pushed up imports. Therefore, to prevent rupee appreciation R.B.I. Intervened by buying dollars (to the extent of Us$ 13 billion during March 1993 - December 1994) in the market.

The reduction in net capital and the widening of the current account deficit in 1995-96 ended the earlier period of surplus dollar availability. in fact, during the prolonged period of stability of the rupee-dollar rate from March 1993 to July 1995, India's competitiveness in international markets eroded due to higher rate of inflation in India as compared to the major trading partner nations. As a result, Real Effective Exchange Rate (REER) of the rupee appreciated by about 8 percent between 1993-94 and August 1995. Had this erosion of India's competitiveness continued, it would have adversely effected exports, the trade balance and overall balance of payments.

The market-triggered adjustment in the exchange rate which occurred after August 1995 resulted in an exchange rate of . Rs. 36.63 in February 1996. This brought REER of rupee back to approximately the level prevailing in March 1993. Thus, the change which occurred in the exchange rate in 1995-96 corrected the erosion in India's competitiveness and thereby stabilised export growth and contained import growth.

But since then the exchange rate of the rupee against the US dollar recovered to Rs. 34.24 in April 1996. In the subsequent months of 1996 and early months of 1997, the rate moved in the narrow range of Rs. 35.01 to Rs. 35.93. The rupee-dollar rate remained steady although inflation in India was higher than in the major trading partner nations. This, again, resulted in some appreciation of the rupee in REER terms. A depreciation in rupee-dollar exchange rate will therefore, be helpful once again to improve the trade balance and current account balance.

Capital Account Convertibility

The measures taken towards current account convertibility of India rupee and the stability shown by the rupee for a fairly long period of months, with certain exceptions, since 1993 have brought to the fore the issue of capital account convertibility. Convertibility essentially means the ability of residents and non-residents and non-residents to exchange domestic currency for foreign currency without limit, whatever may be the purpose of transactions.

Capital account convertibility is differentiated from current account convertibility. According to Article VIII of the I.M.F. Articles of Agreement. Which defines current account convertibility, "no member shall, without the approval of the Fund impose restrictions on the making of payments and transfers for current international transactions" This implies that, domestic importers as well as foreign exporters should be able to exchange domestic money for foreign currency to settle any transactions involving the purchase of goods and services from abroad.

With the significant changes that have been introduced since March 1993 in India's exchange rate system, India has almost achieved convertibility on current account transactions. However, there are still some restrictions relating to some of the invisible transactions such as travel. To conform to Article VIII of I.M.F.. India has to remove controls on these items.

Capital account convertibility implies movement of funds in and out of the country without restrictions. This kind of regime involves certain risks. The major risk is the possibility of capital flight. Another risk is the possibility of macro economic instability arising from the movement of short term capital movement described as 'hot-money'. A free movement of funds will lead to integration of financial markets. Therefore, an efficient domestic financial system free from administrative restrictions is a pre-requisite for the introduction of capital account convertibility.

However indications towards capital account convertibility have already come. In the Union Budget, 1997-98, the Finance Minister has proposed to constitute a Committee of experts to recommend a fixed time period to introduce capital account convertibility. The achievement of :

- sound economic growth (in the range of 8 to 10 percent per annum)
- efficient macro-economic management. (with negligible fiscal deficit)
- controlled current account deficits, if not surplus ; and
- steady and consistent increase in foreign exchange reserves (in the rangeof US $ 40 to 50 billion)
- will enable India to go for capital account convertibility.

14.6. INDIA'S BALANCE OF PAYMENTS : VIABLE OR VULNERABLE ?

Independent India has twice experienced BOP crisis : in the mid sixties and early nineties. **The second BOP** crisis was more severe in magnitude and impact. Since the crisis years of 1990-91 and 1991-92, India has come a long way. Though the crisis has been overcome steps need to be taken to ensure that such a crisis does not recur.

With the exception of certain years, India has been continuously experiencing huge deficits both on trade and current accounts. The ease with which financing requirements can be met from different sources should not become the basis for incurring current account deficits. In fact, international capital flows are fair weather friends. They begin to reverse and flow back, the moment the economy faces trouble. Therefore, the objective shuld be to contain current account deficit at that level which can be financed by normal capital flows.

To make the balance of payments viable, the key lies in consistently stepping up exports. On the import front, POL will require special attention if the country has to be protected from external-price hike-shocks. Petro products being the dominant import item, measures be taken to augment domestic production. There is ample scope for locating new petro reserves as only 6 out of 26 basins that have potential for oil and gas in India have been explored and that too only partially. Significant and consistent export growth so as to over the growing import bill wil bring a turn-around by removing vulnerability of India's balance of payments.

14.7. SUMMING UP

India's balance of payments position was more or less comfortable in the early 50s. The import of machinery and capital equipments due to the large scale promotion of heavy and basic industries caused a steep rise in trade and current account deficits. The inorase in food grain imports, machinery and equipments further increased the import bill and thereby the deficits on trade account as well as current accunts in the early 60s. This severe strained the balance of payments necessitating currency devaluation in 1966. This does not alter the situation significantly in the immediate future. In the mid 70s, due to the shock, India's trade deficit doubled but the situation could be managed by higher export growth, more invisible receipts and external aid.

However, it was only in the later 80s that pressure started building up on the BOP. The gulf crisis in 19 and subsequent developments caused the worst ever BOP crisis in 1991-92. Though the country has successfully overcome this crisis, a long term strategy is imperative to achieve consistent high export growth, control POL imports, reduce country's dependence on external borrowings to the minimum and thereby achieve a sound BOP position.

14.8. KEY WORDS

Current Payments Current payments represent sum of merchandise imports and invisible payments.

Real Effective cnange Rate (REER) India's index of REER is obtained by adjusting the index of nominal effective exchange rate (using a basket of major currencies) by the differential rate of inflation in India as compared to the major currencies.

14.9 SELF ASSESSMENT QUESTIONS

1. What is balance of payments ? What is its significance ? Discuss its composition.
2. Describe the trends of India's balance of payments during the 50s, 60s and 70s. Analyse the major features and its implicaitons.
3. Evaluate the circumstances which led to the BOP crisis in 1991-92. What lessons can be lead from this crisis? How did India overcome this crisis?
4. What is currency convertibility? what should be the pre-requisites for a country to go for capital account convertibility? Do you subscribe to the view that India should go for capital account convertibility in the near future?

5. Discuss the trends of India's balance of payments since 1991-92. What measures need to be taken as part of a long term strategy to prevent the occurrence of another BOP crisis?

6. Define the terms: balance of trade, balance of invisible transfers, current account balance, capital accoutn balance and balance of payments.

Prepare a write up on the merits and demerits of currency convertibility for a developing economy.

14.10. FURTHER READINGS

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UNIT 15 INDIA'S EXPORT-IMPORT POLICY

Objectives

The unit helps you to understand:

- What is trade policy
- Kinds of trade policy
- Phases of liberalisation in trade policies in the process of economic development
- Trends in India's exim policies
- Salient features of India's Import regime during 1950-91.
- Characteristics of India's export promotion policies, and
- India's Trade policy reform in the 90s.

Structure

15.1 Introduction

15.2 India's Exim Policy: A Backdrop

15.3 The Foreign Trade Regime : Analytical Phases and Changes over Time

15.4 India's Exim Policy : Phases of Changes

15.5 India's Import Regime (1950-89) : Major Features

15.6 Export policies and Incentives (1950-89)

15.7 EXIM Policies in the 90s

15.8 Trade Policy Reforms

15.9 Export-Import Policy (1997-2002)

15.10 Summary Up

15.11 Key Words

15.12 Self Assesment Questions

15.13 Further Readings

15.1. INTRODUCTION

Export-Import (EXIM) policy alternatively known as Trade Policy refers to Policies adopted by a country with reference to exports and imports. Trade Policy can be free trade policy or protective trade policy. A free trade policy is one which does not impose any restriction on the exchange of goods and services between different countries. A free trade policy involves complete absence of tariffs, quotas, exchange restrictions, taxes and subsidies on production, factor use and consumption. Though free trade, theoretically, offers several advantages, in reality particularly underdeveloped countries were at a disadvantage in such a system of

international trade. As a result, in the early 20th century, international economy saw the emergence of protective trade policies.

A protective trade policy pursued by a country seeks to maintain a system of trade restrictions with the objective of protecting the domestic economy from the competition of foreign products. Protective trade policy constituted an important plank in the commercial policies of underdeveloped countries during the 50s, 60s and 70s and to some extent in the 80s. Many of the underdeveloped countries continue to have protective trade policies even today.

Trade policies may be outward looking or inward looking. An outward looking trade policy encourages not only free trade but also the free movement of capital, workers, enterprises and students, a welcome to the multinational enterprise, and an open system of communications. An inward looking trade policy stresses the need for a country to evolve its own style of development and to be the master of its own fate, with restrictions on the movement of goods, services and people in and out of the country. An inward looking trade policy encourages the development in indigneous technologies appropriate to a country's resource endowment. Given these, a developing country may adopt commodity specific trade policies such as the following:

1. **Primary outward looking policies :** Aimed at encouraging agricultural and raw material exports

2. **Secondary outward looking policies :** Aimed at promoting manufactured exports.

3. **Primary inward looking policies :** Objective is to achieve agricultural self sufficiency.

4. **Secondary inward looking policies :** Objective is attaining manufactured commodity self-sufficiency through import substitution

Trade Policy will strongly influence the direction, trand and growth of foreign trade of a country. This, in turn, will have a bearing on the economic development process. Therefore, trade policy is an important economic instrument which can be used by a country. with suitable modificaitons from time to achieve its long-term objectives.

15.2. INDIA'S EXIM POPLICY : A BACKDROP

India's experience of the colonial past had a major influence on exim policy in the initial decades after independence. India's strategy towards trade policy was driven by perceived foreign exchange scarcities and the desire to ensure that scarce foreign exchange is used only for essential pursposes for economic development. Industrialisation and self-sufficiency in essential commodities were the important objectives of India's trade policy. This was because it was felt that dependence on other, more powerful countries for imports of essential commodities would lead to political dependence on them as well.

This was succinctly brough out by the National Planning Committee (NPC) in 1946 set up by the Indian National congress, under the Chairmanship of the late Jawaharlal Nehru.

> "In the context of the modern world, no country can be politically and economically independent, even within the framework of international interdependence, unless it is highly industrialised and has developed its power resources to the utmost. Nor can it achieve

or maintain high standards of living and liquidate poverty without the aid of modern technology in almost every sphere of life. An industrially backward country will continually upset the world equilibrium and encourage the aggressive tendencies of more developed countries. Even if it retains its political independence, this will be nominal only and economic control will tend to pass to others".

Earlier the NPC had said that, "The obejctive of the country as a whole was the attainment, as far as possible, of national self-sufficiency. International trade was certainly not excluded, but we were anxious to avoid being drawn into the whirlpool of economic imperialism".

These laid the broad framework for the formulation of EXIM policy in the subsequent years. On the whole, import substitution and protection to domestic industrialisation through a system of tariff and non-tariff controls became the highlights of India's EXIM Policy for most of the period during 1950-51 to 1990-91. Since 1990-91, however India's exim policy has undergone remarkable liberalisation, as part of the overall economic liberalisation process.

15.3. THE FOREIGN TRADE REGIME: ANALYTICAL PHASES AND CHANGES OVER TIME

J.N. Bhagwati and A Krueger, in their comparative analysis of the impact of foreign trade regimes and economic development in a number of countries, defined a set of analytical phases with reference to the EXIM policy of a country. These phase in the foreign trade regime were designed essentially as a classificatory and descriptive device to capture meaningfully the evolution of foreign trade regime in terms of its restrictionist content and the dimensions and pattern of its use of control and price instruments. There are broadly five phases which are as follows:

Phase I: Characterised by the systematic and significant impostion of quantitative restrictions (QR). It might start in response to an unsustainable balance of payments deficit. Throughout Phase I, controls are generally maintained and often intensified.

Phase II: Characterised by continued reliance upon quantitative restrictions and generally increased restrictiveness of the entire control system.. Phase II is distinguished by two additional and related aspects of the QR system, both relatively unimportant during Phase I:

(1) The detailed workings of the control system become increasingly complex, and (2) Price measures, are adopted to buttress the functioning of the control system. Both these characterstics of Phase II arise from dissatisfaction with the results of an undifferentiated system and are often the result of many small decisions rather than an overall policy design.

Price measures are introduced to both exports and imports. The continuation or intensification of foreign exchange shortage leads to the recognition that additional export earnings would be desirable. Rebate schemes, import replenishment schemes, special credits for exporters, and a variety of other devices may be instituted that offset part of all of the discrimination against exports implicit in an overvalued exchange rate. As for imports, price measures are also adopted to absorb part of the excess demand for imports. Tariffs may be increased or surcharges added to the cost of importing.

The following aspects of the price situation in Phase II are then evident: (1) the exchange

parity is overlaid by tariffs and subsidies, levied in lieu of formal parity change, (2) domestic currency is overvalued at the current parity plus trade tariffs and subsidies, implying a premium on imports.

Phase III: In this phase, attempts are made to systematise the changes introduced during the previous phase: It may consist of a mere "tidying -up" operation directed at replacing the diverse import premiums by reasonably uniform tariffs such that the differential incentive effects caused by diverse premiums on different imports are greatly reduced or virtually eliminated.

Alternatively, the tidying-up operation may replace the existing tariffs and export subsidies with a formal parity change, the result being that the effective exchange rates on exports and imports do not change much but the dispersion of tariffs is replaced by uniform devaluation.

On the other hand, Phase III may take the form of a devaluation cum liberalisation package. Such a package may have a gross devaluation large enough to leave a net devaluation despite the removal of trade tariffs and subsidies, and measures of import liberalisation.

Phase IV: The continued liberalisation in Phase III leads to the emergence of Phase IV. There will be consistent decline in QR and import tariffs. The efffective exchange rate for exports will come closer to the effective exchange rate for imports.

Phase V: The transition into Phase V occurs when the excnange regime is virtually liberalised. There will be full convertibility on current account and quantitative restrictions will not be employed as a means of regulating the balance of payments. Thus, Phase V represents a total alternative to the QR regimes of phases I and II. The pegged exchange rate will be at its equilibrium level and a flexible exchange rate policy will be in operation.

The application of these phases to the exim policies of India since independence would help to understand the policy developments in a proper perspective. Recently, T.N. Srinivasan has applied these phases for India's exim policy for the period ranging from 1950 to 1992.

Acitivity 1

Development a case study for a hypothetical developing country which could pass through Phase I to Phase V (Analytical phases of Bhagwati and Krueger) in its foreign trade regime, in the process of economic development.

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15.4. INDIA'S EXIM POLICY : PHASES OF CHANGES

In the early fifities (1950-56) there was a rough equlibrium in the balance of payments, with import demand more or less equalling export earnings. During this period , there was no clear exim policy and import restrictions of any kind were not in use. The conditions were, more or less, similar to Phase IV.

In the second half of the fifties (1956-61), due to heavy industry oriented industrial planning, the rapid rise in imports put pressure on India's balance of payments. The Government imposed quantitative restrictions on imports. The quantitative restrictions were selective so as to encourage the development of particular industries through import licenses. Import substitution was stimulated while exports were not considered a line of activity to be stimulated. Thus, this period resembled the characteristics of Phase I.

In the early sixties (1961-66) quantitative restrictions for imports continued. At the same time, efforts were made to boost exports by creating a favourable atmosphere to export industries, diversification of export markets and the development of export support services. Export subsidisation was introduced in 1962 primarily to offset the penalties that quantitative restrictions imposed, in effect, on exports. This period could be classified under Phase II.

The economy entered Phase III in the second half of the 60s (1966-68) with a devaluation in June 1966 to systematise and rationalise the export incentive system. At the same time, export subsidies were reduced, export duties imposed, and import duties were reduced. The net devaluaiton after allowing for these changes was, on an average, less than the gross devaluation of 57.5 percent and varied among commodities. According to Bhagwati and Srinivasan, th total net devaluation on the trade account was 21.6 percent for exports and 42.3 percent for imports. Consequently, the net effect was a further timultation of import substitution over export production.

At the end of sixties up to the mid seventies (1968-75) the hesitant steps towards liberalisation intoduced with devaluation were abandoned. The country moved back to Phase II. Export subsidies were reinstated and augmented. Import policy became increasingly restrictive and complex. This was due to various shocks which the economy experienced such as (1) refugee inflow due to Bangladesh war in 1971 (2) stagnant agricultural production resulting out of adverse weather conditons, (3) oil-price hike shock of 1973, etc.

The scarcity of foreign exchange became more acute. A new set of restrictive measure for imports was introduced every year. Import allocation criteria became more complex Tariff rates escalated gradually.

The foreign exchange reserves position improved in the latter of the 70s, due to

★ increased remittances from Indians working in West Asia

★ imporoved agricultural production; and

★ decline in public investment.

The net result was a relaxation in the severity of import control regime during 1975-85 signifying the re-entry into Phase III. Import allocation rules were made simpler. Protective quotas, however, remained intact and domestic industry continued to be completely shielded from import competition.

In April 1985, in a significant departure, the Government announced new Export-Import Policy for a period of three years. The obejctive was to bring some stability to the policy and thereby reduce the uncertainty about year to year changes that exporters and importers faced. However, in reality, this did not restrain the Government from announcing chang in the exim policy from time to time.

Although the stringency of the import regime did not dilute substantially, the two three-year policies (i.e. Exim policies of 1985-88 and 1988-91), did represent some major simplifications. In particular, the number of items in the category of Open General Licence (OGL) for capital goods imports icnreased form nil in 1975 to over 1,100 items in the 1988-91 policy. Similarly, many intermediate goods were put in the OGL category. Thus policy changes that occurred in the latter half of the 80s till 1991 (1986-91) characterised the continuance of Phase III, which began in 1975.

However, it was since 1991 that radical changes were introduced in India's exim policy. There has been a gradual and steady curtailment of import tariffs and liberalisation of quantitative restrictions. The rupee has been made almost fully convertible on the current account. There are indications that the rupee will be made convertible on the oapital account within a definite time period. All these signify that India has entered Phase IV with regard to the foreign trade regime.

Broadly, India's trade policy can be aggregated into essentially two categories:

(i) Those that are associated with inducing import substitution as well as those that are import repressive or import rationing, and

(ii) those that influence the level and composition of exports of goods, and services.

15.5. INDIA'S IMPORT REGIME (1950-89): MAJOR FEATURES

India's import regime had two major kinds of protective barriers: (i) Non-tariff controls and (ii) tariffs.

Non-Tariff controls : Non-tariff controls were the principal means of regulating imports and protecting local industries. These controls till the 90s included the (a) import licensing system, (b) canalisation, (c) actual user policy and (d) phased manufactured programmes.

a) **Import Licencing System :** This system divides imports into three categories:

1. Consumer goods
2. Capital goods
3. Intermediate raw materials, components, spare parts and supplies.

Imports of consumer goods are generally banned, excluding those which are imported by canalising agencies of the Government. These products may be judged by the Government as essential on the grounds that they are not produced locally or domestic production is insufficient to meet the local demand e.g: Edible Oil, certain drugs and medicines, kerosene and food grains.

Capital goods are divided into a "restricted category" and an "Open General Licence" (OGL) category. OGL capital goods can be imported without a licence, provided the importing firm is the actual user of the machinery. An import license is requried for the import of any item on the restricted list and also for any item not on the OGL list, even if it is not on the restricted list.

Finally, intermediate goods imports are divided into banned, restricted, limted permissible and OGL categories, Intermediate goods that are not on the first three lists, nor on the separate lists of canalised items, could be imported without a licence.

b) **Canalisation :** Canalising agencies are another means through which the Government exercises control over imports. These organisations are the sole importers of products listed in the EXIM Policy. The most important canlised products and the respective agencies are given in Table 15.1.

Table 15.1 Canalisation : Items and Agencies:

Item	Canalising Agency
1. Crude Oil, and Petroleum Products	Indian Oil Corporation (I.O.C)
2. Iron and Steel, non-ferrous metals and fertilisers	Minerals and Metals Trading Corporation (M.M.T.C.)
3. Edible oils, natural rubber, Sugar, news print, and Cement	State Trading Corporation (S.T.C)
4. Scrapt Metal	Metal Scrap Trading Corporation (M.S.T.C)
5. Cereals	Food Corporation of India (F.C.I)
6. Cotton	Cotton Corporation of India (C.C.I)

Canalised imports account for a significant share in total imports including Petroleum, Oil and lubricants (P.O.L). Policies on the importing, pricing and distribution of the the most important canalised products are determined and supervised by the concerned iministries or departments and others by two committees chaired by the Chief Controller of Imports and Exports. The activities of the canalising agencies are an integral part of the system of non-tariff discretionary controls over imports.

c) **Actual User Policy :** This policy disallows imports for resale by excluding intermediaries from importing. This policy was introduced in the early 70s and became complete in April 1977 with the abolition of the category of "Established Importers" who were earlier

eligible for import licenses. As per this policy, only the actual user of a capital good or intermediate products be allowed to import such goods, through import licenses.

d) **Phased Manfucaturing Programme (P.M.P.) :** As per PMP, the concerned firm agrees to progressively replace imported materials, parts and components with materials, parts and components produced in-house or by other Indian firms. The PMPs acompany industrial licences in a wide range of industries involving assembly of parts and components notably, vehicle, machinery and electronics industries

In order to ensure that a firm sticks to PMP, the import of all parts and components by that firm requires prior clearance by the sponsoring authority for the industry, which attests that the imports are not included in the list of products and should be locally sourced under the PMP. The PMP procedures, therefore, amount to a separate set of quantitative import controls which apply to many intermediate products, including those which appear on OGL lists, and which in theory are importable without restricitpn. Moreover the controls continue to remain in force, since once the required level of indigenisation is achieved, surveillance continues to ensure that firms do not reduce the agreed indigenisation levels.

Tarrifs: The tariffs consist of:

a) basic customs duties, mostly *ad valorem*, applied to the c.i.f. price of the import.

b) an auxiliary duty applied to the c.i.f. price, and

c) additional duties equivalent to excise taxes imposed on locally produced products, applied to the c.i.f. price plus the basic customs duty and auxiliary duty.

The basic *ad valorem* duties range from zero to 300 percent; the general auxiliary duty is 40 percent. The tariff schedule appears very simple, with quite uniform basic customs duties. But in practice, tarif based protection is extremely complex, owing to a large number of exemptions for various products for all three components.

It is difficult to genralise the level and structure of tariffs because of various kinds of exemptions. However, the general level of duties was extremely high absolutely as well as relatively, before allowing for exemptions, (Table 15.2).

Table 15.2 : Tariff levels in India and other Developing Countries (Nominal Tariff Rate, 1985).

(% of value)

Country	Intermediate Goods	Capital Goods	Consumer Goods	Manufactured Goods
Hungary	14.2	15.0	22.6	20.9
Yugoslavia	18.0	20.7	20.0	19.0
Argentia	21.2	25.0	21.9	22.9
Morocro	21.6	18.1	43.0	27.3
Phillippines	21.8	24.5	39.0	28.0
Mexico	25.5	23.5	32.2	24.7
Thailand	27.8	24.8	8.5	33.6
Turkey	29.4	54.9	55.3	37.1
Pakistan	75.0	73.8	127.3	89.8
China	78.9	62.5	130.7	91.2
Bangladesh	97.9	80.5	116.1	100.8
India	146.4	107.3	140.9	137.7

Source: *"India Survey"*, *The Economist*, May 4-10, 1991

Indian tariffs were much higher than tariffs in other developing countries: average Indian tariffs for intermediate, capital and consumer goods as well as for manufactured goods as a whole were much higher than in other countries.

15.6 EXPORT POLICIES AND INCENTTIVES (1950-89)

Exports are subject to a licensing regime to serve a variety of objectives. A number of primary and some manufactured products are subject to export restrictions of varying intensity so as to control domestic prices. The export controls are also used to implement canalisation of some exports, to regulate exports of products subject to quotas in importing countries, to ensure minimum export prices etc. However, the main thrust of export policies has been to promote and not to restrict exports. Further, since 1976, exports taxes which were previously applied to 25 commodities were steadily removed.

In addition, the Government had recognised that manufacturers exporting to the highly competitive world market would have to be provided incentives to offset the higher cost and other disadvantages of operating in the protected and controlled domestic market. Accordingly, a wide vaiety of export incentive and institutions have been established.

Indian Policy incentives to promote exports can be broadly classified as under:

1. Special facilities to make the material inputs needed by exporters available, at reduced cost.
2. Free Trade Zones and Export oriented units.
3. Facilities for making capital equipments available, at reduced rate
4. Incentives for and assistance with export marketing
5. Profit tax and credit subsidies and
6. Subsidies on Domestic raw materials.

Over a period of time, the Government has steadily increased and extended these incentives.

1. Special Facilities for Material Inputs

Availability of qualitative raw materials in sufficient quantity and at the right time, at competitive prices, is crucial for export growth. In India, this was ensured through special import licences for exporters (known as replenishment (REP) and imprest licences) combined with duty drawback and east compensation.

The REP and imprest licences allow the exporter to import certain restricted raw materials and components, upto a specified percentage of specified exports. The imports pay normal customs duties, but refunds can be claimed through the duty drawback scheme.

Impresst licences are issued on the basis of export contracts or on past export performance, and the materials must actually be used in exports REP licences are issued against actual exports after they have taken place, and to the extent that imported materials are not required, the REP entitlement can be legally sold on the open market.

The duty drawback scheme allows the refund of excise, sale and other indirect taxes (apart from customs duties) included in the cost of domestically purchased raw materials. This is supplemented by the cash compensatory support (CCS) scheme, which compensates the export for other domestic taxes such as excise duties and sales taxes included in the cost of electricity.

Import-Export Pass Book

The scheme which was introduced on 1st January 1986, continued by EXIM policy, 1988-91. Its aim was to streamline the import procedures for exporters by providing duty-free

access to imported inputs for exporters of manufacturers. The scheme was wider in scope and more flexible than the previous advance licensing scheme.

Imports used for export production were exempted from customs duty as well as from additional duties on imports for an exporter holding Import Export Pass Book including import license. The pass book is applicable only to registered manufactured exporters

2. Free Trade Zones and Exports Oriented Units (EOU)

Free Trade Zones or Export Processing Zone (EPZs) and EOUs are the other means which Govenment has adopted to promote exports.

The rationale for establishing EPZs is that export production can be initiated without adjusting or transforming the regime of protection for companies producing for the domestic market. EPZs are treated as operating outside the domestic tariff area, and hence have the right to import all their requirements, including capital goods and spare parts as well as raw materials, free of import licensing controls and import duties.

India was the first developing country to establish an EPZ. In 1965, one such zone was established in Kandla while in 1974 a second zone was set up - the Santa Cruz Electronic Export Processing Zone (SEEPZ) near Bombay. In 1983, a decision was taken to create four more EPZs, which came up subsequently: Madras, Kochi, Noida, near New Delhi and Falta, Calcutta.

An EPZ creates a free trade environment allowing for duty free imports of capital goods and intermediate inputs and tax free exports of manufacturers. It overcomes the problem of administrative control and bureaucratic intervention. Ultimately, the obejctive is to attract foreign companies to establish export units.

The Export Oriented Units (EOU) scheme was implemented in 1981 to provide duty-free access to imports of all inputs for such export oriented companies and to create a single point clearance with regards to industrial licencing and foreign collaborations. A company is required to fulfill three conditions to be eligible as an EOU:

(a) its output should entirely be exported,

(b) the domestic value added content of the export value should be 20 percent at least : and

(c) export production should be under custom bond for 10 years for products facing rapid technological change.

The contribution of EPZs and EOUs to India's exports, however, is only limit and has not made any significant progress either

3. Availability of Capital Equipments at Reduced Rates

The liberalisation of imports of capital goods and associated tariff reductions was introduced in 1976. The objective was to make specialised and upto-date machines available and less expensive for export oriented industries such as leather, garment, hosiery, seafood, woolen, textile and diamond processing industries. In 1986, the policy was broadened to other export potential industries.

4. Export Marketing

From an early stage, Government has recognised that marketing of exports is generally a more difficult task than selling in the domestic market. Many small and medium firms and even many large firms, by Indian standards, may not be able to market their products on their own, in the international market. Therefore, the Govenment allowed for the first time in 1960, the coming up of export houses. In 1981, in emulation of Japan and South Korea, it encouraged the development of larger trading houses.

In 1963, an Export Inspection Council (EIC) was established whose function is to conduct

pre-shipment inspection to prevent the export of inferior quality products.

Over a period of time, the Government has also promoted 18 industry specific Export Promotion Councils: Apparel Export Promotion Council'- to promote garment exports, Engineering export Promotion Council - to promote engineering goods exports, etc. The Trade Development Authority (TDA) and Trade Fair Authority of India (T.F.A.I) were the other agencies promoted by the Government for export promotion. [In 1994, T.D.A. and T.F.A.I. were emerged to form Indian Trade Promotion Organisation (I.T.P.O.)]. All these fall under the purview of the Ministry of commerce.

5. Profit Tax and Credit Subsidies

Exporters had received. in one form or another, profit tax concession since the early 1960s. There were also provisions for preferential pre-shipment and post-shipment credit. The formation of EXIM Bank in the early 80s marked another significant development towards improved financial flow for exporters. Export credit guarantees for banks and credit insurance for exporters are available from the Export Credit Guarantee Corporation (ECGC).

6. Subsidies on Domestic Raw Materials

There are also schemes for refunding to exporters the difference between the domestic and world prices of Indian materials. The most important is the International Price Reimbursement Scheme (IPRS) for steel. The scheme was introduced in 1981. In 1986 this scheme was extended from basic steel products to alloy steels. There are also similar subsidy schemes, i.e.. for other import raw materials such as aluminium and copper.

Performance of EXIM Policies (1950-1989)

A review of the main elements of India's system of import controls and export incentives shows that in the course of time, the exim policies have undergone fluctuations in terms of stringency for import control, and have become increasingly comprehensive for export promotion. Of course, this does not mean that the policies have become fully effective in terms of the stated objectives.

The shrinking share of India's exports in world exports. the relatively low share of India's trade in GDP. widening trade deficit, growing external debt, continued deficits on current acount which, in turn, among others, led to the balance of payments crisis in 1990/91 etc., show that India's exim policy till the 90s, did not make any significant contribution to the growth of its external sector on desired path. India could neither achieve self-sufficiency nor could its industry become internationally competitive. Industry suffered from technological obsolescence and high cost due to prolonged protection from both internal and external competition.

15.7 EXIM POLICIES IN THE 90S

EXIM Policy, 1990

After terminating the Exim Policy for 1988-91 a year in advance, the Government announced on 30th April, 1990 a new Exim Policy. The Policy statement said: "Improvement in our Balance of Payments position can be achieved not so much through import curtailment as through promotion of exports". The policy provided further momentum to exim policy liberalisation.

1. The OGL list was explanded to facilitate easy access to import of items, not available within the country.
2. A scheme of automatic licensing was introduced under which upto 10 percent of the value of previous year's license could be imported.

3. A scheme of Star Trading House was introduced for exporters with an average annual net foreign exchange earnings of Rs. 75 crore in the preceding three licensing years of the base period. Star Trading Houses are eligible for grant of special additional licenses calculated at the rate of 15 percent of net foreign exchange earned in the preceeding year.

4. Under the Duty Exemption scheme, Blanket Advance Licensing has been introduced for manufaturer-exporters having a minimum foreign exchange earnings of Rs. 10 crore in the previous three years.

5. The Import-Export Passbook Scheme introduced in 1986 was withdrawn.

EXIM Policy Changes in 1991

In response to the balance of payments crisis in 1990/91, India launched a programme of economic reforms in June 1991. The economic reforms comprised wide ranging changes in trade policies, apart from industrial policies, etc.

High tariff walls and strict import licensing resulted out of the earlier policies had produced a domestic cost structure which was out of line with the world prices. To redress this situation and to augment exports which is crucial to the medium term recovery of the economy, adjustments in the exchange rate of rupee were effected twice in July 1991. These adjustments are aimed at improving India's competitiveness the world market and thereby boost exports. These exchange rate policy changes were followed by structural reforms in trade policy aimed at substantial liberlisation of controls and licenses, decanalisaiton of many items of trade, reduction in peak tariff rates, abolition of export subsidies and other measures.

It was during July-August 1991 that the Government announced for reaching changes in trade policy. These policy changes aimed at strengthening export incentives, eliminating a ubstantial volume of import licensing and optimal import compression. Essential imports of sensitive items (Such as POL and fertilisers) were fully protected, but other imports of raw materials and components were linked to export performance through enlargement and restructuring of the replenishment licensing system. The system of cash compensatory support was abolished consequent upon the change in change rate and other measures of reform which provided substantial incentives for exports across the board.

The major policy change introduced are:

1. The new trade policy made major changes in the import licensing system by replacing large part of administered licensing of imports by import entitlements linked to export earnings. The import replenishment system was enlarged and restructured and renamed as Eximscrips. Eximscrips are freely tradeable and the premium on the scrips, set by the market, represented a further incentive to exporters and means of allocating imports according to market forces.

2. The system of advance licences, designed to provide exporters with duty free access to inputs, was strengthened further by simplifying and speeding up the process of issuing these licenses.

3. The procedure for import of capital goods was simplified following the Industrial policy, 1991. New units and units undergoing substantial expansion would be automatically granted licenses for import of capital goods without any clearance from the indigenous availability angle, provided their import is fully covered by foreign equity or the import requirement was upto 25 percent of the value of plant and machinery subject to a maximum of Rs. 2 crore.

   Import of OGL capital goods, non-OGL capital goods and Restricted goods would be allowed without specific licence, provided clearance was given by the R.B.I. and foreign exchange for their imports are fully covered by foreign equity.

4. Foreign equity upto 51 percent in Trading Houses permitted. with all the benefits available to domestic exports and trading houses.

5. The new trade policy aimed at progressive decanalisation. The Government decontrolled 116 items allowing their exports without any licensing formalities. Another 29 items shifted to OGL. In the case of imports, 6 items decanalised and placed on OGL while 16 items decanalised and listed in Appendix 3, where they will be available for import against Eximscrips.

6. Since EPZs/EOUs have not taken off as expected, the policy introduced several changes to promote them further A significant new policy measure was that Domestic Tariff Area (DTA) sales was permitted in the ratio of 25:75 in relation to export sales in case of units whose use of indigenous raw material is more than 30 percent of production. In all other cases, the ratio of permissible DTA sales to export sales will be 15:85. By another policy measure, the International Price Reimbursement Scheme (IPRS) for supply of steel was extended to EPZs and EOUs.

7. The new policy abolished the Actual User requirement in respect of OGL capital goods and OGL raw materials and components.

8. The phased Manufacturing Programmes was abolished for new projects, and subsequently, for existing project as well.

9. The trade policy indicated that customs duties would be reduced overtime, in tandem with improvements in the fiscal and balance of payments position. The peak tariff rates were reduced to a maximum of 150 percent from as much as 300 percent or more and a moderate across the board reduction in tariffs on capital goods imports.

EXIM Policy, (1992-97)

On 31st March 1992 a new five year export-import policy was announced. This gave a further push to liberalisation by freely allowing imports of all items except a negative list decanalising a large number of raw materials and further liberalisinα import of capital goods against export obligation:

--- Import of all items including capital goods are freely allowed. The negative list will contain consumer goods, baering 28 specific items, and 70 other items, whose imports would be restricted.

--- Import of a number of items including newsprint, non-ferrous metals, nastural rubber, intermediates and raw materials for fertilisers decanalised. Petroleum products, edible oils, fertilisers and cereals continue to be on the canalised list.

--- Exports of all items are free except a negative list.

--- The scope of duty exemption scheme has been enlarged by introducing value based advance licences besides the quantity based advance licences.

--- Export houses, trading and star trading houses to be eligible for self certification under the advance licence scheme which permits duty free imports for exports.

--- The export promotion capital goods (EPCG) scheme liberalised further. Under the scheme, import of capital goods was permitted as 25 percent import duty subject to export obligation of three items the C.I.F. value of imports to be achieved over a period of four years.

--- Keeping in view the important role played by the export promotion councils, exporters will continue to register themselves with the bodies. The registration - cum-membership certificates (RCMG) will continue to be an essential requirement for any importer or exporter to avail the benefits or concession or to apply for any license.

--- Under the new policy, certain categories of exports and exporters are eligible to receive special import licences.

--- A significant aspect of the new policy is that amendments will be made once a quarter.

Thus the Exim Policy (1992-97), further accelerated the process of trade policy reforms.

EXIM Policy Changes (1992-93)

1. Liberalised Exchange Rate Mangement System (LERMS)

A new system of exchange rate managment was introduced. As per this systen rty perent of the proceeds of exports and inward remittances was purchased at the o...ial exchange rate by the Reserve Bank of India (R.B.I) for official use. All other receipts and payments are converted at the market exchange rate. Receipts and payments on capital account continued to be subject to controls.

Imports under advance and imprest licences and replenishment imports against gems and jewellery exports were paid at official exchange rate to the extent of 40 percent of the import value. R.B.I. can enter the free market and intervene at its discretion. EPZs and EOUs were allowed to convert all their exchange earnings at the market rate.

The foreign exchange surrendered at the official exchange rate was utilised to import essential items. All other imports of raw materials, components and also capital goods are made freely importable on OGL but foreign exchange for these imports has to be obtained from the market.

The new system was introduced as a transitional arrangement towards a unified exchange rate with current account convertibility. The system simplified the trade policy by eliminating detailed exchange control.

2. Import Licensing Liberalisation

The introduction of LERMS led to abolishing eximscrips as LERMS made all capital goods raw materials and components freely importable subeject to tariff protection and the imports have to be paid by obtaining foreign exchange from the market. In April, 1992 the negative list of licenceable imports was pruned substantially: three import items banned, 71 items restricted and seven items canalised.

Under the new system, exporters benefited fromt hehigher market rate obtained bysurrendering 60 percent of the foreign exchange earned at market rates instead of the premium earlier available in eximscrips.

3. Export Promotion Capital Goods (EPCG) Scheme

The scheme was further liberalised to allow imports of capital goods at a lower concessional customs duty of 15 percent subejct to an export commitment equivalent to four times the C.I.F value of imports to be achieved over a period of five yea

4. Improvements in Advance Licensing

A system of value based advance licences has been introduced. This permits duty free imports of necessary raw materials and components upto a stipulated percentage of the value of indicated exports. Physical quantities and norms are not laid down for individual inputs. Self-certificaiton advance licences are available for Export Houses, Trading Houses and Star Trading Houses.

5. EPZs /EOUs

These schemes have been liberalised and extended to agriculture, horticulture, acquaculture, poultry and animal husbandry. EPZ units and EOUs can sell upto 25 per cent of their output in the domestic market on payment of duty and as long as the product is allowed to be imported.

6. Special Import Licences (SILs)

Certain categories of exports and exporters are eligible for SILs in order to enable them to import specified items which are on the restricted list. These licences would be freely tradable in the market.

7. Tariff Rationalisation

The Government, following the recommendations of the Tax Reforms Committee, reduced the peak level of tariffs to 150 percent in 1991-92 and further to 110 percent in 1992-93. Further import duties on capital goods, project imports, basic feed stocks for petro-chemicals etc., were brought down.

Thus, the trend of trade liberalisation gained further momentum by 1993.

EXIM Policy Changes (1993-94)

In 1993-94, the EXIM Policy gave a new thrust to exports for agricultural and allied sectors, and services in which the country has comparative advantage. Further reduction in customs duties, decanalisation, pruning of negative lists, expansion of the definition of capital goods, etc. are the other major features:

--- Import of Kerosene oil. Liquid Petroleum Gas (LPG), Low sulphur heavy stock low sulphur waxy residue amongst petroleum products and phosphatic and postassium fertilisers are decanalised.

--- EOUs enngaged in agriculture and allied activities permitted to avail duty -free capital goods imports, even if they export only 50 percent output.

--- Negative list of exports pruned by removing 146 items.

--- A new EPCG scheme intorduced for the services sector which permits import of capital goods at 15 percent import duty.

--- Definition of capital goods enlarged to include sectors like agriculture, mining and services, apart from manufacturing

--- Change in the criterion for recognition as an export or trading or star trading house from net foreign exchange earned to gross f.o.b. value of physical exports. The award of Special Import Liciences for these houses as well as for the electronic sector will also be based on this criterion.

--- The maximum import duties werre reduced from 110 percent to 85 percent. There were substantial reductions in customs duties on capital goods, ferrous and non-ferrous metals and chemicals.

--- But the most significant develdpement was the step towards current account convertibility taken in March 1993. The transactions on trade account were freed from exchange contorl. The determination of the exchange rate of the rupee was left to the market.

Thus exim policy changes in 1993-94 gave a further fillip to the liberalisation process of trade regime

EXIM Policy Changes (1994-95)

To promote exports and simplify import procedures, the following measures were taken during 1994-95:

--- Third party exports were given benefits under EPCG scheme

--- Scope of items importable under the special Import Licenses (SILs) was increased.

--- A new category of super star Trading Houses was created, which are entitled to membership of apex consultative bodies concerned with trade policy and promotion.

--- Second hand capital goods with minimum residual life of over 5 years were made fully importable by actual users.

--- The peak customs duty rate was brought down to 65 percent. The reductions in import duty were especially sharp for capital goods.

EXIM Policy Changes (1995-96)

--- The definition of consumer goods has been changed to suit the needs of importers, so as to allow them to freely import parts, components and spares of consumer goods as well. These were earlier restricted to the extent that these could be imported without a licence only by actual users. With the changes made, any person can import parts or components of consumer durables freely, without a licence and without actual user condition.

--- The list of freely importable consumer goods has been further expanded to include 78 items.

--- The list of goods permitted to be imported under SILs has been expanded further.

--- An alternative route of the Pass Book Scheme for some categories of exporters has been opened. Basic customs duty credit is allowed to be given upon exports. These credits may be utilised for payment of customs duty against imports of non-negative items.

--- The customs duty peak rate was lowered further along with import tariff reductions on various items.

In 1996-97, to accelerate the pace of reforms, the Exim Policy has been reviewed and revised in several ways. The objective is to further phase out quantitative and qualitative restricitons. A number of items from the negative/restricted list has been permitted free for import and many others have been shifted to the list of items which can be imported under SILs. The peak customs duty rate was reduced to 50 percent.

The Union Budget (1997-98), further brought down the tariff rates on imports. The peak customs duty has been reduced to 40 percent. The duty on capital goods came down to 20 percent. Plans, designs and drawings have been completely exempted from customs duty. In addition, there are customs duty cuts on a wide range of commodities.

EXIM Policy Aligned on ITC (HS) Classification

Another significant development on the trade policy front in the 90s is that the exim policy has been aligned on the Harmonised System of Commodity classification. The Harmonised System (HS) of commodity classificaiton, developed by the Customs Cooperation Council (CCS), Brussels has been in use the world over since the late 80s. India has adopted the system for Customs, Excise, Drawback and compilation of foreign trade statistics purposes. The first attempt to introduce the same system in the trade sector was made with the publication of Import Licensing Policy in two volumes in October, 1991, However, the radical change in EXIM policy (1992-97), reduced the utility of the document. The entire exercise was thereafter taken up afresh at the eight digit extended HS level, and the new Indian Trade Classificaitpn (ITC) has been brought out by 1996, with the folowing objetives:

1. Greater transparency im the import and export licensing policy.
2. Compatibility with the system of classificaiton followed by Customs, Central Excise and the DGCI & S on Harmonised System of commodity classificaiton.
3. Reduction in discretionary controls and areas of ambiguity and disputes on import policy matters.
4. Development of the basic module for computerisation and Electronic Data Interchange (EDI)

Acitivity 2

Meet an exporter located in your district and discuss the positive features of India's current exim policy, Prepare a note

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15.8. TRADE POLICY REFORMS

It is now widely acknowledge that major reforms in trade policy and procedures since the EXIM Policy (1992-97) announced in 1992, have stepped up the transitional process of Indian economy towards globalisation by encouraging exports and permitting imports of essential inputs as well as capital goods.

A major objective of the Exim Policy (1992-97) and the subsequent changes introduced during the last five years was to phase out quantitative restrictions in the form of licensing and other discretionary controls. Another significant objective was to continuously scale down the tariff barriers. To a large extent, these objetives have been met:

- In 1991, imports were regulated by means of a positive list of freely importable items. Since 1992, imports are regulated through a limited negative list, which has been consistently pruned year by year.
- Quantitative restricitons on imports of most intermediate inputs and capital goods have been eliminated.
- In July 1991, out of 5021 Harmonisaed System (HS) tariff lines (6digits), 4000 lines were subject to import licensing restricitons As of december 1995, more than 3000 tariff lines covering raw matrials, intermediates and capital goods are free of import licensing requirements.
- A large number of items covering 1487 tariff lines whose import is otherwise restricted, are now allowed to be imported under freely tradable Special Imports Licences.
- Customs duty rate have been substantially cut down across the board, from a peak of 300 per cent in 1990 to a peak of 40 percent in 1997.

All these clearly show that India is consistently marching towards globalisation by opening up its economy, by removing the importers as well as exporters from the clutches of unwanted controls and regulations and also by bringing down the tariff rates to that level comparable to international standards.

15.9. EXPORT-IMPORT POLICY (1997-2002)

On 31st March, 1997 a new five year Exim Policy was announced: The policy carried further the process of trade liberalisation. The new Exim Policy has cut down the list of quantitative restrictions on imports, simplified procedures, reduced multiplicity of schemes, provided special incentives for agro and allied sectors and encourged domestic sourcing of inputs. Some of the major features of the new Exim policy are:

--- The Policy shifted 542 items out of the restricted list to the Special Import Licen (SIL) and OGL lists.

--- About 60 items shifted out of SIL to OGL.

--- About 150 items can now be imported against SIL.

--- The policy has done away with the Value Based Advance Licence Scheme (vabal and passbook scheme and introduced a new duty entitlement pass book scheme.

--- Udner this scheme, the exporter will be issued a pass book. If he seeks this on pre export basis, he would be given adhoc duty entitlement calculated at 5 percent o average f.o.b. value of exports in the preceding three years. This entitlement would enable him to import required inputs duty free.

On post-shipment basis, exporter shall be entitled for duty-free credits at notified rates. He can make use of this to import any freely importable item.

---- The policy has revised the threshold limits of export obligation for the different categories of export/trading houses. The previous threshold limits and revised threshold limits for recognition along with SIL entitlement are presented in Table 15.3

Table 15.3: Export Obligation.

(Rs. Crore)

	Export House	Trading House	Star Trading House	Super Star Trading House
F.O.B. 3 year average	20 (10)	100 (50)	500 (250)	1500 (750)
Net Foreign Exchange (N.F.E) 3 Year average	16 (6)	80 (30)	400 (125)	1200 (400)
F.O.B. preceding year	30 (15)	150 (75)	750 (300)	2250 (1000)
Net Foreign Exchange preceding year	24 (12)	120 (60)	600 (150)	1800 (600)
SIL (%) F.O.B basis	6 (4)	8 (5)	10 (6)	12 (11)
SIL (%) F.O.B basis	7.5 (6)	10 (8.5)	12 (11)	15 (16)

* Figures in brackets present previous limits.

---- Quantity based advance licence scheme (Qabal) will continue.

---- The duty payable udner the Export Promotion Capital Goods (EPCG) scheme has been reduced from 15 percent to 10 percent.

---- EOUs/EPZ units in the agro sector will be allowed to sell 50 percent of their output in the Domestic Tariff Area (DTA) without stipulation of any value addition. These units are allowed to import equipments of Rs.5 Crore and above under zero duty EPCG scheme.

- The Sepcial Import License (SIL) entitlement of exporters holding ISO 9000 series has been increased from 2 percent of f.o.b to 5 percent of f.o.b.

- The export obligation period under advance licence has been enhanced from 12 months to 18 months and similarly the validity of advance license has been enhanced from 12 mohnths to 18 months.

- The value limit for advance licence under production prgoramme basis has been increased from 25 percent of average f.o.b value of exports to 100 percent of average f.o.b. value of exports so that an exporter could obtain advance license at one go for his requirements and need not go to the Regional Licence Authorities again and again.

The new Exim policy has been welcomed by the industry in general and exporters in particular. The simplification of procedures, reduction in duties, prusing of negative list, incentives to promote exports, etc. together are directed to step up the growth of exports.

15.10. SUMMING UP

India's trade policy has undergone remarkable changes since 1950-51. The objectives of achieving self -sufficiency, protecting domestic industry and balance of payments problems prompted the country to go for stringent import control regime through quantitative and non-quantitative restrictions. In the process, competitiveness of domestic industry suffered severely. Export promotion policies could not bring any significant turnaround in export growth so as to exceed imports. Consequently, balance of payments situation did not imporve either. Rather, it only deteriorated in the late 80s, culminating in a crisis in 1990-91.

The 1990-91 crisis led the country to adopt altogether a different strategy on the trade policy front, as part of its economic reforms. Since 1991, radical changes have been introduced in the trade policy through substantial removal of quantitative and non-quantitative restrictions, gradual but consistent reduction in tariffs, convertibility of rupee on current account, increased thrust on export promotion measures through infrastructural supoport, etc. All these have opened up the economy to international competition considrably. Though there has not been any significant change on the trade balance front, the overall balance of payments position has become comfortable since 1991. However, significant export growth in the range of 15 to 20 percent per annum, in dollar terms, has still remained a distant reality. Development of infrastructure such as power, telecommunications, roads, ports, railways etc. to reach the international standard alone, perhaps, will enable India to experience a significant turn-around in export growth. This is essential to improve India's trade balance, current account balance and balance of payemnts.

15.11. KEY WORDS

O.G.L. List : Items in the Open General Licence (OGL) list can be imported without a licence and without quantitative restricitions, but with the payment of existing customs duties.

c.i.f : Cost, insurance and freight or charged in full.

Ad valorem duty : Duties are imposed in proportion to the value of items.

F.o.b. : Free on board. A term given to the system of paying for goods shipped from or to another country when the amount is sufficient to only to cover the value of the goods and excludes insurance and freight

15.12. SELF ASSESSMENT QUESTIONS

1. Distinguish between free trade and protection. Analyse their relative merits and demerits.

2. Discuss the merits and demerits of freee trade Vs. Protection for a developing country like India.

3. Analyse the different phases in the evolutionary process of foreign trade regime for a developing country.

4. Describe the major features of India's import regime till the 90s and their cosequences.

5. What are the alient features of India's export policies during 1950-91? so you justify those export incentives? Why?

6. Analyse the trade policy reforms implemented by India in the 90s? What are its implications?

7. Why India should go for globalisation? What are the advantages and disadvantages?

8. The quantitive and non-quantitative import restrictions have been steadily scaled down in the 90s. In the process, Indian economy had been increasingly exposed to external competition. Do you think that the Indian economy, in general, and industry in particualar can withstand and sruvice against the external competitions in wthe medium to long run? Analyse in detail.

9. What is LFRMS? What were its major features? What were its implications?

10. What are the advantages of current account convertibility of rupee? What are its long-term implications?

11. In what way trade policy reforms will contribute to enhancing India's competitiveness in the international market? elucidate.

12. List out the major changes effected in India's exim policy in the 90s and its implications.

15.13. FURTHER READINGS

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UNIT 16 FOREIGN CAPITAL AND COLLABORATIONS

Objectives

This unit familiarises you with the:

- need for foreign investment & technology
- phases of India's foreign investment policy during 1948-1990
- trends in the growth of foreign capital & technical collaborations
- India's foreign investment policy in the '90s
- foreign collaboration Approvals and foreign investment inflow in the '90s
- composition, direction and magnitude of foreign direct investment, and their
- implications

Structure

16.1 Introduction
16.2 Merits of Foreign Capital
16.3 Foreign Investment Policy in India: An Overview
16.4 Foreign Investment Policy: 1948-1990
16.5 Trends in Foreign Investment and Collaborations: 1948-1990
16.6 Foreign Investment Policy :1991 Onwards
16.7 Foreign Investment & Collaborations in the '90s'
16.8 Summary
16.9 Key Words
16.10 Self-Assessment Questions
16.11 Further Readings

16.1 INTRODUCTION

Economic development necessitates: availability of natural resources like land, water, etc., adequate levels of savings and its transformation into investment; skilled labour force and entrepreneurship; technical knowledge, etc., A developing economy may have a relatively low level of savings, an unskilled labour force, limited entrepreneurship and lack of technical knowledge to exploit its natural resources, for economic development. In such circumstances, it might seek the assistance of countries which are economically better developed in terms of technology, labour skills, entrepreneurship, savings and investment. Assistance from other countries might flow in the form of investment or technical collaboration. It may be from foreign governments, foreign private companies or international financial institutions.

In India, private foreign investment and technical collaboration have been predominant. Though Government of India has always welcomed foreign investment with certain restrictions, the government policy towards foreign investment has undergone remarkable changes, since independence, from time to time. The foreign investment policy, among other things, had a major influence on the direction and flow of foreign investment and technology into the country.

16.2 MERITS OF FOREIGN CAPITAL

An industrialising economy like India can greatly benefit in different wavs by welcoming foreign capital into the country:

1. India can have better technology to exploit the unutilised and under utilised national resources

2. Foreign investment and technology will enable technology upgradition and modernisation of industry to improve quality and productivity.

3. Foreign investment will supplement domestic savings and capital formation and towards accelerating the rate of investment for economic development.

4. Foreign investment and technology will help to build up the much needed infrastructure for the development of agriculture and industry

5. Foreign investment will bring marketing expertise which would enable Indian goods to penetrate the international market on a larger scale.

6. Foreign investment will promote employment generation by absorbing the relatively economical, particularly skilled labour force.

Thus foreign capital and technology can play a crucial role in the economic development of India.

Activity 1

1. Give a list of merits and demerits of foreign investment in the context of a developing economy.

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16.3 FOREIGN INVESTMENT POLICY IN INDIA - AN OVERVIEW

The Industrial Policy of 1991 made a radical departure from the past and heralded a new era for foreign investment in India. Therefore, India's foreign investment policy can be broadly classified under two periods:

- **1948-1990 :** The period which was by and large , characterised by restrictive policies and regulated inflow of foreign capital and technology.
- **1991 onwards :** The period which has been characterised by remarkable liberalisation of foreign investment laws and heartening upswing in foreign investment inflows.

16.4 FOREIGN INVESTMENT POLICY : 1948 -1990

The Industrial policy Resolution (IPR) of 1948 was the first organised attempt by the Government of India to give proper direction to the industrialisation process of the economy. IPR, 1948 fully recognised that the participation of foreign capital and enterprise, particularly as regards industrial technique and knowledge, would be of value to the rapid industrialisation of the country. However, the policy stressed the need to properly regulate foreign capital in the national interest. The policy made it clear that, as a rule, the major interest in ownership and effective control, should always be in Indian hands. IPR, 1948 emphasised that a suitable legislation is necessary for foreign capital.

Subsequently, the then Prime Minister of India made a statement in the costituent Assembly

in April 1949 on foreign investment which brought out three major issues:

1. India would not make any discrimination between foreign and local enterprises.
2. Foreign investors would be allowed remittance of profits and repatriation of capital if the foreign exchange position permits.
3. If nationalisation of a foreign enterprise becomes inevitable, fair and equitable compensation would be given to foreign investors.

Since then, the Government has adhered to this policy statement for almost two decades. Foreign collaborations were encouraged in those industries:

- which were considered essential for the country's development
- which required large capital investments and complex production processes, and
- which helped to produce import substituting and export oriented products, etc

During this period, foreign collaboration with equity participation was encouraged. This is to facilitate technology transfer as it was thought that giving a chance to the collaborator in managing the host firm would enable the country to secure technologies for a variety of high technology areas which otherwise would have been difficult to obtain. The increasing foreign exchange constraint was another factor which prompted the Government to encourage minority foreign capital participation. In 1961, the Indian Investment Centre was established to forge a close link between Indian and foreign investors.

This led to a sharp rise in the number of collaborations. As a result, the outflow on account of remittances of dividents, profits, royalties and technical fees grew sharply and formed a significant portion of the foreign exchange account of the country. This, among others, caused another foreign exchange crisis in the late 1960s. This led to the streamlining of foreign collaboration approvals and the adoption of a more restrictive attitude.

In February 1966, the Government appointed a Committee under the chairmanship of Mr. Ramaswami Mudaliar with the following terms of reference:

1. To what extent import of technical Know-how can be dispensed with now;
2. The general conditions under which the indigenous know-how can be deemed to be capable of commercial exploitation; and
3. General guidelines regarding the types of cases for allowing foreign collaboration.

The Committee submitted its report in 1967 with the following recommendations:

1. Industries where substantial import of capital goods is involved and where the Government policy allows foreign capital participation, joint ventures involving foreign equity participation are more beneficial, compared to other forms of collaboration.
2. There is a need for prior discussion between the Directorate General of Technical Development and the Council of Scientific & Industrial Research regarding the need for foreign collaborations and the terms thereof.
3. There is need for the central co-ordinating unit in the Ministry of Industrial Development and Company Affairs to watch the progress of the disposal of applications for foreign collaboration
4. A liberal approach would be worthwhile in regard to foreign collaborations in case of substantially export oriented industries.
5. The Committee does not believe that foreign collaboration has killed indigenous initiative nor has it placed India at the mercy of other countries for raw materials and components.

In 1968, procedures relating to foreign investments were streamlined. In order to minimise the delays in processing the applications for foreign collaboration, the Government set up a Foreign Investment Board in December 1968. The Board was empowered to deal with all matters relating to private foreign investment and collaboration where foreign investment does one exceed; 1) Rs. 2 Crore of equity capital, and (2) 40 percent of the issued capital. In cases exceeding these limits. the clearance of the Cabinet Committee was required.

In January 1969, the Government of India came out with an illustrative a list of industries where:

a) foreign investment might be permitted

b) only foreign technical collaboration might be permitted but not foreign investment

e) no foreign collaboration (financial or technical) was considered necessary.

In the first two categories, a permissible range of royalty payments was also specified for different items which generally did not exceed 5 percent . The permitted duration of collaborations was reduced from 10 to 5 years and their renewals restricted.

Foreign collaboration for industries not included in any of the three lists was left for consideration on merit. These lists were revised a number of times towards narrowing down the area for foreign collaborations. In 1973, the area where foreign investment was permitted, was confined to 19 industries.

The Industrial Policy statement of 1973 sought to further restrict the activities of foreign companies to a select group of core industries. These industries were considered to be of basic; critical and of strategic importance'. This was followed by the enactment of the Foreign Exchange regulation Act (1973) FERA, which influenced the operation of became the cornerstone of the regulatory frame work for foreign investment in the subsequent years.

The Foreign Exchange Regulation Act (FERA), 1973

This Act has it s origin in the Foreign Exchange Regulation Act 1947 originally enacted as a temporary measure. By Act 39 of 1957, it was permanently placed on the statue book and thereafter it has been subjected to several amendments. Based on long experience, the Directorate of Enforcement and the RBI suggested to the Government of India, the need to regulate among others, the entry of foreign capital in the form of branches and concerns with substantial non-resident interest in them apart from the employment of foreigners in India.

FERA is an act to consolidate and amend the law regulating certain payments, dealing in foreign exchange and securities, transactions indirectly affecting foreign exchange and the import and export of currency, for the conservation of the foreign exchange resources of the country and the proper utilisation thereof in the interest of the economic development of the country.

FERA covered all non banking branches and companies incorporated under the Indian companies Act, 1956 with more than 40 percent foreign equity participation. All such companies were required to obtain the permission of Reserve Bank of India (R.B.I.) to continue business. The permission was subject to the Indianisation or dilution of their foreign equity as per government guidelines. These guidelines required foreign companies to transfer all their businesses to Indian companies that had foreign equity upto 40 percent. Companies operating in the Core Sector, tea plantations and those engaged in manufacturing activities based on sophisticated technology or predominantly producing for exports were, however, permitted to retain upto 51 or 74 percent foreign equity.

FERA, thus, put a general ceiling of 40 percent on foreign equity participation in the country.

By the end of the 1970s, India realised that the international competitiveness of Indian goods was poor because of growing technological obsolescence, inferior product quality

and high cost. These were partly due to a highly protected local market and partly due to the dominance of Multinational Corporations (MNCs) of marketing channels in industrialised countries.

To deal with it, the Government aimed at:

- emphasising the modernisation of plant and equipment through liberalised imports of capital goods and technology
- exposing Indian industry to competition by gradually reducing import restrictions and tariffs; and
- assingning a greater role to MNCs in the promotion of manufactured exports by encouraging them to set up export-oriented units.

The Industrial Policy Statements of 1980 and 1982 announced a liberalisation of licensing rules, and exemption from foreign equity restrictions under FERA to 100 percent export-oriented units. Thereafter, the attitude towards foreign investments started turning increasingly favourable. The power to approve foreign collaborations not involving an outflow of more than Rs. 5 million in foreign exchange and without any foreign equity participation was delegated to administrative ministries. In January 1987 this figure was further raised to Rs. 10 million. Tax rates on royalties were reduced from 40 percent to 30 percent in the 1986 Union Budget.

To facilitate the flow of superior technology to existing industries, the Cabinet Committee on Economic Affairs (CCEA) decided in December 1986, to permit foreign equity participation even in existing Indian companies employing superior technology. Approvals for opening liaison offices by foreign companies in India were liberalised and procedures for outward remittances of royalties, technical fees and dividends were streamlined. New procedures were introduced enabling direct application by a foreign investor even before choosing an Indian partner.

In May 1988, the Government set up a fast channel for speedy clearance, to attract and expendite the inflow of Japanese investments. The export profits of Japanese companies were exempted from income tax with the objective of encouraging them to locate their production bases in India meant for exports. The fast channel mechanism was subsequently extended to other major home countries of foreign investors: the erstwhile West Germany, U.S.A., U.K. and France.

Thus India,s foreign investment Policy during 1948-1990 took a U-turn: from a relatively liberalised approach (in the '50s and early '60s) to a restricted approach (in the '60s and '70s) which again turned fowards a liberalised approach (in the '80s). These policies, among others, determined the trends of foreign investment and technical collaborations over the period.

16.5 TRENDS IN FOREIGN INVESTMENTS AND COLLABORATIONS : 1948-1990

Foreign Investment : In 1948, the stock of foreign investtpresented in Table 16.1 The most significant trend in the increasing size of foreign investment was the growing importance of the manufacturing sector. In 1964, the manufacturing sector had about 40 percent of the stock of foreign investment as compared to less than a quarter in 1948. In 1980 the manufacturing sector accounted for more than three quarters of the stock of foreign investment

This remarkable increase in the share of the manufacturing sector occurred at the cost of petroleum, plantations and services. Even during the 70s, when the total stock of foreign investment in India stagnated, the share of the manufacturing sector steadily went up. This was largely due to the selective policy of the Government:

- Government of India nationalised foreign concerns in banking, insurance and petroleum sectors.
- In plantations, under FERA, 1973, branches of foreign enterprises were forcibly Indiansised (by reducing the foreign equity to 40 percent.)
- Foreign investment in the manufacturing sector, particularly in the core sector was welcomed.".

In the '80s however, there was a marginal improvement in the share of plantations and services.

Table 16.1 : Stock of Foreign Investment : Sectorial Distribution during 1964-1990.

(Rs.crore)

Sector	1964		1974		1980		1990	
	Value	***%***	***Value***	***%***	***Value***	***%***	***Value***	***%***
I. Plantations	10.59	18.7	107.2	11.7	38.5	4.1	256	9.5
II. Mining	4.7	0.9	6.4	0.8	7.8	0.8	0	0.3
III Petroleum	143.3	25.3	137.9	14.7	36.8	3.9	3	0.1
IV. Manufacturing	229.3	40.5	625.6	68.4	811.6	86.9	2298	84.9
- Food & Beverages	30.2	13.2	52.1	8.3	39.1	4.8	162	7.0
- Textile Products	16.6	7.2	35.6	5.7	32.0	3.9	92	4.0
- Machinery & Machine Tools	15.7	6.8	42.1	6.7	71.0	8.8	354	15.4
- Transport Equipment	15.0	6.5	32.1	5.1	51.5	6.3	282	12.3
- Metal & Metal Products	33.1	14.4	86.7	13.9	118.7	14.6	141	6.1
- Electrical Goods	18.2	7.9	68.1	10.9	97.5	12.0	295	12.8
- Chemical & allied products	60.1	26.2	203.7	32.6	301.8	37.2	769	33.4
- Miscllaneous	40.4	17.6	105.0	16.7	100.0	12.3	203	8.8
V. Services	82.3	14.6	39.8	4.4	38.5	4.1	140	5.2
Total	565.5	100.0	916.9	100.0	933.2	100.0	2705	100.0

Source : Kumar Nagesh, *Multinational Enterprises and Industrial Organisation*, 1994, p. 41

Within the manufacturing sector, new invesments were directed at technology intensive sectors such as electrical goods, transport equipment, machinery and machine tools, and chemicals and allied products. These force sectors, together accounted for about 74 percent of the stock of foreign investment in 1990 as compared to about 47 percent in 1964, about 56 percent in 1974 and about 64 percent in 1980. In other words, the relative share of these four sectors in total foreign investment steadily went up. Consequently, the share of

traditional industries such as food and beverages, textile products, metal and metal products in foreign investment declined, particularly till the late '70s. The liberalisation of foreign investment policies in the '80s, however, arrested and to some extent reversed the declining trend of relative share of foreign investment in consumer goods industries.

There has been geographical diversification in the sources of foreign investment in India. At the time of Independence and almost for the subsequent two to three decades the bulk of foreign investment orginated from U.K.In 1964, more than three quarters of the foreign investment in India were from U.K. (Table 16.2). Another significant contribution came from the U.S.A. whereas other industrialised countries had only a negligible presence. By 1980, the relative share of U.K. declined to about 54 percent whereas the shares of U.S.A., Germany, Sweden, Canada and Switzerland increased significantly. By 1990, though still the most prominent source of foreign investment, the share of U.K.in foreign investment in India had fallen below the one-half mark and Germany, Japan and other industrialised countries and emerged as the other prominent sources of foreign investment for India.

Foreign collaboration Approvals

As described earlier, the Governments's attitude towards foreign investment and technology changed from relatively liberal approach during the '50s and early '60s, to a restricted approach during the late'60s and '70s which again changed to towards liberalisation in the '80s. As a consequence, the number of foreign collaborations, both technical and financial, approved during these periods changed accordingly (Table 16.3).

Table 16.2 : Foreign Investment in India · Sources

(Rs. Crore)

Home Country	*1964*		*1980*		*1990*	
	Amount	*%*	*Amount*	*%*	*Amout*	*%*
U.K.	433.0	76.6	503.3	53.9	1321	48.8
U.S.A	82.3	14.5	196.4	21.0	518	19.1
Germany	6.4	1.1	65.0	7.0	267	9.9
Japan	n.a.	n.a	4.3	0.5	132	4.9
Sweden	7.8	1.4	20.1	2.2	77	2.8
Switzerland	13.6	2.4	54.7	5.9	86	3.2
Canada	8.7	1.5	34.1	3.7	76	2.8
The Netherlands	n.a.	n.a.	n.a.	n.a.	36	1.3

source : Kumar Nagesh, *Multinational enterprises and Industrial Organisation,* 1994, p. 43

The liberal policy during the '50s and early '60s followed in the wake of limited foreign exchange reserves of the country, resulted in a steady increase the average number of foreign collaborations approved per year - from 50 during 1948-58 to 297 during 1959-66. Since foreign exchange was the major constraint during that period, a high proportion of the collaborations (about 36 percent) approved were with financial participation. But the subsequent restrictive approach by the Government led to a fall in the number of collaborations approved. During 1965-79, the average number of collaborations approved was 240. The restrictions on financial collaborations was more severe. As a result, the proportion of financial collaborations to total foreign collaborations declined sharply to about 15 percent during 1965-79. In other words, technical collaborations were at their peak during this period.

Table 16.3 : Foreign collaborations Approved : 1948-1990.

Year	Total No.of Cases Approved	Cases Involving Foreign Capital Participation	Foreign Investment Involved (Rs. Crore)
1948-55	284	n.a.	n.a
1956	82	n.a.	n.a
1957	81	n.a.	n.a
1958	103	n.a.	n.a
1959	150	n.a.	n.a
1960	380	n.a.	n.a
1961	403	165	n.a
1962	298	124	n.a
1963	298	115	n.a
1964	403	123	n.a
1965	241	71	n.a
1966	202	49	n.a
1967	182	62	n.a
1968	131	30	n.a
1969	134	29	n.a
1970	183	32	2.45
1971	245	46	5.83
1972	257	37	6.22
1973	265	34	2.81
1974	359	55	6.71
1975	271	40	3.21
1976	277	39	7.26
1977	267	27	4.00
1978	307	44	9.40
1979	267	32	5.68
1980	526	73	3.92
1981	389	57	10.87
1982	592	113	62.81
1983	673	129	61.81
1984	752	151	113.00
1985	1024	239	125.87
1986	957	240	106.25

1987	853	242	107.0
1988	926	282	238.75
1989	605	193	316.67
1990	666	194	128.32

source : Kumar Nagesh, *Multinational entreprises and Industrial Organisation,* 1994, p: 46

The process of liberalisation of foreign investment policies in the 1980s once again, led to an upward trend in the number of collaborations approved, including that of financial. During 1989-90, on an average, about 724 colaborations per year were approved. Of these, about a quarter were with financial participation and the rest were technical collaborations.

Thus, to a large extent the government policies influenced the direction, composition and magnitude of foreign investment in India.

16.6 FOREIGN INVESTMENT POLICY : 1991 ONWARDS

The introduction of the new industrial policy in 1991 to facilitate the Indian economy in general and industry in particular to achieve international competitiveness, led to the implementation of radical changes in India's foreign investment policy. The policy duly recognised the role and importance of foreign capital and technology in the industrial development of India.

To provide a larger role for foreign investment and technology, the Foreign Exchange Regulation (Amendment) Act.. 1993 was brought into force As of now, India welcomes foreign investment and technology virtually in every sector of the economy except those of strategic concern such as defence, railways and atomatic energy. Foreign investment need not necessarily be accompanied by foreign technology.

In 35 groups of 'high priority' industries, foreign investment upto 51 percent would be approved automatically. Foreign trading companies can have majority (51 percent) equity participation in trading houses primarily engaged in export activity. Upto 51 percent equity is permitted as foreign investment in hotel and tourism related industries. In the case of projects, proposed foreign equity must cover import of capital goods required. Automatic approval in the 35 groups of 'high priority' industries for foreign technology collaborations, is accorded upto a lumpsum payment of Rs. 1.0. crore; 5 percent royalty for domestic sales and 8 percent for exports subject to a total payment of 8 percent (net of taxes) of sales from the date of commencement of production. In all these cases, applications have to be submitted to the Reserve Bank of India.

In 22 groups of consumer goods industries, foreign investors have to adhere to 'dividend balancing', for a period of seven years from the date of commencement of production. This is monitored by the Reserve Bank of India. No permission is needed for hiring foreign technicians or foreign testing of indigenously developed technologies. Use of foreign trade marks/brand names is permitted. Foreign investors can set up fully owned subsidiaries. They need not have a local partner even when the equity investment is less than 100 percent . The portion of equity not proposed to be held by the foreign investor can be offered to the Indian Public for subscription.

In addition to the above, foreign investment is allowed even in non high priority industries and upto 100 percent in high priority industries, on a case to case basis. To facilitate these investments, the Government has set up the Foreign Investment Promotion Board (FIPB). A Foreign Investment promotion Council (FIPC) is formed to formulate guidelines for the foreign investmetn policy as well as to promote opportunities for foreign investment in the country (For more details on foreign investment policy and FIPB, see Unit 18).

Foreign equity participation (upto 24 percent) is allowed in small scale enterprises, Foreign

investors can engage in the manufacturing of an item reserved exclusively for small industry manufacturing, provided 75 percent of the output is exported.

Thus today, foreign investment and technology can flow into India with much ease. Fo[illegible]n investment is treated more or less, on par with domestic private investments. Therefo[illegible] [illegible]y and large, India's foreign investment policy compares favourably with any of the dynamic foreign investment policies in the developing world.

Further, unlike in the past, today the delegation of the Prime Minister of India, while visiting different countries, comprises businessmen. Even Chief Ministers of different states, in their endeavour to attract foreign investment and technology, have been leading delegations to different parts of the industrialised world. All these bring out clearly that the perception, attitude and approach of Indian Policy makers towards foreign investment have undergone a remarkable change in the '90s.

16.7 FOREIGN INVESTMENT & COLLABORATIONS IN THE 90s

The unprecedented liberalisation of the foreign investment policy in India in the '90s (through the dilution of FERA, 1973) has given an altogether new image to the country regarding the investment destination for foreign investments.

There has been a remarkable upsurge in the magnitude of foreign collaboration approvals in the '90s (Table 16.4). This is due to the multiple increase in both technical & financial collaborations. However, foreign collaborations involving foreign investment as a proportion of total foreign collaborations has increased steadily from year to year. As a result, the amount of foreign investment approved has gone up considerably (table 16.5).

Table 16.4 : Foreign Collaborations Approvals : 1991-1996.

Channel	1991	1992	1993	1994	1995	1996* (Upto August)
Secretariat of Industrial Approvals (S.I.A)	760	585	307	382	593	300
Reserve Bank of India (R.B.I.)	188	736	676	702	799	502
F.I.P.B.	2	199	493	770	945	696
Total	950	1520	1476	1854	2337	1498

Source : *SIA News letter, September 1996.*

Table 16.5 : Foreign Collaborations Approveals : Composition.

Year	**Technical Collaboration (T.C.)**	**Financial Collaboration (F.C.)**	**Total Foreign Collaboration**	**Ratio of T.C. to F.C**	**Amount of Foreign Investment Involved (Rs.Crore)**
1991	661	289	950	70:30	530
1992	828	692	1520	55:45	3890
1993	691	785	1476	47:53	8860
1994	792	1062	1854	43:57	14190
1995	982	1355	2337	42:58	32070
1996 (upto August))	524	974	1498	35:65	22140

Source : *SIA News letter, September 1996.*

Another significant development is that foreign direct investment is flowing into diversified sectors of Indian economy. Telecommunications and Fuels are the two major sectors which account for the bulk of foreign investment approved during 1991-96. The fructification of these proposed projects might give the much needed relief to the economy on the power and telecommunications front which in turn will accelerate industrialisation. Transportation industry, food processing industries, chemicals, electrical equipments, service sector are the other major sectors attracting much of the foreign investment approved (Table 16.6). Even foreign technical collaborations are as diversified among different sectors as that of foreign investment. These diversified foreign investment and collaborations may further strengthen the diversified industrial structure of Indian economy.

Table 16.6 : Foreign Collaboration Approvals : Sectoral Distribution (1991-96)

	Industries	Number of Collaborations			Amount of Foreign Investment (F.I.) Approved	% of Total F.I. Approved
		Technical	Financial	Total		
1.	Metalliurgic Industries	219	149	368	5068.7	6.2
2	Fuels (Power, Oil refinery, etc.)	102	142	245	16706.0	20.5
3.	Electrical & Equipments	745	867	1612	4766.7	5.8
4.	Telecommunications	76	197	273	19718.5	24.1
5.	Transportation Industry	263	207	470	5243.0	6.4
6.	Food Processing Industries	115	417	532	5547.4	6.8
7.	Chemicals	566	412	978	4798.2	5.9
8.	Service Sector	11	328	339	5643.6	6.9
9.	Others	2152	2350	4502	14187.9	17.4
	Total	4249	5070	9319	81680.0	100.0

Source : SIA News letter, September 1996.

Table 16.7 : Foreign Investment Approved : Sources.

(Rs. Crore)

Home Country	1991-96	% to Total
U.S.A.	22497	27.5
Japan	3605	4.4
South Korea	2775	3.4
Isreal	4167	5.1
U.K.	4974	6.1
Thailand	2390	2.9
Germany	3116	3.8
Australia	2087	2.6

Netherlands	2217	2.7
Switzerland	1594	2.0
Other countries	32263	39.5
Total	81680	100.0

In the '90s there has been much more geographical diversification as far as the origin of foreign investment is concerned. Though the U.S. is the major source of foreign investment, many more industrialised as well as industrialising countries are increasingly turning towards India for investment (Table 16.7). Today India attracts foreign investments from as many as 80 countries across the world. These include countries from America, Europe, Middle East, Africa, Australia and different parts of Asia. Thus, India has been experiencing a significant increase in the magnitude, wider dispersion in terms of origin and direction of foreign investment in the 90s.

The trend in the actual inflow of foreign direct investment is a more clear reflection on the Government's foreign investment policy. Even the actual inflow of foreign direct investment has steadily gone up in the 90s (Table 16.8).

Table 16.8 : Foreign Direct Investment Inflow : 1991-1996.

Year	Amount (Rs.Crore)
1991	351.43
1992	675.18
1993	1786.71
1994	2981.85
1995	6370.16
1996 (upto August)	5714.66

Source : *SAT News Letter*, September 1996.

All these bring out clearly the fact that the liberalisation of India's foreign investment policy has had a major impact on foreign investment and collaborations. The recognition of the role of foreign investment in economic development by India and the recognition of India as an important investment destination by foreign investors will have a long lasting impact on the globalisation process of the Indian economy.

Activity 2

Develop a bar diagram for foreign technical and financial collaborations year-wise from 1950 to 1995. Write a note on the annual trends of these collaborations.

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Activity 3

Prepare a chart on the origin of major sources of India's foreign investment for two different periods; 1948-90 and 1991-96. Comment on the major issues that differentiate the two.

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16.8 SUMMARY

India's foreign investment policy has come a long way since independence. Though foreign investment and technology was welcomed initially, the subsequent strain on the foreign exchange reserves due to dividend repatriation, royalty payments etc. and complaints of repetitive import of same technology prompted the Government to go for a selective and restricted approach. But the failure of the Indian industry to develop technology on its own and the consequent decline of competitiveness, made the Government to liberalise the foreign investment policy. But these policy changes during 1948-1990 did not make any major and significant dents on the trend of foreign investment and collaborations. FERA continued to be a major deterrent for foreign investment

It is in the '90s that the Government has gone for an overhaul of foreign investment policy. FERA 1973 has been diluted largely and foreign investment is welcomed in a wide range of sectors. Foreign investors have responded positively to India's policy changes. There has been a gradual and steady increase in both foreign investment and technical collaborations -- approvals as well as actual inflow.

The question that has often been asked -- is will foreign investment and technology benefit the economy? or will it ruin the economy? Given the resources and diversified economic structure and strength of India, foreign capital and technology will largely be beneficial to India's industrialisation and economic development.

16.9 KEY WORDS

Fully owned subsidiary : Company incorporated in India under the Indian companies Act 1956 but having 100 percent equity holding by a single foreign company

Minority foreign equity participation : A company incorporated in India having less than 50 percent foreign equity.

Majority foreign equity participation : A company incorporated in India having more than 50 percent foreign equity.

Dividend balancing : The outflow of foreign exchange due to dividend payments is matched by inflow of foreign exchange due to export earnings.

16.10 SELF-ASSESSMENT QUESTIONS

1. Analyse the need for foreign capital for a developing country like India.
2. Describe the circumstances that led to the introduction of Foreign Exchange Regulation Act, 1973 and give its implications.

3. "Foreign investment collaborations, in general, were discouraged rather than encouraged during 1948-90". Do you agree? Substantiate. Give reasons.

4. "The liberalisation of foreign investment policy in the 90s led to virtual scrapping of FERA, 1973". Is it true? Why?

5. "The remarkable upsurge in foreign investments and collaborations in the 90s is largely due to policy liberalisation." Analyse this statement.

6. Do you subscribe to the view that liberal foreign in vestment policy is indisoensable for globalisation ? Why?

7. FERA erected a significant barricade for foreign investments rather than technology. Substantiate this argument with statistics.

8. Develop a case to prove that India's foreign investment policy in the '90s is a major departure from the past.

16.11 FURTHER READINGS

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UNIT 17 INDIA'S EXTERNAL DEBT

Objectives

This Unit enables you to understand the:

- Need for external debt and its implications
- Kinds of External debt
- Problems of definition and comparison related to India's external debt
- Dimensions and sources of India's external assistance
- External Debt of India in the '90s, and
- India's Debt Servicing Burden.

Structure

17.1 Introduction

17.2 External Debt : Scope and Classification

17.3 India's External Debt: Methodological Issues

17.4 External Assistance to India: Authorisation and Utilisation (1950/51-1988/89)

17.5 Sources of External Assistance

17.6 External Debt in the 90s

17.7 Debt Service Payments

17.8 External Debt: International Comparisons

17.9 External Debt and Debt Servicing Burden: A Comment

17.10 Summary

17.11 Key Words

17.12 Self-Assessment Questions

17.13 Further Readings

17.1 INTRODUCTION

The economic development of a country may be financed either by domestic savings or by allowing and encouraging foreign investment. But, when there is a gap between domestic savings and investments and foreign direct investments are not significantly forth coming, a country may resort to borrowing from internal or external sources.

In particular, when a country runs a current account deficit on its balance of payments, to finance the deficit, it may borrow from external sources apart from encouraging foreign investments. It is normal for developing countries to run current account deficits which lead to external borrowings.

India had been borrowing both from internal and external sources sonic Independence. The borrowings of the Government is called public debt. Borrowing from internal sources in referred to as internal debt whereas borrowing from external sources is called external debt.

The growth of external debt has more serious implications than the growth of internal debt:

- Internal debt may be deferred or even annulled. The same for external debt would not only affect country's international relations but may upset further inflow of capital and disturb trade flows.

- Internal debt can be monetised i.e. repaid by printing money but external debt cannot be required that way
- Internal debt can be repaid by privatisation. But selling off assets of foreigners to repay external debt may seriouly harm a country's sovereignty.
- Internal debt can be serviced if the return on capital invested is more than the cost of borrowing and amortisation. In the case of external debt, however, this will not be adequate. In addition, the foreign exchange earnings of the country through exports or otherwise must rise in relation to external debt servicing

Thus, the complexities of issues involved in external debt are different from that of internal debt. In fact, the level of India's external debt and debt servicing burden have steadily gone up since Independence. Simultaneously, the composition and sources of India's external debt have undergone significant changes.

17.2 EXTERNAL DEBT: SCOPE AND CLASSIFICATION

India's external debt may be broadly classified under eight categories. These include multilateral, bilateral and commercial loans and cover both the Government and non-government sectors. These also comprise highly concessional loans as well as loans on market terms.

(i) Multilateral Debt

This refers to loans and credits extended by multilateral organisations to the Government or, in some cases, with Government guarantee to Public and Private sector corporate bodies. This includes long term credits (40 years) of International Development Association (IDA, and long term loans from the world bank or the Asian Development Bank (ADB) which have market interest rates and long repayment period (15-20 years).

(ii) Bilateral Loans

This refers to borrowing on varying degrees of concessionality from other governments. Such loans are given to the government and in some cases to public sector organisations.

(iii) Loans from the International Monetary Fund (IMF)

The IMF debt assumed significance in the early 1980s, when India resorted to withdrawals under the Extended Fund Facility (EFF)/ Supplementary Financing Facility (SFF) to ease out the balance of payments difficulties

(iv) Export Credit

This comprises buyers' credit, suppliers and export credit for defence purchases. Buyers credit and suppliers credit are treated as forms of commercial borrowing.

(v) Commercial borrowing

This includes market borrowings abroad by corporate entities and public sector undertakings and includes commercial bank loans, securitized borrowings (including India Development Bonds) and loans or securitized borrowings with multilateral or bilateral guarantees. Commercial borrowings also include loans from International Finance Corporation (IFC), Washington and self liquidating loans.

(vi) Non-Resident Deposits

This refers to various types of Non-Resident (NR) deposits and Foreign Currency (Banks

& others) Deposits (FC(B&O)D) with maturities of over one year.

(vii) **Rupee Debt**

This refers to debt denomination in rupees owed to Russia (with some very small amounts owed to other East European Countries) and paid through exports. Rupee debt is broken up into a defence and a civilian component. Since March 1990, the civilian component of rupee debt has also included rupee suppliers credits.

(viii) **Short-term debt**

This refers to debt with a maturity period of upto one year. This is usually trade related debt.

The first seven categories may be termed as long term debt. The eighth category is short erm, as the very name suggests. A comprehensive definition of India's external debt must include all these items although in different contexts external debt is defined to include only some of these categories.

17.3 INDIA'S EXTERNAL DEBT: METHODOLOGICAL ISSUES

There is no comprehensive and comparable time series data on India s external debt for the period ranging since Independence. The coverage of India's external debt definition has changed overtime. Therefore, differences in the methodology of external debt computation make data for pre- 1988-89 period non-comparable with data for post- 1988-89 period.

Prior to 1988, there was no international definition of external debt. In 1988, an International Working Group on External Debt Statistics was constituted by the World Bank, IMF, the Organisation for Economic Co-operation and Development (OECD) and the Bank for International Settlements (BIS). This Group defined gross external debt " as the amount, at any given time, of disbursed and outstanding contractual liabilities of residents of a country to non-residents to repay principal, with or without interest, or to pay interest with or without principal". The coverage of this definition is considerably wider than what has historically been described as external debt in India.

A consolidated statement on external debt was presented by the Government of India only in the Economic Survey, 1988-89. External debt outstanding was given in rupees but was confined to external assistance. A time series data was given but only from 1980-81.

In 1989-90, the coverage of external debt was extended to include external commercial borrowings and borrowings from the IMF. The time-series data for the revised definition of external debt was presented for the period beginning from 1984-85 and included only medium and long term debt.

In the Economic Survey, 1992 - 93, external debt figures were given both in rupees and in US dollars and the series began with 1988-89. In the Economic Survey, 1993-94 external debt included defence debt, and the revised external debt was presented starting from 1989-90.

Thus, the growth of total external debt including defence debt can be analysed only for the period beginning from 1989-90. But the growth of external debt excluding defence debt can be analysed from 1988-89. Analysis of external debt series for a longer period prior to 1988-90 is possible only for the external assistance component.

17.4 EXTERNAL ASSISTANCE TO INDIA: AUTHORISATION AND UTILISATION (1950/51 - 1988/89)

External assistance to India is broadly classified under loans, grants and P.L. 480/665 assistance. The composition of external assistance authorised for and utilised by India during 1950/51 - 1988/89 is presented in Table 17.1.

Table 17.1 : External Assistance to India, 1950-51 to 1988-89 Authorisation and Utilisation (Rs.Crore).

	Loans	Grants	Pl. 480/665 etc.		Total Assistance
			Repayable in Rupees	Repayable in convertible currency	
1. Authorisations:					
Upto the end of Third plan	3808.8	392.0	1510.8	-	5711.6
	(66.7)	(6.9)			(100.0)
1966-67 - 1968-69	2185.7	164.9	700.2	121.3	3172.1
	(68.9)	(5.2)			(100.0)
1969-70 - 1973-74	3670.8	196.2	96.1	209.1	4172.2
	(87.9)	(4.7)			(100.0)
1974-75 - 1978-79	7912.1	1795.3	-	136.4	9843.8
	(80.4)	(18.2)			(100.0)
1979-80- 1983-84	13739.7	1838.2	-	-	15577.9
	(88.2)	(11.8)			(100.0)
1984-85- 1988-89	27758.7	1955.3	-	-	29714.0
	(93.4)	(6.6)			(100.0)
II. Utilisation:					
Upto the end of Third plan	2768.7	336.9	1403.2		4503.8
	(61.5)	(7.5)			(100.0)
1966-67 - 1968-69	2147.7	223.0	755.0	103.9	3229.6
	(66.5	(6.9)			(100.0)
1969-70 - 1973-74	3656.2	152.8	154.0	220.7	4183.7
	(87.4)	(3.6)			(100.0)
1974-75 - 1978-79	5970.5	1157.0	-	182.0	7309.5
	(81.7)	(15.8)			(100.0)
1979-80- 1983-84	9098.0	1911.7	-		11009.7
	(82.6)	(17.4)			(100.0)
1984-85- 1988-89	12973.5	1791.0	-		14764.5
	(87.9)	(12.1)			(100.0)

Source : *Economic Survey*, Various issues.

Independent India had a negligible share of external debt. However, after the beginning of economic planning in 1951, to cover the investment and the balance of payments gap, the government resorted to seeking external assistance. The amount of external assistance approved by different sources and utilised bv India has grown steadily over a period of time since then.

India got external assistance in several forms. It includes outright grants, loans repayable in rupees and loans repayable in foreign currencies. Technical assistance has also been made available on different terms from different countries. Deferred credits have also been provided by foreign suppliers.

During the first five year plan, the utilisatiion of external assistance comprising loans, grants and commodity assistance amounted to approximately Rs. 400 crore. It was utilised mainly for the procurement of commodities like wheat and capital goods required for various development projects including irrigation and power projects, etc.

The emphasis on the development of basic and heavy industries for rapid industrial development during the second five year plan, prompted the Government to go for more external assistance. Besides, the trade deficit widened during this period owing to a large increase in imports. All this necessitated a huge foreign capital inflow. The total external assistance utilised was approximately Rs. 1500 crore, during the second Plan.

During the third five year plan, the policy of strength erning the industrial base of the country was continued. On the defence front, the Chinese invasion of 1962 and Indo-pak was in 1965, foreced the country to concentrate on defence industry production and development. Further, due to adverse monsoons, agricultural production was far insufficient to meet the Country's demand. This necessitated large imports of food grains and other agricultural commodities under the US public Law 480 programme. As a result of all these, India had to utilise external assistance to the extent of almost Rs. 2900 crores, during the Third plan period.

During the three annual plans, the drought conditions in the country necessitated heavy food imports under PL 480. In addition, the development of defence industries, trade deficit, etc. led to reliance on external assistance to the tune of more than Rs. 3000 crores.

During the Fourth Plan, thanks to recovery in agricultural production, the Country's dependence on PL 480 food aid came down. Further, due to currency devaluation of 1966, exports grew significantly during this period thereby reducing the trade deficit. Due to these factors, the amount of external assistance sought and utilised increased only marginally. The total amount of external assistance utilisation stood at Rs. 4183.7 crores.

After the Fourth Plan external assistance sought by India increased dramatically. The major factors which led to a sharp rise in India seeking external assistance were:

- Steep rise in the international prices of crude oil and petroleum products,
- increase in the prices of food and fertilisers in the world market

Since, both petroleum & petroleum products and food & fertilisers were the major items of India's imports, to bridge the trade gap India had to seek external assistance in a big way. During the Fifth Plan, the total amount of external assistance utilised went upto Rs. 7300 crores. During 1979/80 - 1983/84, external assistance increased further to exceed Rs. 11,000 crores. During 1984/85 - 1988/89, total external assistance utilisation by India reached almost Rs. 15,000 crores.

17.5 SOURCES OF EXTERNAL ASSISTANCE

The sources of external assistance for India are grouped under:

1. **Consortium Members:** Comprising Austria, Belgium, Canada, Denmark, France,

West Germany, Italy, Japan, Netherlands, Norway, Sweden, UK, USA, the World Bank. and International Development Association.

2. **USSR & East European Countries :** Which include Bulgaria, Czechoslovakia, Hungary, poland, USSR, and Yugoslavia.

3. **Others :** Consist of Australia, European Economic Community (E.E.C), Oil Producing & Exporting countries (O.P.E.C), etc.

The external assistance - source wise, authorised and utilised are presented for select years in Tables 17.2 and 17.3. Consortium members have been the major source of external assistance for India, be it loans or grants. The PL 480/665, etc. assistance was obtained from the USA for food imports. On an average, more than three-fourths of the total external assistance came from the consortium members to India.

Table 17.2: Authorisation of External Assistance By Source : Select Years

(Rs.Crore)

Source and Type of Assistance	1968-69	1974-75	1980-81	1985-86	1988-89
I. Consortium. Members					
(a) Loans	753.1	1297.4	2614.9	4118.4	5705.3
(b) Grants	64.6	121.0	68.8	313.4	177.1
(c) PL 480/665 etc assistance:					
(i) Repayable in rupees	71.6	-	-	-	-
(ii) Repayable in convertible currency	53.7	-	-	-	-
(d) Total	943.0	1418.4	2683.7	4431.8	5882.4
II. USSR & East European Countries					
(a) Loans	-	-	485.7	1134.0	6210.0
(b) Grants	0.7	-	-		
(c) Total	0.7	-	485.7	1134.0	6210.0
III. Others					
(a) Loans	-	184.0	670.6	84.6	940.3
(b) Grants	3.2	68.8	7.0		37.1
(c) Total	3.2	252.8	677.6	84.6	977.4
Grand Total	946.8	1671.2	3847.0	5650.4	13069.8

Source : *Economic Survey*, Various issues.

The USSR and the Eastern Europe accounted for a negligible share of India's external assistance. The other countries accounted for a still lower share.

Table 17.3 : Utilisation of External Assistance By source : Select years

(Rs.Crore)

Source and Type of Assistance	1968-69	1974-75	1980-81	1985-86	1988-89
I. Consortium Members					
(a) Loans	591.4	897.0	1687.1	2270.2	4375.3
(b) Grants	61.0	44.3	311.9	281.6	352.0
(c) PL.480/665 etc assistance:					
(i) Repayable in rupee.	84.5	-	-	-	
(ii) Repayable in convertible currency	73.1		-	-	
(d) Total	810.0	941.3	1999.0	2551.8	4727.3
II. USSR & East European Countries					
(a) Loans	86.3	162.0	32.9	161.2	218.8
(b) Grants	0.7	-	-	-	-
(c) Total	87.0	162.0	32.9	161.2	218.8
III. Others					
(a) Loans	2.1	161.4	45.3	61.7	144.5
(b) Grants	3.5	49.6	84.6	161.3	213.8
(c) Total	5.6	211.0	129.9	223.0	358.3
Grand Total	902.6	1314.3	2161.8	2936.0	5304.4

Source : *Economic Survey,* Various issues

A more disaggregated picture reveals that India acquires external assistance for various purposes from various sources:

- Loans are received from international institutions such as the World Bank and International Development Association for specific projects. The loans given by the I.D.A. are on easier terms, i.e., interest free loans for the development of ports, etc
- Credit are given by individual countries such as the U.S.A., the U.S.S.R., the U.K West Germany, Japan, Canada, etc. Most of these loans are project loans.
- Specific aid loans for a particular purpose, such as agriculture development loans from the World Bank, irrigation loans by the I.D.A. etc.

- Grants given for various social purposes including technical training, health, nutrition by different countries like the U.S.A., U.S.S.R., etc.

Among the individual countries, U.K. and U.S.A. were the major contributors of loans to India till the end of the Fourth plan. But thereafter, particularly in the 80s, Japan and Germany were the major lenders to India. A significant feature of India's external assistance was that, India's reliance on international institutions for external assistance had steadily increased over a period of time. In 1969-70, loans of the World Bank and I.D.A accounted for hardly 18 percent of the total loans utilised by India. In 1979-80, the share of loan assistance of these international institutions increased to about 53 percent of the total loan utilisation by India. In 1988-89, the World Bank and I.D.A. loans amounted to almost 73 percent of India's total loans utilised. Consequently, India's reliance on individual countries for external assistance had steadily come down (For a detailed table on sources of External Assistance see *Economic Surveys*).

External Debt Servicing (1950/51 - 1988/89)

India's dependence on external assistance had increased steadily since independence. As a result, India's debt servicing burden had increased over a period of time (Table 17.4). Due to the increasing size of loan burden, both amortisation and interest payments had grown steadily.

Table 17.4 : External Debt Servicing : 1950-51 - 1988-89.

(Rs. Crore)

Period	Amortisation	Interest Payment	Total (Debt Servicing
First Five Year Plan	10.5	13.3	23.8
Second Plan	55.2	64.2	119.8
Third Plan	305.6	237.0	542.6
1966-67	159.7	114.8	274.8
1969-70	268.5	144.0	412.5
1975-76	462.7	224.2	686.9
1979-80	570.1	313.9	884.0
1985-86	780.0	590.0	1370.0
1988-89	1650.0	1300.0	2950.0

Source : *Economic Survey*. various issues.

Activity 1

Prepare a bar diagram for the major sources of external assistance for India and write a note on the growth of external assistance.

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17.6 EXTERNAL DEBT IN THE 90s

The comprehensive data comprising of all the dimensions of India's external debt-long term as well as short term, foreign currency debt as well as rupee debt, external assistance as well as commercial borrowing, public as well as private borrowings, institutional debt as also non-resident Indian deposits are presented in Indian rupees (Table 17.5) and in US dollars (Table 17.6).

To facilitate international comparisons, analysis is confined to external debt in terms of US dollars (Table 17.6). The amount of India's external debt has been increasing steadily in the 90s.

Out of the total external debt multilateral and bilateral assistance together accounted for about 43 percent in 1990. In 1995, these accounted for almost 50 percent of the total external debt. The amount of commercial borrowing though increased in absolute terms, its relative share in total external debt remained more or less at the same level- 12 percent to 13 percent whereas rupee debt which accounted for almost 15 percent in 1990 declined somewhat, to about 10 percent in 1995.

The share of borrowings from the I.M.F. steadily increased from about 2 percent in 1990 to about 5.5 percent in 1994 but declined marginally to about 4.5 percent in 1995.

Non-Resident and Foreign Currency (Banks & others) deposits of long and short-term duration increased from 9424 million U.S. dollars in 1990 to 12122 million U.S. dollars in 1995. But the relative share remained at around 12.5 percent during 1990-95.

The component of rupee debt has marked a steady decline in total external debt from about 15 percent in 1990 to about 10 per cent in 1995.

Table 17.5: India's External Debt : 1990-95

(Rs. Crore)

		End March					
		1990	**1991**	**1992**	**1993**	**1994**	**1995**
I.	Multilateral	32886	40386	68262	77758	82199	89819
II.	Bilateral	22993	27378	47603	50258	54280	63761
III.	I.M.F.	2572	5132	8934	14985	15812	13545
IV	Export Credit	8002	8374	12418	13484	16307	20876
V	Commercial Borrowing	15988	19727	35711	36367	38782	40915
VI	NRI & FC(B&O) Deposits	15719	20030	27384	34941	39729	39129
VII	Rupee Debt	19075	25199	31956	33149	31634	30315
Total Long-Term Debt (I to VII)		117235	146226	232268	260942	279043	298360
VIII	Short-Term	12964	16775	20642	19804	11375	13432
Grand Total (I to VIII)		130199	163001	252910	280746	290418	311792

Source : *Ministry of Finance (DEA)* & Reserve Bank of India

On the whole, long term debt as a component of external debt has increased both absolutely and relatively. It accounted for about 90 per cent of the total external debt in 1990 which went up to almost 96 percent in 1995. Correspondingly, the share of short-term debt in total external debt marked a relative decline: from about 10 percent in 1990 to about 4 percent in 1995.

Table 17.6: India's External Debt : 1990-95

(US & million)

	End March					
	1990	**1991**	**1992**	**1993**	**1994**	**1995**
I. Multilateral	19164	20900	23090	25008	26263	28542
	(25.26)	(24.94)	(27.07)	(27.78)	(28.33)	(28.82)
II. Bilateral	13564	14168	15466	16154	17450	20270
	(17.88)	(16.90)	(18.13)	(17.94)	(18.82)	(20.47)
III. I.M.F.	1493	2623	3451	4799	5040	4300
	(01.97)	(03.13)	(04.05)	(05.33)	(05.44)	(04.34)
IV Export Credit	4655	4301	3990	4322	5203	6629
	(06.13)	(05.13)	(04.68)	(04.80)	(05.61)	(06.69)
V Commercial Borrowing	9335 (12.30)	10209 (12.18)	11715 (13.73)	11643 (12.93)	12363 (13.33)	12991 (12.54)
VI NRI & FC(B&O) Deposits	9124 (12.02)	10209 (12.18)	10083 (11.82)	11141 (12.38)	12665 (13.66)	12422 (13.12)
VII Rupee Debt	11021	12847	10420	10616	10084	9624
	(14.52)	(15.33)	(12.22)	(11.79)	(10.88)	(09.72)
Total Long-Term Debt (I to VII)	68396 (90.12)	75257 (89.80)	78215 (91.71)	83683 (92.96)	89068 (96.09)	94779 (95.69)
VIII Short-Term Debt	7501	8544	7070	6340	3627	4264
	(09.88)	(10.20)	(08.29)	(07.04)	(03.91)	(04.31)
Grand Total (I to VIII)	75857	83801	85285	90023	92695	99042

Source : Ministry of Finance (DEA) & Reserve Bank of India

* Figures in brackets are percentages to Grand Total.

An important feature of India's external debt is that a significant part of the debt, i.e., multilateral, bilateral and rupee debt, has a large degree of concessionality. The share of such debt has remained more or less at the level of 45 percent of the total in the 90s.

India's external debt, as a percentage of gross domestic product (GDP) at current market prices, rose sharply from 28.5 percent in 1989-90 to a peak of 41.1 percent in 1991-92. But the ratio declined to 36.9 percent in 1993-94 and 34.2 percent in 1994-95.

External Debt Currency - wise Composition

India's external debt is denominated in 24 different currencies, including SDRs and the Indian Rupee (Table 17.7). A majority of India's external debt is in the form of US dollars. This is followed by SDRs, Indian rupee, Japanese yen and Deutsche mark. External Debt in the form of US Dollars, SDRs, Indian Rupee, Japanese Yen and Deutsche Mark together accounted for more than 91 percent of the external debt in 1993-94 as well as in 1994-95 External debt in the remaining 19 currencies were less significant and together formed the rest of the external debt.

Activity 2

Prepare a pie-diagram for the composition of external debt of India for 1989-90 and 1994-95. comment on its major features.

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17.7 DEBT SERVICE PAYMENTS

The growing stock of external debt is, indeed, a matter of concern. However, the nominal stock of debt is not a good measure of the debt burden. This is because a majority of the external debt is long term in nature and nearly half of the debt is at a concessions rate. A more appropriate measure of external debt burden is the flow of debt service payments expressed as a percentage of current receipts component of the balance of payments.

India's debt service payments (Table 17.8) increased from 7420 US million dollars in 1989-90 to 8982 US million dollars in 1990-91. This was due to a bunching of debt service payments on the external commercial borrowings account. In the subsequent two years, debt service payments declined due to a decline in payments on commercial borrowings. In 1994-95 debt service payments increased sharply to 10938 US million dollars from 8293 US million dollars in 1993-94 owing to (i) higher repayments to the I.M.F. and (ii) higher repayments on account of commercial borrowings.

Table 17.7 : Currency - wise composition of External Debt.

Currency	End March 1994		End March 1995	
	Debt outstanding (US $ Million)	As% of Total	Debt outstanding (US $ Million)	As % of (Total)
U.S.Dollar	38376	41.41	38755	39.11
S.D.Rs	13818	14.91	15005	15.14
Indian Rupee	13691	14.77	14216	14.35
Japanese Yen	12740	13.75	15385	15.53
Deutsche Mark	5828	6.29	6858	6.92
Pound Sterling	3068	3.31	3315	3.35
French Franc	1663	1.79	1726	1.74
Netherland Guider	994	1.07	1157	1.17
Swiss Franc	736	0.79	945	0.95
Canadian Dollar	693	0.75	645	0.65
Swedish Kroner	378	0.41	408	0.41
Kuwait Dinar	203	0.22	124	0.13
Denmark Kroner	154	0.17	182	0.18
Belgain Franc	139	0.15	154	0.16
Austrian Shilling	58	0.06	65	0.07
Saudi Riyal	57	0.06	42	0.04
Italian Lira	26	0.03	40	0.04
Norwegian Kroner	22	0.02	26	0.03
Finish Marakkas	12	0.01	17	0.02
E.C. Units	8	0.01	5	0.01
Australian Dollar	7	0.01	9	0.01
UAE Dirham	2	Neg.	1	Neg
Singapore Dollar	1	Neg	1	Neg
Spanish Pesetas	1	Neg.	1	Neg.
Total	92677	100.00	92083	100.00

Source: Ministry of Finance (DEA) & R.B.I

Note : 1. Total debt shown in this table will differ somewhat from that shown in Table 17. due to exchange rate mis match

2. Constituent items may not add upto the total due to rounding.

Table 17.8: Debt Service Payments.

(US $ Million)

	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95
1. External assistance *	2214	2315	2447	2541	3024	3202
Repayment	1193	1187	1329	1443	1618	1817
Interest Payments	1021	1128	1118	1098	1406	1385
2 External Commercial borrowing	2244	3414	2830	2707	3232	4273
Repayment	1158	2004	1677	1525	1978	2795
Interest Payments	1086	1410	1153	1182	1254	1478
3. I.M.F.	1043	778	697	614	387	1368
Repayment	87.4	644	459	335	134	1146
Interest Payments*	169	134	238	279	253	222
4. NRI Deposits						
Interest Payments	936	1282	1036	918	905	1045
5. Rupee Debt Service	983	1193	1240	878	745	1050
6 Total Debt Service (1 to 5)	7420	8982	8250	7658	8293	10938
Repayment	4208	5028	4705	4181	4475	6808
Interest Payments	3212	3954	3545	3477	3818	4130
Current receipts	24012	25478	27307	26746	33074	41044
Debt Service Ratio (%)	30.90	35.25	3021	28.63	25.07	26.65

Source : Ministry of Finance (DEA) & Reserve Bank of India.

The debt service payments as a proportion of current receipts of the balance of payments exceeded 35 percent in 1990-91 but steadily decreased thereafter upto 1993-94. Due to repayments of the IMF loan and higher repayments of commercial borrowings, the debt service ration once again increased in 1994-95.

17.8 EXTERNAL DEBT : INTERNATIONAL COMPARISONS

An international comparison of India's external debt burden would be appropriate as it would reveal India's position particularly among the developing countries. India's external debt vis-a-vis other prominent developing countries for 1993-94 is presented in Table 17.9

India's external debt, which stood at 92.68 billion US dollars at the end of March 1994 ranked third among the developing countries in terms of the absolute magnitude of debt. External debt: GDP ratio for India is much higher than that of South Korea, China, Brazil and Argentina. But it is lower than that of Indonesia, Philippines, Turkey, Malaysia, Thailand and Mexico.

Table 17.9 also presents various debt indicators used by the World Bank to classify indebtedness. A country's indebtendness is classified as severe if the Present Value (PV)

of external debt to Gross National product (GNP) ratio exceeds 80 percent and the present Value (PV) of external debt to Exports of Goods and Services (XGS) ratio exceeds 220 percent. The present Value (PV) to GNP ratio for India stood at 24.6 percent for 1993-94 and the present value (PV) to exports of Goods and services (XGS) ratio was 183 percent. Both these ratios are lower than the critical values. India's indebtedness may not therefore, be termed as severe.

Also India's position is not that alarming, as compared to the average ratios for South Asia, SIMICs, SILICs and MILICs. But at the same time, it does not imply that India can be complacent as far as external borrowings are concerned. If India does not manage its external debt position efficiently, it might assume serious proportions in the future.

Table 17.9 : External Debt and Debt Indicators, 1993

International Comparison.

Countries	**Total Debt (EDT) (US $ Billion)**	**EDT/ GNP (%)**	**PV of Debt (US $ Bn)**	**PV/ GNP (%)**	**PV/ XGS (%)**	**TDS XGS (%)**	**Concessional/ EDT(%)**
Indian	92.68	36.9	60.52*	24.6	183.0	25.1	46.7
Argentina	74.47	29.6	72.08	28.6	431.9	47.6	0.7
Brazil	132.75	24.0	130.[illegible]	23.5	295.8	24.4	1.9
China	83.80	21.4	76.59	19.6	81.3	10.7	16.1
Indonesia	89.54	65.9	81.50	60.0	199.7	32.6	27.9
South Korea	47.20	14.4	45.86	14.0	46.2	9.2	10.0
Malaysia	23.24	37.8	22,70	36.7	42.6	7.9	12.3
Mexico	118.03	35.5	116.46	35.0	182.1	32.7	1.2
Philippines	35.27	63.7	33.23	60.0	173.0	24.9	29.5
Thailand	45.82	37.7	44.70	36.7	91.0	18.6	13.0
Turkey	67.86	55.3	63.74*	52.0	209.9	28.3	10.3
Country Groups							
South Asia	146.12	43.3	93.88	27.9	185.4	24.7	56.0
SIMICs	445.37	42.2	370.31	35.1	305.5	26.9	17.0
SILICs	201.06	117.2	163.58	95.1	448.0	18.2	45.3
MILICs	185.20	49.0	124.33	32.9	188.0	23.1	49.8
All DCs	1811.78	39.7	1489.77	32.7	141.5	18.2	20.2

Source : Ministry of Finance, *India's External Debts: Astatuis Report, 1995.*

*Excludes Deposits of Non-Residents.

SIMIC - Severely Indebted Middle- Income Countries

SILIC - Severely Indebted Low-Income Countries

MILIC - Moderately Indebted Low-Income Countries

DCs - Developing Countries

EDT - External Debt Total

PV - Present Value of Debt.

GNP - Gross National Product

XGS - Exports of Goods and Services

TDS - Total Debt service Payments

17.9 EXTERNAL DEBT AND DEBT SERVICING BURDEN : A COMMENT

Of late, the level of external debt and problems of debt servicing burden have become a widely debated issue in India. Till the early 80s, external debt was not a major problem since India had not resorted to much of market and market related external borrowings. But the trend of borrowing externally gained momentum in the late 80s. As a result, India's overall debt and debt-servicing burden increased over the 80s as well as in the 90s.

The growing magnitude of external debt has attracted increasing attention of the Government in the 90s. The Government of India and the Reserve Bank of India have introduced a number of measures to contain the growth of expensive external debt. These include:

- Moderation in the interest rates on non-resident deposits
- discontinuation of some high cost forms of non-resident deposits where the Government bore the exchange risk.
- encouragement to the corporate sector to prepay expensive external debt,
- limits on external commercial borrowings and prioritisation of such borrowings in favour of infrastructure, term lending institutions and exporters,
- a more open and pragmatic policy for non debt creating foreign direct investments.

These measures are being combined with an overall trade policy which gives top priority to promoting exports.

In fact, India should go for a two pronged strategy to reduce its debt - service ratio:

(i) Encourage foreign direct investment inflow through further liberalisation of foreign investment laws. Bureaucratic hurdles must be removed with an iron hand, to realise larger - inflow of foreign direct investment.

(ii) A big push to exports to grow at the rate of more than 20 percent annually. Accelerating the development of infrastructure itself will give a big boost to export growth. Achieving current account balance, if not surplus, should be the medium term objective.

This strategy will reduce the need for external borrowings and bring down the debt servicing burden gradually.

17.10 SUMMARY

The definition of external debt in India has changed and accordingly the scope has been widened over the period. As a result, a time-series comparison of India's external debt is not possible.

Irrespective of the scope of definition of external debt, the level of India's external debt has steadily gone up and so is the debt servicing burden. Multilateral and bilateral loans, particularly concessional debt forms, a significant portion of India's external debt. The proportion of long-term debt is much higher and short-term debt composition has declined in the 90s.

An international comparison shows that India is the third largest indebted country in the world. The different debt position indicators do indicate that India needs to manage its external debt position more efficiently. To reduce the debt servicing burden, the Government of India has taken various steps including policy liberalisation for foreign investments and export promotion. Any sustainable success on the foreign investment inflow front and export growth front would enable India to reduce its external debt burden significantly in the medium to long run.

17.11 KEY WORDS

Amortisation: The process of repayment of the principal loan amount, on maturity in lumpsum or in instalments.

Debt-Servicing Burden: This refers to the amount comprising amortisation and interest in a particular year. Since amortisation and interest differ from year to year, debt servicing burden also differs accordingly.

Gross Domestic Product: A measure of market prices of the total flow of goods produced in an economy during a year.

SDRs: The special Drawing Right is an international financial asset created by the IMF and serves as an international unit of account, a means of payment among certain eligible official entities, and an international reserve asset. Currently the SDRs issued by the IMF can be used only in transactions among monetary authorities (central banks) and certain international institutions. SDRs may be used to purchase foreign currency from the IMF, to make payments to IMF, or to engage in direct financial transactions among the official holders of SDRs like India.

PL 480/665 assistance : It refers to the food aid which India received under the US Public Law 480 and 665 for the import of food items. However, with improvement in good grains production, this assistance gradually declined in importance.

Soft Loans: A loans bearing no rate of interest or an interest rate which is below the true cost of capital lent. The International Development Association (IDA) gives soft loans to developing countries for long term capital projects.

17.12 SELF-ASSESSMENT QUESTIONS

1. What is the role of external debt in the economic development of a country like India? What are the implications of a growing external debt?

2. Distinguish external debt from internal debt and list out the implications of the former for an economy like India.

3. Describe the various kinds of external debt and the relative merits and de-merits of each.

4. What are the different sources of external assistance for India? Why has external

assistance utilisation increased steadily over the period? Comment.

5. Discuss the composition of India's external debt and its growth in the '90s.

6. Critically evaluate the growing debt-servicing burden of India? What measures are needed to counter/check the growth of debt servicing burden?

17.13 FUTHER READINGS

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3. Kapila Raj & Kapila Uma (ed.) : *Indian Economy Update,* Vol.I Academic Foundation TRP, Delhi, 1996.

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BLOCK 5 ECONOMIC REFORMS SINCE 1991

In the previous blocks we discussed several aspects of the economic and social environment of India. We dealt with the structure of the Indian economy, planning and policies and then issues relating to the external sector. The focus of this block is exclusively on economic reforms undertaken in India since 1991. This block has five units

Unit 18 Industrial Policy 1991 Underlines the objectives of the new industrial policy. The various aspects of the new Industrial policy, such as industrial delicensing foreign investments, etc., are examined. The functioning of the Foreign Investment promotion Board (FIPB) is described. The reforms undertaken in relation to the public sector are then discussed. The changes made in the Monopolies and Restrictive Trade Practices Act are also examined. Lastly, the unit examines the impact of Industrial Policy 1991 on industry.

Unit 19 Economic Reforms 'Liberalisation Globalisation and Privatisation has its focus on the measures undertaken in relation of liberalisation, globalisation and privatisation. The unit first explains the definitions of the three basic terms. The inter-relationship between these three concepts is discussed. The unit then attempts a review of the economic reforms related liberalisation, globalisation and privatisation.

Unit 20 Financial Sector Reforms deals with the various aspects of the reforms undertaken in the financial sector of the economy. The unit first explains the basic functions of money and finance. Thereafter the unit briefly discusses the structure, magnitude, and significance of the financial system in India. The functioning of the Reserve Bank of India as the Central Bank of the country and its relationship with the other institution in the financial system are highlighted. Some details of the reforms undertaken in the financial sector of the economy are then briefly discussed and examined.

Unit 21 deals with **Fiscal Sector Reforms.** The unit first explains the basic concepts in the theory of public finance. India's fiscal policy is then discussed in details, including the reforms undertaken since 1991.

Unit 22 Economic Reforms and Social Justice is the last unit of this block as well as the course. The economic reforms in relation to various aspects are particularly examined in the context of social justice. The aspects examined are : Growth Rate of GDP Control of Inflation, Impact of Poverty and Employment, foreign Investments, External Debt, Multinational Corporations, and Foreign Trade. The shortcomings of the economic reforms are underscored. The unit concludes with the brief discussion about economic reforms and social security.

UNIT 18 INDUSTRIAL POLICY 1991

Objectives

This Unit enables you to gain familiarity with:

- Objectives of Industrial Policy 1991
- 'ndustrial delicensing
- Foreign investment policy
- Foreign Investment Promotion Board
- Steps involved in initiating a manufacturing unit
- Public Sector Reforms
- Changes in MRTP Ac.
- Impact of Industrial Policy 1991 on Industry

Structure

18.1 Introduction
18.2 Backdrop
18.3 Industrial Licensing
18.4 Foreign Investment
18.5 Public Sector Policy
18.6 MRTP Act
18.7 Impact of Industrial Policy 1991: Initial Trends
18.8 Summary
18.9 Key Words
18.10 Self-Assessment Questions
18.11 Further Readings

18.1 INTRODUCTION

The Industrial Policies pursued till 1990 enabled India to develop a vast and diversified industrial structure. India attained self-sufficiency in a wide range of consumer goods. But the industrial growth was not rapid enough to generate sufficient employment, to reduce regional disparities and to alleviate poverty. It was felt that government controls and regulations had put shackles on the growth of different segments of Indian industry. Lack of adequate competition resulted in inadequate emphasis on reduction of costs, upgradation of technology and improvement of quality standards. It is to reorient and accelerate industrial development with emphasis on productivity, growth and quality improvement to achieve international competitiveness that the Industrial Policy of 1991 was announced.

18.2 BACKDROP

At the outset, Industrial Policy of 1991 renewed its commitment to the basic objectives of Industrial Policy Resolution (IPR) of 1956:

- Rapid industrial development
- Rapid expansion of employment
- Progressive reduction of social and economic disparities
- Removal of poverty and attainment of social justice.

It was due to the scarcity of capital and lack of an entrepreneurial base that IPR, 1956 accorded a predominant role to the state in industrial development. The Industrial Policy statement, 1973 identified high priority industries for investment by large domestic and foreign enterprises. The Industrial Policy statement of 1977 laid emphasis on the promotion of small scale and cottage industries for economic development. Industrial Policy statement, 1980 stressed on the need for promoting competition in the domestic market.

By the Seventh Five Year Plan, the industrial had been diversified. Basic and capital Goods industries had come up. A high degree of self-reliance had been achieve. New growth centres and new generation of entrepreneurs had emerged.

At this juncture, measures were taken to open up the domestic market to increased competition, both domestic and international Emphasis was laid on promoting industrial growth along with quality and productivity improvements. Industry grew impressively at an average rate of 8.5. per cent during 1985-90.

In the light of these achievements, Industrial Policy (IP) of 1991 renewed its emphasis on removal of poverty, attaining social and economic justice and building a prosperous India. Towards this end, IP, 1991 emphasised the need to integrate the domestic economy with that of international economy.

The IP, 1991 follows the policy of Self-reliance but with greater stress on the ability to pay for imports from exports. It also recognised the need for development of indigenous technology and manufacturing capabilities to world standards. IP, 1991 assigned importance to industrialisation of backward areas through infrastructure development and promotion of Small Scale Industry through technology unpradation and efficiency improvement IP, 1991 underlined the significance of the fact that sector units have to be run on business lines as envisaged in IPR, 1956.

In the light of these issues, IP, 1991 has the following objectives:

1. to build on the gains already made
2. to correct the distortions or weaknesses that have crept in
3. to maintain a sustained growth in Productivity and employment, and
4. to attain international competitiveness.

To achieve these objectives, IP 1991 introduced changes with respect to:

- industrial licensing
- foreign investment
- foreign technology agreements.
- public sector policy,. and the
- MRTP Act.

18.3 INDUSTRIAL LICENSING

Industrial licensing is the most important instrument which has been used by the Government for directing allocation of resources between industries and regions. But in a dynamic global market, enterprises must be enable to swiftly respond to the fast changing external conditions. Entrepreneurs must be free to make investment decisions on the basis of their own commercial judgement. This will facilitate them to achieve technological dynamism and international competitiveness. Therefore, Government should change its role from exercising control and regulation to that of facilitators and guide. Keeping this objective in view, the following changes are introduced:

1. All areas of industrial activity excluding ares of security and strategic importance (Annxure I) are thrown open to private sector investments.

2. Industrial licensing has been abolished for all industries excluding those (a) where either strategic and environmental concerns dominate or the import content is exceptionally high (Annexure II); and (b) which are reserved (836 items) for small industry manufacturing.

3. Industrial licensing is not needed in location other than cities having a population of more than one million, as per the 1991 census (AnnexureIII).
4. Industrial licensing is not required not only for new units but also for new products, as also substantial expansion and change of location for existing units.
5. Phased Manufacturing Programmes (PMP) have been abolished for all new industries and subsequently for all existing industrial projects. Under a PMP, a concerned enterprise has to progressively replace imported materials, parts and components with materials, parts and components produced in-house or by other India firms. The PMPs accompanied industrial licences in a wide range of industries involving assembly of parts and components (notably the vehicle, machinery and electronics industries) prior to IP 1991. The exact nature of PMP was decided on a case by case basis.
6. Re-endorsement scheme is applicable only (a) for industries where licensing is compulsory and (b) within cities having a population of more than one million, for all industries. Re-endorsement scheme was first introduced in 1982. As per the scheme, all those industrial units which had utilised 94 per cent of the licensed capacity over the previous five years were allowed to expand their production by one-third thereof, without licence. In 1986, the scheme was further liberalised by reducing the cut-off limit to 80 per cent capacity utilisation.
7. All the industrial units which have obtained licence for an item covered under Annexure II of IP, 1991 prior to July 25, 1991, have to obtain Carry on Business (C.O.B.) licence.
8. [illegible]reneurs who initiate new industrial units and indulge in substantial expansions in delicenced industries are required to file Industrial Entrepreneurs Memorandum (IEM). IEM has to be obtained from and submitted (6 copies) to Secretariat of Industrial [illegible]vals (SIA) in the Department of Industrial Policy and Promotion, Ministry of [illegible]s per the Industries Development and Regulation (IDR) Act, 1951, along with a crossed demand draft for Rs. 1000/-.
9. For licensing, application has to be obtained from and submitted to (with 8 spare copies) the Secretariat of Industrial Approvals under IDR Act, 1951 along with a cross demand draft for Rs. 2500/-.
10. A[illegible]strial undertakings are required to submit monthly production returns to concerned technical authorities (For e.g.: Textile Commissioner, etc.) and a copy to concerned administrative ministry or department.
11. An Investment Promotion and Project Monitoring Cell is set up in the Department of Industrial Policy and Promotion, Ministry of Industry to provide information to entrepreneurs and to monitor progress of implementation of various projects.

Thus, industrial delicensing has been a central feature of IP 1991. This is to facilitate rational investment decisions of private entrepreneurs not only with respect to new industrial projects, but with respect to expansion of existing projects, changing the product mix and shifting the location of projects as well. Industrial delicensing marked a radical step towards creating 'free entry' situation in Indian industry. However, not much has been done to device an 'exist' policy for non-viable, non-revivable sick units, to facilitate smooth restructuring of the industrial sector.

18.4 FOREIGN INVESTMENT

Along with Industrial delicensing, IP 1991 brought significant changes in the foreign investment policy. These changes are designed to attract enhanced capital inflows into India on a sustained basis and to encourage technology collaboration agreements between Indian and foreign firms. Today, India welcomes direct foreign investment in virtually every [illegible] economy except those of strategic [illegible] as defence, railway transport and atomic energy. Foreign trading companies are [illegible] to assist export activities. Foreign equity proposals, unlike in the past, need not necessarily be accompanied by foreign technology agreements. Accordingly, the Foreign Exchange Regulation Act (FERA), 1973 has been amended. The salient features of the new policies towards foreign investment are:

1. Automatic approval for foreign equity participation upto 51 per cent is granted in high priority industries (Annexure IV).
2. Foreign trading companies can have majority equity (51 percent) participation in trading houses engaged primarily in export activity.
3. Foreign investment in hotel and tourism related industry upto 51 p rcent equity is permitted.
4. Foreign investment upto 0 percent in the Mining sector is allowed.

In all the above cases, applications for foreign investment approvals have to be submitted to the Reserve Bank of India. In the case of projects, the proposed foreign equity must cover import of capital goods required for the project. Imported plant and machinery must be new and not second hand. For proposals with a technical collaboration agreement, the payment of know-how fees and royalties must confirm to specified parameters.

5. Foreign investment propo ls, where the parameters for automatic approval are not met, such as:
   - Where foreign equity does not cover the foreign exchange requirement for import of capital goods
   - Where foreign equity involves more than 51 per cent in high-priority industries
   - Where foreign investment is in non-high priority industries. Proposals have to be submitted to the Secretariat of Industrial Approvals (S.I.A.) or Foreign Investment Promotion Board, [a specifically empowered Board set up to speed up the approval process of foreign investments (see Box 1) or Indian Embassies or Consulates abroad.

Existing enterprises can raise foreign equity upto 51 per cent either as part of an expansion programme or without an expansion programme. These enterprises can obtain automatic approval from the Reserve Bank of India subject to the following conditions:

- when an existing company wishes to raise foreign equity upto 51 per cent as part of an expansion programme, the expansion programme must be in the high priority industries and fresh/additional equity should be part of the financing of the expansion programme
- when an existing company wishes to raise foreign equity without an expansion programme, the company must be predominantly engaged in the high priority industries
- the increase in equity level must result from expansion of the equity base of the existing company
- the foreign equity must be from remittance in foreign exchange, and
- the proposed equity must cover the import of capital goods required for the expansion programme.

7. All other proposals for inducting or raising foreign equity in existing enterprises have to be submitted to S.I.A.
8. Foreign investors need not have a local partner, even when the foreign investor wishes to hold less than full equity of the company. The portion of the equity not proposed to be held by the foreign investor can be subscribed to by the public.
9. Use of foreign brand names/trade marks for sale of goods in India is permitted.
10. Initially all projects involving foreign equity upto 51 per cent in high priority industries were required to adhere to dividend balancing condition. As per this condition, outflow of foreign exchange on account of dividend payments have to be balanced by export earnings for a period of seven years from the date of commencement of production. Beyond this period, dividend balancing is not required. Dividend balancing is monitored by the Reserve Bank of India. Subsequently, dividend balancing condition has been withdrawn for all industries excluding certain consumer goods industries (Annexure V).
11. Foreign equity upto 100 per cent is particularly encouraged in export oriented units, power sector, electronics and software technology parks.
12. Foreign equity is permitted even in small scale enterprises upto 24 per cent.

13. Recently a Foreign Investment promotion council (FIPC), has been formed which will (formulate guidelines for policy as well as) promote investment opportunities in the country.

14. A foreign investment project proposal cleared by FIPB will be referred for further clearance to:

A) the Industry Minister, for all proposals involving foreign investment upto Rs. 600 crore.

b) the Cabinet Committee on Foreign Investment (CCFI), headed by the Finance Minister, if proposals involve foreign investment of more than Rs. 600 crore.

15. Foreign companies engaged in manufacturing and trading activities abroad may open branch offices, project offices or liaison offices in India, with necessary permission of R.B.I.

BOX-I

Foreign Investment Promotion Board

Following the Industrial Policy 1991, the Government has set up a special Board known as Foreign Investment Promotion Board. (FIPB).

Objective

FIPB is set up with the purpose of speeding up the approval process for proposals relating to foreign investment in India.

Composition

FIPB was initially headed by the Principal Secretary to the Prime Minister and the members comprised the Finance Secretary, the Commerce Secretary and the Secretary of Industrial Development. Secretaries of the other Ministries concerned with specific investment proposals were also invited as appropriate.

Recently, FIPB Secretariat has been shifted from the Prime Minister's office to the Industry Ministry. The FIPB is now headed by Industry Secretary and comprises Finance Secretary, Committee Secretary and Secretary (Economic Relations), Ministry of External Affairs, Revenue Secretary and Small Industry Secretary as members. Apart from Secretaries of Ministries pertaining to the case under discussion, professionals from financial institutions, industry and commerce would also be co-opted as and when necessary.

Application Procedure

No special application form is needed for applying to FIPB. Proposals can be sent directly or through any of India's displomatic missions abroad.

Scope and Method

FIPB has the flexibility to examine all proposals in totality, free from predetermined parameters or procedures. Its approach is liberal for all sectors and all types of proposals. A large number of proposals cleared till date by FIPB involved 100 per cent equity participation by foreign investors. FIPB clearance for foreign investment proposals is based on the investment proposed, the technology to be inducted, the export potential or the import substitution factors the foreign exchange balance sheet and the employment potential. The totality of the package proposed is examined and approved on merits.

Additional Functions

In a recent revamp of FIPB, it has been entrusted with the responsibility of reviewing on a continuous basis, the general and sectoral policy regimes relating to foreign direct investment set of transparent guidelines for facilitating foreign investment in various sectors.

It will also identify sectors into which investment may be sought, keeping in view the national priorities and also the specific regions of the world from which investment may be invited throught special efforts.

Foreign Technology Agreements (FTA)

To inject the deisred level of technological dynamism, automatic approval for technology agreement has been made possible in high priority industries. R.B.I. accords automatic approval to foreign techrioloov aoreements within prescribed monetary limits:

lumpsum payments upto Rs. 10 million

royalty payments upto 5 per cent of domestic sales and 8 per cent of exports over a period of 10 years from the date of the agreement or over a period of 7 years from the date of commencement of production.

these payments are subject to an overalll celing of 8 per cent of total sales over a period of 10 years from the date of the agreement of commencement of commerical production.

The prescribed rates are net of Indian taxes.

Repatriation of Capital

Foreign Capital invested in India is allowed to be repatriated with capital appreciation, if any, after the payment of taxes due on them. The disinvestment is permitted in accordance with the terms of the letters of approval granted at the time of approving the foreign collaboration.

Reptriation of Sale Proceeds

Repatriation of slae proceeds of assets held in India is allowed with prior RBI approvals subject to the payment of applicable taxes.

Royalties and Technical know-how Fees

Indian companies that enter into technology transfer agreements with foreign companies are permitted to remit payments towards know-how and royalty in terms of the foreign collaboration agreement approved.

Technical Service Fees

Companies can hire the services of foreign technicians, and make remittances for technical service fees, subject to the terms approved by RBI.

On the whole, IP 1991 introduced radical changes in India's foreign investment policy. As a result, the entry of foreign enterprises into Indian market has been made much easier. Thus, Indian industry has been exposed not only to domestic competition but to foreign competition as well. This is likely to exert more pressure on domestic industrial units to raise quality as well as productivity. The liberalised foreign investment policy is aimed at augmenting foreign investment inflow and bridge the technology gaps between Indian industry and that of International.

The liberalisation with respect to industrial licensing and foreign investment has made implementation of a project far easier. The process of project implementation and clearances to be obtained are outlined in Box II.

BOX-II

How to Implement a Project

The implementation of a project in India, whether a domestic investor or a foreign investor (after obtaining approvals for investing in India) has to undergo the same regulations.

Incorporating a Company in India

Companies incorporated in India and branches of foreign enterprises are regulated by the Companies Act, 1956. The name of the company can be registered and the company incorporated as a private or a public limited company with the Registrar of Companies (R.O.C) A certificate of commencement of business is obtained from the R.O.C. on fulfilment of certain conditions.

Industrial Licence/ Industrial Entrepreneurs

If an industry in which investment is sought, comes under the purview of licensing, an application has to be submitted for an industrial licence. A foreign investor can submit such an application along with the foreign investment proposal. In such cases, they are considered in a composite manner by the FIPB and a composite approval is granted.

In the case of delicenced industries, companies are required to file an Industrial Entrepreneurs Memoranda with the Secretariat of Industrial Approvals and another memorandum at the commencement of commercial production.

Raising Finances in India

Investors can raise a substantial portion of funds in India through debt and equity instruments. Long term loans can be obtained from state and national financial institutions and working capital from commercial banks or through instruments such as fixed deposits. Investors can also raise finances through capital markets through shares and debentures.

Starting Operations

There are various approvals necessary from different authorities to set up an industrial unit. Legislative provisions differ from state to state. However, they are similar in relation to fundamental aspects.

Clearances Required	Authority
A. Clearance required by all industrial units	
Land for Project	
Allotment of plot/shed in industrial estate	State Industrial Development Corporation (SIDC)
Allotment of Government Land	District Collec or
Notified Authority Permission	District Collector or District Development Officer
Construction of Building	
Plan approval in industrial estate	SIDC
Plan approval in other are	Local authority
Vater Requirement	
An Industrial estate	SIDC
River/Public service	Department of Water Resources
Power Requirement	State Electricity Board

Clearances Required	Authority
B. Other Clearances	
Environmental Clearance	State Pollution Control Board
No objection certificate, applicable to polluting industries like chemicals pharmaceuticals, etc.	
Site Clearance Certificate	Office of the Industries
Applicable to 22 highly pollution industries	Commissioner (IC)
Incentives	
Investment subsidy for industrial units coming up in backward areas of the state	District Industries Centre
Sales tax exemption/eligibility certificate	I.C.
C Clearance for Specific Projects, Pharmaceuticals and Cosmetic Project	Food and Drugs Control Administration
Permission Under Boilers Act	
Permission to be obtained for installation of boiler to meet safety requirements	Chief Inspector of Steam Boilers
Mining	
Permission for extraction of minerals permission to be obtained for lease and setting up mineral based industry	Director, Geology & Mining
Port Location	
Permission to locate a project near the Seashore	Port Department/State Maritime Board
D. Clearance before Going into production	
Registration as Factory	Chief Inspector of
Under the factory Act, for the safety of the workmen	Factories
Sales Tax Registration	Sales Tax Officer

18.5 PUBLIC SECTOR POLICY

The public sector has been central to India's industrialisation within the mixed economy framework. The Industrial Policy Resolution 1956 accorded a strategic role to public enterprises. Accordingly, areas of strategic importance and core sectors were exclusively reserved for public sector enterprises. Public enterprises were accorded preference even in areas where private investments were possible. Public enterprises grew dominantly in terms of units and investment, both at the Central and State levels. In 1993, number of Central Public Enterprises stood at 237 with an investment of Rs. 1,47,000 crore.

However, the performance of public sector enterprises has been far from satisfactory; its protected growth over a period of time, has resulted in many shortcomings:

- insufficient growth in productivity
- poor project management
- inadequate attention to research and development
- low rate of return on investment

As a result, many public enterprises became a burden rather than an asset. One-third of the public enterprises were accounted for by nationalised sick units. A number of public enterprises had come up in non-strategic, non-core, consumer goods and service sectors. By 1993, only about 60 per cent of the total investment in public enterprises was in the areas originally envisaged as the "commanding heights". All these necessitated a change in approach. IP, 1991 emphasised that public enterprises must be growth oriented and technologically dynamic. Therefore IP 1991 set the future priorities for public enterprises as follow:

- essential infrastructural goods and services
- exploration and exploitation of oil and minerals
- manufacture of goods of strategic importance such as defence equipments, etc.
- development of technology and manufacturing capabilities in crucial areas for long term economic development.

Thus, public sector would be confined to strategic, high tech industries and essential infrastructure; Chronically sick and unvaiable public sector units would be referred to Board for Industrial and Financial Reconstruction (BIFR). Workers of such units would be protected. In February 1992, the Government established a non-statutory National Renewal Fund (NRF) to provide assistance to cover the cost of retraining and redeployment of labour and also provide compensation to labour affected by the closure of unvaible public sector units, etc.

Government's share holding in public enterprises would be brought down. The shares would be offered to mutual funds, financial institutions, workers and the public to raise resources and to encourage wider public participation.

As part of the measures to improve the performance of public enterprises, more and more of public sector units would be brought under the purview of Memorandum of Understanding (MoU) system. A memorandum of understanding is a performance contract, a freely negotiated document between the Government and a specific public enterprise. MoU aims at moving management of public enterprises from management by controls and procedures to management by results and objectives. MoU was started in 1987-88 with 4 public enterprises. As of now, more than 100 central public enterprises are covered by MoU system, accounting for more than 90 per cent of the total public sector turnover. In 1995-96, financial performance was accorded 60 per cent weightage in MoUs

18.6 MRTP ACT

The principal objectives of the Act were:

- prevention of concentration of economic power and control of monopolies
- prohibition of monopolistic, restrictive and unfair trade practices

The thrust of Industrial Policy 1991 is more on controlling unfair or restrictive business practices. The provisions relating to merger, amalgamation and take-over have been repealed Threshould limits of assets on private sector companies have been removed.

Accordingly, MRTP Act has been restructed and pre-entry restrictions have been removed. with respect to new undertaking, expansion, amalgamation, merger, take over, registration etc. under sections 20-26 of part A of Chapter III of the Act.

Under section III of the MRTP Act 1969, the Act shall now apply to all undertakings and

financial institutions, both public and private. However, units which are owned or controlled by a Government company or Government engaged in the production of arms, ammunition, atomic energy, minerals etc. are exempted.

The basic objective is to curb and regulate monopolistic, restrictive and unfair trade practices which are pre-judicial to public interest.

To summarise, though Industrial Policy 1991 renewed its commitment to the basic objectives of IPR 1956, the policy brought out substantial changes in the industrial policy framework. The regulatory and controlling mechanism has been largely diluted towards creating a competitive environment in domestic industry. Protective barriers have been removed and Industry has been exposed to competition, both internal and external. Industrial delicensing, liberal foreign investment policy, removal of threshold limits on the assets of dominant firms, drastic reduction in the number of industries reserved for public sector, steps towards granting more autonomy to public enterprises, measures to reduce Government share holding in public enterprises, etc. formed the significant features of industrial policy 1991. These marked a clear deviation from the path adopted in the earlier decades for industrialisation. The IP 1991 recognised.

(1) the growth of private sector in terms of size, resources and ability to play a more significant role in industrialisation;

(2) the vital role of foreign investment and technology in supplementing India's investible resources and overcoming technology deficiencies; and

(3) the importance of public sector restructuring and functioning on commercial lines to generate resources.

Accordingly, vast areas of economic activities have been thrown open to private sector investments, both domestic and foreign and steps have been initiated to confine the role of public sector to core and strategic areas and to improve its financial performance.

18.7 IMPACT OF INDUSTIRAL PLICY 1991: INITIAL TRENDS

The all-round changes introduced in the industrial policy framework have given a new direction to the future industrialisation of the country. The industrial reforms resulted out of the Industrial Policy 1991 have already led to encouraging trends on diverse fronts. Industrial growth which decelerated in 1991-92 due to measures like high interest rate, import compression and credit squeeze, has been picking up from year to year. Industrial growth was 1.7 per cent in 1991-92, 4.4 per cent in 1992-93, 4.3 per cent in 1993-94, 8.6 per cent in 1994-95 and 11.7 per cent in 1995-96. Industry is anticipated to experience double digit growth in 1996-97 as well.

A convincing impact of industrial reforms is reflected in multiple increase in investment envisaged, both domestic and foreign (Table 18.1). Project investment plans have more than doubled during 1990-1993. This is due to encouraging response from the private sector. As a result, the ownership pattern of investment projects is undergoing a transformation (Annexure VI).

What is heartening is the response from private sector investment in the power sector. Private and joint sector proposals together accounted for only 10 per cent in 1990 but increased to almost 40 percent in 1993.

Table 18.1 : Investments Envisaged

Year	No. of. Projects	Total Project Cost (Rs. crore)
1982	194	1,07,612
1990	2157	3,14,092
1993	2664	6,34,793

4. The reforms introduced in the public sector are minimal. What more needs to be done? Explain.

5 Describe the overall impact of the Industrial Policy 1991 on Indian Industry.

6. What will be the impact of IP 1991 on the technology status of Indian industry? Analyse.

7. Briefly describe the role, composition, function and-objectives of FIPB.

8. List out the procedures involved in setting up and starting a manufacturing unit in India.

9. Compare the objectives of IPR 1956 and IP 1991 to bring out the distinguishing features of the latter.

10. List out the merits of industrial delicensing.

11. Prepare a case in favour of foreign investment of a developing country.

12. The emergence of large industrial houses need not necessary be bad for the economy. Elaborate this statement.

13. Public sector reforms are essential especially because public sector performance in terms of social objectives and financial returns is dishearteing. Do you agree? Write an essay.

18.11 FURTHER READINGS

1. UNIDO: INDIA: Towards Globalisation, 1995
2. Ministry of External Affairs : India : Business Perspectives, 1995
3. Andesara J.C.: Industrial Policy and Planning, 1947-1991, Sage publications, New Dilhi, 1991.

ANNEXURE - I

List of Industries reserved for the public sector

1. Arms and ammunition and allied items of defence equipment, defence aircraft and warships.
2. Atomic energy.
3. Coal and Lignite.
4. Mineral Oils.
5. Minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953.
6. Railway transport.

ANNEXURE - II

List of Industries for which industrial licensing is compulsory

1. Coal and Lignite.
2. Petroleum (other than crude) and its distillation products.
3. Distillation and brewing of alcoholic drinks.
4. Sugar.
5. Animal fats and oils.
6. Cigars and cigarettes of tobacco and manufactured tobacco substitutes.
7. Asbestos are asbestos-based products.
8. Plywood, decorative eneers and other wood based products such as particle board, medium density fibre board/block board.
9. Tanned or dressed furskins, chamois leather.
10. Paper and Newspring except bagasse-based units.
11. Electronic aerospace and defence equipment: all types.
12. Industrial explosives including detonating fuses, safety fuses, gun powder, nitrocellulose and matches
13. Hazardous chemical.
14. Drugs and Pharmaceuticals (according to Drug Policy).
15. Entertainment Electronics (VCRs, Colour TVs, C.D.players, Tape recorders).

ANNEXURE - III

List of cities with the population of 10 lakh and above according to the provisional results of the 1991 Census

Name of the cities	Provisional population according to the 1991 Census
1. Greater Bombay U.A.*	12,571,720
2. Calcutta U.A.	10,916,272
3. Delhi U.A	8,375,188
4. Madras	5,361,468
5. Hyderabad U.A.	4,280,261
6 Bangalore U.A.	4,086,548
7 Ahmedabad U.A	3,297,655
8. Pune U.A.	2,485,014
9. Kanpur U.A.	2,111,284
10 Nagpur U.A.	1,661,409
11. Lucknow U.A.	1,642,134
12. Surat U.A.	1,517,076
13. Jaipur U.A.	1,514,425
14. Kochi U.A.	1,139,543
15. Coimbatore U.A	1,135,549
16. Vadodara U.A.	1,115,256
17. Indore U.A.	1,104,065
18. Patna U.A.	1,098,572
19. Madurai U.A.	1,093,702
20. Bhopal. M.C.**	1,063,662
21. Visakhapatnam U.A.	1,051,918
22. Varanasi U.A.	1,026,467
23. Ludhiana M.C.	1,012,062

* u.a = Urban Agglomeration, M.C. ** = Municipal Corporation

ANNEXURE - IV

List of industries eligible for automatic approval of foreign technology agreements and 51% foreign equity

1. Metallurgical Industries

- (i) Ferro Alloys
- (ii) Casting and forgings
- (iii) Non-ferrous metals and their alloys
- (iv) Sponge iron and pelletisation
- (v) Large diameter steel welded pipes of over 300 mm diameter and stainless steel pipes
- (vi) Pig iron

2. Boilers and Steam Generating Plants

3 Prime Movers (Other than electrical Generators)

(i) Industrial turbines

(ii) Internal combustion engines

(iii) Alternate energy systems like solar wind etc. and equipment therefore

(iv) Gas/hydro/steam turbines upto 60 MW

4. Electrical Equipment

(i) Equipment for transmission and distribution of electricity including power and distribution transformers, power relays, HT-switch gear synchronous condensers

(ii) Electrical motors

(iii) Electrical furnaces, industrial furnaces and induction hearing equipment

(iv) X-ray equipment

(v) Electronic equipment, components including subscribers' and telecommunication equipment

(vi) Component wires for manufacture of lead-in wires

(vii) Hydro-steam/gas generators/generating sets upto 60 MW

(viii) Generating sets and pumping sets based on internal combustion engines

(ix) Jelly - filled telecommunication cables

(x) Optic fibre

(xi) Energy efficient lamps; and

(xiii) Midget carbon electrodes

5. Transportation

(i) Mechanised sailing vessels upto 10,000 DWT including fishing trawlers

(ii) Ship Ancillaries

(iii) (a) Commercial vehicles, public transport vehicles including automotive commercial three wheeler jeep type vehicles, industrial locomotives

(b) Automotive two wheelers and three wheelers

(C) Automotive components/ spares and anciliaries

(iv) Shock absorbers for railway equipment; and

(v) Brake systems for railway stock and locomotives

6. Industrial Machinery

(i) Industrial machinery and equipment

7. (i) Machine tools and industrial robots and their controls and accessories

(ii) Jigs, fixtures, tools and dies of specialised types and cross land tooling; and

(iii) Engineering production aids such as cutting and forming tools, patterns and dies and tools

8. Agricultural Machinery

(i) Tractors

(ii) Self-propelled harvester combines

(iii) Rice transplanters

9. Earth Moving Machinery

(i) Earth moving machinery and construction machinery and components thereof

10. Industrial Instruments

(i) Indicating, recording and regulating devices for pressure, temperature, rate of flow weights levels and the like

11. Scientific and Electromedical Instruments and Laboratory Equipment

12. Nitrogenous and phosphatic Fertilizers falling under

(i) Inorganic fertilizers under '18-fertilizers' in the First Schedule to IDR Act, 1951

13. Chemical (other than fertilizers)

(i) Heavy organic chemicals including petrochemicals
(ii) Heavy inorganic chemicals
(iii) Organic fine chemicals
(iv) Synthetic resins and plastics
(v) Manmade fibres
(vi) Synthetic rubber
(vii) Industrial explosives
(viii) Technical grade insecticides, fungicides, weedicides and the like
(ix) Synthetic detergents
(x) Miscellaneous chemicals (for industrial use only)
- (a) Catalysts and catalyst supports
- (b) Photographic chemicals
- (c) Rubber chemicals
- (d) Polyols
- (e) Isocyanates, urethanes, etc.
- (f) Speciality chemicals for enhanced oil recovery
- (g) Heating fluids
- (h) Coal for distillation and products thereiorm
- (i) Tonnage plants for the manufacture of industrial gases
- (j) High atitude breathing oxyzen/medical oxygen
- (k) Nitrous oxide
- (l) Refrigerants gases like liquid nitrogen, carbondioxide etc. in large volumes
- (m) Argon and other rare gases
- (n) Alkali/acid resisting cement compound
- (o) Leather chemicals and auxiaries

14. Drugs and Pharmaceuticals (According to Drug Policy)

15. (i) Paper and pulp including paper products
(ii) Industrial laminates

16. (i) Automobile tyres and tubes
(ii) Rubberised heavy dut, industrial betings of all types
(iii) Rubberised conveyor betings
(iv) Rubber reinforced and lined fire - fighting hose pipes
(v) High pressure braided hoses
(vi) Engineering and industrial plastic products.

17. Plate Glass

(i) Glass/shells for television tubes
(ii) Float glass and plate glass
(iii) H.T.insulators
(iv) Glass fibres of all types

18 Ceramics

(i) ceramics for industrial uses

19. Cement Products

(i) Portland cement

(ii) Gypsum boards, wall boards and the like

20. High Technology Reproduction and Multiplication Equipment

21 Carbon and Carbon Products

(i) Graphite electrodes and anodes

(ii) Impervious graphite blocks and sheets

22 Pretensioned High Pressure RCC Pipes

23. Rubber Machinery

24. Printing Machinery

25. Welding Electrodes other than those for Welding mild Steel

26. Industrial Synthetic Diamonds

27 (i) Photosynthesis improvers

(ii) Genetically modified free living symbiots nitrogen fixer

(iii) Pheromones

(iv) Bio-insecticides

28. Extraction and Upgrading of Minor Oils

29. Pre-fabricated Building Material

30. Soya Products

(i) Soya texture proteins

(ii) Soya protein isolates

(iii) Soya protein concentrates

(iv) Other specialised products of soyabean

(v) Winterised and deodourised refined soyabean oil

31. (a) Certified high yielding hybrid seeds and synthetic seeds, and

(b) Certified high yielding plantlets developed through plant tissue culture

32. All food processing industries other than milk food, malted foods, and flour, but excluding the items reserved for Small-Scale sector

33. All items of packaging for food processing industries excluding the items reserve for small scale sector

34. Hotels and tourism related industry

35. Electronics Software

ANNEXURE

List of Consumer Goods Industries where Dividend Balancing is Required

1. Manufacture of food and food products
2. Manufacture of dairy products
3. Grain Mill products
4. Manufacture of bakery products
5. Manufacture and refining of sug (vacuum pan sugar factories

6. Production of common salt
7. Manufacture of Hydrogenerated oil (vanaspati)
8. Tea processing
9. Coffee
10. Manufacture of beverages, tobacco, and tobacco products
11. Distilling, rectifying and blending of spirits, wine industries malt liquors and malt, product of country liquors and toddy
12. Soft drinks and carbonated water industry
13. Manufacture of cigars, cigarettes, cheroot and cigarette tobacco
14. Manufacture of wood and wood products, furniture and fixtures
15. Manufacture of leather and fur/lether products
16. Training, curing, finishing, embossing and japanning of leather
17. Manufacture of footwear (excluding repair) except vulcanized or moulded rubber or plastic wear.
18. Manufacture of footwear made primarily of vulcanzed or moulded rubber or plastic wear
19. Prophylactics rubber contraceptive)
20. Motor cars
21. Entertainment Electronics (VCRs, Colour TVs, CD Players, Tape Recorders)
22. White Goods (Domestic Refrigerators, Domestic Dishwashing Machines, Programmable Domestic Washing Machines, Microwave Ovens, Airconditioners)

ANNEXURE - VI

Ownership Pattern of Projects (in per cent)

1. Mining and Manufacturing

Year	*Central Government*	*State Government*	*Joint Sector*	*Private Sector*	*Foreign*
1990	35	1	19	42	2
1993	32	1	17	44	5

II. Power Sector

Year	*Central Government*	*State Government*	*Private and Joint Sector*
1990	43	47	10
1993	21	40	39

ANNEXURE - VII

Share of Government Holding in Central public Sector Undertakings after Divestment, of 1 May 1995

Cochin Refineries	55.0
Andrew Yule & Co.	62.8
Madras Refineries	67.7

Hindustan Petroleum	62.9
Bharat Petroleum	70.0
Bongaigaon Refineries	74.6
Hindustan Zinc	74.9
Indian Telephone Industries	78.2
Bharat Heavy Electricals	68.5
Bharat Earthmovers	75.0
Bharat Electronics	75.9
Mahanagar Telephone Nigam Limited	67.1
Shipping Corporation of India	81.5
Computer Maintenance Corporation	83.5
Videsh Sanchar Nigam Limited	85.0
Hindustan Photofilms	87.5
National Aluminium Company	87.1
Steel authority of India Limited	89.5
Hindustan Machine Tools	90.3
Rashtriya Chemical Fertilizers	92.5
Neyvelli Lignite Corporation	93.3
State Trading Corporation	91.0
Hindustan Cables	96.3
Indian Petrochemicals Corporation Limited	80.0
National Fertilizers	97.7
Natural Mineral Development Corporation	98.4
Hindustan Copper	98.9
Dredging Corporation of India	98.6
Fertilizers and Chemicals Travancore Limited	98.3
Hindustan Organic Chemicals	79.9
Minerals and Metals Trading Corporation	99.4

UNIT 19 ECONOMIC REFORMS - LIBERALISATION, GLOBALISATION AND PRIVATISATION

Objectives

After reading this unit you should be able to:

- develop a clear understanding about the concepts of liberalisation, globalisation and privatisation
- understand and appreciate the interrelationship between liberalisation, globalisation and privatisation
- understand the merits and demerits of the economic reforms undertaken in relation to liberalisation, globalisation and privatisation

Structure

).1 Introduction
).2 Liberalisation
.3 Globalisation
.4 Privatisation
.5 Liberalisation, Globalisation and Privatisation: To Work for a Common Goal
.6 Review of Economic Reforms related to liberalisation, Globalisation and Privatisation
7 Summary
8 Key Words
9 Self-Assessment Questions
10 Further Readings

).1 INTRODUCTION

›nomic Reforms in India were started by Rajiv Gandhi in 1985 soon after taking over as ne Minister. The young Prime Minister in his first national broadcast said: The public tor has entered into too many areas where it should not be. We shall open the economy he private sector in several areas hitherto restricted to it. Consequently, a number of asures were taken to remove controls, open areas to private sector players. This may described as the first phase of liberalisation. Some of the measures initiated by his ernment were :

- Cement was decontrolled and a number of licences were issued to private sector units to produce cement.
- The share of free sale sugar was increased to help the sugar industry.
- The ceiling asset limit of big business houses was raised from Rs. 20 crores to Rs. 100 crores.
- 94 drugs were delicensed and 27 industries were brought out of the purview of the MRTP Act.
- Electronics industry was freed from the restrictions of the MRTP Act. Foreign firms were welcomed in this area.
- A scheme of broad banding was introduced. This implied that within the overall capacity, firms were free to produce a range of commodities. For instance, in lieu of the licence

to produce upto 350 cc ebgubes capacity, firms were allowed to produce two wheelers of any type - scooters, motor-cycles, mopeds etc. the process of boradbanding was extended to 25 categories of industries. These industries included four wheelers, chemicals, pharmaceuticals, Petro-chemicals, typewriter of all types - manual, electric and electronic. The industrialists were not required to take a licence of each and every item in a group, but were entitled to the production of a range of products within a group.

However, Rajiv Gandhi did not take a very strong and categorical position on the issue of privatisation and globalisation, through some liberalisation of the economy did take place. It was only when P.V.Narasimha Rao took over as Prime Minister in 1991 that a new industrial policy was announced which marked a sharp departure from the earlier industrial policy of 1956.

There were three aims of the New Economic Policy :

- Liberalisation
- Globalisation
- Privatisation

19.2 LIBERALISATION

The main aim of liberalisation was to dismantle the excessive regulatory framework which acted as a shackle on freedom of enterprise. Over the years, the country had developed a system of "Licence-permit raj". The aim of the new economic policy was to save the entrepreneurs from unnecessary Harassment of seeking permission from the Babudom (the bureaucracy of the country) to start an undertaking.

Similarly, the big business houses were unable to start new enterprises because the Monopolies and Restrictive Trade Practices (MRTP) Act had prescribed a ceiling on asset ownership to the extent of Rs. 100 crores. In case a business house had assets of more than Rs. 100 crores, its application after scrutiny by the MRTP Commission was rejected. It was believe that on account of the rise in prices this limit had become outdated and needed a review. The second objection by the private sector lobby was that it prevented big industrial houses from investing in heavy industry and infrastructure which required lumpsum investment. The Bhartiya Janata Party in its election manifesto (1991) had suggested that the asset limit of MRTP companies should be raised to Rs. 1,000 crores. The government thought it wise to abolish the limit altogether so that big business could establish big projects in the core sectors - heavy industry, infrastructure, petrochemicals, electronics etc The government was of the view that in the context of the wave of liberalisation, the MRTP limit had become irrelevant and needed to be scrapped.

The major purpose of liberalisation was to free the large private corporate sector from bureaucratic controls. It therefore, started dismantling the regime of industrial licensing and controls. In pursuance of this policy, the industrial policy of 1991 abolished industrial licensing for all projects except for a short set of 18 industries.

On April 14, 1993, the Cabinet Committee on Economic Affairs decided to remove three more items from the list of 78 industries reserved for compulsory licensing. The three items were: motor cars, white goods (which include refrigerators, washing machines, air-conditioners, microwave ovens etc.) and raw hides and skin and patent leather. In the case of cars and white goods, the basic purpose of dereservation was to increase investment in industries in procuring cars and white goods so that the demand of the large middle class ranging from 100 to 120 million can be satisfied. These commodities are no longer considered as luxury goods, but are considered as domestic gadgets to reduce the drudgery of domestic work. Motor cars are considered to be status symbols and the provision of loans to business executives and other senior officials has also stimulated the demand for cars. The government, in response to the market demand, liberalised the industries producing these

goods and freed them from industrial licensing.

The abolition of licensing for raw hides and skins and patent leather is motivated by the desire to push up exports. Since the potential for leather and good quality shoe exports is vary large, the government decided to abolish licensing so that large scale units could realise this potential by the use of modern technology.

The list of industries in which Industrial Licensing is compulsory:

1. Coal and Lignite
2. Petroleum (other than crude) and is distillation products
3. Distillation and brewing of alcoholic drinks
4. Sugar
5. Animal fats and oils
6. Cigars and Cigarettes of tobacco and manufactured tobacoo substitutes
7. Asbestos and asbestos - based products
8. Plywood, decorative veneers and other wood based products
9. Raw hides and skins, leather, chamois leather and patent leather
10. Tanned or dressed furskins
11. Paper and newsprint except bagasse-based units
12. Electronics, aerospace and defence equipment: all types
13. Industrial explosives
14. Hazardous chemicals
15. Drugs and Pharmaceuticals

19.3 GLOBALISATION

Globalisation intends to integrate the Indian economy with the world economy. Globalisation considered to be an important element in the reforms package. It has four parameters:

(i) Reduction of trade barriers so as to permit free flow of goods and services across national frontiers;

(ii) Creation of an environment in which free flow of capital can take place;

(iii) Creation of an environment permitting free flow of technology among nation-states; and

(iv) Creation of an environment in which free movement of labour can take place in difference countries of the world.

The advocates of globalisation, especially from the developed countries, limit the definition of globalisation to only three components, vix., unhindered trade flows, capital flows and technology flows. They insist that the developing countries accept their definition of globalisation and conduct the debate on globalisation within the boundaries set by them. But several economists and social thinkers in developing countries believe that this definition is incomplete. If the ultimate aim of the globalisation movement is to integrate the world into one global village, then the fourth component of unrestricted movement of labour cannot be left out. But whether the debate about globalisation is carried out at the world Trade Organisation (WTO) or at any other international forum, there is a deliberate effort to black out 'labour flows' as an essential component of globalisation.

To pursue the objective of globalisation, the following measures have been taken:

(I) Reduction of import duties : There has been a considerable reduction in import

duties during the last 5 years. The maximum rate was reduced from 150% in 1991-92 to 110% in 1992, to 85% in 1993-94, and 50% in 1995-96. Custom duties on imports of capital goods were reduced to 80% in July 1991, to 55% in 1992 and to 25% in 1995. Tariffs on imports of raw materials and manufactured intermediates have also been reduced. Besides this, the government has attempted to rapidly dismantle quantitative restriction on imports and exports. It has also undertaken adjustment of exchange rate so as to remove over-valuation of currency,. This has helped in stepping up exports.

On the 8th of February, 1997 the Commerce Ministry removed restrictions on 162 items for imports. Out of them, 39 items were moved from Special Import Licence (SIL) to free imports. Among these items are escalators and moving walkways, cable cars, burglar and fire alarms, cameras of all kinds, auto - bank note dispensers, industrial vacuum cleaners and various kinds of glassware. Besides this, 93 items were moved from industrial to SIL (Special Import Licence) list which included photographic films rubber stoppers, aluminimum beverage cans, car air-conditioning machines, cosmetic perfumes, picture tubes below 14 inches and a wide range of office machines.

(II) Encouragement of Foreign investment: The government has taken number of measures to encourage foreign investment. The main measures taken in this regard are:

(a) Approval would be given for direct investment upto 51 per cent foreign equity in high priority Industries as per Industrial Policy of 1991. There shall be no bottlenecks of any kind in this process. Such clearances will be given if foreign equity covers the foreign exchange requirements for imported capital goods.

On the 31 st of December, 1996 the Cabinet gave irts assent to a new list of industries whereby joint ventures with upto 74 per cent foreign equity would be cleared auto - matically. Among the industries listed for the purpose are: Mining

services such as oil and gas fields services, basic metals and alloy industries, other manufacturing industries related to the items based on solar energy like solar cells, cookers, air and water heating systems, small hydro-equipment, construction and maintenance of roads, bridges, tunnels, pipelines, ropeways, ports, harbours and runways, electric generation and transmission and other infrastructure. The basic purpose of this move is to facilitate direct foreign investment in India.

(b) To provide access to international markets, majority foreign equity holding upto 51% equity would be allowed for trading companies primarily engaged in export activities.

(III) Encouragement to foreign technology agreement : The Industrial Policy o 1991 undertook the following measures :

(a) Automatic permission will be given for foreign technology agreements in high priority industries upto a lumpsum payment of Rs. 1 crores, 5% royalty for domestic sales and 8% for exports, subject to total payments of 8% sales over a 10 year period from the date of the agreement or 7 years from commencement of production.

(b) In respect of other industries, automatic permission would be given if no free foreign exchange is required for any payments.

(c) No permission will be necessary for hiring of foreign technicians and foreign testing of indigenously developed technologies.

19.4 PRIVATISATION

Privatisation is the process of involving the private sector in the ownership or operation of a state owned or public sector undertaking. It can take three forms: (i) Ownership measures; (ii) Organisational measures; and (iii) Operational measures.

(i) **Ownership measures :** The degree of privatisation is judged by the extent of ownership transferred from the public enterprises to the private sector. Ownership may be transferred to an individual, co-operative or corporate sector. This can have three forms:

(a) **Total denationalisation** implies 100 per cent transfer of ownership of a public enterprise to private sector.

(b) **Joint venture** implies partial transfer of public enterprise to the private sector. It can have several variants- 25% transfer to private sector in a joint venture implies that majority ownership and control remains with the public sector. 51% transfer of ownership to the private sector shifts the balance in favour to the private sector, through the public sector retains a substantial stake in the undertakings. 74% transfer to ownership to the private sector implies a dominant share being transferred to private sector. In such a situation, the private sector is in a better position to change the character of the enterprise.

(c) **Liquidation** implies sale of assets to a person who may use them for the same purpose or some other purpose. This solely depends on the preference of the buyer.

(d) **Workers, co-operative** is a special form of denationalisation. In this form, ownership of the enterprises is transferred to workers who may form a co-operative to run the enterprise. In such a situation, appropriate provision of bank loans is made to enable works to buy the shares of the enterprise. The burden of running the enterprises rest on the workers in a workers' co-operative. The workers become entitled to ownership dividend besides getting wages for their services.

(ii) **Organisational measures** include a variety of measures to limited state control. They include:

(a) **A holding company structure** may be designed in which the government limits its control to top level major decisions and leaves a sufficient degree of autonomy for the operating companies in their day-to-day operations. A big company like the Steel Authority of India (SAIL) or Bharat Heavy Electricals Limited (BHEL) may acquire a holding company status, thereby transferring a number of functions to its smaller units. In this way, a decentralised pattern of management emerges.

(b) **Leasing:** In this arrangement, the government agrees to transfer the use of assets of a public enterprise to a private bidder for a specified period, say of 5 years. While entering into a lease, the bidder is required to give an assurance of the quntum of profits that would be made available to the state. Thsi is a kind of tenure ownership. The government reserves the right to review the lease to the same person or to grand the lease to another bidder depending upon the circumstances of the cases.

(c) **Restructuring** is of two types: financial restructuring and basic restructuring.

(1) **Financial Restructuring** implies the writing off of accumulated losses and rationalisation of capital composition in respect of debt-equity ratio. The main purpose of this restructuring is to improve the financial health of the enterprise.

(2) **Basic Restructuring** is said to occur when the public enterprise decides to shed some of its activities to be taken up by ancillaries or small scale units.

(iii) **Operational measures:** The efficiency of public sector enterprises depends upon the organisational structure. Unless this structure grants a sufficient degree of autonomy to the operators of the enterprise or develops a system of incentives, it cannot raise its efficiency and productivity. these measures include : (a) grant of autonomy to public enterprises in decision making, (b) provision of incentives for workers and executives consistent with increase in efficiency and productivity, (c) freedom to acquire certain inputs from the markets with a view to reducing costs, (d) development of proper criteria

for investment planning, and (e) permission to public enterprises to raise resources from the capital market to execute plans of diversification/expansion. The basic purpose of operational measures is to infuse the spirit of private enterprise in public enterprises so that government control is effectively reduced and private initiative is promoted.

Privatisation in a narrow sense indicates transfer of ownership of a public sector undertaking to private sector, either wholly or partially. But in another sense, it implies the opening-up of the private sector to areas which were hitherto reserved for the public sector. Such deliberate encouragement of investment to the private sector in the economy, while emphasising to a lesser degree the expansion or growth of the public sector, will our a period of time increase the overall share of the private sector in the economy. This is the broader view in which privatisation of the economy can be effected. The basic purpose is to limit the areas of the public sector and to extend the areas of private sector operation, including heavy industries and infrastructure.

19.5 LIBERALISATION, GLOBALISATION AND PRIVATISATION : TO WORK FOR A COMMON GOAL

Liberalisation, golbolisation and privatisation are all means to achieve certain ends of the society, just as nationalisation and regulatory framework were intended to achieve certain goals. These are:

1. To achieve high rate of growth of national and per capita income
2. To achieve full employment
3. To achieve self-reliance
4. To reduce inequality of income and wealth
5. To reduce the number of people living below the poverty line
6. To develop a pattern of society based on equality and absence of exploitation.

It is true that the operation of the public sector and the regulatory framework resulted in certain problems as we noted on a previous unit. Let us recapitulate there problems:

- The excessive development of bureaucratic controls began to act as shackles on growth
- Overstaffing in public sector enterprises leads to an increase in cost of operation
- Low rate of return on investment in public sector
- Poor work ethic in public sector enterprises due to excessive job security and absence of incentives for better work
- Entry of public sector in areas of consumer goods for which it was never meant. Thus, this unnecessary expansion resulted in absence of focus and dilution in the quality of management.
- Some public sector enterprises were incurring losses year-after-year and as such had become a burden on the public exchequer, instead of being an asset to the nation.

The measure undertaken, whether under liberalisation, globalisation or privatisation, are all designed to rectify these problems so that working of the economy becomes more efficient and the rate of growth of the economy improves. Higher rate of growth, it is felt, is the remedy to improve the level of employment, to reduce poverty and to assure a better living standard to people. It would, therefore, be necessary to review economic reforms and study their impact during the last 5 years or so.

19.6 REVIEW OF ECONOMIC REFORMS RELATED TO LIBERALISATION, GLOBALISATION AND PRIVATISATION

The advocates of the reforms process claim a number of achievements. Critics of reform have drawn attention to various aspects of reform. However, there seems to be a general agreement long all political parties that the reforms are a historical necessity and it would not be possible to reverse the reform process. Even the Left parties, after the collapse of the Soviet Union, have veered round the view that reforms in the form of liberalisation, privatisation and globalisation will have to be undertaken. The focus of the debate is to ensure that whereas the reform process has helped to accelerate growth, the benefits of growth have not percolated to the poor and weaker sections of the society. It would, therefore, be desirable to consider the various arguments so as to understand the manner in which the measures taken need to be modified so as to achieve the objective of growth with social justice.

Table 19.1: Growth Rate of Gross Domestic Product

(at 1980-81 prices)

Year	Growth Rate
1991-92	0.9%
1992-93	5.0%
1993-94	4.5%
1994-95	6.7%
1995-96	6.3%
1996-97*	6.8%

* Estimated

Higher growth rate achieved : Since the reform process was initiated, the growth rate of the economy started picking up. There is no doubt that the growth rate of Gross Domestic Product slumped down to 0.9 percent in 1991-92, but started picking up thereafter. During 1992-93, it was 5.0 per cent ; it improved to 6.7 per cent in 1994-95 was 6.3 per cent in the 1995-96 and is estimated to be 6.8 per cent for 1996-97. The average growth rate of over 6 per cent during the last 5 years (1992-93 to 1996-97) is an achievement of the reform process. This would result in an average 4 per cent growth rate of per capital GDP. This is an achievement which has not been witnessed earlier during the last 45 years of planning.

Control of inflation : The record of the measures to control inflation has been mixed. During 1992-93, wholesale price index (WPI) (1981-82 = 100) rose by merely 7 per cent as against the price increase by 13.7 per cent during 1991-92. But the situation again took a turn for the worse during 1993-94 and 1994-95, and the WPI rose by 10.8 per cent and 10.4 per cent respectively. Thereafter, due to strong measures taken during 1995-96, the rate of inclation slowed down to 5 percetn. Howver, during 1996-97, upto January 4, 1997, price rise of the order of 6.8 per cent has already taken place and as per indications available, the rate of inflation (WPI) is likely to be in the range of 8-9 per cent during 1996-97.

However, the impact of inflation on the common man is measured by the consumer price index (CIP). Comparable figures of rise of CPI for industrial workers during the last 5 years reveal that CPI for industrial workers has been rising more or less in the range of about 10 per cent per annum. Similarly, the Consumer price Index for Agricultural Labourers (CPIAL) more comprehensive index to measure the welfare of rural workers has shown an average which of over 10 per cent during the last four years. This implies the failure of reform process to control inflation, despite the achievement of high growth rate of GDP. This has serious welfare implications.

Table 19.2 : Wholesale and Consumer Price Index in India

Year	PERCENTAGE INCREASE IN Wholesale Price Index (1981-82 = 100)	Consumer Price Index of Industrial workers (1982=100)	Consumer Price Index for Agricultural Labourers (1986-87 = 100)
1991-92	13.8	13.4	
1992-93	7.0	6.1	0.6
1993-94	10.8	9.9	11.2
1994-95	0.4	9.7	11.1
1995-96	5.0	9.7	7.2
1996-97*	6.8	8.5	9.7

* Upto January 4, 1997

However, the impact of inflation on the common man is measured by the consumer Price index (CPI). Comparable figures of rise of CPI for industrial workers during the last 5 years reveal that CPI for industrial workers has been rising more or less in the range of about 10 per cent per annum. Similarly, the Consumer Price Index for Agricultural labourers (CPIAL) which is a more comprehensive index to measure the welfare of rural workers has shown an average rise of over 10 per cent during the last four years. This implies the failure of reform process to control inflation, despite the achievement of high growth rate of GDP This has serious welfare implications.

Reform of the Public Sector: The major aim of economic reforms is to improve the public sector so that the rate of return improves. To remedy the situation, it was necessary that over-staffing of the public sector undertakings (PSUs) be reduced. The government has already taken steps in this direction by its voluntary retirement scheme (VRS). For this purpose, the government set up the National Renewal Fund (NRF) to provide comensation for voluntary retirement and also arrange for retraining and redeployment of workers. In 1990-91, there were 22.19 lakhsemployees in PSUs of the Central government. but in 1994-95 their number has been reduced to 20.41 lakhs. This implies that, as a result of the VRS, overstaffing has been reduced by 1.78 lakhs, In other works, employees strength has been reduced by 8 per cent. Under the NRF, an amount of Rs. 542 crores was provided in 1993-94 and Rs. 261 crores in1994-95. But a major compliant about the working of the NRF is that the entire amount has been used for providing compensation for voluntary retirement scheme (VRS) and the function of retraining and redeployment of workers has been neglected.

Whenever the government tried to privatise any public sector undertaking, the opposition to the movement was so strong that the government did not succeed. the government under the provisions of Sick Industrial Companies Act (SICA) referred the cases of sick PSUs to the Bereau for Industrial and Financial Reconstruction (BIFR). Upto 31st March 1995, 53 central sick public sector undertakings were registered with BIFR. The BIFR has taken a decision for the revival of Indian Drugs and Pharmaceuticals Ltd., Orissa Drugs and Chemicals Ltd., Smith Stánistreet and Pharmaceuticals Ltd., Bharat Brakes and Valves Ltd., Biecco Lawrie Ltd. and Bengal Immunity Ltd. It has also decided to wind up some PSUs. They are: National Bicycles Corporation of India Ltd., Elign Mill Co.Ltd., British Indian Corporation Ltd., Cawnpore Textile Ltd. and Footwear Corporation Ltd. The cases of other registered Public Sector Enterprises are under enquiry.

The government has also decided to sign Memoranda of understanding (MoU's) with various public sector enterprises. The main goal of MoU policy is to reduce the 'quality of control'

and increase the 'quality of accountability'. The MoUs grant greater operational autonomy of PSUs to pursue their objectives. Out of the 99 PSEs which signed MoUs with their administrative ministries, 46 were rated as 'Excellent' and 28 as 'Very good'.

The net result of the efforts of the government was that the overall net profit earned by Central PSEs increased from Rs. 4,545 crores in 1993-94 to Rs. 7,217 crores which signifies an increase of 58.8 per cent over the previous year. This is a welcome development.

Another step taken by the government was disinvestment of PSUs. The government has been offering equity of 31 elected public sector enterprises varying from 5 to 20 % to Mutual Funds and Financial Institutions. This is only a token privatisation and the government was able to raise Rs.. 9,793 crores during the four year period (1991-92 to 1994-95). However, the disinvestment programme did not pick up during 1995-96 and 1996-97, despite the fact that the government has been making a provision of Rs. 5,000 crores every year in the budget. Moreover, critics describe disinvestment as **deficit privatisation,** because the proceeds of the disinvestment are being used to reduce the budget deficit. The Common Minimum Programme of the United Front Government stipulated that the proceeds of disinvestment will be used in two vital areas - health and education. A part of the proceeds of disinvestment will be earmarked to create an investment fund which will be used to strengthen other public sector enterprises. In view of the pressures to curtail the deficit and the poor response to disinvestment efforts during 1996-97, it appears doubtful whether the guidelines laid down to utilise disinvestment funds will be adhered to.

On the whole the reforms of PSUs, including privatisation and phasing out of unviable units have not gathered as much momentum as head been hoped for. Disinvestment has been piecemeal and the funds so raised are being used to reduce budget deficits, rather than strengthen the PSUs. Along with this, labour problems, political and bureaucratic interference have not been effectively reduced. Since it is not possible to privatise a large component of the public sector, it would be advisable to reform it.

Large dose of foreign Capital to help Indian Economy

The reforms process, especially its emphasis on globalisation, was intended to help the acceleration of the growth process by attracting a larger dose of foreign capital. However, the efforts of the state met only with partial success. The data reveal that during 1991-92 to 1995-96 (upto Nov. 1995), total investment flows of the order of Rs. 11.74 billion were made, out of which portfolio investment was of the order Rs. 8.05 billion (68.5% of total) and direct foreign investment accounted for barely US $3.69 billion (31.5%). The point that needs to be emphasised is taht direct foreign investment is less than one-third Non-Residence total foreign investmetn. if adjustment is made for the contribution of Non-resident Indians is FDI to the tune of 10. 4 per cent, the net contribution of foreigners in FDI flows becomes 21.1 per cent (nearly one-fifth of the total). It need not be mentioned that portfolio investment is of a speculative nature and can take flight in a period of political uncertainty.

Moreover, critics point out that nearly 39 per cent of foreign investment is in the non-priority sector viz. Food processing, service sector, hotels and tourism, The entry of multinationals in consumer goods, like colas, jams, potato chips, wafes, ice-creams, etc. only displaces Indian labour and capital employed in the production of these commodities. The multinationals are keen to enter these areas of short gestation period and very high profitability. The critics, therefore, point out that while foreign investment and technology are needed, the government should be more selective by obtaining these for the capital goods and infrastructure sectors so that they enhance both the capacity and capability of the Indian economy.

Reform process and the foreign trade scenario: The reform process has led to growth of exports, but simulltaneously, it has also led to a larger growth of imports. As a consequence, the trade gap has not been reduced. Moreover, the figures of exports and

imports, as given by DGCIS, do not include defence imports.

Consequently the trade balance as given by the DGCIS and RBI show a wide gap. However, it should be pointed out that it ultimately the RBI data which shows total actual transactions.

Table 19.3: Data about trade balance during the post - Reform period

($ million)

	91-92	92-93	93-94	94-95	95-96	96-97*
Exports	17,866	18,537	22,238	26,330	31,828	36,000
Imports	19,555	21,880	23,303	28,259	36,367	40,400
Trade balance (DGCIS)	-1,689	-3,343	-1,065	-1,929	-4,539	-4,400
Trade balance (RBI)	-2,798	-4,368	-2,386	-4,983	-8,938	-8,500
(as % of GDP)						
Exports	7,1	7,6	8,7	8,7	9,7	10,2
Imports	7,8	9,0	9,1	9,4	11,1	11,1
Trade balance (DGGIS)	-0.7	-1.4	-0.4	-0.7	-1.4	-1.2
Trade balance (RBI)	-1.7	-1.8	-0.9	-1.5	-2.8	-2.3

Source: *Centre for Monitoring Indian Economy.*

The gap between RBI data and DGCIS data shows that the basis of our trade policy should be the RBI data rather than DGCIS data which seriously understates the position.

Data given in table 19.4 reveals that the extent of variation in trade deficit as shown by Director General of Commercial Intelligence & Statistics (DGCIS) and Reserve Bank of India (RBI) is as high as 158 per cent in 1994-95 and about 97 per cent in 1995-96. Consequently, the cold comfort that the Finance Minister have been deriving by stating that trade deficit as a percentage of GDP was below 2 per cent in 1995-96 is a false conclusion, in view of the stark reality that it is 2.8 per cent of the GDP. Obviously, globalisation has failed to reduce the trade gap, more so if we take into account total imports, including defence imports as indicated by the RBI. Even the DGCIS data shows that excluding defence imports, export growth has moved at a lower pace as compared to imports. Consequently, there is need to re-examine the open door policy of imports as also to boost exports.

Table 19.4: Variation between DGCIS and RBI data on trade balance

(US $ million)

	Trade balance		
	DGCIS	**RBI**	**Percentage Variation**
1991-92	-1,689	-2,798	65.6
1992-93	-3,343	-4,368	30.7
1993-94	-1,065	-2.386	124.0
1994-95	-1,929	-4,983	158.3
1995-96	-4,539	-8,938	96.9

Note : Based on data provided by CMIE.

Reform process and fiscal deficit : A major objectives of the structural adjustment programme was to reduce the fiscal deficit. No doubt the government was able to reduce fiscal deficit as a proportion of GDP from 8.3 per cent in 1990-91 to 5.7 per cent in 1992-93, but the fiscal deficit again shot up to 7.5 percent in 1993-94. It was brought down to 6.1 per cent in 1994-95 and 5.8 per cent in 1995-96. Though the Finance Minister P.Chidambaram had promised that during 1996-97, fiscal deficit would be brought down to 5 per cent of GDP, present indications are that the deficit would be much higher. This is in view of the fact that whereas custom duties have been slashed the recorded of increased of exports and imports during 1996-97 is very dismal. Similarly, lower growth rate of industrial production would also reduce the yield from excise duties. These factors taken together would adversely affect revenues. The government has failed to arrest the using non-plan expenditures. It has decided to implement the Fifth pay Commission Report during 1996-97 so as to keep the fiscal deficit low for this year. But this is only postponing the evil day. The need of the hour is to reduce subsidies. both explicit and impact so that a more sustainable effect on fiscal deficit can be made.

Table 19.5: Exchange Rate of Rupee Vis-a-Vis US Dollar

	Rs. Per US $
1990-91	17.96
1991-92	24.47
1992-93	28.96
1993-94	31.37
1994-95	31.39
1995-96	33.45
1996-1997	35.60

Source : *Reserve Bank of India Bulletin.*

Reform process and the exchange value of the Rupee : The exchange rate of the Rupee vis-s-vis US $ was Rs. 17.96 in 1990-91, but gradually the exchange rate has been appreciating and it became 1 US $ = 31.37 in 1994-95 and Rs. 35.6 per US$ in 1996-97. In other words, the international value of the Rupee has become nearly half its level of 1990-91. The fall in the value of the Rupee results in an increase in the burden of international debt. Secondly, it adversely effects the foreign investor's confidence in India. The reform process has not suceeded in stabilising the Rupee exchange rate.

Economic Reform and India's Foreign Exchange Reserves: The advocates of globalisation claim that as a result of the reform process, foreign exchange reserves which had fallen to the level of US$ 2.2 billion started picking up and were around US$ 20.8 billion in 1994-95, but due to sharp deficit in balance of payments on current account in 1995-96, the reserves came down to US$ 17 billion. But the existence of the reserves which can finance imports for nearly six months is considered the sign of health of the economy. However, it may be noted that during the entire period of reform (1991-92 to 1995-96), in none of the year, the balance of payments on current account was positive. It has been negative throughout. The accumulation of foreign exchange reserves, the critics maintain, is the consequence of loans and borrowings from international financial institutions. They cannot be treated as an indicators of the strength of the economy.

Table 19.6: Balance of Payments of Current Account and Foreign Exchange Reserves (in US$ million)

Year	Balance of Payments on Current Account*	Foreign Exchange Reserves
1990-91	-9,678	2,236
1991-92	-1,178	5,631
1992-93	-3,526	6,434
1993-94	-1,158	15,068
1994-95	-2,701	20,809
1995-96	-5,487	17,046

Source : *Centre for Monitoring Indian Economy*

To Conclude it may be said that policies of liberalisation, globalisation and privasation which symbolise economic reforms have concentrated on short-term objectives such as controlling the deteriorating situation in balance of payments, building up foreign exchange reserves, reducing fiscal deficit, controlling inflation etc. However, the long-term goals of reducing poverty, achievement of full - employment, self-reliance and growth with social justice have remained unattended. The reform process has not even succeeded in reducing the fiscal deficit. The deficit is expected to touch Rs. 60,000 crores in 1996-97. Naturally there is a need to reorient economic reforms so as to achieve long-term goals of the society, more especially full-employment, self-reliance and growth with social justice.

19.7 SUMMARY

Economic Reforms were introduced by Shri Rajiv Gandhi soon after taking over as Prime Minister in 1985. He underlined the need for opening several areas hitherto reserved for the public sector to the private sector. Some measures of delicensing, raising the MRTP limit from Rs. 20 crores to Rs. 100 crores, broad-banding scheme etc. were taken, but the government did not take a categorical position on issues relating to privatisation and globalisation.

A sharp departure from the Industrial Policy of 1956 took place with the announcement of Industrial Policy 1991. Three major strategies of new economic policy are: (i) liberalisation, (ii) globalisation, and (iii) privatisation.

The main aim of **liberalisation** was to dismantle excessive regulatory frame work and bureaucratic control which acted as shackles on freedom of enterprise.

The ceiling on assets fixed under MRTP Act was abolishing in order to permit large houses to undertake investment in the core sectors - heavy industry, infrastructure, petro-chemicals, electronics, etc.

The number of items requiring licensing was reduced to a short list of bare 15 industries. This freed the private sector to set up industrial units quickly.

Globalisation intends to integrate the Indian economy with the world economy. Four parameters to globalisation are : Unhindered (i) trade flows, (ii) capital flows (iii) technology flows, and (iv) labour flows. The developed countries restrict the definition to only three and omit labour flows, globalisation will remain incomplete.

Measures promoting globalisation in India include:

(i) Reduction of import duties.

(ii) Encouragement of foreign investment through

(a) Grant of automatic approval for direct foreign investment upto 51 percent equity

participation.(In December 1996, the government announced a new list of industries whereby joint ventures upto 74 per cent foreign equity would be cleared automatically.

(b) majority foreign equity holding upto 51 per cent allowed in trading companies.

(iii) Encouragement of foreign technology agreements within prescribed limited of payments in foreign exchange.

Privatisation is the process involving the private sector in the ownership or operation of a state -owned undertaking. It has three forms:

(i) **Ownership measures** include : (a) Total denationalisation, (b) Joint ventures, (c) Liquidation, and (d) Workers' co-operatives.

(ii) **Organisational measures** include: (a) A holding company structure, (b) leasing, (c) Restructuring - either financial restructuring or basic restructuring, or both.

(iii) **Operational measures** and aimed at improving the efficiency and productivity of an organisation. They include:

(a) grant of autonomy in decision - making

(b) provision of incentives for workers and executives

(c) freedom to acquire certain inputs from the market

(d) development of proper criteria for investment planning

(e) permitting public enterprises to raise resources from the capital market.

The basic purpose is to infuse the spirit of private enterprises in PSUs.

Privatisation in a broader sense implies encouragement of investment by private sector in areas hitherto reserved for the public sector so that the overall share of private investment sector improves in the economy in the long run.

Liberalisation, globalisation and privatisation are intended to achieve certain long term goals of the society. These goals are: (i) higher growth of national and per capita income, (ii) fullemployment, (iii) self-reliance, (vi) reduction of inequalities of income and wealth, (v) reduction of population, below the poverty line. In nutshell those measures aim at creating a society based on growth with social justice.

Some of the problems associated with the public sector are:

(i) Excessive bureaucratic controls, (ii) Overstaffing, (iii) Low rate of return, (iv) poor work ethic, (v) unnecessary expansion in consumer goods sector, and (vi) some enterprises incurring losses year-after-year.

New economic reform should reform the public sector and endeavour to make it more efficient.

Review of Economic Reforms related to liberalisation, globalisation and privatisation

A near unanimity among political circles - from the left to the right - has been achieved on the need for economic reforms.

The need is to identify measures to modify reforms so as to achieve the objective of growth with social justice.

A. High growth rate of over 6 per cent during 1991/92 to 1996-97 - an unprecedented achievement of economic reforms in India.

B. Record of measures on controlling inflation is mixed. In some years wholesale price index indicated more than double digit inflation (1993-94 and 1994-95). But during 1995-96 and 1996-97 inflation rate has been brought down to 5 per cent and 8 percent respectively. However, impact of inflation on the common man has to be judged by the consumer price index which has been rising at the rate of about 10 per cent per year during the reform period This has serious welfare implications.

C. Reforms of the public sector has been attempted by various measures:

(i) Over staffing has been reduced by voluntary retirement scheme (VRS), and National

ewal Fund (NRF) has been created as a safety net. The unfortunate fact is that the :e NRF was used to finance VRS and the function of retrain and redeployment of 'enched workers was neglected.

ses of sick PSUs referred to BIFR which recommended revival packages in units nsidered viable and winding up of unviable units.

emorandum of Understanding (MoU) was signed with 99 public sector enterprises and more autonomy was granted.

As a result, Central PSEs earned overall net profit net profit of Rs. 7,217 crores in 1994-95 as against Rs. 4,545 crores in 1993-94/59 per cent increase. This is a welcome achievement.

(iv) Disinvestment of 31 selected PSUs was undertaken, varying from 5% to 20%, and the equity was offered to mutual funds and financial institutions, but this is 'token privatisation'. The major flow of the disinvestment programme was that is proceeds were used to finance budget deficits and so it is referred to as "deficit privatisation'

On the whole, not enough has been done to reform PSUs. Since it is not possible to privatise a large component of PSUs, it would be advisable to undertake a reform programme seriously.

A large dose of foreign capital to help Indian economy was the chief motive for globalisation. The result in this area are not very encouraging. Out of the total foreign capital inflow, nearly 69 per cent was in the form of portfolio investment and only 31 per cent in the form of foreign direct investment (FDI). Adjusting for 10 per cent received from NRIs, the net whoseof foreigners in FDI was only 21 percent.

Moreover, 39 per cent of foreign investment is in the non-priority sector. Multinationals are keen to enter these areas which involve short gestation period and high profitability.

D. The reform process has led to higher growth of exports along with much higher growth of imports. Consequently, the trade gap could not be narrowed down. Moreover, DGCIS data does not include defence imports. If defence imports are included, the situation becomes more grim. False conclusions are drawn on the basis of DGCIS data. In the light of the RBI data, open door policy of imports needs to be re-examined.

E. Reform process has not succeeded in controlling fiscal deficit within prudent limits. In many situation, Finance Ministers cumouflage a lower fiscal deficit by manipulating certain items. There is a need to reduce subsidies - both explicit and implicit to produce a more sustainable effect of fiscal deficit.

F. The exchange value of the Rupee vis-a-vis US$ was Rs. 17.96 in 1991-92, but gradually it moved up and shot up to Rs. 35.6 in 1996-97. A fall in the value of the Rupee increases the burden of foreign debt. Secondly, it erodes foreign investors confidence in the Indian economy. Success in stabilising exchange rate of the Rupee could not be achieved.

G. Reform process led to increase in foreign exchange reserves from a low level of US$ 2.2 billion in 1990-91 to about US$ 21 billion in 1995-96. The exchange reserved declined to US $ 17 billion in 1996-97. The increase in reserves has not been obtained by the positive balance in current account but by excessive foreign borrowing. Thus, the reserves annot be treated as a real source of strength.

olicies of economic reforms have concentrated on short-term objectives of balance of yments, inflation, foreign exchange reserves, and reducing fiscal deficits. However, the g-term goals of reducing poverty, achieving full employment and growth with social justice remained unattended. There is a need to reorient economic reforms towards the long-

19.8 KEY WORDS

Basic Restructuring implies the shedding by a public enterprise of some of its activities which are taken up by ancillaries or small scale units.

Director General of Commercial Intelligence and Statistics is the organisation which keeps a complete recorded of the volume and value of imports made in India, either on government or private account.

Financial Restructuring implies the writing off of accumulated losses and rationalisation of capital composition of an enterprise in respect of debt equity ratio.

Fiscal Deficit indicates the excess of total expenditure of the government over its total receipts (net of borrowing).

Globalisation is the process of integrating an economy with the world economy. Globalisation involves unhindered trade flows, capital flows, technology flows and, in an ultimate sense, unhindered labour flows among nation states.

Leasing implies the transfer of the right to use an asset to a person or company for a specified period.

Liberalisation is the process of freeing the economy from the stranglehold of unnecessary bureaucratic and other restrictions imposed by the state.

Liquidation implies the sale of assets to a person who may use them for the same purpose or some other purpose (s), depending upon the preference of the buyer.

Memorandum of Understands (MoU) is the agreement made between the government and the public enterprise management which grants greater autonomy for decision-making but simultaneously seeks a higher quality of accountability in return. MoU is signed for a specified period.

National Renewal Fund (NRF) is the fund created by the government to provide compensatory benefits to employees seeking voluntary retirement or rendered unemployed due to rationalisation of labour., The fund is also expected to arrange for retraining and redeployment of retrenched labour.

Privatisation is the process of transfer of ownership or operation of a state-owned unit (public sector enterprise) either wholly or partially.

Voluntary Retirement Scheme (VRS) gives the option to an employee to seek retirement voluntarily and avail of the compensatory benefits provided by the government.

Workers' Co-operative is the form of ownership of an enterprise in which the entire equity transferred to the workers. The ownership and operation of the enterprise is the responsibility of workers.

19.9 SELF-ASSESSMENT QUESTIONS

1. What is liberalisation? Discuss the principal measures initiated by the government to liberalise the Indian economy.

2. What are the four aspects of globalisation? In what aspects have steps been taken to globbalise the Indian economy and what is the particular aspect which has remained neglected?

3. List three major measures taken for integrating Indian economy with the world economy.

4. What are the different forms of ownership privatisation? Explain each of them to bring out their essential characteristics.

5. Discuss the various organisational measures which promote privavatisation.

6 Distinguish between financial restructuring and basic restructuring.

7. Liberalisation, globalisation and privatisation are the means to achieve certain ends by the , society. In the light of this statement, list five major goals/ends which these instruments are intended to achieve.

8. Review the impact of economic reforms in India bringing out their achievements and failures.

9. Is the reforms process reversiable? If not, what measures would you suggest to modify reforms so that the country achieves the goal of growth with social justice.

19.10 FURTHER READINGS

1. Datt, Ruddar (1997), Economic Reforms in India - A Critique, S.Chand & Co, New Delhi.

2. Government of India. Economic Survey (1995-96, 1996-97), and so on.

3. Ramanadham, V.V.(1990). Privatisation in Developing Countries.

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UNIT 20 FINANCIAL SECTOR REFORMS

Objectives

This objectives of this unit are to help you:

- understand the nature and use of money:
- understand the role played by finance in an economy;
- examine the Indian financial system; and
- analyse the significance and need for financial reforms

Structure

20.1 Introduction
20.2 Basic Functions of Money
20.3 Indian Financial System
20.4 Financial Reforms
20.5 Summary
20.6 Key words
20.7 Self-Assessment Question
20.8 Further Readings

20.1 INTRODUCTION

The fundamental function of any monetary and financial system, no matter how simple or complex, is to promote efficiency in the processes of exchange or trade in real goods and services, and thus to contribute to economic welfare. This statement suggests several related questions. In what ways is the exchange of real goods and services beneficial? How do money and finance promote efficienty in trade? What is meant by efficiency in this context?

Let us take the last question first, There are two types of efficiency: (a) transactions or operational efficiency, and (b) allocational efficiency.

Transactions, or operational efficiency, refers to economising on the use of scarce real resources in carrying out the exchange process. The exchange process is not costless in real terms. It requires the time and energy of traders themselves, the services of borkers and other, materials and supplies, and the land and equipemetn to perform the required functions of gathering and analysing information concerning trading opportunities, consummating trade transactions and settling trade accounts. Obviously, scarce resources used to effect transactions are not available to satisfy other wants. Also, high costs reflecting inefficiencies in transactions usually lead to a sacrifice of some allocational efficiency. Allocational efficiency is the degree to which potential gains from trade are exploited. Complete allocational efficiency would mean that all opportunities for ptential gains from trade are exploited; and no opportunities remain unexploited so that at least one party feels "better off" without making the other feel "worse off". In economics, you would recall (refer to unit 3), this is known as pareto efficiency.

However two important questions still remain: What are the sources of benefits from trade? In what specific ways do money and finance facilitate transaction and operational efficiency? In this unit we take up these questions. Further, we shall briefly examine the Indian Financial sytem, and finallly, analyse the significance and need for financial reforms.

20.2 BASIC FUNCTIONS OF MONEY

Not even love has made so many fools fo men as the pondering over the nature of money". -W.E.Gladstone, (1844)

It was the clasical economists who first atempted to provide an explanation for the

holding of cash balances by people, even though such cash balance yielded no returns as contrasted with other forms of assets. The classical economists claimed that money wasdemanded by people for their transaction needs. This is because no economic unit firm or household - enjoyed a perfect synchronisation between the seasonal pattern of flow of receipts and the flow of expenditures. it is these discrepancies which give rise to balances that accumulate temporarily and are used up later when the expenditures catch up. That is, these discrepancies give rise to the need for balances to meet seasonal excesses of expenditures over receipts. These balances are hence transaction balances. This is precisely what the Quantity Theroy of money (QTM) implies-

QTM : MV=PT

where :

- M - quantity of money in circulation
- V - Velocity of money (number of times a unit of currency exchanges hands)
- P - average price level of all transactions
- T - physical volume of transactions

The idea of QTM is that no rational person holds money idle, for it produce nothing and therby yields no utility.

It was in 1936-37 that John Maynard Keynes proposed the idea for the first time that money, apart from acting as a unit of account, was also a store of wealth. This meant that there was an asset demand for money as well. Keynes attacked the classical theory as a great abstraction from reality. He proposed two principal purposes for holding money.

(a) As a unit of account, money facilitates exchange. In this respect it is a matter of convenience. This gives rise to the transactios demand for money.

(b) As a store of wealth, money is held as a speculative balance. In Kenynes own words, "...this balance is held partyly on reasonalble and partly on instinctive grounds. Our desire to hold money as a store of wealth is a barometer of the degree of distruct of our own calculations and conventions concerning the future."

Thus $M^d = M^t (Y) + M^{sp} (r)$

Transactions demand for money, M^t depends on the level of income, Y.Speculative demand for many, M^{sp}, depends on the prevailing rate of interest, r.

The relationship between the rate of interest and the speculative demand for money however need not be similar at all evels of interest rate. Below a critical minimum rate of interest, r_c, all investor's would prefer to hold cash (since in this range, the premium is too low to induce the investor to part such a perfectly liquid asset). This range is called the "liquidity trap". However at higher rates, the high premium on assets would tempt the investor to part with cash. And as the rate of interest rises the incentive to lend would also increase. This is known as the famous "Theory of Liquidity Preference,". Which is presented graphically on the next page:

The four broad functions of money may be described briefly as follows:

1. PRIMARY FUNCTIONS

Money as a Unit of Value : The monetary unit serves as the unit in terms of which the value of all goods and services in measured and expressed (i.e. as rupee, or dollar, or mark, or pound sterling, or yen etc.). The value of goods and services can be expressed as a price which implies the number of monetary units for which it will exchange. The real value of the monetary unit is subject to fluctuation.

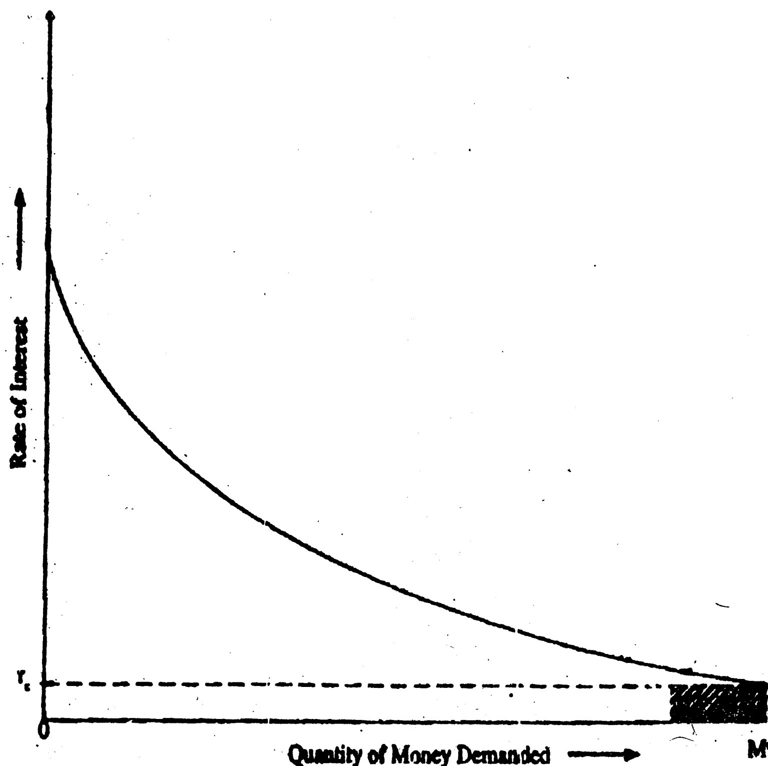
Money as a Medium of Exchange : Money is generally referred to as the generalised Purchasing power or as a bearer of options (since there is freedom of choice in the use of

money). This function of money is served by anything which is generally accepted by people exchange for goods and services. In earlier days copper or gold coins or even proposite teeth served as money. In modern days, however, paper currency, and cheques against commercial banks, current and savings deposits function as the major forms of money. In the well developed financial system credit cards have become a very important from of payment.

II. DERIVATIVE FUNCTIONS

Money as a Standard of Deferred Payments: Modern economic systems require the existence of a large volume of contracts where payment of principal and interest on debt as future payments are in terms of monetary units.

Monetary as a Store of Value: The holding of money is, in effect, the holding of generalised purchasing power. The holder of money is aware of its universal acceptance any time. Also, the value of money remains constant in itself over time. Money is thereby any ideal store of value with which contingencies as well as speculative motives may be satisfied.



Kinds of Money

There are two of money:

1. Ordinary money M May be narrowly defined as the sum of currency, C, and demand demposits, DD of banks held by the public.

M=C+DD

Since other deposits of the RBI i.e., high-powered money may be defined as money (small coins and one rupee notes) produced by RBI and the Government of India and is held by

the public and banks. H is called the "reserve money" by the RBI.

H is therefore the sum of

a) currency held by the public, C

b) cash reserved of banks/ R

c) other deposits of the RBI,OD

However, since OD is a small proportion, it may be left out for simplicity of analysis.

H=C+R

The student should note here that this empirical definition of H is from the point of view of it users or holders and not its producers (RBI and the government).

Let us sum up. In this section we have learned that money performs various functions in the economy. Its basic function is to improve the efficiency of the transaction in the process of econor... Its basic function is to improve the efficiency of the transaction in the process of production consumption, saving and investment. Money can function as a unit of value, medium of exchange, store of value or means of deferred payment.

Ultimately money is liability of the monetary system. The control of money is therefore a direct responsibility of the central bank of the economy. In India it is the Reserve Bank of India (RBI). However in a modern economy the central bank can directly control only a part of money known as high-powered money (H). There is however a stable relationship between H and money supply in the economy.

20.3 INDIAN FINANCIAL SYSTEM

The structure of the Indian financial system may be summarised in the following schematic representation (Figure 20.2). Broadly the Indian financial system may be divided into organised and unorganised segments. The organised market consists of commercial banks, development banks, co-operative banks, post office savings bank operations, stock markets etc. Unorganised financial market operations consist of hundis, money-lending, chit funds etc., They operate mainly in the rural areas,. However in the urban areas also unorganised money market activities are quite significant. There is no precise estimate of the size of the unorganised money market. It is generally expected that the relative size of the unorganised money market transactions would decline over time.

As depicted in figure 20.2 the Indian financial system consists of an impressive network of banks and financial institutions and a wide range of financial instruments. There has been a considerable wide ning and deepening of the Indian financial system, particularly in the last two decades.

Banking operations in India are controlled by the Reserve Bank of India (which, as we have instructed, is also the official central bank of the country). The primary role of the RBI is to maintain a monetary equilibrium and balance in the economy by formulating various policies from time to time and controlling the financial instruments of the economy. The balance sheet identity for the RBI is as follows:

Monetary liabilities (ML) + Non-monetary liabilities (NML

= Financial assets (FA) + Other assets

If net Non-monetary liabilities (NNML)=NML -other assets

then ML=FA - NNML

The monetary liabilities of the RBI are also called Reserve Money. In some text books on monetary economic it has also been referred to as high - powered money.

The monetary liabilities of RBI consist of currency in circulation (CUR) and commercial banks, deposits with the RBI (RES, also known as bank reserves). As against these the

They are two kinds of money:

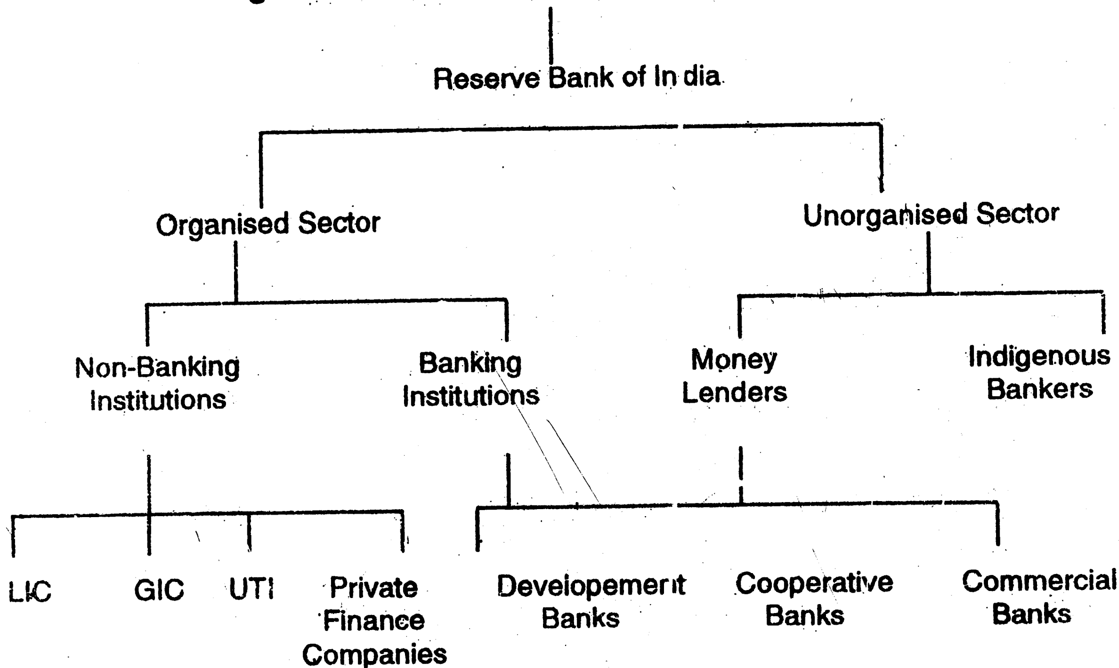
1. Ordinary money M may be narrowly defined as the sum of currency, C, and demand deposits, DD of banks held by the public.

M=C+DD

Since other deposits of the RBI included in the measure of M are a small proportion, they can be reasonably neglected.

2. High-powered money. H i.e., high-powered money may be defined as money (small coins and one rupee notes) produced by RBI and the Government of India and is held by the public and banks. H is called the "reserve money" by the RBI.

Fig. 20.2: Structure of Indian Financial System



financial assets of the RBI consist of RBI credit to the government (RBCG); RBI credit to the government (RBCG), RBI credit to the commercial banks, or commercial banks' borrowings from the RBI(RBCB), RBI credit to the development banks, such as National Bank for Rural Development (NABARD), National Housing Bank etc., and net foreign exchange assets of the RBI.

So by definition:

RBM = RBCG+ RBCB+RBF - NMNL

The variation in the reserve money therefore depend essentially on the RBI's financial assets and liabilities, which in turn are influenced by the government's fiscal policy and various other rules and regulations.

1. Net RBI credit to the Government

As banker tot he government, RBI provide credit to both the central government and the state governments. This is does by investing in government securities (including treasury bills of the central government) and through short-term advances to state governments. Until recently the central government was empowered to borrow any amount from RBI through treasury bills and rupee securities. In recent years the government has made some restrictions on the amount of borrowing from RBI. In the case of state governments, however, RBI had put restrictions on borrowing even earlier

.. RBI credit Commercial Banks

RBI provides credit to commercial banks through loans and advances against government securities, use of bills or promissory notes as collateral and through purchase or rediscounting of internal commercial bills as well as treasury bills. However the RBI does not regard its purchase or rediscounting of bills for banks as a part of its credit to banks. Instead it classifies it as RBC to whatever sector, commercial or government, which issued the bills in the first instanoe.

3. RBI credit to Development Banks

A large number of development banks had been established in the country through the initiative and help of RBI for the provision of long and medium term finance to industry and agriculture. RBI provides them credit by investing in their securities and through loans Prominent development banks created through RBI are, Industrial Development Bank of India (IDBI), Industrial Financial Corporation of India (IFCI) and National Bank for Rural Development (NABARD).

4. Net Foreign Assets of RBI

These assets constitute foreign currency reserves of RBI and therefore represent RBC to the foreign sector (because of the financial liabilities of the foreign governments). Most of these assets held abroad are in the form of foreign securities and cash balances. The RBI comes to acquire them as the custodian of the country's foreign exchange reserves. As the controller of all foreign exchange transactions, whether on private or government account, it regularly buys and sells foreign exchange against Indian currency.

5. Net Non-Monetary Liabilities of the RBI

The net RBC to the above four sectors, vuz., Government, commercial banks, development banks and foreign sector, is financed by RBI partly by creating its monetary liabilities and partly by its net non-monetary liabilities (NNML).

$$FA \text{ or net } RBC = ML + NNML$$

NNML basically consists of the owned funds of RBI (capital and reserves and accumulated contributions to the National Funds) and compulsory deposits of the public. The larger these non-monetary resources of RBI, the lesser its dependence upon the creation of new H (high-powered money) to finance its credit to various sectors. Hence this factor enters with a negative sign in the equation.

The current magnitude of different component of reserve money one shown in Table 20.1

Table 20.1: Sources of Changes in Reserve Money

(Rs.crores)

		Outstanding as on March 1995	Variations during financial year 1995-96
1.	Net RBI Credit to Govt.	101478	19871
2.	RBI Credit to Banks	13470	8485
3.	RBI Credit to Commercial Sector	6593	262
4.	Net Foreign Exchage Assets of RBI	74720	-628
5.	Govt. Currency Liabilities to the public	2379	
6.	Net Non-Monetary Liablities of RBI	29358	2943
7	Reserve Money (1+2+3+4+5-6)	169282	25054

Source : RBI, *Report on Currency and Finance*, 1995-96.

Is H an Autonomous Policy - Determined Variable?

In the Indian case, the monetary authority (RBI) is not autonomous of the government. RBI is obliged to lend whatever amount the Central Government chooses to borrow from it; even state governments can go on drawing unauthorised overdrafts. Thus, for all practical purposes, RBI has no control over the deficit financing of the govrnment. the government shares the monetary authority directly with RBI. H is not a fully policy-determined variable, because it is the decision of both the authorities as well as the public and the banks which lead to the generation or destruction of H. Banks and development banks can change H within narrow limits by varying their borrowing from RBI. The net purchases or sales of foreign exchange by the public also change H. But despite all this, it would not be wrong to say that because of the vast powers of monetary control enjoyed by RBI and the government, net variations in the stock of adjusted H (or disposable H) are directly within the close control of authorities so that the adjusted H can be claimed to be a policy - controlled variable, though not a direct policy or control instrument.

Reserve Requirements

By the technique of varying the reserve requirements the central bank at its initiative can change the amount of cash reserves of banks and affect their credit creating capacity. It may be applied on the aggregate outstanding deposits or the increments after a base date or even on certain specific categories of deposits depending mainly on the origin of deposit expansion. Direct regulation of the liquidity of the banking system is made by the Reserve Bank by two complementary methods. depositing in cash with Reserve Bank of an amount equal to the percentage of deposits with each bank as prescribed from time to time (known as cash reserve ratio or CRR), and maintenance by the bank of a proportion of its deposit liabilities in the form of specified liquid assets (known as the statutory liquidity ratio or SLR). As a result of the application of reserve ratios, the free liquidity at the disposal of banks at any time for lending would be the difference between the total deposits and the total of the sums equivalent to the cash reserve ratio and the statutory liquidity ratios.

Cash Reserve Ratio (CRR)

There was a significant reduction of the CRR required to be maintained by the banks against their total net demand and time liabilities. The CRR was reduced from 14 per cent to 13 per cent in two phases of 0.5 per cent point each, effective April 27 and May 11, 1996. The CRR on Non Resident (External) Rupee Accounts [NR(E) RA] was brought down to zero. There was another phase of CRR reduction to 12 per cent, effective July 6, 1996. CRR was further reduced by one per cent point in two phases of 0.5 per cent point each to 11 per cent effective from October 26, 1996 and November, 9, 1996, respectively. Further one per cent point reduction to 10 per cent was made in two phases of 0.5 per cent point each from the fortnight beginning January 4 and 18, 1997, respectively. (Economic Survey 1996-97)

Statutory Liquidity Ratio (SLR)

The effective SLR of the scheduled commercial banks is estimated to have fallen to 28.0 per cent of their total net demand and time liabilities (NDTL) at end March 1996. Banks are required to maintain (a) 25 per cent SLR on incremental domestic NDTL over September 30, 1994 level, (b) 31.5 per cent on this level, (c) 30 per cent SLR on FCNRA deposits and India Development Bonds and (d) zero SLR on other foreign currency liabilities. Consequent to the reduction in SLR on outstanding liabilities under NR(E)R Accounts from 28 per cent in March end, 1996 to 25 per cent effective from April 13, 1996, average SLR on outstanding NDTL got further reduced, though marginally. Since the growth of aggregate deposit has been strong in this financial year, the effective SLR on total outstanding NDTL came down to 27 per cent by end December 1996.

Development Banks

As the name suggests, development banks are development oriented. Development banks

are specialised financial institutions which perform the twin functions of providing medium and long term finance to private entrepreneurs and of performing various promotional roles conductive to economic development. They are different from commercial banks in three ways:

i) They do not seek or accept deposits from the public,

ii) They specialise in providing medium and long-term finance (commercial banks specialise in providing short- term finance).

iii) Their functions are confined to providing long-term finance.

The distinguishing role of development banks is the promotion of economic development by way of providing investment and enterprise in their chosen spheres (manufacturing, agriculture, etc.). The factors which led to the growth of development banks are the inability of the normal institutions structure to keep pace with the requirements of funds and entrepreneurship of the growing industrial sector.

Figure 20.3 gives a detailed structure of development banks in India. As clearly depicted, the four main categories of development banking in India are

a) Industrial development banks

b) EXIM (export-import) bank

c) Agricultural development banks (NABARD)

d) Housing development banks (HDFC)

Except land development banks (LDBO) the rest are a post-independence phenomenon.

With a variegated structures, the development banking institutions as a group have played a significant part in the economic development of India via the investment market and have emerged as the backbone of the financial system. Development banks provide financial assistance to industry in the following forms,

i) term loans and advances

ii) subscription to share and debentures

iii) underwriting of new issues

iv) guarantees for term loans and deferred payments.

The first two forms place funds directly in the hands of companies as subscriptions to shares and debentures. The last two forms facilitate the raising of funds from other sources.

Aggregative Role of Development Banks

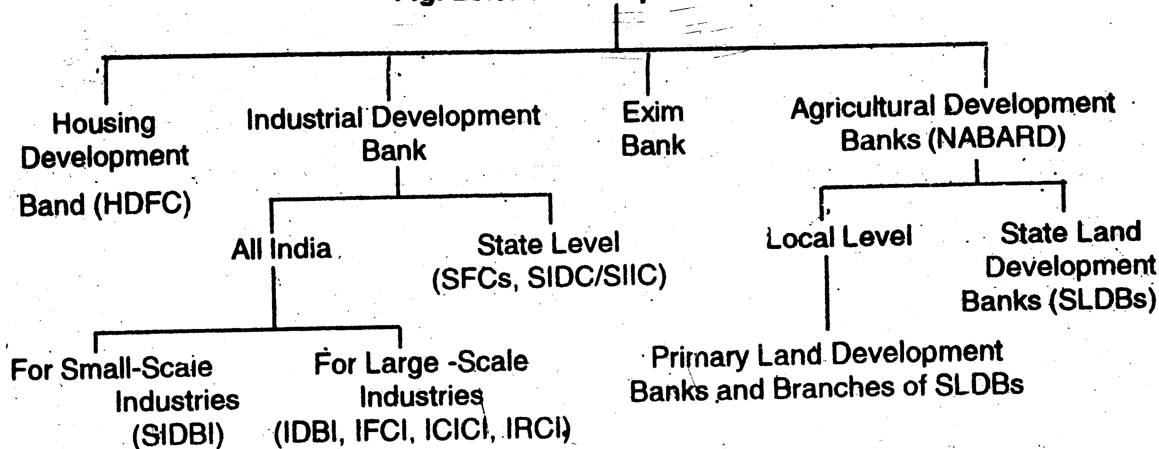
The role played by development banks is of two broad types.

1. Quantitative Role

This is the part played by development banks as a constituent of the industrial financing system in India and refers to the magnitude of funds provided by them jointly to industrial enterprises. The magnitude of industrial financing by these development banks has been considerable.

A. These banks have emerged as the single most important source of institutions finance to industry and have come to occupy a pre-eminent position in the institutional structure of the financial system. The annual average of sanctioned assistance by all the development banks during the three-year period 1978-79 to 1980-81 touched an all time high of Rs. 1808 crores. At present, as much as one-third of the gross fixed capital formation in private industry is being contributed development banks.

Fig. 20.3. : Development Banks



B. In India, their operations have the effect of improving the allocative efficiency of the financial system. The development banks perform the function of being a substitute for the capital market. When industiral enterprises are unable to raise funds from the normal channels, development banks fill the gap as well as restore or resuscitate the capital market.

C. As integral part of their lending operations, they thoroughly appraise projects as regards the priority aspect, financial viability and economic soundness and so on. The rigorous and exacting scrutiny by development banks tones up the quality of industrial projects and enables a more efficient use of available project resources.

D. Appraisal by the development banks is impersonal and objective. This results in financial assistance to diverse enterprises for a wide variety of purposes which would not otherwise have been possible. Included in this category are: new enterprises small or medium-sized firms, enterprises in backward regions, and non-traditional industries.

2. Qualitative Role

Development banking in India has an overwhelmingly qualitative dimension too in terms of the recent orientation towards promotional or innovative functions in their operations. With the evolution of a meaningful strategy of industrial development, a more positive role has been assigned to , and it being played by, development banks in India since 1969-70. IT the essential elements of these are : (i) development of backward regions (ii) encouragement to a new class of small entrepreneurs and enterprises, and (iii) rehabilitation of sick mills.

Commercial Banks

Commercial banks are the single most important source of institutional credit in India. Figure 20.4 shows a detailed structure of commercial banks in India.

There are two essential functions which make a financial institution a bank: (i) Acceptance of cheque-able deposits from the public, and (ii) lending.

Acceptance of cheque-able deposits is the most distinctive function or its unique function. Cheque - able deposits have the following features:

- These are deposits of money and not-financial assets
- Deposits are accepted from public at large
- Deposits are repayable on demand and withdrawable by cheque

The second essential function relates to the use of deposits. (Lending includes direct lending to borrowers and indirect lending through investment in open market securities). Table 20.2

gives some selected indicators about scheduled commercial banks, which Figure 20.5 depicts deposits by bank type.

1. INDIAN BANKS

The bulk of the banking business in India is done by the commercial banks owned and operated from India. Some Indian banks also operate in a few foreign countries. The Indian banks constitute both public and private sector banks.

Public Sector Banks

They constitute the dominant part of commercial banking in India. The public sector banks constitute both nationalised commercial banks and regional rural banks (RRBs). The public sector banks may also have some private by - owned shares.

I) Nationalised Banks:

Nationalisation began in 1955, when the Imperial Bank of India was converted into SBI. In addition this bank has seven other state banks as its subsidiaries. By April 1980, 28 banks were nationalised in the public sector. Together they control more then 90 per cent of bank deposits.

II) Regional Rural Banks :

Regional rural banks are the newest form of banks that have been set up in the country on the sponsorship of individual nationalised commercial banks. These were set up with the express objective of developing the rural economy by providing credit and other facilities for agriculture and other productive activities of all kinds in rural areas. The paid-up capital of a rural bank is Rs. 25 lakhs, 50 per cent of which is contributed by the central government, 15 per cent by the state government, and the remaining 35 per cent by the sponsoring commercial public sector bank.

2. Foreign Banks

These are banks which have been incorporated and have their head offices outside India. They occupy a place of importance in the Indian banking industry, especially in financing foreign trade and in the field of merchantbanking.

Fig. 20.4: Commercial Banks

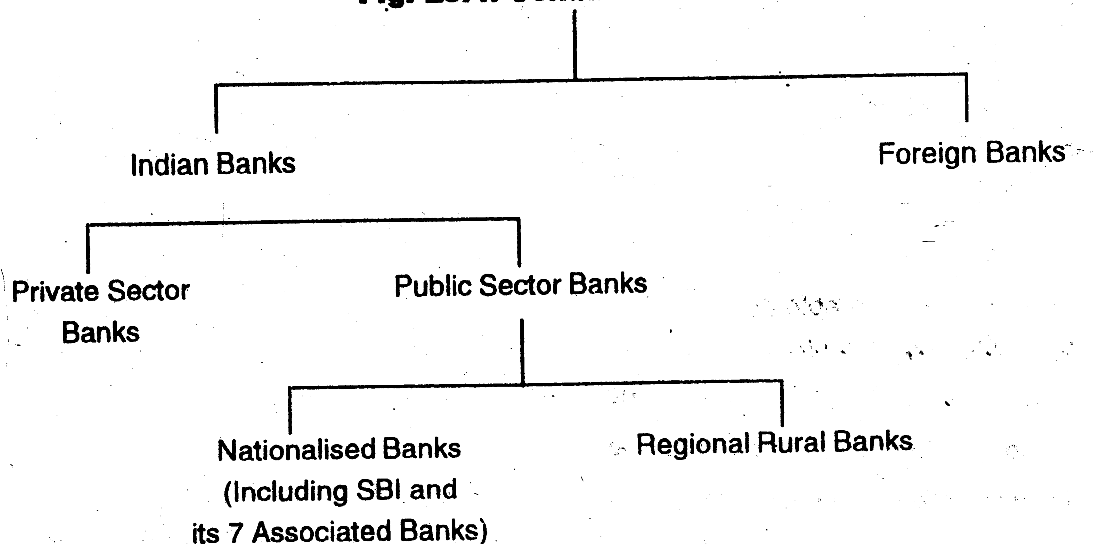


Table 20.2: Scheduled Commercial Banks: Selected Indicators*

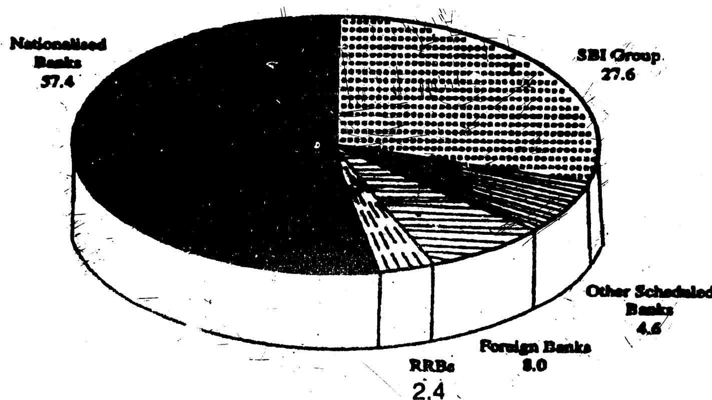
Business in India March (1993)

	Deposits (Rs. Crore)	**Branches** Total	Rural/Semi Urban
Public Sector Banks	239, 361	57,198	44,177
	(87.3)	(93.4)	(94.6)
Regional Rural Banks	6,607	14,567	4,394
SBI Group	75,524	12,558	9,344
Nationalised Banks	157,230	30,073	20,439
Private Sector Banks	34,707	4,037	2.501
	(12.7)	(6.6)	(5.4)
Foreign Banks	21, 957	138	3
Other Scheduled Banks	12,750	3,899	2,538
Total Scheduled Commercial banks	**274,068 (100.0)**	**61,235 (100.0)**	**46.718 (100.0)**

* *Figures in brackets are percentage shares of total.*

Source : Banking Statistics - Quarterly Handout, March 1993 (Reserve bank of India)

Fig. 20.5 : Scheduled Commercial banks Deposits by Bank Type (per cent) In

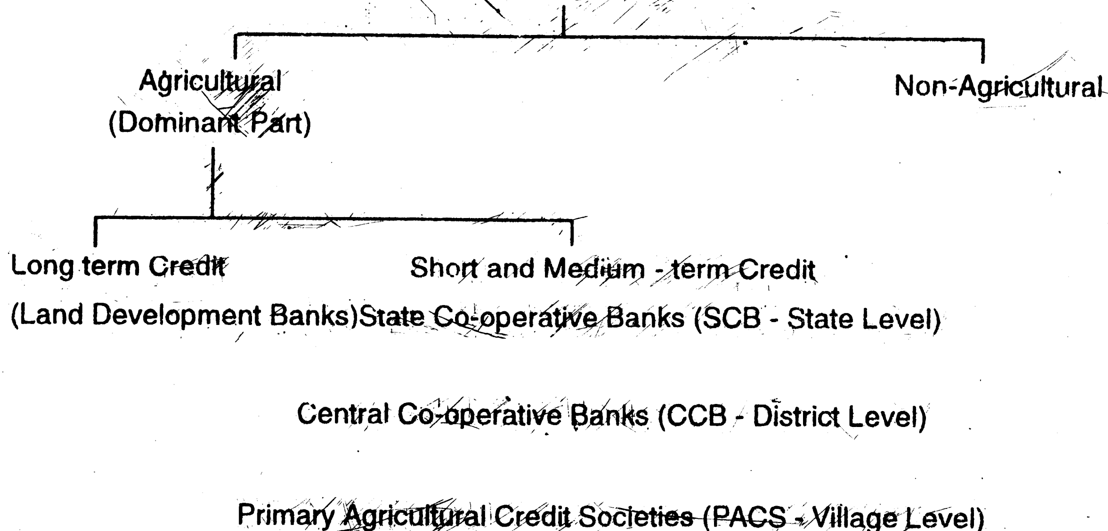


3. Co-operative Banks

Co--operative banks are so called because they have been organised under the provisions of the co-operative societies law of the states. Under the law, co-operative societies law of the states. Under the law, co-operative societies may be organised for credit or for non-credit purposes. The cooperative banking system is much smaller than commercial banking. The major beneficiary of co-operative banking is the agricultural sector in particular and the rural sector in general. Despite several organisational weaknesses, village level primary cooperative credit societies are best suited to the socio-economic conditions of Indian villages.

The co-operative credit structure is represented in Figure 20.6. The arrows denote flow of funds; the downward flow of funds is larger than the upward flow. The State Cooperative Banks (SCBs) and Central Cooperative Banks (CCBs) are also called the higher or central financing agencies (for the primary societies). At the apex are the SCBs. Primary Agricultural Credit Societies (PACS) lend to their individual borrowing members. An SCB does not lend directly to primaruy societies in areas where a CCB exists and the CCB lends only to primary societies and not to their members or other individuals (except in a few cases). This is in the interest of functional specialisation, manageability and cost-effectiveness which is the rationale of the three-tier structure. The basic need for higher financing agencies arises because the PACS are not able to raise enough resources or funds by way of deposits from the public. In fact about 60 per cent of their working capital comes as loans from the CCBS who in turn borrow about from higher financing agencies.

Fig 20.6: Co-operative Banks



Countrary to popular belief, the government is actually the net debtor to the co-operative banking system because -

i) A large part of the government's financial assistance (about 50 per cent) in the form of its contribution to the share capital of societies is advanced by NABARD.

ii) The cooperative banking system (including LDBs) provides funds to the government by way of in vestment in its securities. For SCBs and CCBs such investment is required by RBI under its SLR requirement. Hence, there is a net withdrawal of funds by the government from the co-operative bankir

Investment Institutions

We now refer to Figure 20.2 which depicts four categories of non-banking financial institutions or investment institutions in India, viz.

a) UTI (Unit Trust of India)

b) LIC (Life Insurance Corporation of India)

c) GIC (General Insurance Corporation of India)

d) Private Finance Companies

The Reserve Bank of India (Amendment) Ordinance 1997 confers wide-ranging powers on RBI for controlling the functioning of non-banking financial companies. The ordinance has defined an NBFC as a financial institution which is a company, or a non-banking institution, and which has, as its principal business, the receiving of deposits under any scheme or, arrangement or in any other manner, or lending in any manner. As per the ordinance, no

NBFC can commence or carry on business (a) without obtaining from RBI a certificate of registration; and (b) having net owned funds of Rs. 50 lakhs or such other amount, not exceeding Rs. 200 lakh, as RBI may specify. As the UTI has now become a part of SEBI mutual fund discipline, its loan sanction and disbursement functions are being eliminated, as per SEBI guidelines relating to mutual funds.

Activity 1

Briefly explain the role played by the following institutions:

a) IDBI
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b) ICICI
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c) PACS...
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d) SCBS...
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e) RRBs
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f) LIC
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g) UTI
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2.4 FINANCIAL REFORMS

By now you are well aware that the economic reforms launched by the Government more than half a decade ago were designed to accelerate overall growth and help India realise its full productive potential. The experience of successful developing countries indicates that rapid growth requires a sustained effort at mobilising savings and resources and deploying them in ways which encourage efficient production. Financial sector reform thus constitutes an important component of the programme of stabilisation and structural reform. At the outset the Government has recognised that financial sector reform was an integral part of the new economic policy. A high level committee headed by Mr. M.N.Narasimhan was appointed to consider all relevant aspects of the structure, organisation, functions and procedures of the financial system. Following the committee's report in November 1991, the Government embarked on a far-reaching process of reform covering both the banking system and the capital market. The need for a through going reform of the financial system was further underscored by the now famous securities scam (or irregularities of the banks) news of which broke out in April 1992.

A large part of the agenda for reform of the financial system relates to the problems facing the public sector commercial banks which have dominated banking in India since nationalisation in July 1969. The goal of nationalisation was to extend the reach of banking and financial services to all parts of the country and to all sections of society. It also aimed at widening the net of resources mobilisation.

While there are significant achievement, they have been accompanied by serious shortcomings as well. For instance, the quality of customer service has not kept pace with modern standards and changing expectations. The time taken for processing and completing banking transactions is too long. The banks have also not kept pace with the revolutionary changes in computer and communication technologies. This affected the speed, accuracy and of efficiency of services and the basic intergrity of banking processes such as internal controls and inter-branch reconciliation of accounts. It also militated against prompt decision - making and a against improved productivity and profitability. All these were greatly reflected in the poor financial condition of the banks and the adverse impact it had on the economy.

The Narasimhan Committee recognised the fact that the quantitative success of the public sector banks in India was achieved at the expense of deterioration in qualitative factors such as profitability, efficiency and the most important the quality of the loan portfolio which now needed to take the centre stage. The elements of the recovery programme reiterated by the committee are as follows:

- Reduce presumption of lending capacity through staged reductions in SLR and CRR, while moving the yield on government debt to market-related levels.
- Stress availability rather than subsidy in provision of credit to the priority sector, and restrict cross-subsidy only to the smaller borrowers. The goal should be to establish incentives that induce adequate flows of credit to priority uses, especially agriculture, without compromising on prudential and commercial considerations.
- Move to objective, internationally recognised accounting standards, with suitable transitional provisions to give banks time to adjust. These accounting norms will clarify and strengthen the incentive for bank managements to exercise greater care in credit assessment and recovery.
- Make additional capital available from the government and the capital markets to strengthen banks financial position and provide a basis for future growth. Provision of capital by the government will be conditional on monitorable improvements in the management and recovery performance of each bank. Access to the markets will impose the additional discipline of prospectus registration or assessment by credit rating agencies and accountability to non-governmental shareholders.

- Improve prospects for recovery by setting up special recovery tribunals in major metropolitan areas.
- Set up a credit information database for exchange of information on the credit history of large borrowers subject to confidentiality.
- Upgrade the calibre of appointees to board level posts, stressing longevity and security of tenure.
- Enhance managerial accountability and stress performance-related promotion.
- Encourage technological modernisation in banks through computerisation and greater labour flexibility.
- Encourage greater competition for public sector banks through the controlled entry of modern, professional private sector banks including foreign banks.
- Create a new board for financial supervision to devote exclusive attention to issues of compliance and supervision and review the Banking Regulation Act.
- Ensure viable mechanisms for supply of credit to the rural sector, small-scale industry and weaker sections.

The steadfast pursuit of this agenda promised to transform Indian banking and the public sector banks in particular. By June 1996 the following targets had to be attained.

a) all public sector banks achieving 8 per cent capital to risk - assets ratio

b) half the public sector banks (weighted by deposits) should be quoted on the stock market with appropriate representation of shareholders on bank boards

c) significant entry of new private sector banks

d) SLR and CRR appreciably reduced

e) Interest rates deregulated

f) at least 500 branches of public sector banks would be fully computerised.

Capital Market Reforms

The Securities Exchange Board of India (SEBI) has been issuing guidelines from time to time for establishing a fair and transparent capital market. Some of the major measures announced by SEBI are briefly enumerated below:

- In October 1993, regulations for underwriters of capital issues and capital adequacy norms for the stock brokers in the stock exchanges were announced
- As per modified guidelines, bonus issues can be made out of free reserves built out of the genuine profits or share premium collected and the interest of holders of fully or partly convertible debentures will have to be taken into account while issuing bonus shares.
- The stork exchanges have been directed to broad-base their governing boards and change the composition of their arbitration, default and disciplinary committees.
- SEBI notified regulations for bankers to issues in July 1994. The regulations make registration of bankers to issues with SEBI compulsory. It stipulates the general obligations and responsibilities of the bankers to issues and contains a code of conduct. Under the regulations, inspection of bankers to an issue will be done by the Reserve Bank on request from SEBI.
- RBI has liberalised the investment norms evolved for NRIs by allowing companies to accept capital contributions and issue shares or debentures to NRIs or overseas corporate bodies without prior permission.
- The government has allowed foreign institutional investors (FIIs) such as pension

funds, mutual funds, investment trusts asset or portfolio management companies etc. to invest in the Indian Capital market provided they register with SEBI.

- SEBI has made it compulsory for credit rating of debentures and bonds of more than 18 months' maturity.
- The maximum debt-equity ratio for banks is 2:1 and the minimum debt service coverage ratio required is 1:2

Reductions in Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR)

According to the Narasimhan Committee, one of the problems facing our banking system was that the levels of SLR and CRR has been progressively increased over the past several years. In the case of SLR this happened because of the desire to mobilise even larger resources though so-called market borrowing (at below - market rates) in support of the central and state budgets. In the case of the CRR this happened because of the need to counter the expansionary impact on money supply of large budget deficits. Together the SLR and CRR stipulations pre-empted a large part of bank resources into low income earning assets thus reducing bank profitability and pressurising banks to charge high interest on their commercial advances. The high SLR and CRR were in effect a tax on financial savings in the banking system and served to encourage flows in the market where this tax did not apply. The Government therefore decided to (and has) reduced SLR in stages over a three year period from 38.5 per cent to 25 per cent and that of CRR over a four-year period to a level of 10 per cent.

Reforms in Development Banking Sector

The Narasimhan Committee recognised that the development financial institutions operations, in India were marked by the total absence of competition in the matter of provision of loan and medium-term finances. The system had evolved into a segmentation of business between DFXIs and the banks, the latter concentrating on workding capital finance and the former on investment finance. Borrowers as a consequence had no choice in selecting an institution to finance their projects. The committee suggested delinking of these institutions from the state governments for better efficiency. The operations of the DFXLs in respect of loan sanctions should be the sole responsibility of the institutions themselves based on a professional appraisal of projects. The Government also embarked on a process of disinvestment in some of the bigger institutions like IDBI,ICICI, IFCI etc.

Activity 2

Discuss with some space proof -- experience and fund out if the proposed reform have ------------------------ to the following sectors, Give examples

a) Commercial banks

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b) Development banks ....

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c) Capital Market ....

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d) CRR and SLR ....

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20.5 SUMMARY

Let us summarise the main points of the unit.

- The fundamental function of any monetary and financial system is to promote efficiency in the process of exchange.
- The four broad functions of money are to act as
  - a unit of account
  - a medium of exchange
  - a standard of deferred payments
  - a store of wealth.
- The Reserve Bank of India is the apex institution of the Indian financial system. It regulates and controls, by means of laws, financial instruments, etc., the working of a vast network of financial institutions under it, directly or indirectly
- The monetary liabilities of the RBI are called the Reserve Bank Money (RBM).
- RBM = (1) net RBC to the government
  + (2) RBC to development banks
  + (3) RBC to banks
  + (4) net foreign assets of RBI
  - (5) net non-monetary liabilities of RBI
- High-powered money, H, is the money produced by RBI and the Government of India (small coins and one rupee notes) and is held by the public and banks. It is also called reserve money.
- H is not a fully pr[illegible]-determined variable. However, adjusted H can be claimed to be a policy-cont[illegible] variable.
- Development banks [illegible] specialised financial institutions which perform the twin functions of providing medium and long-term finance to private entrepreneurs and of performing various promotional roles conducive to economic development.

- Commercial banks are the single largest source of institutional credit in India.
- Public sector banks constitute the dominant part of commercial banking in India.
- Cooperative banks are so called because they have been organised under the provisions of the cooperative societies laws of the states. Despite several weaknesses, village level PACs are best suited to the socio-economic conditions of Indian villages.
- The direct regulations of the banking system is done by the Reserve bank by two complemnetary methods:

  a) depositing in cash with the Reserve Bank of an amount equal to the percentage of deposits with each bank as prescribed from time to time known as CRR. (Cash Reserve Ratio)

  b) maintenance by the bank of a proportion of its deposit liabilities in the form of specified liquid assets known as SLR (Statutory Liquidity Ratio)

- A high-level committee headed by Mr. M.Narasimhan was appointed to consider all relevant aspects of the structuring, organisation, functioning and procedures of the Indian financial system. The Committee placed its report before parliament in December 1991.
- The Committee's main recommendations were:

  a) Reductions of SLR and CRR

  b) Norms for income recognition, provisioning and capital adequacy.

  c) provision of balance- sheet and profit and loss accounts formats for banks

  d) Branch licensing

  e) Permission to set up new private sector banks

- Along with banking system reforms, the committee also thought it necessary for capital market reforms to be undertaken. The main features of these reforms (as provided for in SEBI guidelines) are:

  a) no promoters' contribution

  b) underwriting not mandatory

  c) maximum debt-equity ration 2:1, minimum debt service coverage ratio 1:2

  d) credit rating compulsory for debentures and bonds of more than 18 months' maturity.

- The committee also felt the need for reforms in the operations of DFIs.

20.6 KEY WORDS

Reserve Money A component of money supply directly controlled by RBI

High Power Money Money produced by RBI and the Government of India in the form of small coins and one rupee notes which is held by the public and banks. High power money is also called the reserve money by RBI.

Cash Reserve Ratio (CRR) The ratio of cash required to be maintained from time to time with the RBI by the banks against their total net demand and time liabilities (deposits).

Statutory Liquidity Ratuio (SLR) The proportion of deposit liabilities to be maintained by a bank in the form of specified liquid assets.

Investment Institutions All institutions making investments for commercial or industrial purpose. This includes commercial banks, development banks (or institutions) coopérative banks, and non-banking institutions including LIC, GIC, UTI and private finance companies

Development Banks Specified finance institutions performing the twin functions of providing medium and long term finance and performing various promotional roles for

economic development of the country.

Commercial Banks Banks accepting deposits from the public and lending money for short term requirements of industrial and commercial enterprises.

Cooperative banks Banks registered under the provisions of Cooperative Societies Act and providing credit mainly for agricultural purposes.

Public Sector Banks Commercial banks owned and managed by the Government (after nationalisation), banks not falling in this category are called private sector banks.

Monetary Policy Policy of the Government concerned primarily with the maintenance of stability in domestic prices and exchange rate stability. The subsidiary objectives may be social justice, growth etc..

20.7. SELF-ASSESSMENT QUESTIONS

1) What are the functions of money. Explain briefly.
2) What are the components or Reserve Bank Money. Explain each briefly.
3) Briefly describe the present Indian financial system.
4) Critically examine the recommendations of the Narasimhan Committee.

20.8. FURTHER READINGS

Economic Survey 1992-93, 1996-97.

Report on Currency and Finance 1996-97, RBI.

Gupta, S.B.1995, Monetary Planning. S.Chand, Delhi

Reserve Bank of India, Annual Report 1993-94.

Narasimhan Committee Report 1991, GOI.

UNIT 21 FISCAL SECTOR REFORMS

Objectives

The purpose of this unit is to help you:

- understand the basic issues related to fiscal reforms
- outline the basic concepts in the theory of public finance; and
- review India's fiscal system and reforms

Structure

21.1 Introduction
21.2 Domain of Public Finance
21.3 Public Finance Theroy: Basic Concepts
21.4 India's Fiscal Policy
21.5 Tax Refroms
21.6 Summary
21.7 Key Words
21.8 Self-Assessment Questions
21.9 Further Readings
Appendix 1

21.1 INTRODUCTION

In the previous unit we had familiarized you with the Indian Financial system and the recent reforms undertaken by the Government. The focus of this unit is on fiscal sector reforms. We will first discuss some basic concepts in the theory of public finance, and the India's fiscal policy and the recent reforms in this respect.

Government revenue and expenditure generally account for a sizable proportion of the Gross Domestic Product (GDP) in almost all economies of the world. Government revenue and expenditure affect not only the government's own activities but also the entire economy, either directly or indirectly. Taxation affects both household consumption and production. The Government wage bill generates additional demand for consumer goods. Deficit financing by the government increases money supply and thereby affects the price level. Public debt may transfer the burden of Government expenditure from one generation to the next.

If the government follows the principles of public finance properly, its revenue and expenditure would improve the overall economic welfare of the country. The Government may also use the budget to redistribute income from the rich to the poor; or it may even tax or subsidise differentially to benefit selected groups of consumers and producers. However, if the Government violates the basic principles of public finance, the budgetary operations, instead of improving economic welfare, would actually adversely affect the economy.

The term fiscal reforms implies corrections in the Government's budgetary policies towards a more efficient fiscal system. In most cases it begins with cutting unproductive expenditure so taxes and Government borrowing may be reduced to a tolerable limit. It may also require rationalisation of the tax structure. To understand the needs and the rationale of fiscal reform we must therefore begin with the basi. principles of public finance.

21.2 DOMAIN OF PUBLIC FINANCE

A.C. Pigou began his classic volume, *Public Finance*, with the following passage:

"In every developed society there is some form of Government organisation which may or

may not represent the members of society collectively but certainly has coercive authority over them individually".

This passage is important because it highlights the coercive nature of government. Governments force people to do things that they would probably not otherwise do. Also, and just as important, there is no guarantee that the Government will act in the best interests of those governed. thus, one reason for studying public finance is to get a better understanding of this subject which will help us vote wisely in direct referenda and in choosing our elected representatives. If our elected officials become aware that we are keeping track of their activities, they are more likely to work on our behalf and, may be, even make sure that we are getting good value for our tax payments.

Public finance is the study of the financial activities of governments and public authorities. It is a part of the study of economics and is, therefore, concerned with the allocation of scarce resources. Also, it is not merely a matter of public economics, since both the public and the private sectors operate in an intergrated fashion. Public finance is specifically concerned with the effect of the activities of the Government (and also of public enterprises) on the allocation of resources. Several questions arise. Is the public finance system efficient? Does it promote aggregate saving, investment and growth of income? Is it equitable? Do government budgetary operations benefit the poor more than the rich? Does it benefit future generations?

Public finance, like economics, has both prositive and normative dimensions. Positive analysis is aimed at building models to show the effect of people reacting to economic and financial stimuli. Normative analysis provides the criteria which help us determine whatever the predicted economic and financial changes are desirable. Some of the important issues studied in public finance, which are hotly debated (because there is no single correct position on any one of them) may be enumerated thus:

i) What whould be the proper functions of the Government ?

ii) What should be the proper size of the Government budget?

iii) What pattern of financing of Government expenditure could be desirable?

iv) What should be the incidence of taxation?

v) What composition of public expenditure would be desirable/suitable?

vi) What would be the effect of tax rates on people's desires to work, save and take risks?

Some basic propositions about public finance are as follows:

- Public finance is that branch of economics which deals with the expenditures and revenues of the public sector.
- The basic norms of public finance are universal.
- Fiscal deficit measures the difference between Government revenue and expenditure.
- Excessive fiscal deficit is harmful for the economy.
- Fiscal reform is needed to improve the efficiency of governmental budgetary allocation of both revenue and expenditure.

we will take up those propositions as we proceed with our discussion.

21.3. PUBLIC FINANCE THEORY: BASIC CONCEPTS

This section deals with some of the basic tools which help us in understanding the fiscal system of an economy better.

Fiscal Policy

To quote the Seventh Five year Plan (1985-90), "through it (i.e.fiscal policy) the Government

creates and sustains the public economy consisting of the provision of public services and public investment; at the same time it is an instrument for reallocation of resources according to national priorities, redistribution, promotion of private savings and investments, and the maintenance of stability."

Major Functions of Fiscal Policy

There are three major functions of a fiscal policy:

i) The allocation function of budget policy, that is, the provision for social goods. It is a process by which the total resource are divided between private and social goods and by which the mix of social goods is chosen.

ii) The distribution function of budget policy, that is distribution of income and wealth in accordance with what society considers at "fair " or "just" distribution.

iii) The stabilization function of budget policy, that is, maintaining high employment, a reasonable degree of price stability and an appropriate rate of economic growth, with due consideration of its effects on trade and the balance of payments.

Though policy implementation, if fully coordinated, might permit the simultaneous achievement of the various goals outlined above, in practice it is oftern quite difficult. Most policy-makers therefore make compromises between various objectives depending on economic conditions from time to time. These decisions are also influenced by political considerations. However if the decisions are too distorted, they may cause adverse consequences for the economy.

Table 21.1 depicts various policy objectives and the potential conflict areas. We suggest that you go through these carefully to understand the problems and conflicts in the operations of the public finance and fiscal policy, and a text book on public finance , such as Musgrave, referred in Further Readings.

Table 21.1: Major and Subsidiary Objectives of Economic Policy and Potential conflicts

	Policy Objectives	Potential Conflicts Areas
A.	Static Efficiency (Short run)	
	1. Statisfaction of private consumption wants	D,2,3,4
	2. Satisfaction of public wants *	D,3,4
	3. Balance of payments equilibrium*	4
	4. Price stability*	D
	5. Removal of market imperfections*	
B	Social Justice	
	6. Increased employment*	D,3,4
	7. Reduced inter-personal income inequalities*	D
	8. Reduced inter-personal income inequalities*	D
C.	National Cohesion	
	9. Economic independence	A,D
	10. Provisions of economic symbols of nationhood	A
D.	Economic Development (long run)	
	11. High Savings	
	12. Maximum capital inflows from the rest of world	A C
	13. Structural change (modernisation)	A,C
	14. Reduced population growth*	

* denotes a subsidiary objective that tends to promote more than one major objective.

Theory of Social goods

The allocation function of [illegible] policy is provided a rationale by the theory of social goods

This is of prime importance to the economies of the public sector. The market economy, if certain conditions are met, enables an efficient use of resources for providing private goods. However, when it comes to providing of public/social goods (e.g. parks roads, bridges, free or subsidised educational facilities), the market economy often runs into trouble. Social goods are goods which are required for the welfare of society as a whole, but for which the market fails to provide a value. People are generally ignorant of the value or utility of social goods. An individual knows that once one piece of social goods say a road, is constructed he cannot be denied its use whether he paid for its construction or not. Everyone assumes that others would pay for it. It is these failures of the market (i.e., provision of social goods) which bring the role of the government in focus for providing social goods for the welfare of the public in general.

Categories of revenue for the Government

To finance nay proposed expenditure and purchases or to pay off public debt, governments need revenues. These reveues may be denied from taxes, charges for the use of public goods and services, or borrowings. Taxes and charges are raised from the private sector without any obligation to pay them back. Borrowings however involves an obligation to repay at a future stipulated date as well as to pay interest for the period. Taxes are compulsory payments while charges and borrowings involve voluntary transactions.

Taxes may be imposed on the factor inputs or on outputs, on buyers or sellers in the market. It may be useful to distinguish between the following types of taxes.

A) Personal versus Inrem taxes

Personal taxes are taxes which are imposed on taxpayer's income. Income net of taxes is referred to as the disposable income. Personal taxes are imposed on householders. Inrem taxes are imposed on activities or objects, e.g. on purchases, sales or the holding of property. Rem taxes are independent of the characteristics of the transactor or the owner (as in the case of sales tax).

B) Direct versus Indirect taxes

Direct taxes are those which are imposed on individuals or householders who bear the burden. Personal income tax falls in this category. Indirect taxes are those which are imposed on an entity at some point in the system but whose (final) burden can be shifted to some other entity or entities. Excise and customs duties and sales tax are generally the major indirect taxes.

A good tax structure has the following requirements:

1. Tax burden must be equitably distributed among citizens. Each should pay his or her fair share.
2. Excessive tax burden (which may interfere with the economic decisions in otherwise efficient markets) should be avoided.
3. The cost of administration and compliance should be kept at the lowest possible level.
4. The tax structure should facilitate the objectives of fiscal policy of stabilization and growth.
5. Where tax policies are used to achieve other objectives such as encourage investment in certain sectors of the economy, interference with the equity of the system should be minimum.

The policy makers should keep in mind the basic requirements of a good tax structure while formulating tax policies.

Approaches to tax equity

The ideal tax system is fair and equitable. But an important questions is how we interpret this requirement. We now review two of the most commonly used approaches to tax equity

A. Benefit Principle

Proposed initially by Adam Smith this principle lays down that each individual should pay taxes according to the benefits he receives from the use of public services. Though this principle sounds appealing, its implementation is brought with several difficulties.

B. Ability to pay and choice of tax base

The benefit principle, whether the taxes are levied on general benefit or specific benefit bases, helps in raising finance directly for certain Government functions, it does not , as observed earlier, solve the problem of tax structure formulation. Specific benefit taxation may be applicable for a limited range of services. The bulk of tax revenue can not be derived based on this principle. An alternative approach must be thought about.

The ability-to-pay approach to tax equity rests on the rule that people should contribute to Government expenditure in proportion to their abilities to pay. In this approach, taxation is independent of expenditure. While this approach has the advantage that it considers the distribution aspects, it has the disadvantage of dealing with the tax problem in isolation, It does not consider the provision of social goods.

Horizontal versus Vertical equity

The abilitiy-to-pay principle calls for a distribution of the tax burden in line with horizontal and vertical equity. In order to obtain a horizontal equity in the system, taxpayers with equal ability to pay should be required to contribute equally. Vertical equity, on the other hand, requires taxpayers with unequal capacities to contribute correspondingly different amounts.

The implementation of equitable taxation in line with the ability to pay requires the definition of a specific index by which ability to pay is to be measured. Unfortunately however the preparation of such a comprehensive index is not feasible.

Income is the most widely used general measure of people's ability to pay (economic capacity). Income should, however, be defined broadly for this purpose, so as to include all forms of accretion, independent of the source from which it is derived and the uses to which it is put.

Consumption is the alternative measure of economic capacity which is based on the assumption that the rich consume more. From the point of view of horizontal equity. The equal potential-consumption rule seems superior. However between the two bases of income and consumption, the income base is superior.

Taxation of welath is not necessary if all income has already been subjected to a comprehensive income tax. But since this condition in practice is not met, supplementary taxes on consumption and wealth may be called for on the ability - to-pay ground.

Equal Sacrifice Rules

Vertical equity requires the tax payment to involve an equal sacrifice or loss of welfare by all taxpayers for the taxation system to be equitable. Loss of welfare is related to the loss of income. If the level of welfare as a function of income is the same for all taxpaying individuals, then the equal sacrifice rule requires people with equal incomes to contribute equal amounts of tax.

Tax Incidence

Tax incidence refers to the distributional effects of particular budgetary measures, and the effects on output and employment. Two points must be noted here. First, it should be recognised that the entire tax burden must ultimately be borne by individuals. Second, the final burden may differ from that of statutory liabilities, whether the tax is imposed on individuals or firms. Incidence involves the effect of taxation on both the sources and the uses side of household account.

therefore unsustainable in the long run.

Most fiscal reforms therefore begin with cutting gross fiscal deficit. This can be done by either raising more tax revenue or reducing Government expenditure. In most countries the latter is now preferred over the former. The International Monetary Fund (IMF)Structural Adjustment Policy loans, for instance, are tied to the reduction of gross fiscal deficit.

The gross fiscal deficit as a ratio to GDP in India had climbed to as high as 10 per cent by 1990-91. Since then the ratio has come down for the Centre, from 8.4 per cent in 1990-91 to about 4.5 per cent in 1995-96. The ratio of GFD to the states' budget has however remained more or less the same. Rich states, like punjab, Maharashtra and Gujarat have a lower fiscal deficit than the national average and poor states like, Bihar have a high fiscal deficit.

Revenue deficit

Revenue deficit measures the difference between Government revenue expenditure and tax and non-tax current revenues. It measures the extent to which the Government borrows to finance its current expenditure. At this stage it is useful to distinguish between Government revenue (or current expenditure) and capital expenditure. When government expenditure affects only the current income of the economy, it is called revenue expenditure. In contrast, capital expenditure affects not only tthe current but also the future income of the economy. Defence expenditure has no impact on the future income of the economy and therefore is a perfect example of revenue expenditure. On the other hand, public investment in industry would generate future income and therefore it would be classified as capital expenditure.

Since Government borrowing for revenue expenditure, do not generate future income,. they are worse than Government borrowing for capital expenditure. Prudent fiscal policy therefore attempt to minimise the revenue deficit and utilises Government bnorrowings exclusively for the capital expenditure of the Government. In this case the repayment of public debt in future can be met from future income. In fact in the ideal case the Government should have a revenue surplus rather than a revenue deficit. However, it may not always be possible.

In India the revenue deficit as a ratio to GDP has increased sharply during the last two decades. Currently, it is about 4 per cent for the Centre. In some states the ratio is much higher. The persistance of high revenue deficit in the Central and States' budgets is now the most serious problem of fiscal policy in India.

Monetised deficit

This measures the monetary expansion on account of the Government budget. It is also popularly called deficit financing. It is generally the most regressive form of public borrowing. However monetised borrowing, when utilised within limits for capital expenditure, may not be very bad for the economy. The basic problem of monetised deficit is that it increased money supply (typically through Government borrowing from the central bank) and thereby causes inflation. Along with the gross fiscal deficit the ratio of monetis deficit to GDP has also decreased somewhat during recent years.

Public debt - concept and measurement

All forms of fiscal deficit increase public debt. Public debt can be defined in various ways. In the narrowest sense it can be defined as the debt of the Government proper. A somewhat wider definition would be the debt of the Government proper plus the debt of the crore (departmental) public enterprises. For instance we may included as public debt the debt of the railways and other departmental undertakings which are directly covered in the Government budget. A still broader definition would cover the debt not only of all public enterprises but also of local authorities and other public-funded and/or guaranteed public institutions (for instance universities, research institutions, welfare boards, etc). In India, at the moment, systematic data are available only on the debt of the Government proper, i.e., the central and state Governments.

The growth of public debt has several implications. First, when the debt becomes sizeable, interest payments on it may crowd out vital public enxpenditures on health, education and other schemes on social and economic welfare. Second, when the debt becomes too large, repayment of past debt may substantially reduce the Government net borrowing (it may even become zero or negative) and erode resources for public investment. Third, as debt servicing becomes difficult the Government may resort to monetizing an increasingly larger proportion of domestic debt and create hyper-inflation. Fourth, public debt may crowd out private investment and affect growth, especially when public debt is utilised for the Government's current expenditure. Fifth, public debt may affect inter-generational equity, the current generation benefiting at the expense of future generations. Sixth, a debt trap may not oly create a fiscal crisis but may lead to a political crisis. Seventh, external debt is liable to create a balance of payments crisis and thereby threaten the economic sovereignty of the nation.

Let us at this stage sum up the main points.

- The three major functions of a fiscal policy are: the allocation function, the distribution function and the stabilization function.
- The objectives of economic policy are complementary as well as conflicting.
- Social goods are goods which are consumed by all citizens and increase the welfare of society
- The market fails to provide the economy with social goods. The state must take up this activity.
- Taxes, charges and borrowings are the three major sources of revenue for a government.
- A good tax structure satisfies the requirements of equity, efficiency and low administrative costs.
- The benefit principle is an approach to tax equity according to which each individual pays in proportion to the benefits he/she receives from the social goods in question. This principle is not practicable (except in certain special cases).
- The ability -to-pay approach requires taxpayers to pay according to their economic capacity
- The ability -to-pay principle requires the tax burden to be in proportion to horizontal and vertical equity.
- Vertical equity can be measured in terms of the equal sacrifice principle.
- Tax incidence refers to the distributional effects of the tax burden.
- Tax incidence has effects on the uses as well as sources.
- Public expenditure in all economies has exhibited on upward trend.
- A fiscal crisis results from excessive fiscal deficits.
- Public debt is debt of the Government proper and the debt of departmental public enterprises. It is internal as well as external in nature, the latter being a more serious problem.

21.4 INDIA'S FISCAL POLICY

Fiscal policy plays a crucial role in pursuing planned economic development for a mixed economy like India's. In fact in India it plays a multidimensional role in trying to satisfy the twin objectives of growth and social justice. This section attmepts to briefly highlight the important aspects of India's past fiscal policies. But before that we will embark on a journey of the Indian economy since independence.

Following the years of the Great Depression, John Maynard Keyens came up with his scholarly masterpiece. "The Genreal Theory of Employment, Interest and Money" in which first time he propounded the idea that the level of economic activity can be influenced by judicious use of public spending and taxation. Deficit spending by the pubnlic sector could stimulate the economy. On the other hand, a fiscal surplus during the boom phase of a cycle would prevent inflation from getting out of hand.

Belief in the ability to control the level of economic activity grew over time and by the 1960s it was almost taken for granted that the economy could be finetuned to achieve and maintain full employment. Economists and politicians even began to talk about the distribution of the fiscal dividend(i.e.benefit accusing to society from government budgetary operating) which would be generated by a progressive tax structure in a growing economy.

Of course, there were always some people who were not convinced of the need for such an active role for the Government in achieving stability. Some, infact, have always claimed that Government stabilization policy has been the main force creating instability and, surely, it must be admitted that perverse and ill-time monetary and fiscal policy can have an undesirable effect on economic activity.

Indian development experience of the past suggests a great deal of significance attached to the Five year plans, which however may be dimnishing with time. The principal way in which a fiscal policy influences growth in a country at India's stage of development is mainly through increasing the efficiency of mobilising resources for development. Fiscal policy may affect growth by influencing the efficiency of resource allocation both in the public and private sectors of the economy.

1. Mobilisation of resources for the economy

The main sources of funds for financing development expenditure can be grouped under t he following categories:

A. Taxation

B. Pricing of public goods (or more appropriately profit from sales of public goods)

C. Domestic non-monetary borrowing

D. External borrowing

E. Borrowing from the RBI (monetised borrrowing)

We have noted that the impact of Government expenditure on aggregate demand and supply varies with each type of expenditure. Table 21.2 shows the long term trend in the financing of Government expenditure in India. The changes in the broad pattern of financing are showwn in figure 21.2 It may be noted that it had deteriorated during the eighties and is improving in some respects during the nineties.

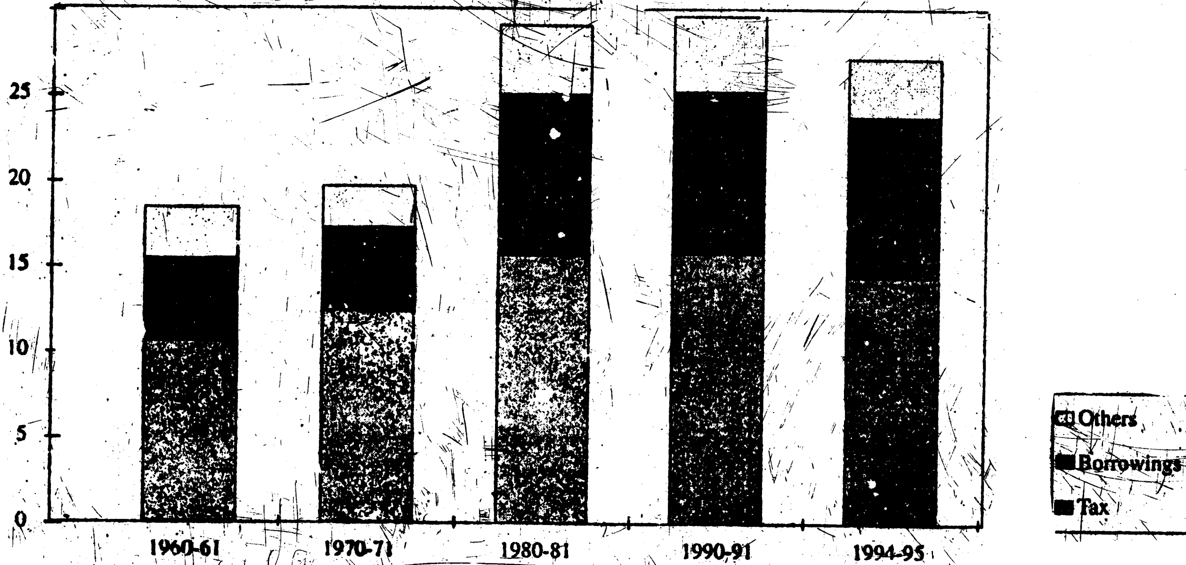
Total Government expenditure as a ratio of GNP has doupbled between 1960-61 and 1990-91 from 17 per cent 34 per cent. Although tax/ GNP ratio has also doubled during this period from 10 percent to 20 per cent, the gap between Government expenditure to GNP has increased from 7 per cent to 14 per cent. With Government income from other sources rent, interest and profit - remaining more or less stable around 3 to 4 per cent of GNP. Government dependence on borrowing has increased. The bulk of Government borrowing has been from the domestic private sector: households, commercial banks and other financial institutions. The Government's external borrowing accounted for less than 1 per cent of the GNP during the last fifteeen years. However, the share of external borrowing has increased during recent years. The Government has also resorted to higher monetisation, or printing of money, to finance its experditure during the 1980s.

Table 21.2: Financing of Government Expenditure (As a per cent of GNP)

Year	Total Expenditure	Tax Revenue: Direct	Tax Revenue: Indirect	Tax Revenue: Total	Borrowing: Domestic	Borrowing: Abroad	Borrowing: Total	Other Sources
1960-61	17	2.8	6.8	9.6	3.0	1.6	4.6	2.8
1965-66	22	3.3	9.5	12.8	4.5	2.0	6.5	2.7
1970-71	19	2.8	9.9	12.7	3.5	0.8	4.3	2.0
1975-76	25	3.7	12.5	16.2	4.2	1.8	6.0	2.8
1980-81	28	2.9	13.6	16.5	7.4	1.1	8.5	3.0
1985-86	32	2.8	[illegible]	18.7	8.9	0.6	9.5	3.8
1990-91	34	2.8	16.8	19.6	10.0	0.7	10.7	3.7
1994-95	34	3.1	16.5	19.6	9.8	0.5	10.3	3.7

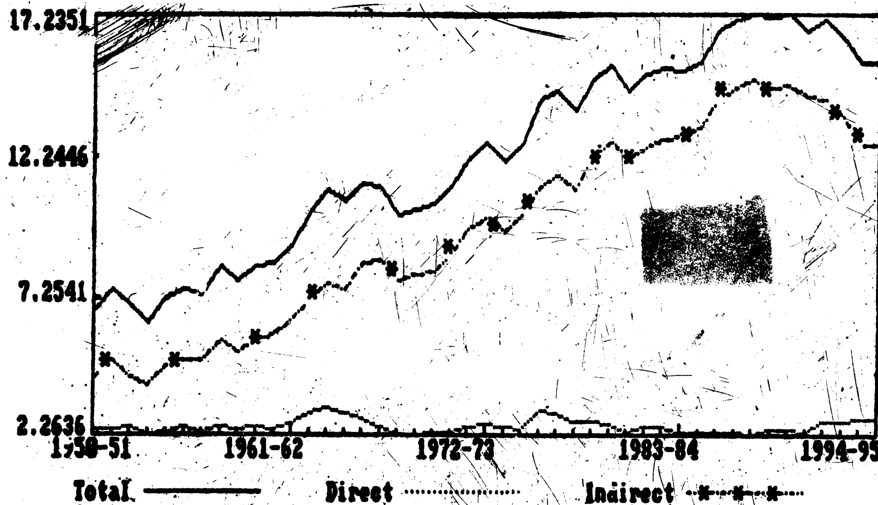
Source: *Public Finance* (various issues), Govt. of India, Dept. of Economic Affairs, Ministry of Finance.

Fig. 21.3: Share of Govt. Revenue (per cent of GNP)



Source: GOI. *Economic Survey 1995-96.*

Fig. 21.3: Tax Revenue as a Percentage of Nominal GNP, 1950-51 to 1994-95



Source: *Public Finance*, GOI, Department of Economic Affairs, Ministry of Finance.

The relative shares of direct and indirect tax revenues have changed significantly over time (see figure 21.3). The figure shows that the direct tax revenue as a proportion of GDP increased up to the mid-seventies but thereafter it has shows a decleration. On the other hand, the ratio of indirect taxes to GDP has gone up almost continuously throughout. This proves the heavy dependence on indirect taxes for resource mobilisation. Direct taxes (personal income tax, corporation tax, welath tax, estate duty etc.) are more difficult to collect in a country like India. The greater reliance on indirect taxes to finance Government expenditure is regarded as an unhealthy characteristic of public finance in India.

The shares of income tax and land revenue in the total direct tax have fallen secularly during the last four decades. Land revenue and agriucltural income tax, which together contributed one third of direct tax revenue in 1955-56. contributed only a meagre 6 per cent in 1990-91. Infact the share of agricultural income tax and land revenue in total tax revenue (direct plus indirect tax revenue) was less than one per cent in 1990-91.

The indirect tax structure has also changed over the years. In the early years of planning. customs duties were the most important source of indirect tax revenue. But after import restrictions, the share of customs duties declined and that of taxes on domestic goods increased. With the import liberalisation of the eighties and nineties, the share of customes duties has once again started rising. The share of union excise duty first rose and then fell. Sales tax, which is collected by the States has steadily improved its share in total indirect tax revenue.

If there is a social preferance for a larger supply of public goods and services. Society has to bear the cost of such supply. Politicians generally promise more Government with less tax. This policy leads to a continuous rise in Government borrowing and public debt. But all debt must be repaid eventually. Which means that in future the Government must either increase tax or cut public expenditure. This game, therefore, cannot be played forevever. Sooner or later, it would lead to a fiscal crisis. If there is a general agreement on the size of the Government then there should also be a general understanding to pay for it either through taxation or through pricing of public goods and services.

Income tax policy

The share of income tax - general as well as agricultural - has not increased rapidly over the years. In the early eithties about 2 million people paid income tax. By 1990-91 it increased to only 6 million. The number of taxpayers has remained very low partly because of large-scale tax evasion and partly because of a continuous hike in the tax exemption limit. There are two criticisms against personal income tax: first, it acts as a disincentive to earn income and produce output, and, second, high rates of taxation induce evasion and generate black income. Both the criticisms are valid in view of the marginal tax rates which have been very high.

In India personal income tax policy is progressive in structure (although there is no horizontal equity since taxation is on individual incomes and not on combined family incomes). The personal income tax rates were very high in the mid-seventies when the highest marginal tax rate was as high as 97.5 per cent. Since then the rates have been gradully lowered. In the recent (1997-98) Union Budget, the highest marginal tax rate has been brought down to only 30 per cent. In fact with the budget of 1997-98 the incidence of direct taxation in India has become one of the lowest in the world. The effective tax rate is however much lower because of numerous concessions. The averate rate of incidence in the lowest income slab (below Rs. 20.000) in 1984-85 was 2.7 per cent which came down to 1.2 per cent in 1987-88. In the Rs. 20,000 - 50,000 slab the rate decreased from 14 per cent in 1984-85 to 3.6 per cent in 1987-88. In the next slab (Rs.50.000 - 1 lakh) the rate dropped from 32 to 26 per cent. The middle income group (Rs. 20,000 - 1 lakh) contributed the bulk of tax revenue. 71 per cent in 1984-85 and 69 per cent in 1987-88.

Most salaried income households fall in the middle income group. Effectively, therefore. the middle income salaried group bears the brunt of income taxation in India. Non-salariec

groups are generally hard to tax and effective income tax paid by this group is less than what is due from them. There is, therefore general discontent in the salaried group against the high tax rate it has to bear because the incidence falls relatively more on them than on non-salaried groups having a higher income. Given this and even otherwise it would not be desirable to increase personal income tax rates. A better policy would be lower rates and simple tax rules, with less exemptions.

21.5 TAX REFORMS

In formulating its recommendations the Tax Reforms Committee (1994) headed by R.J.Chelliah enunciated the following goals which formed the blueprint for tax reforms.

i) reduction of rates of all major taxes viz. customs, income tax, and central excise;

ii) widening of the bases of all taxes by removing or curtailing exemptions and concessions, drastic simplification of the laws and procedures;

iii) replacement of the existing taxes on domestic production and trade by a value added tax (VAT):

iv) a though revamping and modernisation of the administration.

Regarding the revenue objective, the committee postulated that the reforms should be fully or, at least, nearly revenue neutral in theri totality: however the system should become more income elastic" (TRC, Interim Report, Chapter 5). Several of the recommendations of the TRC have been implemented while action on some, especially on the administration front, is under way

The reforms so far have succeeded in making a small change in India's tax structure by reducing the weight of custon es from 23.5 per cent in 1990-91 to 18 per cent in 1993-94 and raising that of direct taxes from 14 per cent ot 18 per cent but the share of taxes on domestic trade (made up mainly of union excise duty and states sales tax) remains at 63.4 per cent as compared to 62.5 per cent at the commencement of the reforms. The shift away from foreign trade taxes appears to have taken place at the cost of overall revenue growth, with a clear drop of more than 1 percentage point in the tax/ GDP ratio. The rise in the relative share of direct taxes has resulted parily from the decline in revenue from customs, contrary to the belief that it was caused by the reduced in rates. The recent reforms relating to liberalisation may have actually helped in the collection of direct taxes by imporving the compliance rate.

Adoption of VAT would however require reforms in two phases- first, there are immediate reforms which could be attempted without facing major problems. Once the economy has adjusted to these immediate reforms and the administrative system has been suitably developed, the machinery to administer the changes, medium measures can be set in motion.

A. Immediate Reforms

The following immediate reforms are essential to pave the way for major reforms to be taken up in the medium-run.

i) Reducing the number of rates

The reform related to the multiplicity of rates requires efforts at simplifying the tax structure. Over time, attempts were made to attain a large number of objectives (including progressivity) through all these taxes and hence the number of rates classified according to their characteristics increased. Such a system, however complicated the administration of all these taxes. Also a very fine gradation through tax rates does in no way serve any useful purpose of having progressively. Rather, it complicates both the structure and administration of the taxes and causes evasion of tax as well as endless litigation. Hence, it is advisable to reduce the number of tax slabs to two or three (except the selective excise duty on non-

essential commodities or commodities injurious to health which could be levied at higher rates).

ii) Lowering of total tax incidence

Lack of transparency in the tax structure does not allow us to estimate the cumulative total commodity tax burden in the economy. The data on public Finance published by the Government of India does not give disaggregated (or separate) impact of various changes in the policies on the economy. As evisaged in the TRC, import duties should be reduced considerably. Domestic taxes (viz. excise and sales tax) on commodities should also be suitably reduced to provide efficient allocation of resources.

iii) Reforming sales tax system

The existing sales tax system is such that it has considerably reduced the income elasticity of the tax system. Moreover, the cascading effects of taxation at initial stages as well as taxation on raw materials need to be rationalised. Reforming sales tax would imply some other recommendations as well, viz. reduction in tax rates, lowering tax incidence, granting a limited number of exemptions, and shifting the rate structure towards the retail point.

B. Medium - Term Reforms

Once the administrative system has absorbed the immediate reforms,the medium-term reforms must aim at two major changes.

i) Adoption of VAT

The foremost reform in the medium term has to be in the direction of adopting a full-fledged VAT. A Preliminary step towards the reform of a complex structure of taxes has already been attmepted by introducing MODVAT. The TRC option in this regard is the suggestion that we could have an admixture of VAT (called MODVAT) at the central level extended to most commodities and a rationalised sales tax system at the state level (TRC, final report, part-I). The TRC recommends that MODVAT could be extended to the wholesale level (the quantum of which seems to be indeterminate which could be Rs.15 million or Rs. 20 million depending on the level of economic activites in the states. However, rationalisation of sales tax thats, introduction of VAT might would require rationalising the tax on the manufacturing sector at both the central and state levels, it might make the compliance by taxpayers more complex since it would require compliance at different stages between purchase and sale(instead of compliance at one point as at present).

ii) Broadening of the tax base

As suggested by the TRC, broadening the base of the tax system implies inclusion of services as well. From the economic point of view there is harldy any difference between the taxation of commodities and that of services. In fact the services sector expands at a relatively highly rate as the economy expands. Multifarious services are produced for the benefit of consumers as well as producers. Hence exclusion of services tends to create distorions. The TRC however feels that the tax on services should be levied at the central level only. The following services were suggested to be brought under the tax net for raising resources by the TRC:

1. transport services
2. private nursing homes
3. computer maintenance and consultancy services
4. automobile repair and services

Pattern of public expenditure in India

Government expenditure has risen faster than GNP all over the world during the last several decades. Basically there are three reasons for this: a) advent of socialism and mixed economy; b) rise of the welfare state, and c) predominance of Keynesian stabilisation policy. In pure socialist states the Government does all key economic activities. The share

of Government expenditure tends to grow with the degree of socialism in a mixed economy. In the welfare state the state takes the responsibility to provide education, health services, basic social infrastructure and social security. The capitalist mode of production can be combined with the welfare state so that production and employment is provided by the private sector and unemployment benefit and social welfare are taken care of by the state. Keynesian stabilisation policy with Government expenditure as a key regulator of aggregate demand and supply provided the third impetus to the growth of public expenditure, especially in the industrial countries (the success of the Marshall Plan after the Second World War provided tremendous inspiration and faith).

Although in principle Government expenditure is discretionary, in practice it is generally flexible upwards but not downwards. Bureaucratization of Government expenditure is also a major obstacle to discretionary cuts in Government expenditure. Expenditure once committed creates a bureaucratic vested interest to perpetuate it. Even if bureaucrats allow society once habituated to the supply of some public goods and services finds difficult to adjust without them. A cut in Government expenditure is therefore very unpopular.

In the four and a half decades of economic planning in India the share of Government expenditure in GDP has increased from 10 per cent to about 35 per cent. The growth has been more or less uniform in all decades. In the eithties, in fact, there was no noticeable acceleration. Between development and non-development expenditure, the former has increased relatively faster than the latter. However the distinction between development and non-development expenditure as used in official publications has no special significance in economics, except in a broad sense. The share of Government expenditure in GDP in India is five percentage points above the average of low-income countries. The central Government accounts for the bulk of the total Government (centre and states) expenditure. In fact the share of the central in total Government expenditrue has risen during the four decades of planning.

Hower the report of the tenth finance commission has suggested devolution. The long run expenditure (consumption plus investment) has grown much slower than transfers, financial investments and loans. The overall expenditure for capital formation by the centre (financial investment plus loans) has increased from about Rs 1.5 billion in 1950-51 to Rs. 286 billion in 1990-91. The share of expenditure for capital formation in the total expenditrue of the centre increased during the first two decades but has declined since then. There has, however. been a phenomenal growth of current transfers in the Central Budget.

Public expenditure in India may be broadly classified under the following heads.

Defence Expenditure:

Since independence the defence budget of India has accounted between 1 to 4 per cent of GDP and between 10 and 16 per cent of total Government expenditure. If expenditure on para-military forces and on the R and D of defence-related infrastructure like nuclear energy space etc. are considered, defence expenditure in India may go up by another about 1 to 2 per cent of GDP. However even then the total defence expenditure in India as a proportion of either GDP or total Government expenditure would be much lower than that some of the our principal adversaries like China and Pakistan.

In general defence expenditure does not promote growth. However some military expenditures promote growth, such as defence support to capital goods industry, border area development, construction activities, space and nuclear research etc.

Education and Health Expenditure : Education and health may be regarded as merit goods which should be made accessible to all irrespective of income and capacity to pay. This is the case in most advanced economies of the world. Investment in human capital is a productive investment The Government in India spend relatively more on education than on health. Expenditures on education and health vary widely betwen the states with the southern states like Kerala spending relatively more on education.

Employment and wage policy : Government consumption expenditure has two components: a)compensation to employees b) purchase of consumer goods and services.

The second component is basically related to the first ; more employees means more office space, furniture, equipment, transport, energy consumption etc. Over the years the growth of employment in the public sector has increased tremendously and as a result both Government administration and public enterprises are grossly over staffed. This means that the average productivity of labour in Government is very low.

Subsidy : Subsidy in India is given for various pruposes, such as

1 protection of living standard of the poor via food subsidy,

2 production incentive via fertiliser subsidy.

3. consumption of merit goods via health and education subsidy.

4. protection of ecology and envjronoment via bio-gas subsidy etc., and

5. Promotion of industrial production via export subsidy.

Both the centre and the states subsidise goods and services in India.

Unifortunately, the volume of subsidies given has been accelerating with time mainly because of vested political interests. Overprotection through subsidies has prevented the potential competitiveness of the system from being realised. Beyond a point, however, the fiscal system cannot absorb such subsidies.

Public debt in India

Gross public debt is the gross financial liability of the Government. Net public debt is the gross debt minus the values of capital assets of the Government and loans and advances given by the Government to other sectors. However, measurement of the real net worth of the public or Government sector remains an intricate problem in public finance. The Government may be unable to service the debt due to the liquidity problem, but if it wishes it can repay the debt by sellinq its assets, (through privatisation).

Between 1950-51 and 1990-91 the gross debt of the centre (internal, external and other liabilities) has risen from Rs. 29 billion to Rs. 3114 billion, i.e., by 106 times. As a percentage of GNP, the increase has been from 32 per cent to 68 per cent. This growth is phenomenal considering that during the eighties the increase was as much as 19 per centage points.

Internal debt consists mainly of the states' loans from the centre, Governmednt securities (this is a negligible amount), market loans, treasury bills etc. External debt consists of bilateral loans or loans from international monetary agencies. The growth of external debts is a far more seriuous matter than internal debt. External debt directly affects a country's balance of payment position, trade flows and currency valuation. The fiscal crisis of 1990-91 was caused by the phenomenal increase in the external sector defict. In fact external debt is all the more difficult since the principal amouint and interest repayments keep accelerating with increasing debt as also due to currency devaluation (chiefly because of the balance of payments crisis). This in fact forms a vicious circle and the country falls into a debt trap which threatens its sovereignty in the long.

In Conclusion, theretore, it can be said that the current fiscal system in India is not very efficient. The administrative machinery for revenue collection muyst be technologically upgraded and its efficiency must be increased. Public expenditure and debt must be curbed and similar reforms must be made so that they stay within limits. The Government must stop expenditure in areas where the private sector can take over and work more efficiently. Also the increasing volume of extrernal debt must be curbed in order to avoid another fiscal crunch. The Government sould take judicious decisions independent of its political interests. Most of the subsidies barring a few like, the subsidy on food, health, and education etc. for the poor are unwarranted and should be gradually abolished. This would be not only reduce the fiscal deficit but would improve the overall efficiency of resource allocation in the economy.

Finally, it would release resources for productive uses in the private sector.

The development experience elsewhere has shown that fiscal efficiency is a pre-requisite for the faster growth of the economy.

It is even more important for a poor and resource-starved economy like India. Mismanagement of fiscal resources affects the welfare not only of the current generation but also of future generations.

Let us summarise the main points of this section:

- Fiscal policies play a multidimensional role in mixed economies like India's
- There are five major sources of revenue for the Indian Government - taxation, profit from sales of public goods, domestic non-monetary borrowing, external borrowing, borrowing from RBI.
- Indirect tax revenues are the major source of tax revenues. Their share has risen significantly over the years.
- The major recommendations of the Tax Reforms Committee were:

  i) reduction of all tax rates

  ii) widening of the bases of all taxes

  iii) adoption of VAT

  iv) modernisation of administration.
- Adoption of VAT would require two sets of reforms - immediate and medium term.
- Public expenditure has been rising phenomenally in India with the centre accounting for the major proportion.
- Four broad categories of public expenditure in India are - defence, education and health, employment and wages, and subsidies.
- The growing size of external debt was responsible for the financial crisis of 1990-91

21.6 SUMMARY

We summarise here the main points from different sections of this unit. At the outset it may be stated that public finance forms the core of public policy in any economy. The role of public finance is generally greater in most developing countries where the Government performs not only traditional fiscal policy functions but also bears the main burden of development of the economy. The over-dependence on the state however is not considered good. In many countries the Government has tried to rely too much on the its fiscal machinery to solve all macro and micro economic problems, resulting in excessive fiscal deficit. The need for fiscal reforms, which essentially imply not only rationalisation but also reduction of fiscal activities, originated from the excessive Government regulations of the economy.

Now the main points are:

- Public finance is that branch of economics which deals with the expenditures and revenues of the public sector.
- The three major functions of a fiscal policy are: the allocation function, the distribution function, and the stabilization function
- One nature of the objectives of economic policy is complementary as well as conflicting.
- Social goods are those goods which are consumed by all citizens and increase the welfare of society.
- The market fails to provide the economy with social goods. The state must take up this activity.

- Taxes, charges and borrowings are the three major sources of of revenue for a Government.
- A good tax structure satisfies the requirements of equity, efficacy and low administrative costs.
- **The benefit principle** is an approach to tax equity according to which each individual pays in proportion to the benefits he/she receives from the social good in question. This principle is not practicable (except in certain special cases).
- The **ability - to pay approach** requires taxpayers to pay according to their economic capacity.
- The ability - to pay principle requires the tax burden to be in line with horizontal and vertical equity.
- **Vertical equity** can be measured in terms of the equal sacrifice principle.
- **Tax incidence** refers to the distributional effects of the tax burden. Tax incidence has effects on the uses as well as sources sides of the budget.
- **Excess burden** is the net burden placed on the economy due to the imposition of a tax.
- Public expenditure in all economies has exhibited on upward trend
- A fiscal crisis results from excessive fiscal deficits.

  Public debt is the debt of Government proper and the debt of departmental public enterprises. It is internal as well as external in nature, the latter being a more serious problem.
- Fiscal policies play a *multidimensional role* in mixed economics like India's.
- Ther are five major sources of revenue for the Indian Government: taxation, profit from the sale of public goods domestic non-monetary borrowing, external borrowing, borrowing from RBI.
- Indirect tax revenues are the major source of tax revenues. Their share has risen significantly over the years.
- The major recommendations of the Tax Reforms Committee were i) reduction of all tax rates; ii) widening of bases of all taxes; iii) adoption of VAT; and iv) modernisation of administration.
- Adoption of VAT would require two sets of reforms - immediate and medium - term.
- Public expenditure has been rising phenomenally in India with the centre accounting for the major proportion.
- Four broad categories of public expenditure in India are - defence, education and health, employment and wages, and subsidies.
- The growing size of the external debt was responsible for the financial crisis of 190-91.

21.7 KEY WORDS

Direct taxes: Taxes imposed on individuals or householders who also bear the burden i.e. the impact and the incidence of tax is on the same person e.g. Income tax, Wealth tax, etc.

Excess burden Burden placed on the economy of a country which is in excess of the revenues received by the Government

Fiscal Crisis Crisis resulting from excessive fiscal deficits, cared mainly by excessive public expenditure.

Fiscal Deficit The excess of Government expenditure over its revenue.

Fiscal policy Policy of the Government concerned with allocation, distribution and stabilization functions.

Horizontal Equity The principles that tax payers with equal ability to pay should be required to contribute equally.

Income tax Tax imposed on incomes of tax entities viz. individuals, Hindu Undivided families, firms, companies and cooperatives etc.

Indirect taxes Taxes imposed on an entity at some point in the chain from production of goods to their distribution e.g. Sales tax, Excise and Customs duties. Since the burden of the tax can be passed on to others, the impact and incidence of tax is not on the same person.

Merit goods Though not purely public goods, the provision of such goods is supposed to be the moral responsibility of the government, e.g., health - care services, primary education, sanitation, etc.

Multiplier effect Ratio of incremental increase in aggregate expenditure in the economy to one unit of increase in government expenditure.

Personal taxes Taxes imposed on tax payers' income and borne by individuals/householders.

Public debt The debt of the Government plus the debt of the departmental public enterprises e.g. Railways.

Public expenditure Expenditure incurred by the Government for public welfare and maintenance of public systems.

Public Fianance The study of the financial activities of Government and public authorities. It represents an aspect of the Government concerned with revenue, expenditure, budgeting, and resource allocation with the overall objective of promoting economic well being of the citizens and ensuring distributive justice.

Social goods The goods provided by the Government free or at subsidised rates in the form of public services or utilities e.g parks, roads, bridges, educational facilities etc. provided. Available to all citizens, such goods are required for the welfare of the society as a whole, but the market often fails to provide them.

The incidence The effect of a budgetary tax measures on individuals, output or employment. It refers to distributional effects of budgetary measures

Vertical equity The principal that taxpayes with unequal capacities to contribute snould be required to pay different amounts agreeing to theri capacities.

Value added Tax Tax imposed on the value addition made/contributed by a taxable entity.

21.8 SELF-ASSESSMENT QUESTIONS

1. Why is the study of public finance crucial to the understanding of an economy?
2. In industrial economies like the U.K. and the U.S.A., a flat taxation rate (per head tax) is followed. What can you say about this system in terms of equity, efficiency, administrative costs? Is it a good tax structure? Why?
3. What are the major problems of fiscal policy?
4. What are the basic objectives of a fiscal policy? Are they conflicitng? Analyse the objectives enumerated in Table 21.2 and put forward your arguments as to which ones should be given greater priority in a country like India.
5. Is the growth of public expenditure in India justified in all four categories? Explain.

6. Critically examine the recommendations of the Tax Reforms Committee.

21.9 FURTHER READINGS

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3. Bagchi, Amaresh (Ed.), Debts, Deficits and Taxation in India's Government Finance (National Insititute of Public Finance & Policy), Oxford University Press, Delhi, 1994.

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5. Report of the Tax Reforms Committee, 1994, GOI.

APPENDIX 1

Economic Survey 1996-97: Some Excerpts

Deficit Measures

The key deficit measures viz. gross fiscal deficit (GFD) and primary deficit are budgeted lower, compared not only with the preceding year's level but also to their average levels during the past five years (1991-96) (Table 2.1) The GFD is estimated to decline to 5.0 per cent of GDP in 1996-97, from 5.8 per cent in 1995-96 (RE). Similarly, the revenue deficit as a proportion of GDP is budgeted at 2.5 per cent as against 3.0 per cent in 1995-96 (RE) and 3.1 per cent on an average, during 1991-96. The proposed reduction is quite conspicuous in the case of primary deficit, which is budgeted at 0.2 per cent of GDP as against a 1.1 per cent in 1995-96 (RE)and 1.7 per cent on an average during 1991-96.

Budget Deficit

The budget deficit, defined as total receipts (revenue and capital) minus total expenditure, both revenue and capital, is estimated to decline from Rs. 7600 crore for 1995-96 (RE) to Rs. 6578 crore in 1996-97 (BE). In the past the actual budget deficit has tended to overshoot the budgeted estimate. With a view to constrain the enlargement of the budget deficit, Central Government entered into a formal agreement with the Reserve Bank of India in 1994 to limit its borrowing through *ad-hoc* treasury bills to a predetermined amount. Past experience in this regard has shown the difficulty of staying below the within-year limit. However, before the system of ad- hoc treasury bills is phased out it is necessary to put in place a better expenditure control mechanism. This would also need a more transparent method of defining and reporting the true budget deficit, including all forms of monetisation.

The fiscal deficit is defined as the difference betweenm, the revenue receipts (net) plus non-debt capital receipts, and the total expenditure including loans net of repayments. This has also been at higher levels during the course of 1996-97. At the end of June, 1996, the fiscal deficit was Rs. 24718 crore as against Rs. 21157 crore at the end of June, 1995. At the end of September, 1996 it stood at Rs. 30908 crore compared with Rs. 28298 crore at the end of same period last year. It increased to Rs. 41347 crore at the end of December, 1996 as against Rs. 37112 crore at the end December, 1995.

Tax Measures

Direct Taxes

Personal Income Tax

In budget 1996-97, the Government's objective has been to remain steadfast on the course

of economic reforms and liberalisation aimed at accelerating economic growth with social justice. During the past several years the endeavour of the Government has been to increase the revenue without levy of fresh taxes. This has been possible by moderation of the tax rates and rationalisation of the tax system. No new taxes were levied in the 1996-97 budget also, save one.

Rates and Exemptions

The trend towards tax rate reduction continued with lowering of the tax rate on the first slab from 20 per cent to 15 per cent. The standard deduction was raised from Rs. 15,000 to Rs. 18,000 in respect of an employee having a salary income of Rs. 60,000. This has the effect of raising the exemption limit to almost Rs. 60,000 in the case of a salaried employee. A salaried employee with an income of Rs. 60,000 per annum, making the minimum contribution to his provident fund. will pay to tax at all. In order to simplity and rationalise the tax structure the distinction between specified HUF and unspecified HUF has been abolished. The rates applicable to individuals will also be now applicable to all Hindu undivided families. Section 80 R, Section 80 RR and Section 80 RRA of the Income Tax Act, provided deduction from total income in respect of foreign exchange earnings from export of services. The admissible deduction was equal to 50 per cent such income of remuneration or 75 per cent of such remunerations is brought into India. The deductions under these sections have now been linked to repatriation of foreign exchange. The deduction under sections 80R. 80RR and 80RRA shall now be equal to 75 per cent of the foreign exchange earnings which are brought into India. within period of six months from the end of the previous year.

Corporate Tax

Corporate tax rates have been reduced and simplified over the past few years and the result has been very encouraging. There has been a significant increase in corporate tax collection as a percentage of GDP. The policy of moderation of tax rates has been continued in 1996 by reducing the rate of surcharge on corporate tax from 15 per cent to 7.5 per cent.

At the same time an effort has been made to tackle the phenomenon of zero tax companies having substantial book profits by bringing such companies under "Minimum Alternate TAx" (MAT). This applies where the total income of a company as computed under the Income Tax Act. after awailing all eligible deductions, is less than 30 per cent of the book profit. The total income of such companies shall be deemed to be 30 per cent of the book profit (subject to certain adjustments) and shall be charged to tax accordingly. However, the companies in power and infrastructure sector or a sick industrial company or companies located in backward areas entitled to exemption under Section 80 IA, have been kept out of the purview of MAT. The tax under MAT would in reality work out to about 12 per cent only.

As a step towards achieving a level playing field, the rate of tax on long term capital gains in the case of domestic companies as well as other nresident assesses has been reduced from 30 per cent to 20 per cent.

Revenue Impact of Reforms

The recent trends in direct tax collection show that the decision to reduce rates, simplify and rationalise tax procedures, and thereby encourage compliance, has yielded good results. The reduction in personal and corporate tax rates over the past years have brought a substantial increase in tax collections. Average buoyancy, as measured by the ratio of change in tax revenue to the change in GDP at current prices, has shown substantial improvement. The reduction in personal income tax rates over the assessment years 1991-

92 to 1995-96, from the maximum marginal tax rate of 56 per cent on income above Rs. 1 lakh, to 40 per cent of income above Rs. 1.2 lakh has not resulted in a reduction in revenue collections. The buoyancy of personal income tax revenues rose from an average of about 1.1 during 1986-87 to 1990-91 to around 1.5 during 1991-92 to 1995-96, and is expected to remain well above unity for the current year as well. Effective corporate tax rates have similarly been reduced, from a peak of 57.5 per cent for certain domestic companies to 43 per cent for all domestic companies having income above Rs. 75,000. Surcharge which was reduced from 15 per cent to 7.5 per cent is not leviable in the case of companies having income below Rs. 75,000 and these are thus taxed at the rate of 40 per cent only. Despite this, the buoyancy has risen from an average of 0.8 during 1986-87 to 1990-91 to 1.6 in 1991-92 to 1995-96. The buoyancy is expected to decline, but may remain well above unity for the year as well.

Excise

The MODVAT scheme was introduced in 1986 mainly for reducing industrial costs and prices by relieving taxes on inputs, thereby mitigating the cascading effects on the final products. Since 1986, the MODVT scheme has undergone many changes.

In the 1996-97 budget, the scheme has been extended to the textiles sector by rationalisation of rate structure to help modernisation and revival of the textile industry. Further, invoices issued only by the first and the second stage dealers will be valid documents for availing MOTVAT. Mandatory penalty has been introduced for evasion of excise duty or misuse of MODVAT credit scheme on account of fraud, collusion etc.

Beside the above changes, duty rates have been reduced on a number of items of daily consumption and more mass consumption items were exempted from excise duty.

Note: *For more details you may please refer to the full text of the Economic Survey.*

UNIT 22 ECONOMIC REFORMS AND SOCIAL JUSTICE

Objectives

The objectives of this unit are to:

- Examine the impact of economic reforms on various aspects of Indian economy
- Point out the deficiencies in the economic reforms and
- examine in particular the social security aspect of economic reforms

Structure

23.1 Introduction

22.2 Economic Reforms and Growth Rate of GDP

22.3 Economic Reforms and Control of Inflation

22.4 Economic Reforms and the Impact on Poverty

22.5 Economic Reforms and Employment

22.6 Economic Reforms and Foreign Investment

22.7 Economic Reforms and India's External Debt

22.8 Economic Reforms and Multinational Corporations

22.9 Economic Reforms and India's Foreign Trade

22.10 Neglect of Agriculture - the Major Sin of Economic Reforms

22.11 Economic Reforms and Social Security

22.12 Conclusion

22.13 Summary

22.14 Key Words

22.15 Self assessment Questions

22.16 Further Readings

22.1. INTRODUCTION

Economic Reforms introduced in 19991 by the Congress (I) government led by P.V.Narasimha Rao have completed five years. Although five years is not so long a period to asses the impact of economic reforms, it is also not so short a period that an assessment of its impact should not be attempted. Need it be mentioned that the growth process can have a meaning to the masses, if teh benefits of growth are distributed more favourably towards the poor and weaker sections of teh society? In other words, growth is accompanied by social justice. It would be in the fitness of things to make an assessment of economic reforms, especially its impact on the the common man, in terms of more employment, stabilisation of prices of articles of essential consumption or control of inflation, a better spread of growth benefiting the weaker sections of the society - in other words, its effect on social justice.

Table 22.1A: Selected Economic Indicators

	90-91	91-92	92-93	94-95	96-97	97-98	Average Annua Growth Rate (1991-96))
Cross Domestic Product (1980-81) Prices) Rs. Thousand Crores)	212.6	214.2 (0.9)	224 9 (5.0)	236.1 (4.5)	251.0 (6.7)	266.5 (6.3)	4.7
Industrial Production (Trie.1980-81=100)	212.6	213.9 (0.6)	218.9 (2.3)	232 0 (5.6)	252.0 (8.6)	262.3 (4.0)	4.3
Agricultural Production Index (1980-81=100)	148.8	145.5 (-2.0)	151.5 (4.1)	156.9 (3.5)	164.1 (4.5)	163.9 (-0.2)	2.0
Food grains Production Index (Trie.(1980-81=100)	143.7	137.6 (-4.2)	144.3 (4.8)	150.2 (4.1)	155.3 (3.4)	154.4 (-0.6)	1.4
Wholesale Price Index Average of Weeks (1981-82 = 100)	182.7	207.8 (13.7)	228.7 (10.1)	247.8 (8.8)	274.7 (10.8)	289.7 (8.7)	10.3
Primary articles	185	218 (17.8)	235 (7.8)	251 (6.8)	283 (12.7)	307 (8.5)	10.6
Food articles	201	241 (19.9)	271 (12.4)	284 (4.8)	313 (10.2)	342 (9.3)	11.2
Non-food articles	194	229 (18.0)	229 (0.0)	249 (8.7)	299 (20.1)	320 (7.0)	11.2
Fuel, Power, Light & Lubricants	176	199 (13.1)	227 (14.0)	262 (15.4)	280 (6.9)	284 (1.4)	10.0
Manufactured, Light & Lubricants	183	203 (10.9)	226 (11.3)	243 (7.5)	269 (10.7)	297 (10.4)	10.1

Table 22.1B: Selected Economic Indicators

	90-91	91-92	92-93	93-94	94-95	95-96	*Average Annu Growth Rate (1991-96))*
Cross of living Index Industrial Workers (1982=100)	193	219 (13.5)	240 (9.6)	258 (7.5)	279 (8.1)	315 (12.9)	10.3
Urban Non-annual Employees (1984-85 = 100)	161	183 (13.7)	202 (10.3)	216 (6.9)	232 (7.4)	254 (9.5)	9.5

Agricultural Labourers (1960-61 = 100)	803	958 (19.3)	1076 (12.3)	1114 (3.5)	1204 (8.1)	1390[3] (15.4)	11.6
Export (US $ million)	18,143	17,866 (-1.6)	18,537 (3.7)	22,238 (20.0)	26,330 (18.4)	31,830 (20.9)	21.3
Import (US $ million)	24,073	19,411 (-19.4)	21,882 (12.7)	23,306 (6.5)	28,654 (22.9)	36,380 (27.0)	[illegible].6
Balance of Trade	-5,930	-1,545	-3,345	-1.068	-2,324	-4,530	
Money Supply (M_3) (000 crores)	277.6	329.0 (18.1)	378.9 (15.5)	452.2 (19.3)	530.8 (17.3)	581.8 (9.6)	
Exchange Rate (Re) (US $)	17.94	24.65 (37.4)	28.96 (17.4)	31.37 (8.3)	31.40 (0.1)	34.06[4] (8.5)	13.7

Note : Figures in brackets indicate growth over the previous year.

1. Quick Estimates.
2. Advance estimates
3. As on March 16, 1996
4. As on March 1, 1996

Source : Data have been compiled from Government of India *Economic Survey* (1993-94), (1994-95) and (1995-96).

22.2. ECONOMIC REFORMS AND GROWTH RATE OF GDP

The Economic survey(1995-96) states: "Despite the deep crisis of 1991-92, average growth over the first four years of the Eighth plan at 5.7 per cent is higher than the plan target of 5.6 per cent. This is a remarkable post-crisis achievement by international standards."

(Government of India, *Economic Survey* (1995-96), P.I.)

The average annual growth rate of GDP works out to 4.7 per cent for the period 1990-91 to 1995-96 as against 6.4 per cent for the proceeding five year period (1985-86 to 1989 - 90).

Though the economy has picked up, it cannot yet be stated with confidence that the economy will be able to achieve a growth rate of 7 per cent per annum in the Ninth Plan (1997-2002).

22.3. ECONOMIC REFORMS AND CONTROL OF INFLATION

Another major achievement of the economic reforms is the control of inflation. There is no doubt that during 1995-96, there has been a decline in the rate of growth of the wholesale price index (WPI) to 8.7 per cent as against 10.8 per cent during 1994-95. But a broad view of the 5-year period reveals that the annual average growth rate of WPI was of the order of 10.3 per cent during 1990-91 and 1995-96. A more distressing aspect of the price situation is the average increase of price of food articles which effect the common man by 11.2 per cent per annum during the last five years.

But a more reliable index which measures the cost of living is the consumers' price

ıdex (CPI). The CPI for agricultural labourers which is the most pervasive index for our :ountry has show a rise by 15.4 per cent and that of industrial workers by 12.9 per cent luring 1995-96 - teh year for which the Government claims to have brought inflation under control. If we take the entire 5-year period, CPI for industrial workers showed an annual average rise by 10.3 per cent and that for agricultural labourers by 11.6 per cent. A more than double-digit rise in CPI over the entire post reform period has serious welfare implications.

22.4. ECONOMIC REFORMS AND THEIR IMPACT ON POVERTY

Another claim made by the Government is: "The proportion of population below the poverty line declined from 25.49 per cent in 1987-88 to 18.96 per cent in 1993-94. The lower incidence of poverty in 1993-94, despite the intervening crisis of 1991-92, suggests that the various policy and programs adopted in the process of economic reform have helped the poor in in the country."(Government of India, *Economic Survey* (1995-96), P.12.) Nothing can be farther form the truth than this claim of the Government.

Exploding the myth of poverty reduction, *The Economic and Political Weekly* writes. "It is surprising that the Planning Commission should continue to release these estimates obtained by its'conventional'method. Less than three years ago, a high level expert groups on estimation of the proportion and number of the poor composed of eminent statisticians and economists and appointed by the Planning Commission, recommended certain important modifications to the Commission' conventional method of estimating poverty. Among the recommendations the two most important were, first, discontinuance of the practice of 'adjusting' the NSS survey estimates for possible differences with CSO estimates because this involved an arbitrary pushing up of the consumption level of every household, when in fact much of the consumption expenditure supposedly missed out by the NSS is likely to have been incurred by the non-poor; and, second, the use of price indices which accurately reflect inter-state and urban-rural differences in the rate of inflation facing those at or near the poverty threshold. (*Economic and Political weekly*, January 27, 1996 editorial ' Poverty Reduction by Manipulation' p.183.)

Table 22.2.: Trend of Poverty in India

	Per cent of poor			*Absolute number of poor (million)*		
	Rural	*Urban*	*Total*	*Rural*	*Urban*	*Total*
1987-88 Full Sample (June-July)	39.1	40.1	39.3	231.4	78.7	310.1
1989-90 Thin Sample (June-July)	33.7	36.0	34.3	206.7	75.1	281.8
1991-91 Thin Sample (June-July)	35.0	37.0	35.5	218.4	79.5	297.9
1992 Thin Sample (Jan..Dec.)	41.7	37.8	40.7	269.0	85.8	354.8
1993-94 Half Sample (June-July)	40.2	36.2	39.0	262.5	83.5	346.0

Source : Social Cost of Economic Reforms by S.P. Gupta and Mousumi Rai

Dr. S.P. Gupta, Director, ICRIER using the methodology of the Expert Group has calculated the proportion and number of the poor. His study reveals that poverty ratio shot up from 35.5 per cent in 1990-91 to 39 per cent in 1993-94. The total number of poor increased from 298 million in 1990-91 to 346 million 1993-94. (Dr. S.P. Gupta has worked out poverty ratio not on the basis of half-sample. The conclusions drawn have been supported by the Planning Commission in its latest estimates.) This implies that although poverty was stagnant at 39 per cent during 1987-88 and 1993-94, the number of poor has increased by 48 million during the three year period (1990-91 to 1993-94).

Thus the claim of the former Finance Minister Dr. Manmohan Singh that poverty ratio has been reduced from 29.9 per cent in 1987-88 to 19 per cent in 1993-94 is totally fallcious. New economic reforms have not been able to make any dent on poverty, not to speak of making a serious dent on poverty reduction. The United Front Government by accepting the methodology suggested by the Expert Group led by the late Professor D.T. Lakdawala has agreed that in 1994-95, the poverty ratio stood at 39.6 per cent. which indicates the failure of economic reforms to reduce poverty. (Planning Commission, *Draft-Mid-term Appraisal of the Eighth Five Year Plan (1992-97)*, September 1996 p.60)

22.5. ECONOMIC REFORMS AND EMPLOYMENT

The Economic Survey (1995-96) mentions: "The Government has accorded the highest priority to promoting sustainable, employment-intensive growth in its economic reform policies. As a result, the total employment growth in the economy is estimated to be about 7.2 million in 1994-95 as compared to only 3 million in the crisis year of 1991-92." (Government of India, *Economic Survey (1995-96), p. 13.)* In his speech while presenting the interim budget for 1996-97, the then Finance Minister stated:"The total increase in employment in the economy was 3 million in 1991-92. It doubled to an average of 6 million in the next two years and exceeded 7 million in 1994-95." (Speech of Dr. Manmohan Singh, Minister of Finance, presenting Central Government's budget for 1996-97 (Interim), 28th February 1996 p.4.)

Eighth Plan (1992-97) had envisaged that "employment potential will grow at about 2.6 percent per annum. In absolute terms it implies the generation of about 8 million jobs per annum during the first couple of years of the Eighth plan, and about 9 million jobs per year during the latter years, and more than 10 million jobs per year in the post-Eighth Plan period."

According to the Planning Commission, additional employment opportunities of the order of 18.78 million are estimated to have been generated during the first three years of the Plan, implying an average rate of employment growth of 2.03 per cent per annum. This is certainly less than the target of 2.6 per cent per annum set by the planners for employment generation. In absolute terms, this indicates a shortfall of over 6 million jobs during 1992-93 to 1994-95. But if we add the shortfall of 3 million jobs estimated for 1991-92, then during the first 4 years of liberalisation, the target of employment generation has lagged behind by over 9 million. The view presented in the *Economic Survey* (1995-96) that "The Government has accorded the largest priority to promoting sustainable, employment-intensive growth in its reform policies" is totally untenable, because all through the Government has been holding that labour displacement is the natural outcome of its reform programme in the short period and as the growth process will pick up in the medium term, the employment scenario would improve. In fact, the policy of liberalisation and the adoption of hi-tech by multinationals coming to India and the Indian industrialists generated a capital-intensive pattern of employment even in the consumer good sectors. The multinationals by entering consumer goods like Bhujia, bakery products, food processing, soaps, detergents and articles of domestic consumption are displacing labour working in the small scale sector. In the public sector enterprises, the Government has been vigorously following the policies of voluntary retirement and providing golden handshake. A silent exit policy was followed in the organised

private sector. All these policies resulted in contraction of employment. There can be nothing farther from truth than to assert towards the end of five years of liberalisation that the Government has been following employment-intensive growth policies.

22.6. ECONOMIC REFORMS AND FOREIGN INVESTMENT

One of the major achievements of the new economic reforms was that it provided a big boost to the inflow of foreign investment. It would be desirable to make an objective analysts of the facts in this regard.

An analysis of foreign investment flows for the period 1991-92 and 1995-96 (upto Nov.95) reveals that total investment flows of the order of US $ 11.744 billion were made, out of which direct investment accounted for US$ 3.694 billion i.e. 31.5 per cent of total. As against it, portfolio investment accounted for US $ 8.05 billion i.e. 68.5 per cent of total. The point which needs to be emphasised is that direct foreign investment is less than one-third of total foreign investment and even of this, 10.4 per cent is contributed by non -resident Indians. This implies that only 21.1 per cent (nearly one -fifth of the total) is contributed by foreigners.

Table 22.3: Foreign Investment Flows by Category (US. $ million)

	91-92	*92-93*	*93-94*	*94-95*	*95-96**	*Total*	*%*
A. Direct Investment	150	341	620	1,314	1,269	3,694	(31.5)
a. RBI automatic route	---	42	89	171	72	374	3.2
b. SIA/FIPB route	87	238	314	701	762	2,102	17.9
c. NRI (40% & 100%)	63	61	217	442	435	1,218	10.4
B. Portfolio Investment	8	92	3,490	3,581	879	8,050	(68.5)
a. FII s	---	1	1,665	1,503	764	3,933	33.5
b. Euro-equities	---	86	1.460	1,839	60	3,445	29.3
c. Offshore funds and other.	8	5	365	239	55	672	5.7
Total (A+B)	158	433	4,110	4,895	2,148	11,744	100.0

**For April - November*
Source: Government of India, *Economic Survey (1995-96).*

Portfolio investment of the order of $ 8.05 billion is of a speculative nature and is not money which can take to flight in a period of political and economic uncertainty. It was not wise on the part of the Government of India to permit portfolio investment because this has only strengthened the foreign business firms control of the share market. Such a course is not beneficial to the country.

Table 22.4 provides data about foreign direct investment (FDI) approvals and actual infolws. The data reveal that although during 1991-95 (upto SEPTEMBER 1995), approvals of FDI of the order of US $.14.995 billion were given, actual inflows accounted for barely US $ 3.437 billion i.e. 22.6 per cent of total approvals. Obviously, the realised foreign direct investment is less than one fourth of the total approvals. Unless the lag between actual inflows and approvals is reduced, the rate of FDI is giving boost to our economy would remain a myth.

Table 22.4: Direct Foreign Investment [illegible] Approvals

	Approvals		Actual Inflows		Actual Inflows as % of Approvals
	Rs. Crores	US Millions	Rs.Crores	US Millions	
1991	739	325	352	155	47.5
1992	5,256	1,781	675	233	12.8
1993	11,189	3,558	1,786	574	16.0
1994	13,591	4,332	2,972	958	21.9
1995*	15,805	4,999	4,729	1,517	29.9
Total (1991-95)	46,580	14,995	10,514	3,437	22.6

**Upto September, 1995.*

Note: Approvals and Inflows Include NRI investments as well.

Source: Government of India, *Economic Survey (1995-96).*

22.7. ECONOMIC REFORMS AND INDIA'S EXTERNAL DEBT

Table 22.5 provides data about the growth of India's external debt from 1990 to 1995 - the period of intensive economic reforms. The data reveal that in dollar terms, India's external debt rose from US $ 75.86 billion in 1990 to US $ 99.04 billion in 1995, indicating a growth rate of 5.5 per cent per annum. But figures of external debt in dollar terms really conceal the burden of debt, since the exchange rate between the US Dollar and Rupee had also deteriorated from Rs. 17.94 in 1990-91 to 34.06 in 1995-96. Consequently in rupee terms, India's external debt rose from Rs. 1,30,199 crores in 1990 to Rs. 3,11,972 crores in 1995, indicating a growth rate of 19.1 per cent per annum. This wide difference between the growth rate of Indian's external debt in dollar and rupee terms highlights the actual burden of debt. Whereas India's external debt rose by 30.6 per cent in dollar terms between 1990-95, it rose by 139.5 per cent in rupee terms during the same period.

"India's external debt, as a percentage of Gross Domestic Product (GDP) at current market prices, rose sharply from 28.5 per cent in 1989-90 to a peak of 41.1 per cent in 1991-92. But the ratio declined to 36.9 per cent in 1993-94 and there was a sharp drop to 34.2 per cent in 1994-95." (Government of India, Ministry of Finance, India's External Debt - *A status Report,* December 1995, p.6). Although the then Finance Minister Dr. Manmohan Singh claimed that external debt as a percentage of GDP has declined from 41.1 per cent in 1991-92 to 34.2 per cent in 1994-95, still it cannot be denied that the country is in the danger zone of debt trap.

While making international comparisons, the White Paper mentioned: "India's external debt, as percentage of GDP was 36.9 per cent in 1993-94. This is comparable with Thailand and Malaysia and much lower than the figures for Indonesia, Philippines, Turkey." (Government of India, Ministry of Finance, India's External Debt --- *A Status Report,* December 1995, p.6) While making this comparison, the then Finance Minister Dr. Manmohan Singh conveniently overlooked the fact that the figures of external debt- GDP ratio for China was 21.4 per cent, for South Korea 14.4 per cent and even for Brazil and Argentina 21.4 per cent and 24.0 per cent respectively. Obviously, debt GDP ratio with China needs to be taken up a bench-mark since for the purpose of comparison in terms of size and diversity these two countries become highly relevant.

Similarly, debt-service ratio for India was 25.1 per cent in 1993 as against that of China being only 10.7 per cent. Despite all the window dressing, the white paper is forced to accept that the debt - service ratio is higher as compared with many other countries. It states:

Table 22.5: India's External Debt

	US $ Million	Rs. crores
1990	75,857	1,30.199
1991	83,801	1,63.001
1992	85,283	2,52.910
1993	90,023	2,80.746
1994	92,695	2,90.418
1995	99,042	3,11,792
Average Annual Growth Rate (1990-95)	5.5	19.1

Source: Compiled and computed from Government of India, Ministry of Finance, *India's External Debt--- A Status Report. December 1995.*

India's debt-service payment as percentage of exports of goods and services (current receipts) at 25.1 per cent in 1993-94 is lower than the corresponding ratio for Argentina (47.6 percent). Indonesia (32.6 per cent), Mexico (32.7 per cent), Turkey (28.3 per cent) and the average ratio for severely Indebted Middle-Income Countries (26.9 per cent); but is higher than the ratio for the other countries and country groups... It needs to be recognised that the debt service ratio for India remains high by international standard." (Government of India, Ministry of Finance, India's External Debt - A Status Report, December 1995, p.19).

The other countries in which debt service ratio is much lower than India are China 10.7 per cent), South Korea (9.2 per cent), Malaysia (7.9 per cent), Thailand (18.6 per cent). But in 1994-95, the debt service ratio of India stood at 26.65 per cent as given by the White Paper and thus India has reached the level of Severely Indebted Middle Income Countries.

22.8. ECONOMIC REFORMS AND MULTINATIONAL CORPORATIONS.

Tarun Dass, Director General of Confederation of Indian Industry in a document on the multinational corporations (MNCs) argued for rethinking on India's strategy towards MNCs

The main arguments are being summarised below:

"The first trend is the sales approach towards India as distinct from manufacturing. This is an issue which reflects reluctance to invest in India but to access the market through minimum production on the group and maximum production at home. A by product of this approach is to rely on continued import of components rather than India-made components and parts.

Table 22.6: India's Debt Service payment

US $ million

	Debt Service Payments	*Total Current Receipts*	*Debt Service Ratio*
	(1)	*(2)*	*(1)(2) X 100*
1989-90	7,420	24,012	30.90
1990-91	8,982	25,478	35.25
1991-92	8,250	25,037	30.21
1992-93	7,658	26,746	28.63
1993-94	8,293	33,074	25.07
1994-95	10,938	41,044	26.65

Source: Government of India, Ministry of Finance, *India's External Debt--- A Status Report. December 1995.*

The second trend is focusing on the short-term rather than the long terms. The strategy seems to be to generate profits quickly rather than go for the long haul, be patient, stay in India and build credibility as a steady process.

The third is to bring in technology and products which are being phased out in the home country of the MNC. Not to bring in the state-of-the art technology or the most modern products.

The fourth is to leverage an Indian Partner to get to India on a 50/50 or 40/40 basis, to get sanctions and approvals quickly and then having reached a certain minimum level of comfort in India, to want to move quickly to 51 per cent equity holding.

Another trend is that is spite of having a joint venture company with an Indian partner, the MNC sets up a 100 per cent subsidiary without any partner and where it has total control.

Another trend is the use of expatriate managers and CEOs for the joint venture company rather than the competitive Indian management available in the country.

Another trend is that MNC investment is limited essentially to the supply of second hand plant and machinery which has been declared obsolete in their country and is available for relocation to a country like India.

The issue which comes out of these trends and indications is that the MNCs actual financial investment are low when compared to the size of the company.

A second conclusion on that emerges is that the MNCs are not committed to partnership in the long term and there seems to be unwillingness to accept questioning or disagreement from the Indian partner. There is a one-way street approach, not a two-way partnership approach. This is reflected in wanting to raise their equity holding to 51 per cent or setting up a parallel 100 per cent subsidiary.

Another perception which has emerged, and this is largely from the fast track power projects, is that the MNCs have pitched their investment costs at a higher than necessary level and the price of the power similarly. Renegotiation has taken place in almost every case and the project cost as well as the price of power have been reduced." (*Mainstream*, March 30, 1996, Document: MNCs' India strategy Needs Rethink, p.6).

Tarun Dås after making a forthright indictment of MNCs concludes:

"Teh feedback from Indian Industry is that they want to have MNCs here but even though the MNCs have much to contribute to India's development and great deal to gain from being a strong partner, there is discomfort with dominance and control, there is discomfort with a one-way street approach and there is clear discomfort with outdated of obsolete technology and products." (*Mainstream*, March 30, 1996, Document: MNCs' India Strategy Needs Rethink, P.6).

Many industrialists have realised the domineering role of MNCs, but do not have the courage to speak the truth. It was rare on the part of Rahul Bajaj, CMD, Bajaj Auto Ltd., to state categorically: "I am against allowing MNCs to set up 100 per cent subsidiaries in India. There are a lot of joint ventures where foreign partners want control of company. If 100 per cent subsidiaries are allowed, foreign partners can put pressure on the Indian partners saying that they could also do so." (*Financial Express*. April 7, 1996)

The current philosophy with the present United Front Government (belonging to all political parties) is to invite MNCs but some add a caveat that this should not be at the cost of the national interest. Consequently, there is a need to have transparency in dealing with MNCs so that the undesirable trends in their unbridled and domineering behaviour can be checked and the oneway street approach yields to two-way partnerships. Secondly, the MNC's should not be allowed to enter into consumer goods and thus thwart the growth of small scale industries and become a threat to employment expansion. Thirdly, greater care and vigilance should be observed in negotiating agreements so that the need for renegotiation be obviated and MNC's can contribute towards building infrastructure or capacity expansion. Lastly, the joint venture should make use of India CEOs in areas in which competent Indians are available. In several of the South East and East-Asian countries, stringent limits on foreign equity have been imposed and joint venture partners are insisted upon where the domestic market is to be accessed.

Table 22.7: Exports, Imports and Balance of Trade during 1991-92 to 1995-96

	Rs. Crores			US. $ million		
	Exports	Imports	Balance of Trade	Exports	Imports	Balance of Trade
1990-91	32.553	43,193	-10,640	18.143	24,073	-5,930
1991-92	44,042	47,851	-3,809	17,866	19,411	-15,545
	(35.3)	(10.8		-(1.5)	-(22.2)	
1992-93	53,688	63,375	-9,687	18.537	21,882	-3345
	(21.9)	(32.4)		(3.8)	(12.3)	
1993-94	69,547	72,806	-3,259	22.173	23,212	1.039
	(30.4)	(15.7)		(20.4)	(10.6)	
1994-95	82,338	88,705	-6,367	26,223	28.251	-2,028
	(18.4)	(21.8)		(18.3)	(28.4)	
1995-96	1,06,46[illegible]	1,21,647	-15,182	31,831	36,370	-4,539
	(29.3)	(37.1)		(21.4)	(29.6)	
1991-92 to 95-96	3,56,080	3,94,384	-38,304	1,16,630	1,29,126	-12,496
Annual Average	71,216	87,515	-7,661	23,326	25,825	-2,499

Note : Figures in brackets increase/decrease over the previous year.

Source: Compiled and computed from *Economical and Political Weekly*, May 18, 1996.

22.9. ECONOMIC REFORMS AND INDIA'S FOREIGN TRADE

Data about the trend of exports and imports given in table 7: The data reveal that efforts of export promotion were not more than nullified by the policy of import liberalisaiton. The trade gap narrowed only in the years in which import growth was restricted, but export promotion was accelerated. It is only during 1991-92 that imports increased by 10.8 per cent as against the export growth of 35.3 per cent and consequently, trade gap narrowed down to Rs.3,809 crores. Similarly, in 1993-94, as against an increase in exports of the order of 30.4 per cent, imports increased by 15.7 per cent and the unfavourableness in trade balance got reduced to Rs. 3,259 crores. But in all the other years, the trade gap got enlarged due to a policy of import liberalisaiton. The culmination of this trend could be seen in 1995-96 in which as against an increase of exports by 29.3 per cent, imports increased by 37.1 per cent and the trade deficit touched a record level of Rs. 15,182 crores. In dollar terms, the trade deficit touched $ 4,539 million in 1995-96. Thus the benefits of export promotion were not used to bring about a surplus on current account balance, but were frittered away in policy of indiscriminate import liberalisation under World Bank ---- IMF pressure by reducing import duties.

The need of the hour is to go in for a policy of selective liberalisation of imports so that the country is not forced to borrow in the international markets to finance its deficit in balance of payments on current account. As a consequence of this policy, foreign exchange reserves which stood at US $ 20.76 billion on May 5, 1995 got reduced to US $ 17.09 billion on May 3, 1996 - a fall by US $ 3.69 billion during a year. This trend has to be arrested. Dr. C. Rangarajan, Governor Reserve Bank of India has warned that under no circumstances, foreign exchange reserves should be allowed to fall below $ 17 billion level.

22.10. NEGLECT OF AGRICULTURE -- THE MAJOR SIN OF ECONOMIC REFORMS

A major charge against the process of economic reform is the neglect of agriculture. Data provided in table 8 reveal that during the five year period (1990-91 to 1995-96), there has been a virtual stagnation in agriculture. This is evidenced by the fact that the production of foodgrains increased from 176.4 million tonnes in 1990-91 to 190 million tonnes in 1995-96, signifying an annual growth rate of 1.5 per cent per annum. Need it be mentioned that the growth rate of foodgrains production is less than even the growth rate of population (2.1 per cent per annum). Thus, the growth of foodgrains production during the period of reforms has not been able to neutralise the population effect, not to speak of taking care of the income effect as a result of an average 4.7 per cent increase in GDP.

The failure is particularly noticeable in rice in which the compound annual growth rate (CARG) was only 1.5 per cent and in coarse cereals (the main food item for the poor) in which growth rate was (-) 1.6 per cent per annum. In pulses there was a virtual stagnation of production. The poor who derive the bulk of their protein requirements from pulse are hardly able to afford them since the prices of pulses have shot up at an astonishing rate. It was only in the output of wheat that relatively better performance of 3.4 per cent per annum was noticed. In sugarcane and jute as well, low growth rates of 1.9 per cent and 0.4 per cent per annum respectively were recorded.

The over-all scenario continued to be one of stagnation, more so if we keep in mind the fact that India had the rare privilege of having seven continuous good monsoon years. New economic reforms can legitimately be held responsible for neglect of agriculture. But for using agriculture as an export promotion area via multinationals and Indian big business

there was gross neglect of agriculture to enlarge irrigation, to develop better varieties of seeds and to ensure credit and fertilisers in adequate measure so as to give a further boost to agriculture.

Table 22.8: Production of Principal Crops

million tonnes

	90-91	91-92	92-93	93-94	94-95	95-96 likely	CARG(95-96) Over 90-91)
Rice	74.3	74.7	72.9	80.3	81.1	80.0	1.5
Wheat	55.1	55.7	57.2	59.8	65.5	65.5	3.4
Coarse Cereals	32.7	26.0	36.6	30.8	30.4	30.0	-1.6
Pulses	14.3	12.0	12.8	13.3	14.1	14.8	0.7
Total Foodgrains	176.4	168.4	179.5	184.3	191.1	190.0	1.5
Oilseeds	18.6	18.6	20.1	21.5	21.4	22.0	3.4
Sugarcane	241.0	254.0	228.0	229.7	271.2	265.0	1.9
Cotton*	9.8	9.7	11.4	10.7	12.1	12.3	4.6
Jute & mesta**	9.2	10.3	8.6	8.4	9.5	9.4	0.40

* million bales of 170 kg. each

** million bales of 180 kg. each

Note: CARG implies Compounded Annual Rate of Growth.

Source: Compiled and computed from the data provided by Economic Survey (1995-96)

22.11. ECONOMIC REFORMS AND SOCIAL SECURITY

Social security has three aspects: Food security, employment security and health security. Food security is related to (i) employment security via rate of growth of the economy, (iii) government policies regarding prices of foodgrains and food subsidies, and (iii) general rate of inflation and more especially the prices of foodgrains. Since the period of economic reform has been characterised as the period of jobless growth or very slow growth of employment, this has produced an adverse effect on food security of the poor by a fall on employment. The continuous rise in the prices of food grains, more especially of consumer price index of agricultural labourers, remaining above the double digit level, also adversely affected food security of the poor. Agricultural labourers suffered the impact of double squeeze - firstly, lower level of employment resulted in an erosion of their real earnings over the year; secondly, the continuous rise of Consumer Price Index for Agricultural Labourers (CPIAL) by over 10 per cent for the entire 5-year period (1990-91 to 1995-96) has reduced their real wages in two ways - a depreciation of the purchasing power of the Rupee and the failure of the wage to increase commensurate with the rise of CPIAL. There is no doubt that the food security of the poor has been adversely hit by the reform.

Employment Security and New Economic Reform

The new economic reforms have been emphasing new power projects both in the public and the private sector. Besides causing environmental problems, these projects have been displacing people from their traditional livelihood systems. By encouraging multinationals to enter food processing industries, the reform process by the sheer competition from these business giants has led to labour displacement. The entry of big business in

agriculture has also led to displacement of labour engaged in the marketing of agricultural produce. The case of fisherman is glaring and has resulted in massive protests from fishermen who were faced with a threat to unemployment as a consequence of competition from mechanised boats. Consequently, there is a good deal of evidence to corroborate the view that the process of economic reform has generated far greater backwash effects in terms of labour displacement, than in generating spread effects in terms of enlarging new employment opportunities. The net effect of these trends is the deterioration in the quality of employment and this is witnessed in the growing increase in the number of casual labourers - the most unprotected form of Indian labour. Casualisation of labour is witnessed even in industry as a result of the growing phenomena of lockouts and closures. G. Parthasarthy reviewing the impact of structural adjustment on employment concludes: "Given this short period experience, what the medium-term has in store for the Indian poor is anybody's guess. It is essentially dependent upon the rate and composition of growth and its effects on employment. With past experience as a guide, we may achieve a high growth rate, the benefits of which may flow to the affluent and middle class. The poor may not gain because jobs are not found to grow with incomes. This type of scenario could call for effective safety nets for unorganised sectors in the form of right to work at a minimum subsidised wage and guarantee against unemployment through unemployment insurance." (Parthasarthy G. Social Security and Structural Adjustment, *The Indian Journal of Labour Economics,* Vol.39, No.1, Jan-March 1996).

Health Security

As a result of the process of economic reform privatisation of health services is recommended. But according to the 42nd round of NSS, the average payment for private hospitals in rural areas was Rs. 735.4 as against Rs. 304.3 for Government hospitals i.e. 2.3 times more than charge by Government hospitals. In urban areas, the situation was even worse. Private hospitals charged Rs. 1,206 as against Government hospitals charging Rs.355. In other words, charges in private hospitals in urban areas were 3.13 times more than in Government hospitals. Privatisation is thus bnound to affect adversely the maintenance cost of health services of the poor. This has been compounded by the fact that in view of the patent rights payments to be made to patent-holders, viz. multinational corporations, the cost of medicines has been rising under the new economic reforms.

22.12. CONCLUSION

From the ongoing analysis, it may be concluded that economic reforms seem to have a better record in terms of growth, but have failed on the front of social justice, since neither poverty nor employment situation has improved. Failure to control inflation in terms of the consumer price index rising on an average by over 10 per cent per annum during 1991-92 to 1995-96, has serious welfare implications. Moreover, economic reforms have a narrow focus since they are concerned with the corporate sector only and have neglected agriculture. The reform process by permitting multinationals and Indian capitalists to appropriate the fruits of higher growth has led to casualisation of labour. A silent exit policy is already on and retrenchment of labour with the help of voluntary retirement scheme is going on in an unbridled manner. This is the consequence of the introduction of highly capital intensive technology in the name of improving global competitiveness and modernisation.

Activity 1

In its attempt to improve the socio-economic environment of India, the Government introduced a number of anti-poverty schemes. Some of them are listed below. Write informative notes on each of them. Your note should be up-to-date.

1. 20-point Economic Programmes
2. backward Area Development programme

3. *Employment Guarantee Scheme*
4. Food for Work Programme
5. Small Farmer Development Agency
6. Operation Flood
7. Integrated Rural Development Programme
8. Family Planning Programme

You may consult the latest issues of any Year Book, and also 'the latest Reports from the relevant Ministry, Government of India. You may also refer to recently concluded Five Year Plans i.e., 7th and 8th Five Year Plans, and the Approach Document to 9th Five Year Plan.

22.13. SUMMARY

The following conclusions emerge from our analysis:

1. The claim made in *Economic Survey* (1995-96) about the remarkable rate of growth of the economy is, to say the least, unsustainable. The GDP growth rate of the period 1990-91 to 1995-96 works out to be 4.7 per cent per annum as against 6.4 per cent for the preceding five year period (1985-86 to 1990-91).

2. On the inflation front, the consumer price index for agricultural labourers showed an annual average rise by 11.6 per cent and that for industrial workers by 10.3 per cent.

3. Regarding the proportion of population below the poverty line, studies about the number of poor indicated an increase from 298 million in 1990-91 to 346 million in 1993-94 - an increase by 48 million during the 3-year period. The proportion of the poor has increased from 35.5 per cent in 1990-91 to 39.0 per cent in 1994-95.

4. According to the estimate of the Planning Commission, the rate of growth of employment was 2.03 per cent per annum during the first three years of the Eighth plan, as against the target of 2.6 per cent per annum. This indicates that during the first 4 years of liberalisation, the target of employment generation has lagged behind by over 9 million. The capital-intensive pattern of development promoted under the new economic reforms, labour displacement by multinationals in the consumer goods sector, policies of voluntary retirement and providing golden handshakes in the public sector and the tacit approval to the exit policy have all contributed to contraction of employment.

5. Regarding foreign investment, the realised foreign direct investment during 1991-95 is of the order US $ 3.44 billion as against approvals of US $ 14.99 billion - indicating that less than one-fourth of the FDI has actually been realised. Of the total foreign investment flows of US $ 11.74 billion, about US $ 8.1 billion is in the nature of portfolio investment which is only of a speculative nature and does not lend itself to conversion into real investment.

6. India's external debt has risen from Rs. 1,30,200 crores in 1990 to Rs.3,11,972 crores in 1995 indicating a growth rate of 19.1 per cent per annum. Judged by the debt-service ratio criterion, the former Finance Minister Dr. Manmohan Singh recognised that this ratio remains high by international standards.

7. Multinationals bring in phased-out technology and products. The process of swallowing Indian firms after entering into joint ventures continues unabated. The MNCs set up 100 per cent subsidiaries and eliminate the Indian partner.

8. The gains of export promotion are frittered away by the policy of indiscriminate liberalisation of imports. Current account deficit which was merely US $ 0.32 billion in 1993-94 has shot up to a record level of US $ 6.4 billion in 1995-96.

9. Agricultural growth has stagnated despite the privilege of having seven continuous good monsoons. Foodgrains production growth rate was 1.5 per cent during the reform period which did not neutralise even the population increase.
10. Food security and health security have been adversely affected for the poor as a consequence of new economic reforms. Less than one third of the food grains provided by the Public Distribution System are availed of by the poor.

Economic reforms have succeeded in growth, but failed on social justice.

22.14. KEY WORDS

Casualisation of Labour is a process of displacement of labour from secure permanent employment to insecure employment (daily wage labour) or temporary employment.

CEO is the Chief Executive Officer of a company or a corporation.

Debt service Payments refer payments arising out of amortisation (payment of instalment of principal) and those arising as a result of interest on borrowed funds.

Debt Service Ratio refers to debt service payments as a percentage of total exports of goods and services (current receipts).

Foreign Direct Investment refers to investment made by foreigners in terms of fixed assets as well as working capital.

Inflation is a genral increase in prices and fall in the purchasing power of money. It is measured by a rise in the wholesale price index. To have an idea of its impact on the common man, inflation is measured by consumer price index

Multinational Corporations are business organisations operating in several countries.

Portfolio Investment is a range of investments held by a person or a company in the form of equity or shares.

Poverty Ratio indicates the proportion of total population living below the poverty line.

22.15. SELF-ASSESSMENT QUESTIONS

1. Discuss the impact of economic reforms on poverty and employment.
2. Economic reforms have failed on the front of social security. Do you agree? If so, why?
3. Discuss the benefits of foreign investment flows received by the Indian economy. What are the problems generated by these flows?
4. List three major achievements and four major failures of economic reforms.

22.16. FURTHER READINGS

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