MP-201

Vardhaman Mahaveer Open University, Kota

Business Environment

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CONTENTS

Business Environment

Unit - 1 : Business Environment : A Framework

Unit Structure:

1.0 Objectives

After studying this unit you will be able to:

- Explain the meaning of business environment.
- Establish relationship between business and environment.
- Identify the features of business environment.
- Understand the need for the study of business environment.
- Describe the importance and types of business environment.
- Understand the recent trends in business environment.

1.1 Introduction

The business firm is an open system which gets resources from the environment and supplies its goods and services to the environment. There are different levels of environmental forces. Some of them are internal forces and others are external. External forces may be those related to national, regional or international levels. These environmental forces provide opportunities as well as threats to the business community. Every business organization tries to use the opportunities available and face the threats that emerge from the business environment.

Business Organizations due to limitations cannot change the external environment but they just react. They change their internal environment in their internal business components to avail the external opportunities and face the external environments threats. It is thus, very important to analyze the business environment to survive and to get success for a business in the industry. It is therefore very important for managers to analyze business environment so that they could pursue effective business strategy.

Thus, business environment may be defined as total surroundings which have a direct or indirect bearing on the functioning of the business. It may also be defined as the set of external factors such as social factors, economic factors, demographic factors, technical, political and legal factors., which are uncontrollable in nature and affect the business decisions of a firm.

The business firm gets its human resources, capital ,technology, energy, raw materials, information from the society. It follows government rules and regulations, social norms and cultural values regional treaty and global alignment ,economic rules and tax policies of the government. Business organization is therefore, a dynamic entity because it exists in a environment.

1.2 Relationship between Business and Environment

A business entrepreneur must know various critical, complex and changing factors of environment business. Every business entorprise can flourilsh in dynamic environment, within which it has to operate. The environment expects from every business enterprise the satisfaction of needs.Whatever resources are available to business from its environment, it returns them by transformation of utilities created by it.

The study of business environment provides full knowledge about the internal environment such as business policy, organisational structure, its resources etc.It also provides knowledge about business problems and its complexities.The different forms of economic system influences the business in different ways.For facing the challanges and problems of the business, a proper evaluation and study of the business environment is necessary.

1.2.1 Features of Business Environment

On the basis of above discussion features of business environment can be summarized as follows:

- Business environment is the sum total of all factors external to the business firm and that greatly influence functioning of the business of the firm.
- It covers factors and forces like customers, suppliers, competitors, government and the social, cultural, political, technological and legal conditions.
- The business environment is dynamic in nature that means it keeps on changing.
- The changes in business environment are not predictable and it is very difficult to assume the exact nature of future happenings and the changes in economic and social environment.
- Business Environment differs from place to place, region to region and country to country.

1.3 Systems Approach

Formal organizations or businesses are made of groups of people working together for some common purpose. Something very similar to the business organizations we as individuals are part of a family which is a component of bigger system. This same society is a part of a nation.

Thus in this approach nothing exists in isolation. Everything is interlinked and interrelated. Organizations are open systems as they get resources from others and give output to others. A business has to deal with number of key environmental forces. These forces from where business gets resources and supplies resources, the forces that influence business operations, and factors which present opportunities and threats constitute business environment.

In this regard business can be seen as an internal system or controllable system of a manager or a staretegist. Managers can control their own businesses, they can collect their own resources such as capital,human resources, ideas, information, land and equipments. All these components are controllable. Managers can operate their organizations and use their decisions to run it.In the same way ouput of the organization is also under their control. But other broader systems that cover the business may not be under control.

Gropus of similar organizations which become an industrial system comprises business organizations as its subsystems.Industry level environment is common to all businesses running within an industry. A country and its environment is a broader system that covers different sectors or industries such as banking,health, education,trade,manufacturing and service industries. Thus, it affects all business operations in a nation. . In case of business it is very small subsystem that should follow the industry norms, regional policies, national agreements and global systems.

Businesses and its internal areas are something which can be controlled by managers but other broader systems control the businesses. Therefore, strategy of the manager is to control internal areas and react with external forces to utilize the opportunity and face the threats presented by external environment.

Activity A:

Define the term business environment in your own words.

1.4 Components of Business Environment

Business firm exists in two levels of business environment: a) Internal and b) External. Internal business environment comprises of internal structure, systems culture, staff and resources of the organization. This is sometimes identified into the internal functional areas such as marketing distribution, finance accounting, human resources, production-operation and research and development. All these components of business environment are under control of the organisation.

External business environment comprises of two layers. These are: Task business environment, and General business environment. Task business environment is also known as close or industry level business environment .Such environment interacts directly with business operation and is semi-controllable in nature.General environment is more broader and indirect in nature that covers the effect of environment emerged at national, regional and international level.

Business as we know is an economic activity of generation income through buying and selling, manufacturing and rendering auxiliary services to trade. Thus, business in a system made up of all environmental factors which require the business to adopt new strategy. Business environment refers to these surroundings of business enterprise which affect its operations and determines its effectiveness. Now-a-days modern business is not independent. It cannot work in isolation. It is the economic and social organ of the society. So it must achieve its economic goal. It cannot ignore the interest of the society. The government of the country has also the interest in business affairs. It enacts legislation, formulates business policies and controls business in the best interest of people.

According to M. Weimer, "Business environment is the climate or set of conditions -i.e., economic, social, legal, technological and political situations in which business activities are conducted. In the words of Keith Davis, 'Business environment is the aggregate of all conditions, events and influences that surround and affect it." In the words of Reicre and Schoell, 'The environment of business consists of those external things to which it is exposed and by which it may be influenced directly or indirectly." From the above discussion, we conclude that business environment is a wide term as it has got two dimensional relationship with the environment. On the one hand it affects the social, political and economic environment and on the other hand it is affected by country's social, political, economic and legal environment. The business environment these days consists of internal, operational and general environment.

1.6 Importance of Business Environment

The competent and successful management must be capable of adapting to the environment. The knowledge of the environment helps in followign ways:-

Capitalizing early opportunities:

Environment friendly enterprises are the first movers to avail the existing opportunities of resources to grab the market. These enterprises do not loose emerging opportunities to their competitors. For example: Asian paints have been loosing their market to Nerolac because of their failure to match their technology with Cathodic Electro Deposition (CED) technology, which helped the competitor to grab the opportunity of meeting 90% paint requirement of Maruti Udyog.

Activating management according to changing needs:

The knowledge of environmental changes sensitizes the management to make strategy to cope with the emerging problems. For example, The turmoil in the USSR resulted in the loss of market to many companies like Hoechst. In order to meet the situation Hoechst divested its manufacturing facility in favor of IPCA Laboratories Ltd.

Image building:

Environmental understanding by the top management builds image of the company in the minds of the people. They feel that the company is sensitive and responsive to their needs and problems. For example: G E is said to be image conscious. It divested its computer and air-conditioning business because they could not attain 1st or 2nd position in the business as per their policy. Now they are thanking outsourcing in India, for aircraft engineering, plastic etc..

Basis of strategy:

Strategists can gather qualitative information regarding business environment and utilizing them in formulating effective plans. For example: ITC Hotels foresaw bright opportunities in the travel and tourism industry and started building hotels in India and abroad.

Intellectual stimulation:

Knowledge of environment changes intellectual stimulation to planners and decision-making authorities. They can do it by paying more attention to people by listening to their problems and suggestions. They can also eliminate procedure complexities in a visible way. The drastic and dynamic steps will definitely keep the company better placed.

Continuous learning:

Environmental scanning provides continuous broad based learning to his executives. Reliance adopted the policy of decentralization and empowered their managers to close the deal themselves even regarding price. In 1993 managers were required to chat with the proprietors on alternate days for 15 minutes. The process made them so competent that now the managers are required to chat only three times in a month. It shows that continuous learning made the managers competent to take independent decision.

1.5 Types of Business Environment

Business environment confined to external uncontrollable factors may be classified as: a) Economic Environment and b) Non-Economic Environment

Economic environment constitutes economic conditions, economic policies, and economic system the country. While Non-economic environment comprises of social, political, legal, technological, demographic and natural environment.All these things have a bearing on the strategies adopted by firms and any change in these areas is likely to have far-reaching impact on their operations.

Economic Environment

Survival and success of any business organisation depends fully on its economic environment .Main factors that affect the economic environment are:

a) Economic Conditions:

Economic conditions of a country refer to a set of economic factors which have great influence on business organizations and their operations. These include Gross Domestic Product, Per capita income, markets of the goods and services, availability of capital, foreign exchange reserves, growth of foreign trade, strength of capital etc..

b) Economic Policies:

All business activities and operations are directly influenced by economic policies framed by government from time to time. The government keeps on changing these policies from time to time in view of the developments taking place in the economic scenario, political expediency and changing environment. Every business firm has to function within the policy framework and respond to the changes therein, as these policies have direct impact on the business activities in the country.

Important Economic Policies

a) **Industrial Policy**: Industrial policy of the government covers all those principles, rules and regulations and procedure that direct and control the industrial enterprises of the country and shape the industrial development pattern of the nation.

b) **Fiscal Policy**: It includes government policy in respect of public expenditure, taxation, public debt, public revence and financial administration.

c) **Monetary Policy**: It includes all those activities and interventions that aim at smooth supply of credit to the business and a boost to trade and industry.

d) **Foreign Investment Policy:** This policy aims at regulating the inflow of foreign investment in various sectors for speeding up industrial development and take advantage of the modern technology.

e) **Export-Import Policy (EXIM Policy):** It aims at increasing the exports and bridging the gap between export and import. By Exim policy government announces varios duties /levies.The focus nowadays is on removing barriers and controls and lowering the customs duties.

c) Economic Systems:

The world economy is primarily governed by three types of economic systems:

- Capitalist System where the emphasis is on private ownership.
- Socialist System where resources are owned and managed by state.

- Mixed Economy wherethere is co-existence of private and public sectors.In case of India there is mixed economy system.

Economic system will certainly influence development of business of that country.

Non-Economic Environment

These factors have indirect effect on the economic environment. The elements of non-economic environment are as follows:

• Social Environment:

It includes social factors like customs, traditions, values, beliefs,poverty,literacy, life expectancy rate etc.. The social structure and the values that a society holds has a considerable influence on the functioning of business firms. For example during festive seasons, there is an increase in the demand for new clothes, sweets, fruits, flowers etc.. Consumers are becoming more conscious of quality products of due to increase in literacy rate. More nuclear families with single child concept have come up due to changes in family composition.This increases the demand for different types of household goods. It may be noted that the consumption patterns, the dressing and living styles of people belonging to different social structure and culture may vary a lot.

• Political Environment:

This includes the political system, government policies, attitudes towards the business community and the unionism. All these aspects have a bearing on the strategies adopted by business firms. The stability of the government also influences business and related activities to a great extent. It sends a signal of strength, confidence to various interest groups and investors. Further, ideology of the political party also influences the business enterprises and their operations. Again trade union activities also greatly influence the operations of business enterprises. Most of the labour unions in India are affiliated to various political parties.Strikes, lockouts and labour disputes etc. also adversely affect the business operations. However, with the competitive business environment, trade unions are now showing great maturity and started contributing positively to the success of the business organisation and its operations through workers participation in management.

• Legal Environment:

This refers to sets of laws, regulations which influence the business organizations and their operations. Every businesses organization has to obey, and work within the framework of the law. The important legislations that concern the business enterprise mainly include:

- Companies Act,1956
- Foreign Exchange Management Act,1999
- The Factories Act,1948
- Industrial Disputes Act,1947
- Payment of Gratuity Act,1972
- Industries (Development and Regulation) Act,1951
- Prevention of Food Adulteration Act,1954
- Essential Commodities Act,2002
- The Standard of Weights and Measure Act,1956

- Monopolies and Restrictive Trade PracticesAct,1969
- Trade Marks Act,1999
- Bureau of Indian Standards Act,1986
- Consumers Protection Act,1986
- Environment Protection Act
- Competition Act,2002

Besides the above legislations following also form part of the legal environment of business:

a) Provisions of the Constitution: The provisions of the articles of the Indian constitution particularly directive principles, rights and duties of citizens, legislative powers of the central and state government also affect the business operations.

b) Judicial Decisions: The judiciary has to ensure that the legislature and government function in the interest of the public and act within the boundaries of the constitution. The various judgments given by the courts in different matters related to trade and industry also influence the business activities.

Technological Environment:

This includes the methods, techniques and approaches adopted for production of goods and services and its distribution. The varying technological environments of different countries affect the designing of products. For example in countries like US and others electrical appliances are designed for 110 volts. But when these are made for India, they have to be 220 volts. In the modern competitive era, the pace of technological changes is very fast. Hences in order to survive and grow in the market a business has to adopt the technological changes from time to time.Scientific research for innovation in products and services is a regular activity in most big organizations. Now a days no firm can afford to persist without updating production techniques.

Demographic Environment:

This refers to the size, density, distribution and growth rate of population. All these factors have a direct effect on the demand for various goods and services. For example in a country where population rate is high and children constitute a large section of population, then there is a more demand for baby products. Similarly the demand of people in cities and towns are different than the people of rural areas. The increase in population indicates more availability of main power. These factors encourage the business enterprises to use labour-intensive techniques.However,availability of skilled labour encourages firms to set up their units in such areas.

Activity B:

1. What is meant by Exim Policy?
2. Identify the types of non-economic environment in the following cases:
   a) Demand for new clothes increases during festive season
   b) Computer has outdated typewriter
   c) Coca-cola is now being sold freely in Indian market
   d) Sugar factories are being set up where sugarcane is grown abundantly
   e) Availability of skilled labour in particular region

1.7 Recent Trends in Business Environment

Economic environment in India is changing fast due to changing economic policies of the government. At the time of independence Indian economy was basically agrarian with weak industrial base. To speed up the industrial growth and solve various economic problems, the control were adopted measures on the functioning of the private enterprises. All these efforts resulted in a mixed response. There was a growth in net national product, per-capita income and development of capital goods sector and infrastructure. But rate of industrial growth was slow, inflation increased and government faced serious foreign exchange crisis during the eighties. As a result government of India introduced radical changes in economic policies in 1991. This policy abolished industrial licensing in most cases, allowed private participation in many industries, disinvestment was carried out in many public sector enterprises and opened up the economy considerably.

These trends are discussed under three heads:

A) **Liberalisation** refers to removing unnecessary controls and restrictions for the smooth functioning of business enterprise. It includes:

- Abolishing industrial licensing requirement in most of the industries
- Freedom in deciding scale of business activities;
- Freedom in fixing prices of goods and services;
- Simplifying the procedure for imports and exports;
- Reduction in tax rates and
- Simplified policies to attract foreign capital and technology to India

Through this liberalization process, Indian economy has opened up and started interacting with the world in a big way. This has resulted in easy entry of foreign business organizations in India which has further resulted in stiff competition and efficiency. Ultimately, liberalization has helped us in achieving a high growth rate, easy availability of goods at competitive rates, a healthy and flourishing stock market, high foreign exchange reserve, good industrial relations etc.

B) **Privatisation** refers to reducing the role of public sector by increasing the role of private sector in most activities. As a result of policy reforms announced in 1991,expansion of public sector has literally come to a halt and private sector registered fast growth in post liberalization period.

C) **Globalization** refers to integrating the economy of a country with world economy. This implies free flow of goods and services, capital, technology, and labour across national boundaries. To achieve these objectives of globalization, the government has adopted various measures such as reduction in custom duties, removal of quantitative restrictions or quotas on exports and imports, facilitating foreign investment, and encouragement of foreign technology. These measures are expected to achieve higher rate of growth, enlargement of employment potential, and reduction of regional disparities.

Activity C:

1. What is meant by Globalisation?
2. Write 'L'for Liberalisation, 'P'For Privatisation and 'G' for Globalisation.
   a) Freedom in fixing prices of goods and services.
   b) Disinvestment of shares of public sector industrial enterprises.
   c) Reduction in sales tax
   d) Reduction in custom duties.
   e) Reduction in number of industries reserved for public sector.

1.8 Summary

The environment comprises of all external forces which have a bearing on the functioning of business. The factors affecting environment are economic and non-economic- which have been discussed in detail. The discussion reveals that economic environment is not static one but it is a changing phenomenon. The factors affecting economic environment always keep on changing. Invovations population, advancment of science and technology all go under change and consequently economic environment also changes.

1.9 Key Words

- **System Approach:** Every thing is interlinked and interrelated to each other.
- **Business Environment:** Total surroundings which have a direct or indirect bearing on the functioning of business.
- **Liberalization:** Removing of unnecessary controls, and restrictions for the smooth functioning of business enterprises.
- **Privatization:** Reducing the role of public sector by increasing the role of private sector in most activities of an economy.
- **Globalization:** integrating the economy of a country with world economy.

1.10 Self Assessment Test

1. State any two features of business environment.
2. Mention the different types of business environment.
3. List the various elements of non-economic environment of business.
4. State any two effects of liberalisation of Indian economy
6. How does demographic environment of business influence the business activities?
7. What are the steps Government of India has taken as a part of its liberalization process?
8. Explain the effect of political environment in the normal functioning of business Enterprises?
9. What are the effects of Globalisation of Indian economy?
10. Describe the importance of business environment for the business firm.
11. Explain any two non-economic environment of business.
12. Describe in brief the economic environment of business.

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Unit – 2 : Socio-cultural Environment

Unit Structure:

2.0 Objectives

After studying this unit you should be able to understand the following:

- Concept of socio-cultural environment of business.
- Identification of critical elements of social and cultural environment.
- The interaction of business with society and culture.
- The emerging trends of socio-cultural environment.

2.1 Introduction

The socio-cultural environment includes everything about the society. Economic life is organized primarily through a market in which individuals relate to one another as buyers and sellers and the purpose is production. In political life individuals relate to one another as citizens and the basic purpose is making collective decisions and rules. The economic and political systems together create the conditions—goods, the services and rules—which are needed by all in order to live the lives that we choose. The social cultural environment, consists of the whole range of behaviours and relationships in which individuals engage themselves and decide their private lives.

In a broad sense, the socio-cultural environment happens to be a culmination of forces operating from different platforms such as history, culture, policy, ethics and morality. The society itself has to balance the achievements and aspirations of various individuals groups and institutions. No business can survive and grow without social harmony.

2.2 Concept

As other aspects of the environment, the relationship between business, culture and society involves a two-way interaction. Although we tend to think of business as a operation according to a distinctive instrumental rationality of profit-and-loss and the 'bottom line' it is also influenced by the social-cultural setting in which it is embedded. At the same time business affects the wider culture and society profoundly.

2.2.1 Business and Society

Business is an integral part of the society, interacts in different ways with the social environment. Every action which a business undertakes is related to the external world around it, and everything which occurs in the external world is related to business. Concept of society is similar to civilisation. Society is the aggregate of people, imtitutions and technology that together make up a recognizable human community. Business enterprise work within society, affect and get affected by society. No business can survive in isolation of society.

The term business is used in different senses. In a functional sense, it is used to refer to the functions or activities of an organization or individual. Sometimes it is used to refer to the enterprise or unit rendering the business. The term is also used in a very broad sense to embrace the whole business system. But it cannot be denied that both society and business enterprise interact with each other and influence each other destiny.

The traditional concept of business, confining it to commerce and private profit, has undergone a radical change. Today, business is regarded as a social institution forming an integral part of the social system. David and Blomstorm said, business is "Social institution, performing a social mission and having a broad influence on the way people live and work together". As Calkins remarks; " It is now recognized that the direction of business is important to the public welfare, that businessmen perform a social function."

Thus, one can say that Business cannot isolate itself from the rest of society. Both environment and business enterprise are interwoven and deeply inter related.

2.2.2 Business and Culture

Culture is a very critical component of business environment. In order to have better product development, promotion, business negotiations, human resource management, management of the social and political environment etc., a proper understanding of the cultural dimensions is very important.

According to E.B. Taylor, "Culture of civilization is that complex whole which includes knowledge, belief, art, morals, law, custom, and other capabilities and habits acquired by man as a member of society".

On the basis of the various definitions, Francis Merill formulated the concept of culture as follows. Culture:

- is the characteristically human product of social interaction;
- provides socially acceptable patterns for meeting biological social needs;
- is cumulative, for its is handed down from generation to generation in a given society;
- is meaningful to human beings because of its symbolic quality;
- is learned by each person in the course of his development in a particular society;
- is, therefore, a basic determinant of personality; and
- depends for its existence upon the continued functioning of society but is independent of any individual or group.

2.3 Significance

Business and socio-cultural environment are tied together in many ways. It creates and changes people's tastes and preferences for commodities which in turn influence the habits and customs. Business firms as social units must operate within the larger cultural system. In any decisive situation, the alternatives open to management may be greatly restricted because the values of the total culture may not permit other alternatives to be considered.

Awareness of the socio-cultural environment of business may be useful to management in several ways:

- People are conditioned to behave, believe and perform in particular ways because of culture, thus awareness of the cultural background of employees may help management to better understand their behavior and conduct.
- It also helps in predicting behavior i.e. how people will act in different situation.
- It also facilitates change. Traditions, customs and existing modes of behavior often make it difficult for an organization to adapt itself to changing conditions. An understanding of the cultural background and the knowledge of how to bring about cultural change can be considerably helpful in meeting the need for change.

2.4 Elements

Socio and cultural environment refers to the influence exercised by certain factors which are beyond the company's gate. Such factors include people's attitude to work and health, role of family, marriage, religion and education, ethical issues and social responsiveness of business. Social and cultural environment is highly relevant for a business unit as the variety of goods it produces, the type of employees it gets and its obligation to soiety depends on the cultural impact in which the firm operates. Our social and cultural system is based on some of the major pillars that are discussed below:

1. Family Size

This is often called as basic social institution, because of its important functions of procreation and socialization. Burgess and Locke defined family as, "a family is a group of persons united by the ties of marriage, blood or adoption constituting a single household, interacting and intercommunicating, with each other in their respective social role of husband and wife, mother and father, son and daughter, brother and sister, cradling and maintaining a common culture."

Family represents both an institution and associations. A big family naturally has more requirements than a smaller one. A large family will find ways and means of salisfying and fulfilling their needs, some of which will not be important for a smaller family. The family being the smallest unit of the society is an important component of the soical environment as its decision to accept or to reject work, fashion etc. will affect business.

2. Language

Language is central to the expression of culture. Within each cultural group, the use of words reflects the lifestyle, attitudes and many of the customs of that group. Language is not only a key to understanding the group; it is the principal way of communicating within it. As such the tastes and preferences of a people can only be met through communication which is clear and demands from the firms can only be met if they are clearly stated. This is the only way for good progress.

3. Social Interaction

It means meeting people and exchanging their ideas with them. In this process we get to know more and more about new places, products and their advantage. It is easy to work with well exposed people than socially closed people.

4. Material Culture

Material culture relates to the way in which a society organizes and views its economic activities. It includes the techniques and know-how used in the creation of goods and services, the manner in which the people of the society use their capabilities, and the resulting benefits. When one refers to an 'industrialized' or a ‘developing’ nation, one is really referring to a material culture. The material culture of a particular market will affect the nature, extent of demand and modifications for a product.

5. Aesthetics

A culture’s aesthetics refer to its ideas concerning good taste and beauty as expressed in the fine arts - music, art, drama and dance - and in the appreciation of color and form. Insensitivity to aesthetic values can not only lead to ineffective advertising and package design for products, it can also offend prospective customers.

The significance of different colors may vary considerably from one culture to another. For example, in many societies, colors are often associated with emotions: “to see red”, “to be green with envy” or “to be feeling blue”.Green, a popular color in many muslim countries, is often associated with disease in countries with dense, green jungles. It is associated with cosmetics by the French, Dutch and Swedesh and increasingly with an environmentally world. Various colors represent death. Black signifies death to Americans and many Europeans, but in Japan and many other Asian countries, white represents death. Aesthetics also embrace people’s dress and appearance, i.e. their outward garments and adornments or accessories.

6. Social Organization

Social organization refers to the ways in which people relate to one another, form groups and organize their activities, teach acceptable behavior and govern themselves. It thus, comprises the social, educational and political systems of a society. Social organization is also evidenced in the operation of the class system, e.g. the Hindu caste system and the grouping of society members according to age, sex, political orientation, etc..

7. Religious Beliefs

A religious system refers to the spiritual side of a culture or its approach to the supernatural. Western culture is accepted as having been largely influenced by the Judeo-Christian traditions, while Eastern or Oriental cultures have been strongly influenced by Buddhism, Confucianism, Taoism and Hinduism. Although very few religions influence business activities directly, the impact of religion on human value systems and decision-making is significant. Thus, religion exerts a considerable influence on people’s actions and outlook on life, as well as on the products they buy.

A society’s religious belief system is often dependent on its stage of human or economic development. Primitive tribesmen tend to be superstitious about life in general while people in technologically advanced cultures seem to have dismissed the notion of traditional religious worship and practice in favor of a more scientific approach to life and death.

8. Attitudes

Attitudes are psychological states that predispose people to behave in certain ways. Attitudes may relate, for example, to work, wealth, achievement, change, the role of women in the economy, etc.. Western cultures, for example, value individualism and promote the importance of autonomy and personal achievement needs. In contrast, in many eastern and developing countries, there is a strong sense of collectivism and the importance of social and security needs. For instance, the Hindu religion imparts a type of work ethic that considers work central to one’s life but maintains that it must be performed as a service to others, not for one’s own personal achievement.

9. Values

Values are judgments regarding what is valuable or important in life, and they vary greatly from one culture to another. People who are operating at a survival level will value food, shelter and clothing. Those with high security needs, on the other hand, may value job security, status, money, etc. From its value system, a culture sets norms, i.e. acceptable standards of behavior.

Pepsodent reportedly tried to sell its toothpaste in regions of south-east Asia through a promotion which stressed that the toothpaste helped enhance white teeth. In this area, where some local people deliberately chewed betel nut in order to achieve the social prestige of darkly stained teeth, such an ad was understandably less than effective. The slogan "wonder where the yellow went" was also viewed by many as a racial slur.

2.5 Emerging Trends

1. **Open Society:** In open societies, government is purported to be responsive and tolerant, and political mechanisms are said to be transparent and flexible.
2. **Transparent Communications:** It involves sharing relevant information. It means that individuals work together to share all pertinent information and not withhold information from one another. It also involves being forthcoming regarding motives and the reasoning behind decisions. Such transparency about motives helps avoid the problem of faulty attributions that can often break down communication process. It also involves proactively seeking and giving feedback.
3. **Disappearing lines of divide:** Now a days people have become more open and the lines of distinction between religions & castes in typical networking among youngsters in society have disappeared.
4. **Fast Food Culture:** New a days this culture is more developed in the socity. The product which is consitdered fashionable is bound to sell in the market.
5. **Technological and spiritual progress**
6. **Emphasis on efficiency, productivity and quality**
7. **Participation in Management**

2.6 Social Responsibility of Business

Prior to 1930s majority view as to the business objectives was profit and maximizing profit only. This view has undergone change and now, the thrust of enterprises is to crease and sustain customers by serving their interest in the best possible manner.

Every business operates within a society. It uses the resources of the society and depends on the society for its functioning. This creates an obligation on the part of business to look after the welfare of the society. So all the activities of the business should be such that they will not harm, rather they will protect and contribute to the interests of the society. Social responsibility of business refers to all such duties and obligations of business directed towards the welfare of society. These duties can be a part of routine functions of carrying on business activity or they may be an additional function of carrying out welfare activity.

Social responsibility is an obligation of businessmen to pursue those policies to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society.(Bowen)

Social Responsibilities may be regarded as the personal obligation of people as they act in their own interest, to assure that the rights and legitimate interests of others are not impinged. (Koontz 0' Donnell.) In real sense, social responsibilities imply recognition and understanding of the aspirations of society and determination and contribute towards their achievements. (George A. Steiner). The social responsibilities of business to do what are in the interest of society. By doing so it will serve its own interest also. (Peter F. Drucker)

2.6.1 Why should business be socially responsible?

Social Responsibility is a voluntary effort on the part of business to take various steps to satisfy the expectations of different interest groups. But the question arises why should the business come forward and be responsible towards the interest groups. Let us consider the following points:

2.6.2 Responsibility towards Different Interest Groups

Social responsibility therefore implies adopting such policies and taking such decisions in course of business, which are not contradictory to the culture and value system followed by the society, nor the policies or dicisions taken by the business be such which adversely affect the society.

Concept of social responsibility is an ethical concept which involves human welfare, concern relating to social dimensions of business activities, and pay attention on the soical impact generated by their work and conduct. Social reeponsibility implies the obligation which business owes to society for dealing with problem emanating from their activities. Social responsibility involves issues like combinations of business with human welfare and fulfilment, meaning and prupose of business in society, nature of human community and place of business in that community.

A business enterprise represents the economic activities of society. In the course of achieving its economic objectives a business, has to interact with various socio-economic groups and organs of society, e.g., consumess, suppliers, competitors, investors, employees, etc.. All of these groups have different aspirations/expectations from business. Business therefore, owes sesponsibility to several interest groups which can be listed as follows :-

(1) **Ownrers/Shareholdres :** An enterpeeneur is normolly the owner and is known as proprietor. In case of corporate entities shouholders are the owners. The owners expect a fair return on their investment as well as growth appreciation of their investment. The responsibility of business in relation to owners is :-

- Fair return on capital invested
- Growth/appreuciation of capital
- Safety of investment,
- Profitable utilisation of capital

(2) **Investors :** Investors include the category of persons and institutions who provide the medium term and short teem finance by way of investment in debentiures, bonds, public deposits and short term and medium term loans. Investors therefor include the investing public, finance companies, banks and financial institutions. The twin responsibility of business in selation to investors is.

- Regular payment of interest
- Safety of investment

(3) Suppliers and Creditors: Suppliers mean those who supply the required raw material, intermedirey peoducts, etc., for the purpose of the production and trading of goods and services. The suppliers who supply on credit basis are known as creditors. The responsibility of business in relation to suppliers and creditors is :-

- Regular orders.
- Fair terms regarding supplies.
- Reasonable credit period
- Limely payment to suppliers/creditors.
- To promote and protect small scale & cottage industies

(4) Competitors : Competitors mean those dealing in the similar goods or services. Competitors try to create their own market by adopting various unfair trade practices. The responsibility of business in relation to competitors is :-

(a) Not to adopt unfair trade practices, e.g., offer heavy discount, offer free products on each purchase and exceptionally high sales commission, etc..

(b) To adopt healthy sales promotion and advertising methods.

(5) Employees : Employees are the working hands of any business. Therefore, a business while pursuing its objectives should provide such environment and working conditions which make the employees satisfied. The terms of employment, i.e., wages, working hours, transfer contributis on of prodident fund and other terms need to be fair. the responsibility of business in relation to employees is :-

- Fair and competitive wages
- Job security
- Reasonable working conditions.
- Health and safety measures
- Welfare facilities like provident fund, housing, subsidies, transportation, canteen facility, group insurance and terminal benefits like gratuity and pensions.
- Training & development of employees
- No discrimination on account of cast, creed and religions

(6) Customers : Customer is superme. Entire business activities revolve around the customer. No business enterprises can survive without caring for the customer. All that is produced is for sale to the customer. Therefore, the requirements. Aspirations and expectations of customers must be considered while planning the product. The responsibility of business in relation to customers is :-

(a) Production and supply of useful and want satisfying goods and services at reasonable price.

(b) Regular and reliable supply of goods & services as per Quality standards.

(c) Quick removal of consumer complaints & grievances.

(d) Avoiding unfair trade practices misleading advertising, of food items, etc.

(7) **Government (Central and State) :** Business enterprises must carry on their business activities within the framework of rules, regulations, directions laid down by the central, state Governments and local bodies like municipal board. The responsibility of business in relation to Government is :-

(a) Payment of tax, levies imposed honestly & regularly.

(b) Setting up new enterprises in undeveloped or backward areas to promote balanced groveth.

(c) Maximising export so as to earn foreing exchange.

(d) To contribute and participate in community development projects like poverty alleviation, population control, illiteracy eradication, etc.

(e) Net to encourage corruption by indulging in tax evasion or bribing public servants.

(8) **Public (Community) :** A business enterprise work for public or the community. It is important for a business to contribute towards the overall social development and werfare of the public so that the general standaed and quality of life gets improved. The responsibility of business in relation to community is :-

(a) Not to discriminate on the basis of caste, religion & gendee while offering employment.

(b) Preserving, protecting & promoting social and cultural values.

(c) Adheving to norms while ensuring optimum resovrces utilisation.

(d) Helping Government in providing infrastrucure facilities like roads, drinking water, sanitation and low cost housing etc.

(e) Providing assistance in the fields of medical, educational, vocational and sports facilities.

(f) Helping the weaker and backward people of society.

2.7 Summary

The social-cultural environment consists of the range of behaviours and relationships in which people engage in their personal and private lives. The relationship between business, culture and society involves a two-way interaction. People carry values and attitudes shaped by the wider culture into business . At the same time business affects the culture and society profoundly. The critical elements of the socio-cultural environment are : family size, language, material culture, aesthetics, social organizations, values, attitudes,religious beliefs 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 emerging trends. In the current competitive scenario, there is more emphasis on open societal system, transparent communication, disappearing lines of divide, fast food culture, speedy transport and communication, technological and spiritual progress, emphasis on efficiency, productivity and quality, participation in management and many more ways.

2.8 Key Words

- **Family:** This is often called as basic social institution because of its important functions of procreation and socialization.
- **Language:** Language is central to the expression of culture. Within each cultural group, the use of words reflects the lifestyle, attitudes and customs of that group. Language is not only a key to understanding the group; it is the principal way of communicating within it.
- **Material culture:** It includes the techniques and know-how used in the creation of goods and services, the manner in which the people of the society use their capabilities, and the resulting benefits.

- **Social Organization:** It refers to the ways in which people relate to one another, form groups and organize their activities, teach acceptable behavior and govern themselves.
- **Religious Beliefs:** It refers to the spiritual side of a culture or its approach to the supernatural.
- **Attitudes:** These are psychological states that predispose people to behave in certain ways.
- **Values:** Values are judgments regarding what is valuable or important in life, and they vary greatly from one culture to another.
- **Open Society:** In this government is purported to be responsive and tolerant, and political mechanisms are said to be transparent and flexible.
- **Social Responsibility:** It refers to all such duties and obligations of business directed towards the welfare of society.

2.9 Self Assessment Test

1. What do you understand by the socio-cultural environment of business and how is it important for business ? Explain.
2. What are the critical elements of the socio-cultural environment of business? Explain each element with examples.
3. Explain the link between business, society and culture.
4. Write a note on the emerging trends in socio-cultural environment of business.
5. What do you mean by the social responsibility of business ? What could be some arguments for and against business assuming social responsibility ? Discuss.
6. "Business must be run in a socially responsible manner". Comment on the statement in the context of Indian business.

2.10 References

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Unit - 3 : Political Environment

Unit Structure:

3.0 Objectives

After studying this unit you should be able to understand the following:

- The concept and meaning of political environment of business.
- The significance of studying the political environment.
- The elements comprising the political environment.
- The relationship between the state and the social process.
- The political influence/implication to social process.
- The meaning of Government and its various roles in the economy.
- The rationale for undertaking a political analysis of international Business.
- How political risk is managed at different stages of operation.

3.1 Introduction

Business, now-a-days is vitally affected by the economic, social, legal, technological and political factors. These factors collectively form business environment. Business environment, as such, is the total of all external forces, which affect the organization and operations of business. The fact that it is often politics that determines economic and business policies highlights the critical importance of the political environment to business. Dimock observes: “The two most powerful institutions in the society today are business and Government; where they meet on common ground amicably or otherwise together they determine public policy, both foreign and domestic, for a nation.”

Political environment includes factors such as the characteristics and policies of the political parties, the nature of the Constitution and Government system and the environment encompassing the economic and business policies and regulations. These factors may very considerably between different nations, between different provinces of the same nation and also over time.

The political screnario in a country is the outcome of the interacting influence of various interest groups such as households, firms, politicians, bureaucrats, and many others. The stronger particular group, the more prominent ideology will manifeast in the overall political scenario. The political scenario in different states may be different. Even at the centre, the political scenario may change with change in dominant intrest group.

The political environment of a country is influenced by the political organizations such as philosophy of political parties, ideology of Government or party in power, nature and extent of bureaucracy influence etc. They political stability in the country, foreign policy, defence and military policy, image of the country and its leaders in and outside the country. The political environment of the country influences the business to a great extent. For instance, bottling and sale of coca-cola was discontinued in India in the late seventies following policy of restricting the growth of multinationals in Indian markets. But, its entry was allowed under the New Industrial policy of 1991. Under this new policy, Government allowed liberalized licensing, imports and exports, inflow of foreign capital and technology on more liberal terms. The trend towards globalization and signing of GATT in 1993 has posed new challenges before Indian business.

In day to day conduct of the business and its long term growth, in its success or its failures, political aspects of environment play a very critical role. Over sixty years of independence, India has seen a vibrant ever changing political environment.

3.2 Significance

Political environment is one of the most important factors affecting the operations of a business. Political forces are said to be part of the Macro- Environment. All the factors of the Macro-Environment are external to an organization and completely beyond its control.

Political factors are concerned with the overall situation of politics in a country which in turn can be associated with the situation of Government. If a country is democratic by nature, people will have full voting authority and they would be able to choose a Government that would work for the betterment of the people and the country. In such a situation, businesses will thrive because of the good policies of the Government.

On the other hand, if there is no democracy, there is no respect for the chosen government. There will be instability and uncertainty in the country. Governments will come and go and so will their respective decisions and policies. Businesses will suffer in such a case as they will not know what will be their future. That is why it is said that a stable and democratic government and its political decisions are important for a country and overall business. A stable political situation will also attract more and more investors from other nations.

3.3 Elements

Political Environment in India has undergone significant changes in last sixty years. Some of the features of present day political environment are as follows:

1. **A Strong Democratic Tradition:** Survival and growth of democratic tradition is one of the achievements of post independent India. Except for a period of 'internal emergency' from June 1975 to February 1977, democratic rights and individual freedom have been preserved and promoted in India. In March 1977, in January 1980 and again in November 1989, India witnessed changes in its government where ruling party was voted out of power by democratic elections. Despite some incidences of violence and corrupt practices elections have been by and large free and fair. It is a tribute to the poor and illiterate voters of India that they have actively participated in periodic elections in this democratic system.

2. **Growth of Regional Parties:** India today has a number of strong and politically active regional parties who have dominated the state and acquired political power in State and Local Bodies. The regional parties have totally different perspective than that of the national party and still their contribution to the national politics cannot be undermined. The most important recent political change in India is the shift away from a single party state. For instance, the rise of the Hindu nationalist party (the BJP) and the development of an array of secondary parties have drastically changed the Indian political landscape. Congress dominated politics until 1996, when it was finally unseated by the BJP. While Congress remains an important force, it no longer commands sole power and is often required to enter into the type of coalition-building pioneered by the BJP.

3. **Concentration of Power:** Despite increasing weightage of the regional groups, Central Government has become more powerful than before. Major policy decisions affecting large number of people and businesses are taken at Central level. The authority of the centre is more evident in the area of Home, Finance and Defence.

4. **Democratic Decentralization:** It is interesting to note that political environment today has conflicting features of democratic decentralization in the midst of concentration of political power at the Centre. The process of socio-economic development requires grassroot participation of people and process democratic decentralization, through the institution of Panchayati Raj, is sought to be promoted as a major means for change.

5. **Modernization and Liberalization:** An important aspect of political environment is the thrust for modernization and liberalization of economic policies. A number of controls have been modified or eliminated. Encouragement is given for adopting modern technology. The Central Government has itself committed to greater Research and Development activities in its own areas of operations. Success of advanced technologies in communication, space research and defence have created appropriate environment for modernization.

6. **Violent activities:** It is unfortunate that the last decade has witnessed increasing violence for political ends. Nowhere is this more evident than Punjab and J & K where the activities of extremists demanding a separate nation would have caused total disruption of social, economic and political life of the people. Other states, notably Assam, North Eastern States and Andhra Pradesh have also witnessed recourse to violence as a way towards gaining political ends.

7. **Corruption:** Administration and economic set up in the country has been significantly weakened by corruption. Favoritism, nepotism, smuggling and black money are many forms of corruption. It has also extended its reach to most social and political institutions. Even the areas of health, education or rural development have suffered from its adverse effect.

8. **Regional Super Powerism:** In 1980s through remarkable growth in the areas of defence and scientific technology India has acquired regional super status in the South Asia. Its foreign policy for the region whether in Maldives or Sri Lanka has been persuaded with the new status of a regional super power. Larger and more advanced countries have basically endorsed India's status of regional super power. In the process, India has acquired a very strong and effective force for national defence.

9. **Growing Uncertainty:** Political scene in India today, is more uncertain than it was in the beginning of the last decade. In the election in November 1991, the then ruling party Congress (I) was returned into power with a very thin majority. With a minority strength in the Lok Sabha, the government

rules with the support of ideologically opposite parties. In order to muster their support, the Govt. is unable to make long term and policy decisions with courage.

10. **Politics of Religion:** During the second half of the decade of 1980s, religion has become a dominating variable in politics. Movement for Khalistan has been backed by religious institutions of Sikhs. Fundamentalists among the followers of Islam have been leading supporters of cessessionist demand for independence of Kashmir. Bhartiya Janta Party and Shiv Sena as well as Vishva Hindu Parishad with their cry for 'Hindutva' have let the movement of building temple at Ram Janma Bhoomi.

3.4 Effects of Political Environment

Political environment can affect a business either positively or negatively depending on the prevailing situation in a country. It mainly forms the external factors which are part of the macro-environment. These factors touch on the way politics are conducted in a country, which directly reflects on what is happening with the government. Some of the factors are as follows:

Positive Factors:

1. **Growth Opportunities:** With rising population higher economic growth, better spread of infrastructure, the opportunities for growth for individual business have significantly improved. Industrial diversification has been impressive. Significant feature is the rise of agro-based industry.

2. **Liberalization and Modernization:** The industry had been greatly benefitted by the political thrust towards modernization and liberalization. Liberalized policies and procedures have created a climate of competitiveness. Adoption of modern techniques of production and updating the technology for existing production facilities have received strong social and political approval. This process of liberalization and modernization have created opportunities in the industries like electronics, telecommunication, space research, transportation etc. These have provided outlets for creativity for Indian scientists, technologists and entrepreneurs.

3. **Market Expansion:** Increase in population, increasing consumerism, impact of media, increasing incomes has resulted in expanding markets. In this competition era, competitive conditions established by policy of liberalization, Indian businesses are committed to improved product and service quality, reduced costs and reduced prices.

4. **Establishing the Industries in Backward Region:** Political needs for regional equality and government policies aimed at encouraging establishing the industries in backward areas. Large industries have found the benefits of locating their plants in backward regions. Such dispersion has also indirectly added to improvement in social set up in backward regions.

5. **Increased Efficiency and Quality:** Increased use of computers, professionalism, advances in management education have created positive climate for career growth for promising young talent and also increased the quality and efficiency level.

Negative Factors:

1. **Decreasing Values:** There has been a marked erosion of political values which have negatively influenced the business practices. Confronted by corruption in the routine working, business units have taken the line of least resistance and have become partners in corruption. Businesses have become instruments for generation and distribution of black money. A serious erosion of work ethics has also taken place resulting in 'get rich quick' group of people whose material success set wrong standards for the others in society to follow.

2. **Uncertainties:** Frequent changes in policies dictating by political pressures have generated uncertainties and increased the risk factor in business. Short term gains oriented business strategies have negative effect on long term balanced socio-economic growth.

3. **Disruption through Violence:** Frequent social and political violence affected the business units adversely in some of the states, especially in Punjab. It has scared the other states too resulting in slow down of economic growth. The cost of violence in Assam in early 80s disrupted supplies of crude oil valued at thousands of crores of rupees. Violence creates a sense of insecurity among businesses that retards its development and growth.

4. **Distortion of Priorities:** Increasing inequality of income, consumerism and to an extent liberalization, coupled with growing elitism have caused distortion of priorities in the market place. Big cities provide expensive up to date medical facilities where the rural poor people are deprived of elementary health care.

3.5 State and Social Process

State, in its wider sense, refers to a set of institutions that possess the means of legitimate coercion, exercised over a defined territory and population referred to as society. The state monopolizes rulemaking within its territory through the medium of an organized government. In most modern economies the state's role is now broader and more complex than ever before, covering such areas as the environment and the financial sector, as well as more traditional areas such as monopolies.

The first half of the twentieth century witnessed an increase in the state intervention in the economy. The Russian Evolution of 1917 and the consequent establishment of communist rule in the USSR had great influence across the globe on the thinking of the state's role. When India became independent in 1947, income per capita had been stagnating for a half century, and modern industry was minimal.The Great Depression in the USA that set in with the Wall Street collapse of 1929 and assumed terrific proportions in the early 1930s, brought to the fore the important role the state has in a capitalist economy. Shortage of entrepreneurship and other development resources and ideological flavor encouraged many developing countries to assign a very important role to the state in the socio-economic system.

After the Second World War, the three pillared consensus remained undisturbed until the first oil price shock of 1973. They were:

- The need to provide welfare benefits to those suffering from transitory loss of income or other deprivation.
- The desirability of a mixed public-private economy which would often mean nationalizing a range of strategic industries.
- The need for a coordinated macroeconomic policy, on the grounds that the market alone could not deliver stable macroeconomic outcomes that were consistent with individual's objectives. So the goals of macroeconomic policy were made explicit: full employment, price stability, and balance of payments equilibrium.

States thus took on new roles and expanded existing ones. By mid-century the range of tasks performed by public institutions included not only wider provision of infrastructure and utilities, but also muchmore extensive support for education and health care. The old national consensus on socialism has given way over the course of a few years to a new consensus on Liberalization. But formidable challenges remain. Most parties agree on the need for reform, yet no party is eager to retrench surplus labor, close unviable factories, or reduce subsidies.

The evolution of the role of the state can be seen in the following points:

- **The Nehru Years (1947-64):** The then prime minister, Jawahar Lal Nehru believed technical education as vital for industrialization in India. According to him Industrialization was the key to alleviate poverty, and a powerfull state with a planned economy as essential if the the country was to industrialize rapidly, accelerate public saving and investment, and reduce the role of foreign trade and achieve self sufficiency.
- **Garibi HataoManagement (1966-77):** In this era, two major shifts took place in the role of the state. First, the neglect of agriculture was reversed through state activism in subsidizing new seeds and fertilizers, agricultural credit, and rural electrification. The green revolution took off, and by mid-1970s India was self sufficient in grains. The second shift was the tightening of state control over every aspect of the economy. Banks were nationalized, trade was increasingly restricted, price controls were imposed on a wide range of products, and foreign investment was squeezed. The state achieved a stronghold on the economy.
- **Rising Fiscal Deficits (1977-91):** Between this period, stringent controls on imports and industrial licensing were gradually relaxed stimulating industrial growth. The government expanded anti-poverty schemes, especially rural employment schemes.
- **The Reform Phase (since 1991):** Rising interest payments on India's foreign debt meant that neither the central government nor the state governments could continue to finance both subsidies and heavy public investment. As a result, the govt. began to woo private and foreign investment. Thus, impending bankruptcy drove the reform process and changed the state's role from that of principal investor to that of facilitator of entrepreneurship. This was expected to free up government finances for more social spending. The new coalition governments that came to power in 1996 and thereafter has by and large sustained these reforms.

3.5.1 Political Influence to Social Process

Populism

India's enduring populism derives from both powerful interest groups and the political strength of the lower classes, who vote in greater numbers than the middle or elite classes. Parties often seek to secure short-term political gains through populist policies like subsidies and tax breaks. In an appeal to poor rural voters in 2005, Congress passed a bill that promised 100 days of work for all agricultural laborers, despite the fact that such political pandering drains money from other vital public programs and fails to stimulate the economy. Anti-incumbency trends and the constant presence of elections further exacerbate political fragmentation and populist influence.

The Communist Party

Economic reform proposed by today's ruling coalition is often stifled by the Communist party, on which Congress relies to maintain control. In a very real demonstration of the crippling effects of populist policy in India, the Communists have thwarted many reforms in the run-up to the 2006 spring elections. While the initial reforms of the early 1990s shifted the paradigm of economic policy toward liberalization in all areas, most of the early reforms did not invoke political opposition, leaving many politically difficult reforms ahead. The difficulties also extend far deeper than the presence of the Communist party, which has proved an easy scapegoat. The BJP, without the constraint of the Communists, also failed to drive these politically complicated changes.

Center-State Division of Politics

The center-state division of Indian politics also has important policy implications. Marshall Bouton, President of the Chicago Council on Foreign Relations, said that India resembles the European Union more than a unified nation. Homogenization of politics has not occurred except at elite levels. The 1971 delinking of state assembly polls from national Parliament polls has resulted in a nearly constant flow of elections. While most infrastructure, education and agriculture are managed by state governments, taxing, power and revenue raising ability generally lie with the central government. This misalignment creates difficulties in implementing effective reform policies.

Corruption

Corruption abounds among government officials and everyday working in India, and impedes economic growth. "It's possible to have more efficient forms of corruption," said Simon Long, South Asian correspondent for The Economist, "India has an inefficient form of corruption that doesn't work." While China and India have similar levels of corruption, China is able to accomplish more, because the corruption is less distributed. Fortunately, attempts to reduce corruption are being implemented at multiple levels of government. Under the recently enacted Right to Information Act, for example, government officials must make information available to the public or face fines. In the municipality of Delhi, a citizen-government participation program called *Bhagidari* – "partnership" in Hindi – encourages direction interaction between citizen groups and politicians in order to reduce corruption. The devolution of power enabled by the 73rd and 74th Amendments, which allow the center to bypass states and send money directly to local governments, has potential to be an effective strategy for reducing corruption by increasing accountability and compliance.

3.6 Role of Government

The term government is often used differently in different context. It can refer to the process of governing, to the exercise of power. It can also refer to the existence of that process to a condition of "ordered rule". "Government" often mean the people who fill the position of authority in the state. Finally, the term may refer to the manner, method or system of governing in a society: to the structure and arrangement of office and how they relate to the governed.

Government is normally regarded as consisting of three distinct set of power, each with its assigned role. One is the Legislatures whose role is to make the law. The second is the Executive (sometimes referred to as "the government") which is responsible for implementing the law. The third is the Judiciary which is responsible for interpreting and applying the law. Government normally plays four important roles in an economy, viz., regulation, promotion, entrepreneurship, and planning. as discussed below:

1. **Regulatory Role:** Government regulation of the business may cover a broad spectrum extending from entry into business to the final results of a business. The reservation of industries to small scale, public and co-operative sectors, licensing system etc. regulate the entry. Regulations of product mix, promotional activities etc. amount to regulation of the conduct of business.Results of business operations may be regulated by such measures as ceilings on profit margins, dividend etc.. The state may also regulate the relationship between enterprises. For example, restrictions on intra-corporate investments, inter-locking of directors and appointment of sole selling agents. Government regulation may be broadly divided into:

Indirect Controls: These are usually excercised through various fiscal and monetary incentives and disincentives or penalties. For instance, a high import duty may discourage imports and fiscal and monetary incentives may encourage the development of export-oriented industries.

Direct Controls: The direct administrative or physical controls are discretionary in nature. They can be applied selectively from firm to firm and industry to industry at the discretion of the State.

Initiatives of Government of India on regulatory reform can be best understood in the perspective of the federal polity which incorporates features of unitarism cluttering of statute books with laws, lack of documentation of subordinate legislations issued under different Central Acts by individual Ministeries/ Departments as well as by State Governments by virtue of the authority vested in them by Central laws; and above all, the process of Globalization of the economy and tremendous expansion of Information Technology.

To have look at the ideals of social justice accompanied with economic growth an action plan for effective and responsive Government was discussed and endorsed at the Conference of Chief Ministers Several initiatives followed the endorsement of the action plan such as:

- Formulation of Citizen's Charters
- Setting up of Information and Facilitation Counters
- Streamlining of public grievance redressed system
- Decentralization and devolution of power and review of laws
- Regulations and procedures

Besides these measures, concrete steps have been taken through amendments to the Constitution (73rd and 74th amendment) to empower the elected local administration both in rural urban areas. To improve Transparency in the functioning of government, a "Freedom of Information Bill" had been passed.

2. **Promotional Role:** The promotional role played by the Government is very important in developed countries as well as in the developing countries. In developing nations where the infrastructural facilities for development are inadequate and entrepreneurial activities are scarce, the promotional role of the government assumes special significance. The Government will have to assume direct responsibility to build up and strengthen the necessary development infrastructures, such as power, transport, finance, marketing, institutions for training and guidance and other promotional activities.

   The promotional role of the Government also encompasses the provisions of various fiscal, monetary and other incentives, including measures to cover certain risks, for the development of certain priority sectors and activities.

3. **Entrepreneurial Role:** It involves establishing and operating business enterprises and bearing the risks. A number of factors such as socio-political ideologies, dearth of private entrepreneurship, neglect of certain sectors, like the unprofitable sectors, by the private entrepreneurs; absence of or inadequate competition in certain segments and the resultant exploitation of consumers, etc. have contributed to the growth of state owned enterprises.

   There was tendency in many developing countries to assign a dominant place to the public sector. Public sector dominance was usually established in capital intensive projects like steel, capital goods, petro chemicals and fertilizers for which investment requirements were very large and the expected private returns, at least in the short runs were too low to provide an incentive for private profitability. In many cases even when the private sectors was prepared to undertake the risk and invest. State ownership of such industries existed for one reason or other. However, recently many governments have resorted to privatization in vary degrees, and have redefined the role of public sector.

4. **Planning Role:** Especially in developing countries, the Government plays a verying important role as a planner. The national necessity for proper utilization of scar resources and privatization of development objectives and ideological reasons have made this an important role of Governments in developing and socialist countries.

   The importance of planning to a less developed economy was often emphasized by Jawahar Lal Nehru, the chief architect of Development Planning in India. He rightly observed: "Whatever it may be in other countries, in underdeveloped countries like ours, which have to develop fairly rapidly, the time element is important and the question is how to use our resources to the best advantage. If our resources are abandoned it will not matter how they are used. They will go into a common pool of development. But where one's resources are limited, one has to see that they are directed to right purpose so as to help to build up whatever one is aiming at."

3.7 Political Environment and International Business

The buoyancy or depression of the stock market in the immediate pre-election and post-election period clearly demonstrates the impact of political changes on business conditions. A government by its perspective on business enterprise influences the business environment. For any firm, the role of government will influence its activities. The government may choose to allow and in fact provide free and fair competition, choosing to let the economic direction of the country be directed by business entities as in the case of U.S.A., or it may choose to provide the economic direction itself.

Although a firm regards itself as an economic entity, it is drawn and affected by political developments. It therefore, becomes necessary for the firm, particularly an international firm to monitor not only the domestic but also the international political environment. Since the international business firm operates in a host country and as a guest of that country, it becomes particularly important for it to monitor the developments taking place in the domestic political environment of the host country.

The three main concerns facing any international business entity are political stability, the government's orientation and nationalism. While political stability is necessary for a business entity, it is particularly important for an international business firm because they reflect the success or failure of any business concern, for political stability is often associated with stability of economic policies. Changes in regime, violence and cultural divisions based on language or other factors can lead to a very uncertain environment to conduct business. The other concerns facing international business are orientation of the government and nationalism. The orientation of the government can very often reveal whether international business can survive in that country or not. A country's ideological leaning may be capitalism, socialism, a mixture or other form. In the last years remarkable changes have been taking place in the ideologies of many countries. The most dramatic example has been the collapse of the communist USSR and Eastern Europe and its replacement with market led policies and ideologies. Another dramatic change has been seen in the opening up of Chinese economy along with India. Similarly, many African countries are abandoning their centrist leanings in favor of market led economies, for example, Zimbabwe and Tanzania. Nationalism also influences this variable because the business entity has to exist and operate within that country. Nationalist lineage can lead to expropriation of foreign held assets. These concerns through their impact give rise to political risks.

3.7.1 Political Risk

Political risk is the vulnerability of returns of a project to the political acts of a sovereign government. This definition gives rise to several issues but the most important issue is that political risk is associated with blockage of funds and expropriation (or domestication of investment) by the foreign government, for a firm operating across its national borders. The exporting firm also faces political risks because political developments also affect the areas of import restriction, tax controls, price controls, exchange regulations, counter trade etc. which can create a major impact on the value of the exporting firm and its survival.

Blockage of Funds: An issue associated very closely with the subject of political risk is a temporary or permanent blocking of funds. Blockage of funds refers to the fact that although a business entity may own the funds and still hold property rights, it cannot export its earnings.

Expropriation: The most extreme case of political vulnerability is expropriation. Expropriation refers to the government confiscation of property with or without proper reimbursement. Even where reimbursement is forthcoming, it doesn't equate with the value of the firm, which is the summation of future earnings by a firm. Reimbursement is often fixed keeping in mind the book value of assets. Modern economic history is replete with cases of expropriation. It may occur for a number of reasons, including the desire to retain national assets, as a "hostage" situation in international disputes.The seizure of Union Carbide's assets after the Bhopal disaster in India is an example.

While these risks are faced by firms operating within the boundaries of the host countries, companies operating from outside the political boundaries are also influenced by political risks.These risks often manifest themselves in form of exchange control, import restrictions, tax controls, price control, counter trade and other similar measures.

Domestication

Domestication refers to transfer of control of foreign investment to national ownership to bring the firm's activities in line with national interests. It differs from expropriation in the sense that It is a gradual encroachment of freedom of operations of a foreign operator. There are three types of domestications. They are: 1.Firm initiated domestication, 2.Government initiated domestication, and 3.Predetermined domestication.

Whereas firm initiated and predetermined domestication involves low level of risk, government initiated domestication is ranked at par with expropriation. The difference in risk profile is a product of discount factor used in the capital budgeting decision. While in case of predetermined and self-initiated domestication, the firm has the freedom to use discount rates having known the project life, in the case of government initiated domestication both variable are unknown or unplanned for. Besides, in a government initiated domestication programme, the economics of the operation may go haywire as companies are instructed to sell off a certain percentage of their stake by a given date.

3.7.2 Managing the Political Risk

Political risk management process can be undertaken either before or after the investment is made. The former refers to pre-investment planning whereas the latter refers to post-investment planning.

1) Pre-investment Planning:

Under the pre-investment planning for political risk management, four options are available to the international marketer. They are:

Avoidance: This method involves avoiding political risk by not undertaking any foreign investment. However, this is an option which can be exercised only prior to the decision of going international.

Insurance: Today, several business and non-business entities have come up which underwrite the insurance of political risk. Any businessman can have political risk underwritten for him. Although varying premiums are charged for different business activities, the international businessman now, has open to him the option of insuring his political risk of expropriation. However, insurance does not offer a full coverage because insurance companies underwrite the book value of assets whereas the value of the firm is dependent upon the stream of future earnings. Any expropriation would mean a lowering in the value of the firm. What insurance does is that it minimizes the losses through underwriting the value of assets. Today about 90 to 95% of the insured value is recoverable. In India, Export Credit Guarantee Corporation undertakes the role of insuring political risks.

Negotiating the Environment: Negotiating the environment refers to agreements drawn up between the company and the ruling government. It is also referred as concession agreements. The only drawback with this method is in countries with low degree of political stability where the emergence of new ruling party may mean repudiation of the earlier contract by the new government.

Structuring the Investment: It involves diversification of investment so that it is a not concentrated in any one country. The firm can also undertake financial structuring. This involves raising capital along with the government participation i.e., some portion is contributed by MNC whereas the remaining is raised from *the* domestic sources viz. the foreign government and its citizens.

2) Post-investment Planning

Political risk also arises even after the investment decision has been taken Which means the firm is already committed so far as the country is concerned. Therefore, the company must evolve strategies even after the investment decision has been taken so as to minimize the losses and to maximize the compensation in case of expropriation. These strategies include the following:

Planned Divestment: This refers to divestment of assets in the foreign country over a fixed period of time so as to minimize the risk involved. Effectively, this strategy involves recovery of the invested capital along with desired return over a fixed period of time after which the productive asset is sold to the local citizens.

Short-term Profit Maximization: This strategy involves sacrificing long-term goals in favor of short-term objectives. In the light of the developing circumstances, the firm cuts costs and increases profit margins to recover the initial investment.

Change of Benefit/Cost Ratio: Another available strategy for preventing or postponing expropriation involves changing the benefit/cost ratio. Before taking over the foreign investments, a government usually undertakes a cost benefit analysis of the advantages and the disadvantages associated with expropriation. If the analysis can be made in favor of the firm by increasing the cost v/s the benefit then; probably the expropriation decision may be withheld.

Develop Local Stockholders: This strategy of developing local stakes has worked wonders for minimizing the political risk involved and often has even resulted in favorable treatment being meted out to them.

Adaptation: Businessmen today have learnt that it is not necessary to own assets, to earn profits. Profits can also be earned through management contracts. Indian experience of management contracts in Middle East countries has demonstrated the existence of this fact.

3.8 Summary

Business environment as such, is the total of all external forces which affect the organization and operations of business. The political environment of the country influences the business to a great extent. The political environment of a country includes various elements such as Strong Democratic Tradition, Growth of Regional Parties, Concentration of Power, Democratic Decentralization, Modernization and Liberalization, Violent

Activities, Corruption, Regional Super Powerism, Growing Uncertainty etc and as a result there may be positive and negative impacts in the form of Growth Opportunities, Liberalization and Modernization, Market Expansion, Establishing the industries in Backward Region, Increased efficiency and quality, Decreasing Values, Uncertainties, Disruption through Violence, Distortion of Priorities etc. The government plays a very active role in all economies including the market economies, albeit, the extent and nature of State intervention vary widely between nations. Roles of Government may be classified into four categories viz. regulatory, promotional, entrepreneurial and Planning.

A firm regards itself as an economic entity, it is drawn and affected by political developments. It therefore, becomes necessary for the firm, particularly an international firm to monitor not only the domestic but also the international political environment. Since the international business firm operates in a host country and as a guest of that country, it becomes important for it to monitor the developments taking place in the domestic political environment of the host country. The three main concerns facing any international business entity are political stability, the government's orientation and nationalism.

3.9 Key Words

- **Blockage of Funds:** Blockage of funds refers to the fact that although a business entity may own the funds and still hold property rights, it cannot export its earnings.
- **Expropriation:** Refers to the government confiscation of property with or without proper reimbursement.
- **Domestication:** Refers to transfer of control of foreign investment to national ownership to bring the firm's activities in line with national interests.
- **Avoidance:** This method involves avoiding political risk by not undertaking any foreign investment.
- **Planned Divestment:** This refers to divestment of assets in the foreign country over a fixed period of time so as to minimize the risk involved.

3.10 Self Assessment Test

1. Explain the concept of Political Environment of Business.
2. "A stable and democratic government and its political decisions are important for a country and overall business." Explain.
3. What are the elements of Political Environment? Explain each of them in detail.
4. Describe briefly the impact of Political Environment on Business organizations. Illustrate the answer with reference to the organization you are working for.
5. What do you mean by a 'State'? Bring out its relationship with the social process.
6. What is 'Government'? What role does it play in the Economy? Explain.
7. Bring out the rationale of political analysis in International Business.

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Unit - 4 : Economic Environment

Unit Structure:

4.0 Objectives

After completing this unit, you will be able to:

- Discuss the nature and importance of economic environment
- Understand the effect of economic environment on industries
- Understand the recent trends in economic policies
- Analyze the recent data of the of Indian economy
- Analyze the Government policies for economic improvements

4.1 Introduction

All activities in the industry related with economic environment, beginning from raw material purchase, production, finance to marketing. Many economists are playing vital role in business units. They are building their career in the field of management and business. Trained economists analyze macro-economic factors and they forecast happening in business which be may be helpful in manufacturing, commerce and finance departments.

There are mostly three types of economics systems normely capitalism, communism and mixed Different countries have their own freedom to follow these economic systems:

Capitalism means the citizens believe in private ownership of production and distribution facilities. USA, Japan and the UK are the nation who follows the capitalism.Where state reserve all right of all the factors of production and distribution are known as communism. Cuba, Russia, China and Chechnya are example of the communism.Mixed economic system is one where major units of business are controlled and owned by the state. India, France, Holland and India are examples of mixed economies.

4.2 Economic Factors

Economic factors are constituents of the economic environment of business. There are many macro and micro economic factors which influence the business decisions. Business strategies are decided on the basis of these economic factors. Such factors are discussed below:

1. Growth Strategy and Economic Planning

Our growth strategy was based on Soviet Model. It gave central role of control and direction of economic activity to the government. It was believed that saving rate and growth rate could be increased if India invested heavily in the capital goods and heavy industry sector at the expense of the consumer goods sector. Due to low profitability in private sector, the responsibilities was taken by the state government for those investments.

During the first plan (1951-56), the annual growth rate of Net National Product was only 3.6 per cent which improved to 4% in the second plan (1956-61). The second five year plan was known as mobiliser for saving. The policy had been decided to control and regulate the private sector so that state government may conform the objectives of the policies.In the third plan (1956-61), the annual average increased in National Income slumped to 2.4 per cent, which was sufficient to neutralize the growth of population.

After 1967-68, the growth rate in the nation's economy showed the sign (Table 4.1) of improvement and from that period to till now i.e. during the ninth plan (1997-2002), Net National Product (NNP) growth rate of 5.5 percent was achieved with per capita growth of 4.6 per cent.

Table 4.1

Plans	At 1980-81 Prices NNP at Factor Cost (Growth Rate)	Prices per capita NNP (Growth Rate)
First Plan (1951-56)	3.6	1.8
Second Plan (1956-61)	4.0	2.0
Third Plan (1961-66)	2.4	0.2
Fourth Plan (1969-74)	3.3	1.0
Fifth Plan (1974-79)	5.0	2.7
Sixth Plan (1980-85)	5.4	3.2
Seventh Plan (1985-90)	5.9	3.6
Eighth plan (1992-97)	6.8	4.9
Ninth Plan (1997-2002)	5.5	3.6

The growth strategy also meant, in the early years of planning, that government and policy makers neglect the public investment in agriculture. The ultimate aim of the policy makers was to faster economic development of industry. The developing countries had more unemployment and that could match higher speed of industrial growth by supplying more and more labour to industries.However, since the rich countries themselves grew at a very rapid clip of 2.7 percent during the period 1960-2000, few developing countries consistently managed to close the economic gap between them and the advanced nations. The countries of East and Southeast Asia constitute the sole exception. Excluding China, this region experienced per-capita GDP growth of 4.4 percent over 1960-2000. Despite the Asian financial crisis of 1997-98 countries such as South Korea, Thailand and Malaysia ended the century with productivity levels that stood significantly closer to those enjoyed in the advanced countries.

Elsewhere, the pattern of economic performance has varied greatly across different time periods. China has been a major success story since the late 1970s, experiencing a stupendous growth rate of 8.0 percent (as compared to 2.0 percent in 1960-80). Less spectacularly, India has roughly doubled its growth rate since the early 1980s, pulling South Asia's growth rate up to 3.3 percent in 1980-2000 from 1.2 percent in 1960-1980. The experience in other parts of the world was the mirror image of these Asian growth take-offs. Latin America and Sub-Saharan Africa both experienced robust economic growth prior to the late 1970s and early 1980s—2.9 percent and 2.3 percent respectively—but then lost ground subsequently in dramatic fashion.

The aggregate picture hides tremendous variety in growth performance.We have high growth countries and low growth countries; countries that have grown rapidly throughout, and countries that have experienced growth spurts for a decade or two; countries that took off around 1980 and countries whose growth collapsed around 1980.

Activity A:
1. What do we learn about growth strategies from the above study material. Make small points and compare.

2. Economic Systems

The economy of India is the eleventh largest economy in the world by nominal GDP and the fourth largest by purchasing power parity (PPP). In the 1990s following economic reform from the socialist-inspired economy of post-independence India, the country began to experience rapid economic growth as markets opened for international competition and investment. In the 21st century India is an emerging economic power with vast human and natural resources, and a huge knowledge base. Economists predict that by 2020, India will be among the leading economies of the world.

India's economic history can be broadly divided into three eras, beginning with the pre-colonial period lasting up to the 18th century. The advent of British colonization started the colonial period in the early 19th century, which ended with independence in 1947. The third period stretches from independence in 1947 till now.

The citizens of the Indus Valley civilization, a permanent settlement that flourished between 2800 BC and 1800 BC, practiced agriculture, domesticated animals, used uniform weights and measures, made tools and weapons, and traded with other cities. Evidence of well planned streets, a drainage system and water supply reveals their knowledge of urban planning, which included the world's first urban sanitation systems and the existence of a form of municipal government. Religion, especially Hinduism, and the caste and the joint family systems, played an influential role in shaping economic activities. The caste system functioned much like medieval European guilds, ensuring the division of labour, providing for the training of apprentices and, in some cases, allowing manufacturers to achieve narrow specialization. For instance, in certain regions, producing each variety of cloth was the speciality of a particular sub-caste.

Company rule in India brought a major change in the taxation environment from revenue taxes to property taxes, resulting in mass impoverishment and destitution of majority of farmers and led to numerous famines. The economic policies of the British Raj effectively bankrupted India's large handicrafts industry and caused a massive drain of India's resources. Indian Nationalists employed the successful Swadeshi movement, as strategy to diminish British economic superiority by boycotting British products and the reviving the market for domestic-made products and production techniques. India had become a strong market for superior finished European goods. This was because of vast gains made by the Industrial revolution in Europe, the effects of which was deprived to Colonial India. The Nationalists had hoped to revive the domestic industries that were badly affected by polices implemented by British Raj which had made them uncompetitive to British made goods.

Indian economic policy after independence was influenced by the colonial experience (which was seen by Indian leaders as exploitative in nature) and by those leaders' exposure to Fabian socialism. Policy tended towards protectionism with a strong emphasis on import substitution, industrialization, state intervention in labor and financial markets, a large public sector, business regulation, and central planning. Five-Year Plans of India resembled central planning in the Soviet Union. Steel, mining, machine tools, water, telecommunications, insurance and electrical plants, among other industries, were effectively nationalized in the mid-1950s.

In the late 1980s, the government eased restrictions on capacity expansion for incumbents, removed price controls and reduced corporate taxes. While this increased the rate of growth, it also led to high fiscal deficits and a worsening current account. The collapse of the Soviet Union, which was India's major trading partner, and the first Gulf War, which caused a spike in oil prices, caused a major balance-of-payments crisis for India, which found itself facing the prospect of defaulting on its loans. India asked for a $1.8 billion bailout loan from IMF which in return demanded reforms.

In response, the government initiated the economic liberalisation of 1991. Since 1990 India has emerged as one of the fastest-growing economies in the world. During this period, the economy has grown constantly, but with a few major setbacks. This has been accompanied by increase in life expectancy, literacy rates and food security.

While the credit rating of India was hit by its nuclear tests in 1998, it has been raised to investment level in 2007. In 2003, Goldman Sachs predicted that India's GDP in current prices will overtake France and Italy by 2020, Germany, UK and Russia by 2025 and Japan by 2035. By 2035, it was projected to be the third largest economy of the world, behind US and China. India is often seen by economist as a rising economic superpower and is believed to play a major role in the global economy in the 21st century.

3. Industry and Services

India has Asia's largest outsourcing industry and is the world's second most favorable outsourcing destination after the United States. India has one of the world's fastest growing automobile industries. Industry accounts for 54.6% of the GDP and employ 17% of the total workforce. However, about one-third of the industrial labour force is engaged in simple household manufacturing only. In absolute terms, India is 16th in the world in terms of nominal factory output. India's small industry makes up 5% of carbon dioxide emissions in the world.

Economic reforms brought foreign competition, led to privatization of certain public sector industries, opened up sectors hitherto reserved for the public sector and led to an expansion in the production of fast-moving consumer goods. Post-liberalization the Indian private sector, which was usually run by oligopolies of old family firms and required political connections to prosper was faced with foreign competition including the threat of cheaper Chinese imports. It has since handled the change by squeezing costs, revamping management, focusing on designing new products and relying on low labour costs and technology.

Textile manufacturing is the second largest source for employment after agriculture and accounts for 26% of manufacturing output. Tirupur has gained universal recognition as the leading source of hosiery, knitted garments, casual wear and sportswear. Dharavi slum in Mumbai has gained fame for leather products. Tata Motors' Nano attempts to be the world's cheapest car.

India is fifteenth in services output. It provides employment to 23% of work force and it is growing fast with growth rate of 7.5% in 1991–2000 up from 4.5% in 1951–80. It has the largest share in the GDP, accounting for 55% in 2007 up from 15% in 1950. Business services (information technology, information technology enabled services, business process outsourcing) are among the fastest growing sectors contributing to one third of the total output of services in 2000. The growth in the IT sector is attributed to increased specialization and an availability of a large pool of low cost, but highly skilled, educated and fluent English-speaking workers, on the supply side, matched on the demand side by an increased demand from foreign consumers interested in India's service exports, or those looking to outsource their operations. The share of India's IT industry to the country's GDP increased from 4.8 % in 2005-06 to 7% in 2008. In 2009, seven Indian firms were listed among the top 15 technology outsourcing companies in the world. In March 2009, annual revenues from outsourcing operations in India amounted to US$ 60 billion and this is expected to increase to US$225 billion by 2020.

Organized retail such supermarkets accounts for 24% of the market as of 2008. There are taxes for moving goods to states, from states, and even within states.Tourism in India is relatively undeveloped but growing at double digits. Some hospitals encourage medical tourism.

4. Agriculture

India ranks second worldwide in farm output. Agriculture and allied sectors like forestry, logging and fishing accounted for 16.6% of the GDP in 2007, employed 60% of the total workforce and despite a steady decline of its share in the GDP, is still the largest economic sector and plays a significant role in the overall socio-economic development of India. Yields per unit area of all crops have grown since 1950, due to the special emphasis placed on agriculture in the five-year plans and steady improvements in irrigation, technology, application of modern agricultural practices and provision of agricultural credit and subsidies since Green revolution in India. However, international comparisons reveal the average yield in India is generally 30% to 50% of the highest average yield in the world.

India is the largest producer in the world of milk, cashew nuts, coconuts, tea, ginger, turmeric and black pepper. It also has the world's largest cattle population: 193 million. It is the second largest producer of wheat, rice, sugar, cotton, silk, peanuts and inland fish. It is the third largest producer of tobacco. India is the largest fruit producer accounting for 10% of the world fruit production. It is the leading producer of bananas and mangoes. India is the second largest producer and the largest consumer of silk in the world.

5. Financial and Fiscal Sector

The Indian money market is classified into: the organised sector (comprising private, public and foreign owned commercial banks and cooperative banks, together known as *scheduled banks*); and the unorganised sector (comprising individual or family owned indigenous bankers or money lenders and non-banking financial companies (NBFCs)).

Government nationalised 14 banks in 1969, followed by six others in 1980, and made it mandatory for banks to provide 40% of their net credit to priority sectors like agriculture, small-scale industry, retail trade, small businesses, etc. to ensure that the banks fulfill their social and developmental goals. Since then, the number of bank branches has increased from 10,120 in 1969 to 98,910 in 2003 and the population covered by a branch decreased from 63,800 to 15,000 during the same period. The total deposits increased 32.6 times between 1971 to 1991 compared to 7 times between 1951 to 1971. Despite an increase of rural branches from 1,860 or 22% of the total number of branches in 1969 to 32,270 or 48%, only 32,270 out of 5 lakh (500,000) villages are covered by a scheduled bank. More than half of personal savings are invested in physical assets such as land, houses, cattle, and gold.

6. Natural Resources

India has the world's fifth largest wind power industry with an installed wind power capacity of 9,587 MW. India's total cultivable area is 1,269,219 km² (56.78% of total land area), which is decreasing due to constant pressure from an ever growing population and increased urbanisation. India has a total water surface area of 314,400 km² and receives an average annual rainfall of 1,100 mm. Irrigation accounts for 92% of the water utilisation and comprised 380 km² in 1974 and is expected to rise to 1,050 km² by 2025, with the balance accounted for by industrial and domestic consumers. India's inland water resources comprising rivers, canals, ponds and lakes and marine resources comprising the east and west coasts of the Indian ocean and other gulfs and bays provide employment to nearly 6 million people in the fisheries sector. In 2008, India had the world's third largest fishing industry. India's major mineral resources include coal, iron, manganese, mica, bauxite, titanium, chromite, limestone and thorium. India meets most of its domestic energy demand through its 92 billion tonnes of coal reserves (about 10% of world's coal reserves).

India's huge thorium reserves — about 25% of world's reserves — is expected to fuel the country's ambitious nuclear energy program in the long-run. India's dwindling uranium reserves stagnated the growth of nuclear energy in the country for many years.

7. Petroleum and Natural Gas

India's oil reserves, found in Bombay High, parts of Gujarat, Rajasthan and eastern Assam, meet 25% of the country's domestic oil demand. India's total proven oil reserves stand at 11 billion barrels, of which Bombay High is believed to hold 6.1 billion barrels and Mangala Area in Rajasthan an additional 3.6 Billion Barrels.

In 2009 India imported 2.56 million barrels of oil per day making it one of largest buyers of crude oil in the world. The petroleum industry in India mostly consists of public sector companies such as Oil and Natural Gas Corporation (ONGC), Hindustan Petroleum Corporation Limited (HPCL) and Indian Petrochemicals Corporation Limited (IPCL). There are some major private Indian companies in oil sector such as Reliance Industries Limited (RIL) which operates the world's largest oil refining complex.

8. External Trade and Investment

In March 2008, India's annual imports and exports stood at US$236 and US$155.5 billion respectively. India's economy is mostly dependent on its large internal market with external trade accounting for just 20% of the country's GDP. In 2008, India accounted for 1.45% of global merchandise trade and 2.8% of global commercial services export. Until the liberalization of 1991 India was largely and intentionally isolated from the world markets to protect its economy and to achieve self-reliance. Foreign trade was subject to import tariffs, export taxes and quantitative restrictions, while foreign direct investment (FDI) was restricted by upper-limit equity participation, restrictions on technology transfer, export obligations and government approvals; these approvals were needed for nearly 60% of new FDI in the industrial sector. The restrictions ensured that FDI averaged only around US$ 200 million annually between 1985 and 1991; a large percentage of the capital flows consisted of foreign aid, commercial borrowing and deposits of non-resident Indians. India is a founding-member of General Agreement on Tariffs and Trade (GATT) since 1947 and its successor, the WTO. While participating actively in its general council meetings, India has been crucial in voicing the concerns of the developing world.

9. Foreign Direct Investment in India

As the fourth-largest economy in the world in PPP terms, India is a preferred destination for foreign direct investments (FDI); India has strengths in telecommunication, information technology and other significant areas such as auto components, chemicals, apparels, pharmaceuticals, and jewellery. Despite a surge in foreign investments, rigid FDI policies resulted in a significant hindrance.

India's recently liberalized FDI policy (2005) allows up to a 100% FDI stake in ventures. Industrial policy reforms have substantially reduced industrial licensing requirements, removed restrictions on expansion and facilitated easy access to foreign technology and foreign direct investment FDI. The upward moving growth curve of the real-estate sector owes some credit to a booming economy and liberalized FDI regime. In March 2005, the government amended the rules to allow 100 per cent FDI in the construction business. This automatic route has been permitted in townships, housing, built-up infrastructure and construction development projects including housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, and city- and regional-level infrastructure.

10. Per Capita and National Income

As of 2005:

- 85.7% of the population lives on less than $2.50 (PPP) a day, down from 92.5% in 1981. This is much higher than the 80.5% in Sub-Saharan Africa.
- 75.6% of the population lives on less than $2 a day (PPP), which is around 20 rupees or $0.5 a day in nominal terms. It was down from 86.6%, but is still even more than the 73.0% in Sub-Saharan Africa.
- 24.3% of the population earned less than $1 (PPP, around $0.25 in nominal terms) a day in 2005, down from 42.1% in 1981.
- 41.6% of its population is living below the new international poverty line of $1.25 (PPP) per day, down from 59.8% in 1981. The World Bank further estimates that a third of the global poor now reside in India.

Today, more people can afford a bicycle than ever before. Some 40% of Indian households owns a bicycle, with ownership rates ranging from around 30% to 70% at state level. Housing is modest. According to Times of India, "a majority of Indians have per capita space equivalent to or less than a 10 feet x 10 feet room for their living, sleeping, cooking, washing and toilet needs.

11. Human Resources

Agricultural and allied sectors accounted for about 60% of the total workforce in 2003 same as in 1993–94. While agriculture has faced stagnation in growth, services have seen a steady growth. of the total workforce, 8% is in the organised sector, two-thirds of which are in the public sector. The NSSO survey estimated that in 1999–2000, 106 million, nearly 10% of the population were unemployed and the overall unemployment rate was 7.3%, with rural areas doing marginally better (7.2%) than urban areas (7.7%). India's labor force is growing by 2.5% annually, but employment only at 2.3% a year.

Official unemployment exceeds 9%. Regulation and other obstacles have discouraged the emergence of formal businesses and jobs. Almost 30% of workers are casual workers who work only when they are able to get jobs and remain unpaid for the rest of the time. Only 10% of the workforce is in regular employment. India's labor regulations are heavy even by developing country standards and analysts have urged the government to abolish them.

Unemployment in India is characterized by chronic or disguised unemployment. Government schemes that target eradication of both poverty and unemployment (which in recent decades has sent millions of poor and unskilled people into urban areas in search of livelihoods) attempt to solve the problem, by providing financial assistance for setting up businesses, skill honing, setting up public sector enterprises, reservations in governments, etc.. The decreased role of the public sector after liberalization has further underlined the need for focusing on better education and has also put political pressure on further reforms.

Activity B:

1. Out of following points mentioned below here to whom do you blame for increase in unemployment and poverty in India and why?
   1. Government Policies
   2. Illiteracy
   3. Indian Customs and Culture
   4. Cast

4.3 Economic Trends

In the revised 2007 figures, based on increased and sustaining growth, more inflows into foreign direct investment, Goldman Sachs predicts that "from 2007 to 2020, India's GDP per capita in US$ terms will quadruple", and that the Indian economy will surpass the United States (in US$) by 2043. In spite of the high growth rate, the report stated that India would continue to remain a low-income country for decades to come but could be a "motor for the world economy" if it fulfills its growth potential. Goldman Sachs has outlined 10 things that it needs to do in order to achieve its potential and grow 40 times by 2050. These are:

1. Improve Governance
2. Raise Educational Achievement
3. Increase Quality and Quantity of Universities
4. Control Inflation
5. Introduce a Credible Fiscal Policy
6. Liberalize Financial Markets
7. Increase Trade with Neighbours
8. Increase Agricultural Productivity
9. Improve Infrastructure and
10. Improve Environmental Quality.

4.4 Issues

- **Agriculture in India**

According to "India: Priorities for Agriculture and Rural Development" by World Bank, India's large agricultural subsidies are hampering productivity-enhancing investment. Overregulation of agriculture has increased costs, price risks and uncertainty. Government interventions in labor, land, and credit markets are hurting the market. Infrastructure and services are inadequate. Illiteracy, slow progress in implementing land reforms and inadequate or inefficient finance and marketing services for farm produce is another problem. The average size of land holdings is very small (less than 20,000 m^2) and is subject to fragmentation, due to land ceiling acts and in some cases, family disputes. Such small holdings are often over-manned, resulting in disguised unemployment and low productivity of labour. Adoption of modern agricultural practices and use of technology is inadequate, hampered by ignorance of such practices, high costs and impracticality in the case of small land holdings. World Bank says that the allocation of water is inefficient, unsustainable and inequitable. The irrigation infrastructure is deteriorating. Irrigation facilities are inadequate, as revealed by the fact that only 52.6% of the land was irrigated in 2003–04, which result in farmers still being dependent on rainfall, specifically the Monsoon season. A good monsoon results in a robust growth for the economy as a whole, while a poor monsoon leads to a sluggish growth. Farm credit is regulated by NABARD, which is the statutory apex agent for rural development in the subcontinent.

India has many farm insurance companies that insure wheat, fruit, rice and rubber farmers in the event of natural disasters or catastrophic crop failure, under the supervision of the Ministry of Agriculture. India's population is growing faster than its ability to produce rice and wheat. The most important structural reform for self-sufficiency is the ITC Limited plan to connect 20,000 villages to the Internet by 2013. This will provide farmers with up to date crop prices for the first time, which should minimise losses incurred from neighbouring producers selling early and in turn facilitate investment in rural areas.

•Corruption in India

The Right to Information Act (2005) and equivalent acts in the Indian states, that require government officials to furnish information requested by citizens or face punitive action, computerisation of services and various central and state government acts that established vigilance commissions have considerably reduced corruption or at least have opened up avenues to redress grievances. The 2009 report by Transparency International ranks India at 84th place and states that significant improvements were made by India in reducing corruption.

• Government Performance

The current government has concluded that most spending fails to reach its intended recipients. Lant Pritchett calls India's public sector "one of the world's top ten biggest problems — of the order of AIDS and climate change". The Economist's 2008 article about the Indian civil service stated that the Indian central government employs around 3 million people, including "vast armies of paper-shuffling peons".

• Education in India

India has made huge progress in terms of increasing primary education attendance rate and expanding literacy to approximately two thirds of the population. The right to education at elementary level has been made one of the fundamental rights under the Eighty-Sixth Amendment of 2002. However, the literacy rate of 65% is still lower than the worldwide average and the country suffers from a high dropout rate.

• Infrastructure

Development of infrastructure was completely in the hands of the public sector and was plagued by corruption, bureaucratic inefficiencies, urban-bias and an inability to scale investment. India's low spending on power, construction, transportation, telecommunications and real estate, at $31 billion or 6% of GDP in 2002 had prevented India from sustaining higher growth rates. This has prompted the government to partially open up infrastructure to the private sector allowing foreign investment which has helped in a sustained growth rate of close to 9% for the past six quarters. Some 600 million Indians have no mains electricity at all. While 80% of Indian villages have at least an electricity line, just 44% of rural households have access to electricity. According to a sample of 97,882 households in 2002, electricity was the main source of lighting for 53% of rural households compared to 36% in 1993. Some half of the electricity is stolen, compared with 3% in China. The stolen electricity amounts to 1.5% of GDP. Almost all of the electricity in India is produced by the public sector. Power outages are common. Many buy their own power generators to ensure electricity supply. As of 2005 the electricity production was at 661.6 billion kWh with oil production standing at 785,000 bbl/day. In 2007, electricity demand exceeded supply by 15%. Multi Commodity Exchange has tried to get a permit to offer electricity future markets.

Indian Road Network is developing. Trucking goods from Gurgaon to the port in Mumbai can take up to 10 days. India has the world's third largest road network. Container traffic is growing at 15% a year. Some 60% of India's container traffic is handled by the Jawaharlal Nehru Port Trust in Navi Mumbai. Internet use is rare; there were only 7.57 million broadband lines in India in November 2009, however it is still growing at slower rate and is expected to boom after the launch of 3G and wimax services.

- **Indian Labour laws**

India's labor regulations — among the most restrictive and complex in the world — have constrained the growth of the formal manufacturing sector where these laws have their widest application. Better designed labor regulations can attract more labor- intensive investment and create jobs for India's unemployed millions and those trapped in poor quality jobs. Given the country's momentum of growth, the window of opportunity must not be lost for improving the job prospects for the 80 million new entrants who are expected to join the work force over the next decade.

- **Economic Disparities and Poverty in India**

Lagging states need to bring more jobs to their people by creating an attractive investment destination. Reforming cumbersome regulatory procedures, improving rural connectivity, establishing law and order, creating a stable platform for natural resource investment that balances business interests with social concerns, and providing rural finance are important.

One of the critical problems facing India's economy is the sharp and growing regional variations among India's different states and territories in terms of per capita income, poverty, availability of infrastructure and socio-economic development. Six low-income states - Chhattisgarh, Jharkhand, Madhya Pradesh, Orissa, Rajasthan, and Uttar Pradesh - are home to more than half of India's population.

The five-year plans have attempted to reduce regional disparities by encouraging industrial development in the interior regions, but industries still tend to concentrate around urban areas and port cities. After liberalization, the more advanced states are better placed to benefit from them, with infrastructure like well developed ports, urbanisation and an educated and skilled workforce which attract manufacturing and service sectors. The union and state governments of backward regions are trying to reduce the disparities by offering tax holidays, cheap land, etc., and focusing more on sectors like tourism, which although being geographically and historically determined, can become a source of growth and is faster to develop than other sectors.

Activity C:

1. Read the economic issues mentioned above and prepare a essay on each points on your language

4.5 Summary

Economic factors constituent of the economic environment of business. India growth strategy was based Soviet Model. It is based on five years plan growth strategy. India's currency is Indian Rupees (INR) and GDP US \$ 1.367 trillion (nominal: 11th Plan) and GDP growth is 6.7%. India's has 37.2% i.e. 410 (year 2010) million people who are living below poverty line. Unemployment rate is 9.5% (2009).India normally export software, petroleum products, textile goods, gems and jewellery. Engineering goods, chemical, leather manufactures to different countries of the world. This constituent US \$ 155 billion (2009.) India imports crude oil, machinery, gems fertilizer, chemicals etc, and outward remitted US \$ 232.3 billion f.o.b(2009) Industry accounts for 54.6 % of the GDP and employ 17% of the total workforce. India is the second largest producer of the rice in the world after China.Percentage of population living under the poverty line of \$ 1 (PPP) a day, currently 356.35 rupees a month in rural areas (around US \$ 7.4 a month).

4.6 Key Words

- **Economic System** Deals with production, distribution and consumption of goods and services in a society people, institutions and their reletionships are studied
- **Market Economy :** It is an economic system in colinch physical ownership of factors of production and right of consumption are in the hand of private people and the only objective is to earn maximum profit.
- **Mixed Economy** Capitation and socialism have some demarits and in order to take advantage of looth the system socialist countries followed the way in between the two systems known as mixed economy.
- **Public Sector :** Wherein the ownership, management and centrol lie in the hands of Government.
- **Private sector -** Wherein the ownership, management and control lie in the hands of private sector.

4.7 Self Assessment Test

1. What do you mean by economic environment? Explain its importance.
2. Business strategies are decided on the basis of economic factors, Explain these economic factors.
3. India's economy can be broadly divided into three eras. Explain the history of economic development.
4. Bring out the salient features of the economic systems.
5. What will be the likely growth of the economy? Explain
6. What reforms are needed at the agricultural front?
7. What can we do to accelerate industrial growth.
8. What are the shares of top five investing countries n FDI inflows (2000-2007).

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Unit - 5 : Structure of Indian Economy

Unit Structure:

5.0 Objectives

After studying this unit, you should be able to understand:-

- Basic features of Indian Economy
- Structure of Indian Economy
- Concept of economic growth and development
- Determinants of economic growth and development
- Analysis of macroeconomic indicators

5.1 Introduction

Indian economy is the third largest economy in the world, in terms of purchasing power, is going to touch new heights in coming years. As predicted by Goldman Sachs, the Global Investment Bank, by 2035 India would be the third largest economy of the world just after US and China. It will grow to 60% of size of the US economy. This booming economy of today has to pass through many phases before it can achieve the current milestone of 9% GDP.

5.2 Indian Economy

According to the UNO, “An underdeveloped country is one in which per capitareal income is low when compared with the per capita real income of U.S.A. canada, Australia and western Europe. The solient features of Indian economy include the following:

1. Low National Income -Due to under utilisation of resources, the National Income of India is very less than that of developed countries. On the basis of current price, the National Income of India was Rs. 9,142 crores in 1950-51 which increased to Rs. 48,77,842 crores in March, 2011. Even then, it is very less than that of other developed countries like USA, Britain, France etc.

2. Low Per Capita Income: Indian Economy is characterized by low per capital income, it is Rs. 53,331 in 2010-11 and is expected to grow Rs. 60,000/- in 2011-12. India's per capital income is very low as compared to the advanced countries. This trend of difference of per capita income between under developed and advanced countries is gradually increasing in present times. In India not only the per capita income is low but also the income is unequally distributed. The unequal-distribution of income and wealth makes the problem of poverty more critical.

3. Predominance of Agriculture- Indian economy is agriculture dominant. Bulk of Indian population resides in small villages. About 23% of Indian national income is obtained from agriculture. Land and labour ratio is not appropriate in India and per capita land availbility is very less. Most of our man power is engaged in agriculture and farming sector. On the other hand, in developed countries majority of population is engaged in non-agriculture sector. In India about 52% of the total labour force is engaged in agriculture sector. Among the total export 13% are agriculture products and 23% of the national income is obtained through agriculture.

4. Population Explosion - India stands second to China in population in the world. The main problem in India is the high level of birth rates coupled with a falling level of death rates. In 2010-11 the compound annual growth rate of population is 1.344% with this high growth rate of population about 1.7 crore new persons are added to Inidian population every year. According to population census in 2001 the total population of India was 1.02 billion which increased to 1.21 billion in 2011.

5. Unemployment and Under- employment-In India labour is an abundant factor and consequently it is very difficult to provide gainful employment to the entire working population. In India unemployment is structural and is the result of deficiency of capital. The Indian economy does not find sufficient capital to expand its industries to such an extent that the entire labour force is absorbed. At present, on an average more than 5 crores of people are unemployed.On the other hand under employment is also a vast problem in India. Rural areas are severely affected by unemployment. Disguised unemployment in rural areas is the result of heavy pressure of population, on land and the absent of alternative employment opportunities in our villages.

6. Lack of Capital and Low Rate of Capital Formation-Another basic characteristics of Indian economy is the existence of capital deficiency which is reflected in two ways - Firstly, the amount of capital per head available is low, and Secondly, the current rate of capital formation is also low. Lack of capital formation is due to the utilisation of savings for unproductive purposes. Therfore, saving are less in India due to low national income and high consumption expenditure.

7. Low Standard of Living-The higher standard of living of any country reflects its development. Due to low per capita income and less national income, most of the Indian people cannot fulfil their basic needs. Failure to secure a balanced diet manifests in the low calorie intake and low level of consumption of proteins. In addition to this, there is deficiency of per head utilisation of things like-clothes, sugar, edible oil, vanaspati, tea etc. Most of the people lack good housings and health facilities.

8. Disparities in Income Distribution- High degree of disparity in income and wealth distribution is found in India. According to the data shown by NSSO, 39% of rural population possesses only 5% of all the rural assets, while on the other hand, 8% top households possess 46% of total rural assets.

9. Unbalanced Foreign Trade-After independence, the trade of India proved to be unfavourable except the initial two years of independence. Even after making various efforts for increasing exports and import substitution, trade loss is increasing continuously which is indicative of failure of our economic policies. In the year 2004-05 (up to October 2004) it was unfavourable by Rs. 91,472 crore. The foreign trade was favourable only in year 1972-73 and 1976-77 by Rs. 103 crore and Rs. 69 crores respectively.

10. Unbalanced Industrial Growth-Industrial growth rate of India-is unbalanced along with slow pace. Here, the consumer based industries have developed more as compared to the capital based industries. In the planning period stress has been laid down on the growth of iron and steel, chemical, machine manufacture, electricity production etc. industries to remove the industrial unbalance but these things are still lacking. Some states like Maharashtra, Gujarat, West Bengal, Tamilnadu, Bihar etc. have many industrial units on the other hand in some state like Rajasthan, Jammu-Kashmir, Orrisa, Assam etc., industrial development is negligible.

11. Poverty in Plenty-Indian economy is the sign of "Poverty in Plenty". India is full of natural resources, human power, fertile land, mineral resources, vegetation etc. but due to lack of capital, they are un utilised or under utilised leading to persistence of poverty, and unemployment. That is why, India is not able to get rid off with the cycle of poverty. About 37 percent of the total population is below poverty line and have low living standard.

12. Planned and Mixed Economy-India has adopted planned economy for achieving faster economic development. Five year plans are adopted for economic development. Indian economy is called mixed economy because here equal opportunities are provided for working in public and private sector. From July 1991, country has taken over the policy of liberalization, privatisation, and globalisation. Liberalisation policy has been started in industries, foreign trade, finance and banking.

13. Dual Nature of Economy-Indian Economy is dual in nature. On one hand, the rural side of economy is related to superstitions, illiteracy, backwardness, customs etc. whereas on the other hand in urban areas, cities, towns etc. a well developed, prosperous, literate society is developing. In rural areas the main source of employment are small scale and cottage industries and in urban areas large industries are present with lot of money and prosperity.

5.3 Obstacles in the Economic Development

It is clear from the study of features of Indian economy that it is a developing economy. The main obstacles in the Economic Development of India are-

1. Lack of Capital- Insufficient amount of national income and low amount of income per head lead to low savings. Every developing country requires huge amount of capital for its development. The rate of Gross Domestic capital formation in India was 8.5% in 1950-51 which increased to 26.3% in 2008 but it is still very less in comparison to USA and Japan.

2. Industrial Backwardness- Due to lack of captial, the basic industries have not developed. India is still confined largely to the production of consumer goods like textiles, sugar etc. There is still a long way to go in the development of capital goods industries. Our country lacks heavy machinery and latest technologies, due to which we have to depend on foreign countries.

3. Unutilized Natural and Human Resources- India is full of mineral resources, forest reserves, water resources and cheap human resources but their under utilisation has led to slow pace of economic development.

4. Lack of Technology and Technical Knowhow -India is lacking in advanced technology and technicians which is required for the newer developments in the field of agriculture, industries transport and communication.

5. Insufficient Growth in Literacy Rate- Due to lack of education, people continue to develop traditional approaches and also do not understand the importance of economic development. According to 2011 population census, the rate of literacy in India is 74.04 percent. The percentage of professionally educated persons is very less in India. India's effective literacy rate has recorded a 9.2 percent rise to reach to 74.84 percent in 2011. Interestingly literacy rate improved sharply among females as compared to males. For males it rose from 75.26 to 82.14 percent making a rise of 6.9 percent whereas it increased by 11.8 percent for females from 53.67 to 65.46 percent.

6. Predominance of Primary Sector -Agriculture predominates in Indian economy. In addition to this, there is also dominance of animal husbandry and mining which are less profitable as compared to industrial sector. In these fields, there are less savings and therefore their is lack of capital for investment.

7. Widespread Unemployment and Under-employment- Population explosion has resulted in lot of human resources available at low costs but due to small number of industries these resources are unutilised or under utilised. The unemployment rate is 10 percent. People have to face the problem of unemployment and therefore crime in the country.

8. Natural Calamities - India has always faced a large number of natural calamities due to floods, famines, epidemics etc. which led to loss of human life and wealth. Indian agriculture is gamble of monsoon so the year in which monsoon does not come on time, the whole economy get disturbed and backwardness continues.

9. Small-Scale of Production - Lack of capital leads to the development of only small scale and cottage industries. The cost of production is high in such industries. The goods produced are costlier and of low quality. Such type of industries in India are prohibiting its economic development.

10. Under-utilisation of Production Capacity- Their is under utilisation of installed capacity in the industries. Most of the industries do not utilise even 50-60 percent of their capacity. This under utilisation of production capacity is more prevalent in public sector industries as compared to that of private sector.

11. Imbalanced Foreign Trade-In the last 65 years, except two years (1972-73 & 1976-77) our imports are always higher than exports in terms of value, due to which our balance of trade is unfavourable. Development of a developing country requires modernised technologies, huge machines so that industrial development of the country can be made possible. As a result India have to limit the development processes. This slows down the speed of economic development.

12. Lack of Cordial Relations with Neighbouring Countries - Since independence, India's neighbouring, countries like China, Srilanka, and Pakistan do not have cordial relations with India. As such, India has to spend more funds on defence purposes which reduces the money available for development programmes.

13. Lack of Effective Planning-From the first five year plan started in 1951 to eleventh five year plans, the targets of maximum plans cannot be achieved due to ineffective planning.

14. Industrial Unrest-Due to lack of harmonial relations between the employers and employees, India has to face deficiency of industrial production and products. Strikes, lock out of industries has become very common. This has led to hindrance in development of other economic fields. Industrial struggle leads to loss of human working days and thus adversely affects industrial production.

15. Political Instability-The state of political instability has created losses in Indian economy. Since, 1991 there is political instability in India. Due to this it is not possible to follow a well planned economic policy. These policies changes with the ideology of the ruling party.

16. Defective Taxation System-Due to defective taxation system, the problem of tax evasion has increased. In Indian taxation system, such taxes are imposed on general public whose collection is costlier than recovery. High rates of tax neutralises business and industrial development.

17. Inflation and Increasing Prices - Inflation has resulted in high prices in India. Due to enemity approach with neighbouring countries a lot of money has to be spent for defence purposes and also the expenditure of plans is more than the target expenditure. Prices has also increased due to increased demand and less supply in the last years. Thus due to inflation, developmental expenditures have increased resulting in slow pace of economic development.

From the above description we can conclude that the above obstacles have slowed down economic development, among which lack of capital is the main obstacle. If our country take foreign assistance and completely utilise the available natural and human resources then these obstactescan be avoided.

5.4 Suggestions for the Rapid Economic Development

Following are the suggestions for the economic development of India-

(A) For Agricultural Development

1. Land Reforms - Even after banning Zamindari system a lot of disparities are present in land distribution. In addition to this, most of the agricultrule farms are small in size and segregated. To overcome this problem, technique of ceiling of land holdings has to be used.

2. Arrangement of Institutional Finance-Few years back farmers used to take loan from money lenders, and therefore get very less benefit of his crop. Most of the money received by sales is spent in overcoming loans and interest. The Indian farmers have to be provided institutional finance at low rates. Considering it, cooperative finance institutions established during planning period. 19 large commercial banks have been nationalised and by, establishing rural banks, farmers are provided institutional finance. But still poor and illiterate farmers are devoid of these facilities. So, rural farmers have to be given knowledge of such facilities.

3. Arrangement of Agricultural Inputs-The farmers have to be provided with standardized seeds, chemical fertilisers, advanced agricultural machines, insecticides etc. at appropriate rates by government. This will reduce their cost of production and will get benefited in agriculture.

4. Improvement in Agriculture Marketing-The present condition of agriculture marketing is polluted and thus the farmer does not get full payment of his production. A farmer can get the benefit of agriculture development and modernization only when he gets full payment of his production. Reforming of the agriculture marketing requires establishment of controlled mandies, warehousings and developing transport facilities.

5. Increase in Non-agricultural Employment-It is also necessary to establish non agricultural employment like small scale and cottage industries, handicraft industries. This will increase employment opportunities and decrease the dependence of population on agriculture.

6. Establishment of Warehousings-As a result of lack of safe and large ware housing, a large proportion of crop is destroyed by insects and rodents. So, the government should establish sufficient and safe ware houses.

(B) For Industrial Development

1. Establishment of Basic Industries-A large number of industries have been set up in public sector but still there is need of efficient administration and maximum utilisation. To support industrial development basic and capital intensive industries have to be established. The basic industries include iron and steel, heavy chemicals, electricity, machine manufacturing and engineering industries.

2. Arrangement of Social-overhead Capital -The facilities of harbors, transport and communication and power production plays a very important role in industrial development. Thus, the government should invest more and more on these so that industrial development can be raised. Now, the government is concentrating more on infrastructure development.

3. Modernization - Many industries working in India like cotton fabric, iron and steel etc. are utilising very old machines whose production capacity is very less. These industries require modernization and for this huge capital is required. This problem can be solved by providing loans for modernisation by financial institutions and assistance of weak units by government.

4. Check on Industrial Sickness - A large number of industries in India are uneconomic and less productive due to lack of finance, inefficient management, burden of loans and lack of power and necessary inputs. These problems can be nullified by modernisation and providing finance to these non economic institutions.

5. Full Utilisation of Installed Capacity-Many industrial units cannot fully utilise their installed capacity, as a result of which cost of production can not be lowered. The main obstacles in full utilisation of installed capacity are lack of raw material, electricity supply, transport facilities and strikes etc. Problem of insufficient and discontinuous electricity supply can be removed by developing, alternative sources of power.

(C) Other Suggestions

1. Increase in Saving and Investment-For the economic development of country, stress has to be laid on generating internal financial resources. So, taxation system, structure of financial institutions and working of investment institutions have to be improved. Proper arrangement should be made for increasing domestic savings.

2. Increase in Employment Opportunities- Government has to increase employment opportunities so that people get employment, the living standard will increase which will further increase demand of production and capital formation.

3. Efficient Operation of Public Undertaking- Public sector undertakings, are bearing heavy losses due to mismanagement. They are unable to utilise their full installed capacity resulting in increasing cost of production. Therefore, skilled, trained and professional management should be appointed so that they can fully utilise their installed capacity and able to make cost efficiency.

4. Social Awareness- In India, economic disparities prevails in society. The common man of the country is neutral towards the economic development of country. A country can develop only by public awareness and social reforms.

5. Administration Reforms- India is lacking fair and efficient administration. Government cannot implement progressive economic policies without honest and efficient administration.

6. Public Cooperation - Public co-operation is the main instrument of economic development. The success of economic planning is totally dependent on public cooperation. Therefore, each and every person of the country should cooperate in the economic development of country. All the above suggestions may be helpful in the rapid economic development of our country.

5.5 Indian Economic System

Even before independence, India had a fairly important public sector, the most important component of which was the railway system. Nationalisation of Banks, setting up a number of enterprises in the public sector and such other measures may create and illusion that the economy has towards socialism but in fact socio-economic relations have not undergone any such change as to warrant the corclusion that the Indian Economy has drifted away from its capitalist form. The two facts in Indian Economy viz the growth of public sector and economic planning make it obstinctly defferent from the capitalist economies of the west in the earlier phase of their development. In essence, however, state capitalism is the same thing as the mixed economy.The Indian economy is a mixed economy. It acquired this form with the adoption of economic planning and growth of a large public sector since Independence. The main features of India's economy that determine its character as a mixed economy are as follows :

1. Private Ownership of the Means of Production - Under Indian Constitution private ownership of the means of production has been allowed. It is this reason why the private sector in this country remains pervasive. The share of the public sector in the total national output is less than 25 per cent.

2. Predominance of the Market- Market holds a predominant position in the Indian economy. At present this country has markets for commodities as well as productive factors. In these markets prices are determined by the interplay of demand and supply forces. Business firms guided by the product prices usually decide as to what commodities they will produce. Even the choice of inputs depends on their prices. However, the market mechanism in India has not been completely free from the State control. Apart from the licensing system, the government also introduced certain other controls and incentive measures for influencing the decisions in the markets. Among these, most, notable were import controls, distribution of essential goods at fair price shops and government purchase of agricultural products at support prices.

3. Growth of Private Sector Monopolies - Since Independence, monopoly houses have grown rapidly and with it the concentration of economic power in the country has increased. Monopoly trends appear to have become stronger and the grip of big business on the economy seems to have increased, in spite of the government measures to control them.

4. Public Sector - In India, a large public sector co-exists with the private sector and this fact alone is enough to determine the character of the economy as mixed. The creation of a large public sector by the government in this country has not been inspired by any ideological considerations. At the time of Independence the private enterprise lacking both resources and will to make heavy investments had expected from the government to develop infrastructure and basic capital goods industries.

5. Economic Planning - Economic planning has been an integral part of the Indian economy since 1951. Economic planning in India has always been different from the one adopted in former Soviet Union and other East European countries. This country adopted planning while retaining its capitalistic structure, whereas former Soviet Union and other East European countries had transformed their economies into socialist economies and the planning was an important instrument in this exercise.

The Indian experience shows that the mixed economy framework is a feasible proposition for a developing country as it allows for a modest rate of growth.

5.6 India : A Developing Economy

The Indian economy is still underdeveloped but this is not an adequate description of the nature of the Indian economy. With the beginning of economic planning, an era of economic development was ushered in the nation as per following description:

National Income Trends -

The rate of economic growth, however, remained low in the first three decades of economic planning. During this period, the net national product (NNP) increased at a modest rate of 3.4 per cent per annum. Increase in per capita income in this period was as low as 1.2 per cent per annum. The situation drastically changed in the 1980s. The trend rate of growth suddenly picked up and for ten years the NNP increased at the rate of 5.6 percent per annum.

The new economic policy which was adopted in 1991, temporarily put the Indian economy on a high growth path. During the Eighth Plan period the rate of increase in the NNP was 6.7 per cent per annum. The per capita income also registered an impressive growth rate in this period as it was as high as 4.5 per cent per annum.

However, the rate of increase of national income improved considerably over the Tenth Plan period (2002-03 to 2006-07) and stood at 7.8 per cent per annum. The rate of growth of NNP in 2007-08 (which was the first year of the Eleventh Plan) was as high as 9.1 per cent but fell considerably to 6.7 per cent in 2008-09 due to economic slowdown in the economy following by global recession in the world.

Significant Changes in Sectoral Distribution of Domestic Product -

The importance of agriculture and allied activities in the Indian economy has declined since Independence. In 2010-11 the share of agriculture and allied activities in the gross domestic product (GDP) is 18.1 per cent as against 55.1 per cent in 1950-51 and 31.4 per cent in 1990-91. The share of the output in the industrial sector (comprising mining and quarrying, manufacturing, electricity, gas and water supply) which was 10.6 per cent of GDP in 1950-51 rose to 19.8 per cent of GDP in 1990-91 and stood at 18.5 per cent of GDP in 2007-08. Service sector is not a homogeneous category. It includes construction, trade and transport, finance, insurance, and community and personal services. The share of this sector in GDP was 34.3 per cent in 1950-51. This rose to 48.8 per cent of GDP in 1990-91 and further to 64.5 per cent of GDP in 2008-09.

In India, where primary sector accounted for 57.3 per cent of the workforce in 2001 as against 72.7 percent in 1951, whereas in 2011 it is 52 percent. The occupational distribution of workforce had not changed significantly during the 60 years period from 1951 to 2011.

These facts clearly indicates significant changes in the structure of the economy. The Indian economy is no longer a subsistence agrarian economy. Now its structure provides beyond any doubt a far more congenial environment for business activities as compared to about two decades ago.

Growth of Basic Capital Goods Industries -

Since Independence, pattern of industrialisation has been determined by the policies of the State. Under the Second Plan, a high priority was accorded to capital goods industries, as their development was considered a prerequisite to overall growth of the economy. This strategy of development was at the heart of India's economic planning for about two and a half decades-beginning from 1956. Consequently, a large number of basic industries which produce capital equipment and useful raw materials have been set up making the country's industrial structure pretty strong. These industries now account for more than fifty per cent of the industrial production.

Development of Infrastructure -

Infrastructure includes transport facilities, energy production, and telecommunication system.In India, though presently infrastructure is a major constraint on business growth, at the same time the fact remains that over the years it has registered an impressive growth. The railways' route length increased by more than 9,000 kms and the operation fleet has practically doubled.

The Indian road network is now one of the largest in the world as a result of spectacular development of roads under various plans. The total road length comprising National highways, State highways and other roads is 32.2 lakh kms. Progress of shipping and civil aviation has been equally impressive.The installed generating capacity in the country which was only, 2,300 MW in 1950 rose to 33,400 MW in 1980-81 and to 1,47,965 MW as at end-March 2009.

After the announcement of new telecom policy in India, there has been a spectacular progress in telecom in India. With more than 300 million connections in March 2008, the Indian telecommunication network is now third largest in the world and the second largest among the emerging economies of Asia. Nevertheless India with tele-density of 23.9 in December 2007 lags far behind China and Brazil where tele-density is more than 40. However, in near future Indian telecom is well set for high growth.

Progress in the Banking and Financial Sector -

Since Independence significant progressive changes have taken place in the banking and financial structure of India. In this period, organisation of money and capital markets has improved, specialised industrial financing institutions were set up, banking services have increased and modern banks have reached small towns and villages. The growth of commercial banks and cooperative credit societies has been really spectacular.

Since nationalisation, the banks radically changed their credit policy, and as a result more funds were made available to priority sectors such as agriculture, small-scale industries, transportation etc. However, the directed credit and directed investment programmes together with mounting expenditures eroded the profitability of the banks. The government thus introduced comprehensive financial sector reforms. For banks, new income recognition and provisioning norms and accounting procedures and formats have been laid down. Regarding capital market, the policy of liberalisation is being pursued without abandoning all regulations. Since regulation along with liberalisation helps in capital market development, the government set up a regulatory body, the Securities and Exchange Board of India (SEBI) in 1988. The SEBI was given statutory powers in 1992. In brief, the financial markets and institutions are now more viable and efficient and can thus serve business better.

5.7 Measurement of Economic Growth

Economic growth may be defined as an increase in aggregate output of real goods and services during a given period of time, generally a year. But aggregation of output in terms of physical units is not possible when different units of measurement are adopted. Therefore, it is measured in a common unit of measurement, that is, money; but the value of money changes with price level changes. The real output of a given period can be calculated by neutralising the effect of price changes. Thus the initial estimate of aggregate output prepared at current prices for a given period is adjusted for price level changes during the period, which indicates the real output in terms of the prices of the base year.

The method of adjusting the total output for a given period in terms of prices of the base year is as follows:

$$\text{Aggregate Product at constant prices} = \frac{\text{Aggregate product at current prices}}{\text{Price index of the current period}} \times 100$$

To illustrate the point, the national product at factor cost at current prices was Rs. 14,26,670 crores in 1997-98 which when adjusted for price level changes was equal to Rs. 10,49,191 crores at 1993-94 prices. Now, when NNP at current prices is estimated at Rs. 12,85,259 crores for the year 1996-97, the growth rate comes to 11 %. But this does not reflect the growth in real output because such growth could be calculated only when NNP is considered at constant prices. Thus taking the NNP at constant prices of 1993-94 equal to Rs. 998,978 crores, it comes to around 5.02% only. It is the latter rate of growth which is correct estimate of rate of growth.

5.8 Growth V/S Development

To be more specific, economic growth means more output in quantitative terms (say higher gross national product) while economic development implies both more output and qualitative changes in technical, structural and institutional arrangements by which higher output is made possible and distributed.

The difference between the two can be summarised in the following points:

1. Economic Concept : Economic growth is a narrow concept. It focuses just on the rise in real per capita income or increased flow of goods and services in the economy. On the other hand, economic development is a broader concept which includes economic welfare along with increase in real per capita income.

2. Quantitative Concept : Economic growth is a quantitative concept. It is concerned with rate of production or rate of increase in national income. On the other hand, economic development is both a quantitative and qualitative concept. It is concerned with quality of life along with increase in per capita production.

3. Distribution of Income: Distribution of income is ignored in the case of economic growth. A country is said to have registered economic growth if national income increases. But as a result of increase in income, number of poor people may increase if the distribution of income becomes unequal. This fact is ignored while assessing the overall growth of the economy. In the case of economic development, distribution of income is kept in view while assessing a country's development. Inequality of income-distribution must be reduced if the country has to economically develop in real sense.

4. Outlook: Growth occurs without change in outlook of the people towards quality of life. On the other hand, development is associated with change in outlook of the people. People start appreciating the concept of quality of life and make efforts for improving the quality and standard of their life.

5. Structural Changes: Economic growth may occur independent of any structural, institutional or technical changes in the economy whereas economic development is invariably associated with some structural, institutional or technical changes in the economy.

6. Increase in Productivity. Economic growth may not be associated with increase in productivity (output per hectare of land or output per worker). On the other hand, economic development is essentially associated with increase in productivity so that greater output is realized per unit of input.

5.9 Indicators of Economic Growth

Indicators of economic growth have been discussed below:

1. National Income - In term of this indicator growth is said to take place if Gross National Income (GNP) of an economy increase over a long period of time. This index is considered useful as it highlights the gross performance of an economy and a rise in it indicates larger opportunities for future growth. This measure, though apparently sound, is not wholly scientific and exposes itself to criticism. It is evident that in a country where the population grows at a faster rate than the rate of increase in GNP, product per capita will decline. In such a case, this index will not give a true picture of the actual growth of a nation.

2. Per Capita Income- In terms of this indicator, growth is said to take place if growth rate in real national income exceeds growth rate in population. While per capita income as an index of growth is useful, there are some criticisms too which are leveled against it. The main criticism is that it ignores distribution which has an important bearing on the welfare of the people. The increase in income-inequalities, alongside a rise in the per capita income of a number of developing countries in recent years, has led to the questioning of the use of income-index of growth.

3. Social Welfare: Some economists have suggested social welfare as a true measure of economic growth. Social welfare can be expressed in terms of calorie intake, consumption of energy, expenditure on health and education etc.Some economists have adopted Economic Performance Index (EPI) as the measure of economic growth. Economic growth should not only consider the material attainments of an economy in terms of real aggregate output but it should consider the rate of inflation and unemployment. It will not promote social welfare or improve the standard of living of the people. Therefore, they argue that measure of growth of the economy should be chosen to be such which reflects not only its economic performance but also performance in the social fields.

5.10 Determinants of Economic Development

The process of economic development is a highly complex phenomenon and is influenced by numerous and varied factors such as political, social and cultural factors.

(A) Economic Factors -

The four most important factors determining the rate of economic development are:

(a) The Rate of Capital Formation: Capital formation is the very important for economic development. No economic development is possible without irrigation works, the production of agricultural tools, land reclamation, building of dams, bridges and factories with machines installed in them, roads, railways, and airports, ships and harbors are neccessary.

(b) Technological Progress: Technical progress i.e. turning out a better product at the same cost or the same product at lower cost, or both together, contribute to economic development. New knowledge of production methods gets embodies in new machines and new equipment capable of producing more goods or new goods. This results in growth of national output.

(c) Capital-output Ratio: The capital-output ratio determines the rate at which output grows as a result of a given volume of capital investment. A lower capital-output ratio tends to lead to a comparatively higher rate of growth of output as a result of a given volume of capital investment.

(d) Rate of Population Growth: For significant improvement in living standards, the rate of capital formation and the consequent rate of growth of output must be seen in relation to the rate of population growth. It may be that the population may be increasing so fast as to offset even a quick rate of capital formation and the resultant increase in output. It is therefore, necessary to ensure that the rate of capital formation is high enough to yield a high per capita output.

(B) Non-economic Factors -

Apart from economic factors the various non-economic factors are also important. These are as follows:

(a) Political Factors include political sovereignty of the country, the complexion of its government. A good government can for instance, frame suitable policies, prepare right kinds of plans, create opportunities for growth etc. It can help growth by promoting institution to mobilise finances and channel investments in the desired directions.

(b) Social and Cultural Factors are also important and are very extensive in scope. Each society has certain institutions which have a strong bearing on economic development. In India, for example, the institutions of caste, joint families, non materialistic attitude of the people have been some of the serious impediments of economic development.

5.11 Macro Economic Scenario of India

1. Fluctuations in Economic Growth -

GDP rose at the rate 6.5 per cent per annum over the Eighth Plan Period (1992-97). However, this rate of growth fell to only 5.5 per cent per annum during the Ninth Plan (1997-2002). This slipped to 3.8 per cent in 2002-03 largely cause of setback to the agricultural sector. In fact, the agricultural sector had grown at an annual rate of 3.5 per cent during the early 1990s. This naturally supported industrial growth. However, since 1995-96 agricultural growth has been both slow and erratic. It was a mere 0.2 per cent in 1995-96 and shockingly negative in 1997-98. 2000-2001 and 2002-03. In terms of composition, despite good monsoons, the average growth of agricultural production for the 1990s (1992-2001) was 2.5 per cent compared to 3.5 per cent in the 1980s (1981-90). A mere 1.2 per cent per annum increase in foodgrains output during 1990s led to an annual increase of 5.0 per cent in foodgrains prices since 1995-96.

However, economic growth picked up during the Tenth Plan period (2002-07) and the rate of increase in national income in this plan was as high as 7.8 per cent per annum. The rate of growth of GDP rose further to 9.0 per cent in 2007-08. This created a conducive business environment and there was an all round optimism. However, following global recession, these was a marked slowdown in the economy during the year 2008-09.

2. Erratic Industrial Growth -

Since 1996-97 industrial growth in this country has been erratic. The rate of industrial growth had collapsed to 5.6 per cent in 1996-97 from 12.2 per cent in 1995-96. It was 6.7 per cent in 1999-2000 but registered a further decline to 5.0 per cent in 2000-01 and to 2.7 per cent in 2001-02. There was some recovery in 2002-03. However, industrial growth remained modest at 5.8 per cent. In 2002-03, the industrial production increased by 7.0 per cent. During Ninth Plan as a whole, the rate of growth of industrial production averaged just 5.0 per cent. This rose considerably to 8.2 per cent per annum in the Tenth Plan (which was nevertheless less than the target of 10 per cent per annum). The year 2007- 08 recorded 8.5 per cent growth in industrial production. However, this growth slipped to just 2.7 per cent in 2008-09.

3. Savings and Investment Growth in Recent Years -

The gross domestic savings rate failed to increase during the 1990s. It was 22.8 per cent in 1990-91. Thereafter for three years it continued to decline and in 1993-94 was at a level reached in 1978-79. The recovery started in 1994-95 and for two years the gross domestic savings rate fluctuated around 25.0 per cent. Thereafter it declined again and was 23.5 percent in 2001-02. However, since 2002-03 it registered a spectacular increase. According to CSO's estimates, the gross domestic savings rate was as high as 29.8 per cent in 2003-04 and this rose further to 37.7 per cent in 2007-08.

4. Prices and Inflation -

During 2005-06, the average annual rat of inflation (based on WPI) was 4.4 per cent while it was 5.5 per cent in 2006-07. Towards the last quarter of 2007-08 inflationary pressures started building up and the inflation rate rose to 8.02 per cent in March 2008. The inflation rate touched the high level of 12.6 per cent on August 9, 2008. However, during the last quarter of the financial year 2008 09, the inflation rate started coming down due to declining commodity prices and crude oil prices.

5. Fiscal Imbalance -

Fiscal imbalance has persisted over the years in the form of large government deficits.The gross fiscal deficit refers to the difference between the revenue receipts (net) plus non-debt capital receipts and the total expenditure including loans net of repayments.Gross fiscal deficit of the Central government was 7.8 per cent of GDP in 1990-9l. gross fiscal deficit was brought down to 4.5 Per cent of GDP in 2003-04. The government adopted the FRBM Act in2004 committing itself to fiscal discipline and brought down the gross fiscal deficit to 3.5 per cent of GDP in 2006-07 and to 1.1 percent of GDP in 2007-08. However, the gross fiscal deficit rose to as high as 6.2 per cent of GDP in 2008-09 as government introduced massive expenditure programmes to tackle the problem of economic slowdown.

6. Capital Market Developments

Capital market plays a crucial role in fund raising by the corporate sector. In 2001-02, the Indian private sector companies raised Rs. 5,692 crore through capital issues. This amount rose to Rs. 21,154 crore in 2005-06, Rs. 30,603 -re in 2006-07 and further to Rs. 63,638 crore in 2007-08.

7. External Sector

These are two important issues to be analysed in the external sector :

(i) External Trade Position. India's external trade position looked satisfactory in the first half of the 1990s.

Exports have shown considerable growth during the Tenth Plan period. From $ 52,719 million in 2002-03 the first year oTthe Tenth Plan) exports rose to $ 1,26,414 million in 2006-07 (the last year of the Tenth Plan). The average rate of growth of exports during this Plan has been 24 per cent as against the target of 12.38 per cent. Exports increased further to $ 1,68,704 million in 2008-09. Both external and domestic factors have contributed to this satisfactory performance.

(ii) Foreign Capital Flows-

Prior to the 1990s the government relied completely on foreign borrowing to bridge investment- savings gap. Foreign direct investment (FDI) which was virtually non-existent until 1990-91, rose during the post-reform period at a considerable pace. This would be clear from the fact that FDI which was merely $ 129 million in 1991-92 rose to $ 22,826 million in 2006-07 and further to the high figure of $ 34,362 million in 2007-08.

In addition to FDI, considerable portfolio investment has also taken place during the post-reform period. From just $ 4 million in 1991-92, portfolio investment rose to $ 7,003 million in 2006-07 and further to $ 27,271 million in 2007-08. The main reason for rising portfolio investment has been the sharp increase in FII (foreign institutional investment) which was negligible in 1991-92 but picked up to $ 9,926 million in 2005-06 and further to $ 20,328 million in 2007-08.

5.12 Summary

In this unit the concepts, problems and issnes pertaining to Indian economy were highlighted. State of Indian Economy after the post Independence development is discunel. Various trends of Indian economy such as population, agricultural growth, development of Industrial sector, Infrastruotural development, capital market, banking and financial institutions, international trade are discussed at length. Towards the end various socio economic problems infront of nation,macro economic scanario of India are highlighted.

5.13 Key Words

- **Economic System-** Economic system is an organized way in which a state or nation allocates its resources and apportions goods and services in the national community.
- **Per Capita Income-** Per Capita Income is the total national income (GDP) divided by total population. It is not the average income (because it includes children and non-working population) but serves as an indicator of a country's living standards.
- **Inflation-** Inflation is a rise in the general level of prices of goods and services in an economy over a period of time.

- **National Income-** National Income is the total net value of all goods and services produced within a nation over a specified period of time, representing the sum of wages, profits, rents, interest, and pension payments to residents of the nation.
- **Infrastructure-** Infrastructure is the basic physical and organizational structures and facilities (e.g., buildings, roads, and power supplies) needed for the operation of a society or enterprise
- **Industrial sickness -** Industrial sickness is defined as 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 net worth and has also suffered cash losses in such financial year and the financial year immediately preceding such financial year.
- **Capital Good-** Capital good is a manufactured means of production. Capital goods are acquired by a society by saving wealth which can be invested in the means of production.

5.14 Self Assessment Test

1 Describe the basic features of Indian Economy.

2 Explain the obstacles in the economic development of India.

3 "Poverty exists within prosperity in Indian Economy." Prove this statement.

4 Give suitable suggestion for the economic development of India.

5 Explain the concept of economic growth and economic development

6 Explain in detail the indicators of economic development.

5.15 References

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Unit - 6 : Economic Reforms

Unit Structure:

6.0 Objectives

The objectives of this unit are to:

- Describe different economic reforms.
- Show how primary economic inrdicators influence business.
- Show how the economic environment is analysed and evalnated.

6.1 Introduction

After pursuing an inward-looking development strategy with the state assuming an important role for more than four decades, India decided to take a historic step of changing tracks in 1991. It embarked on a comprehensive reform of the economy to widen and deepen its integration with the world economy as a part of structural adjustment. After a period of relatively robust economic performance in the late 1980's, the Indian economy entered into a period of unprecedented liquidity crisis during 1990-91. This crisis was a combined effect of number of events coinciding with Collapse of the Soviet Union (India's major trading partner); Gulf War 1991, which worsened the BOP crisis with rising oil prices, and by causing a virtual stoppage of remittances from Indian workers in the Gulf; and Political uncertainty that led international credit rating agencies to lower India's rating for short and long term borrowings. These events together brought the country to the verge of default with respect to external payments liability which could be averted by resorting to borrowings from the IMF and by mortgaging gold to the Bank of England.

The economic crisis was precipitated mainly by the growth of public spending through 1980s which increased the budget deficit as a proportion of India GNP, although external shocks played a contributory role.The public debt-to-GNP ratio increased through the 1980s, going up to 60% at the end of the decade, implying a doubling of the ratio at the end of the previous decade.

As is now well-understood, India faced an economic crisis that required immediate attention. But, as in many South American countries in the 1980s, the economic crisis became an occasion for undertaking substantial economic reforms that had been long overdue. In fact, these reforms were necessary because we had evidently failed to generate adequate rates of growth of income and of per capita income.

In order to avoid the economic crisis, the Govt. of India took-up the task of redesigning its economic policy from July 1991 onwards by initiating certain preliminary steps, viz;

1. Controls have been way to liberalization,
2. Private sector has been given better environment of development in place of public sector,
3. Private foreign investment has been encouraged,
4. Introduction of improved technology of production,
5. Encouragement of Modernization in the field of agriculture.
6. Monetary policy, Trade policy and Fiscal policy to be suitably amended, and
7. Fiscal deficit to be curtailed.

Thus, economic reform implies various policy measures and changes undertaken after July 1991 with the objective of creating competitive environment in the economy so as to increase its overall productivity and efficiency.

6.2 Economic Reforms

By the time the crisis of 1991 occurred, there was considerable support among key figures in and out of Govt. for the view that a thorough going reform was necessary to pull the economy out of the morass it has gotten into. The reform package outlined by Dr. Manmohan Singh in 1991, had following distinct components:

1. **Liberalization-** To increase competitive pressures, leaving enterprises free to make their production and investment decisions in the light of market conditions and enlarging the scope and freedom for private enterprise.
2. **Privatization-** Private Sector entrepreneurs have been invited for the ownership and management of public enterprises. With the reform measures and the expansion of privatization, there is every possibility of increase productivity and efficiency.
3. **Globalization-** Integration with the global economy by removing controls on foreign trade and exchange rates, lowering tariffs and rationalizing the structure and substantially relaxing regulations regarding external capital flows and a proactive policy attracting foreign direct investment.
4. **Others-** a) Modernization

    b) Fiscal Reform

    c) Financial Reform

6.3 Liberalization and Indian Economy

Liberalization means to removal of controls so that economic development is encouraged. It envisages abolition of those economic policies, rules, regulations, administrative controls and procedures which impede economic development.

Rationale of Liberalization:-

The following arguments have been put forward for adopting the policy of liberalization in Indian economy:

1. Rapid industrial development.

2. Optimum utilization of resources.
3. Competitive and favorable industrial environment.
4. Encouragement of foreign investment.
5. Generation of Employment opportunities.
6. Economic globalization.
7. Improvement in standard of living.
8. Availability of cheap and superior goods.

Objectives of Liberalization:-

Before studying the impact of liberalization on various sectors of economy and its appraisal, it would be desirable to state the goals of process of economic development, the policy of liberalization and reforms while accelerating economic development should lead to the following ends:

1. Higher growth rate.
2. Generation of employment opportunities leading to full employment.
3. Reduction of population living below poverty line.
4. Reduction of regional disparities between rich and poor states of India.
5. Promotion of equity leading to a better deal for poor and less well-off sections of our society.

Advantages:-

The processes of liberalization and economic reforms have been appreciated in the country. Some of the advantages being advocated by the supporters are given as under of the liberalisation:

1. Increase in foreign exchange reserves.
2. Increase in foreign private investments.
3. Decrease in debt burdens.
4. Increase in annual growth rate.
5. Control of inflation.
6. Increase in production.

Criticism:-

The policy of liberalization has been proved favorable to India's trade development. However there are certain demerits/drawbacks of these measures as discussed below:

1. Declining tax receipts.
2. Mass unemployment
3. Dominance of MNC's
4. External interference.

5. Unfair competition.

6. Adverse impact on indigenous sector.

Recent Trends towards Liberalization:-

With the introduction of liberalization, following trends are visible in the Indian economy:

1. **Abolition of inspector Raj:** Before July 1991 the industrial sector was under the strict control and regulation through the system of licensing and inspector Raj. The new industrial policy of July 1991 abolished all industrial licenses except for 15 industries of strategic importance.
2. **Downsizing of public sector enterprises:** Industrial policy resolution of 1956 had laid emphasis on basic and heavy industries and given the top priority to public sector enterprises. In July 1991 the new industrial policy reduced the number of public holding to eight and then further to six.
3. **Abolition of MRTP asset limit:** Prior to the economic reforms, the asset limit of a monopoly house was Rs. 100 Crores. This limit has been completely abolished. The provisions of MRTP Act have also been liberalized.
4. **Hike in foreign equity participation:** In India earlier the foreign equity participation was allowed up to 40%. It was raised to 51% from 1991. It had led to the transfer of ownership from Indian hands to foreign hands.
5. **Devaluation of Indian rupee:** Indian rupee was devalued by 18% in 2 phases in July 1991. The devaluation aims at promoting exports and reduction in imports and was only measure available with the government to initiate liberalization process or the package of reforms for restructuring the economy.
6. **Reference of sick units to BIFR:** The sick industrial company act of 1985 was amended in Dec. 1991 to enable sick public enterprises to be referred to the Board for industrial Finance and Reconstruction [BIFR].
7. **Trade policy reforms:** The recent policy changes in external sector are in favor of export promotion. Now exports are based on the new policy has limited the imports to the level of availability of foreign exchange through exports. EPZ's have been widened.
8. **Fiscal reforms:** Cheeliah committee on tax reforms recommended simplification and rationalization of tax structure and these reforms had been introduced in 1991. It has reduced the tax brackets, moderating tax rates and widening tax base to some extent leading to check on tax evasion and tax avoidance. The scope of MOD VAT has been extended.
9. **Monetary reforms:** On the recommendation of Narsimham committee on financial sector reforms, the SLR has been reduced to 25% and incremental cash reserve ratio has been withdrawn. CRR has been reduced from 14% to 11.5% and then to 8.25% at present. SBI act has been amended and public sector commercial banks have been allowed to approach capital market for equity.

6.4 Privatization and Indian Economy

A strong reversal of the trend of the statist economic expansion set in, globally, since around the 1980 and has become the hallmark of the new wave of economic reforms that has been sweeping across the world. Privatization means transfer of ownership and/or management of an enterprise from the public sector to the private sector. It also means the withdrawal of the state from an industry or sector, partially or fully. Another dimension of privatization is opening up of an industry that has been reserved for the public sector to the private sector. Privatization marks a change from dogmatism to pragmatism and amount to a reversal of policy.

Causes of Privatization:-

Prof.Samuel Paul has rightly pointed out that in country after country; unbridled state expansion has led to:

(1) Economic inefficiency in the production activities of the public sector.

(2) Ineffectiveness in the provision of goods & services.

(3) Rapid expansion of bureaucracy.

There are major problems faced by the public sector enterprises as given under:

(1)Freedom for decision-making by the managing directors was extremely limited.

(2)Pricing policies are not guided by rational economic considerations.

(3)Absence of hard economic decisions.

(4)Procedure-oriented rather than outcome-oriented.

Techniques of Privatization:-

There are different ways of achieving privatization ways or techniques of privatization are discussed as given below:

(1)Public offering of shares: - Under this measure wholly or partially the shares of the public limited companies are offered for sale to the public. Shares can be offered in domestic as well as international market.

(2)Private sale of shares: - Here, all or part of the shares of a state owned enterprise are sold to private individual or a group of purchasers.

(3)New private investment in a state owned enterprise: -Under this category, primary shares issues are subscribed by the private sector.

(4)Sale of the government enterprises: - The assets of the public sector are sold as private sale instead of shares. Such sale of government enterprises may be of two types viz:

(a)Sell part of its excess assets as extra. and (b)Sell entire assets to recover the investment to the extent feasible.

(5)Reorganization of an enterprise into small units: -

A holding company with number of subsidiaries can be privatized separately.

(6)Management employees buy out: -The management or employees acquire the controlling interest in the unit in which shares are purchased on credits extended by the government or financial institutions.

(7)Lease management contracts: -Here ownership remains with the government while the lease assumes full responsibility for operations and maintenance.

Conditions for success of Privatization:-

Prof.Samuel Paul has pointed out that if privatization is to succeed, in the sense of raising efficiency or effectiveness in the production or delivery of goods & services the following conditions are essential:

- Political leadership is committed.
- No style competition among suppliers.
- Freedom or entry to provide goods & services.
- Public services provided by private sector must be specific & must have measurable outcome.
- Consumers should be able to link the benefits they receive from a service to the costs they pay.
- Privately provided services should be less susceptible to fraud.
- Equity is an important consideration in the delivery of public services.

Benefits of Privatization:-

Privatization is an important strategy of economic rejuvenation of even the "communist" nations is a testimony to the economic role of Privatization.

- Reduces fiscal burden of the government.
- Enables the government to mop up funds.
- Helps the government to have neat & tidy the size of administration machinery.
- Helps the government to concern more or essential state functions.
- Helps to accelerate the pace of economic development.
- Helps in better management of the enterprises.
- Encourages entrepreneurship in the country.
- Transparency in the working of the enterprises.

Privatization in India:-

The wave of privatisation that swept the world was found to have its effect on Indian economy. The economic reform erstwhile Soviet Unoin and East European countries are not of much relevance to India on account of two reasons:

- There was **absence of the market mechanism** in these countries and the entire pricing system was based on cost plus pricing.
- The size of the **public sector covered the whole of the economies** in these countries and now it has been replaced by a new economic order.

Although there is a strong case in favors of privatization in India. In reality it is becoming verydifficult to push through proposals of privatization on account of the following reasons:

- Strong opposition from the trade unions.
- Political parties are also not in favor of privatization.
- The transfer of the part of the shares to Public financial Institutions does not represent true privatization.
- Both the Central and State Govt. do not have a clear view, strong determination, political will and a perspective view.

  The New Industrial Policy 1991 has proposed privatization of public enterprises by selling shares to mutual funds, workers and the public. The Govt. of India has been reviewing the existing portfolio of public investment with the view to off-loading public investment from areas where the following conditions are in existence:

- Industries based on low technology,
- Small scale and non-strategic areas,
- Inefficient and unproductive areas,
- Areas with low or zero social responsibility or public purpose, and
- Areas where private sector had developed sufficient expertise and resources.

Effectiveness of Privatization:-

Privatization in India will lead to foreign investment including investment from NRIs. The following effective measures are suggested for Privatization in India:

- Clear-cut and transparent policy provisions
- An administrative independent body
- A comprehensive strategy for privatization for different categories of public enterprises.
- Identification of potential condition
- Introduction of structural changes.

6.5 Globalization and Indian Economy

Globalization may be defined as "the growing economic interdependence of countries world-wide through increasing volume and variety of cross-border transactions in goods and services and of international capital flows and also through the more rapid and widespread diffusion of technology. Globalization is advancing and is unstoppable so that the challenge is now to live with it and take advantages of the opportunities.

Globalization is not a new phenomenon. The period of 1870 to 1913 experienced a growing trend toward Globalization. The new phase of Globalization which started around the mid 20th century became very widespread, more pronounced and over changing since the late 1980s by gathering more momentum from the political and economical changes that swept across the communist countries, the economic reforms in other countries, the latest multi-lateral trade agreement which seeks to substantially liberalize international trade and investment and the technological and communication revolutions. The **Human Development Report** mentions the following features of the Globalization:-

- New Markets,
- New Rules and Norms,
- New Actors,
- New Tools of Communication, and
- New Technologies.

India's economic integration with the rest of the world was very limited because of the restricted economic policies followed until 1991. With the New Economic Policy ushered in 1991, Globalization become a buzz word with Indian firms.

Provisions in New Economic Policy:-

1. Foreign Investment Equity- The equity has been raised from 40% to 51%.
2. Devaluation of Rupee- Rupee was devalued by 20% with a view to stimulate exports, discourage imports and accelerate the influx f foreign capital.
3. Full Convertibility-It implies the conversion of all export earning into rupeeat the prevailing market rate by the exporters.
4. Customs and Tariffs-They have been modified to bring Indian economy within the ambit of international competition.

The intent of Globalization is efficiency improvement and market optimization taking advantage of the opportunities of the global environment. Therefore, in many cases, Indian companies have to globalize to survive and grow in the emerging competitive environment. If the Indian firms have the facility to obtain the latest technology in the world, to raise finance from the cheapest source and procure the materials from the best source in the world, they are on equal footing with the foreign firms in many respects. And if the Indian firms can muster some edge over the foreign firms in respect of labour cost, productivity, product quality/ features etc., that could be a competitive advantage.

6.6 Financial Sector Reforms in India

The Financial sector plays a major role in the mobilization and allocation of savings. Financial institutions, markets and instruments which constitute the financial sector act as a conduit for the transfer of financial resources from net savers to net borrowers, i.e., from those who spend less than they earn to those who earn less than they earn to those who earn less than they spend. The gains to the real sector, therefore depends on how efficiently the financial sector performs this function of intermediation.

Institutional Structure:-

At present, the institutional structure of the financial system is characterized by:

a. Banks, either owned by Govt., the RBI or the private sector and regulated by RBI;
b. Development Financial Institutions and Refinancing Institutions, set up by a separate statute or owned by the Govt., RBI, private or other development Financial institutions under the Companies Act and regulated by the RBI; and
c. Non- bank Financial Companies (NBFCs) owned privately and regulated by the RBI.

Provision of short-term credit is entrusted primarily to commercial and co-operative banks. Of late, commercial banks have diversified into several new areas of business such as merchant banking, mutual funds, leasing, venture capital, factoring and other financial services.

Medium-term and long-term finance is provided primarily by a few large all India development banks together with a spectrum of state level financial institution. While IDBI, NABARD, EXIM bank and NHB serve as apex agencies in their respective areas of concern, there are also other financial institution which specializes in areas like tourism and the small-scale industry. Besides these, there are investment institutions, which include the UTI, LIC and GIC. In recent years, a number of public sector mutual funds have been set up by banks and financial institutions.

The capital market has witnessed a remarkable growth in the paid-up capital of listed companies and market capitalization in the recent years. With a network of 23 stock exchanges and as many as 9413 listed companies in 2003 it has emerged as one of the important market in the developing world. The SEBI has been established to regulate the capital market.

Strategy of Development:-

The role of Central Banking and the Financial System in the process of economic development was recognized at an early stage. During the 1950 and 1960, the major concern was to create the necessary legislative framework to facilitate reorganization and consolidation of the banking system. The year 1969 was a major turning point in the Indian financial system when 14 large commercial banks were nationalized.

Between June 1969 and March 1991, the total number of commercial bank offices rose from 8,261 to as much as 60,570.The number of rural branches increased from 1833 to 35187 during the same period, accounting from58.4% of the total as compared with barely 22% in 1969. The role of indigenous bankers and money lenders has declined considerably over the years. Studies based on surveys indicate that the dependence of rural households for cash debit from non-institutional agencies has come down from 93% in 1950-51 to as low as 39%. Banking has acquired a broad based and has also emerged as an important instrument of socio-economic change. The other components of financial system such as term lending institutions has also recorded a similar quantitative and qualitative change.

The Indian financial system today has a wide network of institutions. The commercial banks have their presence in most remote parts of the country. The development of different segments of the financial is, however, uneven. The co-operative system is effective only in certain parts of the country. But new institutions have come on the scene. The capital market has also become more active, with both primary and secondary markets showing strong upward movement.

6.7 Summary

In this chapter features of Economic, Reforms and its destines component Liberalization, privatilization & Globalization have been discusses. Their rationalization, objectives, advantages critiasm & recent trends towards liberalization & Globalization, privatisation have been explained.Liberalisation refers to remove controls so that economic development encouraged. It envisages abolotion of those economic policies, rules regulations administrative coontrols and procedures which impede economic development.The term privatisation suggests a wide range to ideas. Privatisation implies the induction of private ownership in publicly owned Enterpreses. Privatisation also implies besides private ownership the induction of private managements and control in the public sector enterprises.

6.8 Key Words

- **Economic Reforms-** It has three distrinct
- **Component-** Liberalization, Privatization & Globalization.
- **Liberalization:** Liberlization referms to removal of Control so that economic development to encouraged.
- **Finical Sector Reforms-** Financial Institution, market & instrument act as a conduit for transfer of financial resources form net severs o net borrowers.

6.9 Self Assessment Test

1 How Economic Reform helps Indian economy?

2 Explain Liberalization with its advantages.

3 What are the Techniques of Privatization? Also explain privatization activityes in India.

4 How Globalization effect Indian Economy? Explain

5 Describe the provisions of New Economic Policy.

6 What do you mean by financial sector? And also define the role of financial sector in India?

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Unit - 7 : Industrial Policy

Unit Structure:

7.0 Objectives

After completing this unit, you will be able to:

- Define and understand the meaning of industrial policy.
- Explain the objectives of industrial policy.
- Explain all industrial policies upto 1991.
- Explain the new industrial policy of 1991.
- Assess the new industrial policy.

7.1 Introduction

Industrialization plays a vital and crucial role in the economic development of an underdeveloped nation. Industrialization accelerates economic growth in various ways, like it increases the capita per income, expands employment opportunities, builds a self-reliant and self-sustained economy and ensures growth with stability. Therefore, an industrial policy is required to guide, regulate and control industrial development of a country. The Industrial policy helps the country to make it self-sufficient and prosperous by preparing a structure and basis of industrial development. The industrial policy refers to such formal declaration by the government through which general policies for industries adopted by the government are made public. Any industrial policy may have two parts – first, the ideology of the government which determines the nature of industrialization and second, the governing rules and principles which provide a certain framework for industrial development.

7.2 Objectives of Industrial Policy

The objectives of an industrial policy can be explained through following points:

1) **Deployment of Natural Resources:** The industrial policy helps in identifying, collecting and using resources properly.

2) **Increase in Industrial Production:** Industrial policy provides an impetus to rapid development of industries in the country.

3) **Modernization:** The industrial policy envisages the use of modern and new production techniques in industrial sector.

4) **Balanced Industrial Development:** The industrial policy facilitates balanced development of various sectors of the economy.

5) **Balanced Regional Development:** The industrial policy may contain provisions regarding providing facilities or subsidies for development of industrially backward areas of the country.

6) **Coordination Between Basic and Consumer Industries:** The industrial policy envisages development of basic and key industries on the one side and attention is paid to the growth of consumer industries on the other. Thus by balanced and coordinated development of both type of it industries provides a pace of economic growth.

7) **Development of Small and Cottage Industries:** The industrial policy plays a vital role in establishment and development of small and cottage industries by providing various facilities.

8) **Area Determination:** The industrial policy determines the area of operation under public and private sectors.

10) **Direction for Foreign Investment:** An appropriate industrial policy envisages to attract foreign capital. It helps rapid industrial development of the country.

11) **Cordial Industrial Relations:** A comprehensive and well-defined industrial policy is needed to establish cordial relations in the industries.

After independence the Govt. of India spelt out its approach to the development of the industrial sector in the Industrial Policy Resolution 1948. This was followed by the Industrial Policy Resolution 1956. In between the government introduced the Industries (Development and Regulation) Act, 1951 to regulate and control the development of the private sector. In 1969, MRTP Act (Monopolies and Restrictive Trade Practices Act) was adopted to prevent concentration of economic power and control monopolies. Another legislation that had considerable implications for industrial policy (as far as the participation of foreign companies in industrial sector of India is considered) was the Foreign Exchange Regulation Act (FERA) adopted in 1973 Now modified as Foreign Exchange Management Act (FEMA)

The industrial policy and regulation had grown more and more restrictive until about the mid seventies. Having realized the regime, the government started liberalizing the industrial policy in 1970s and 1980s. The most drastic liberalization was carried out in 1991 when a new industrial policy was announced.

7.3 Industrial Policy upto 1991

Industrial Policy – 1948

After independence, the Govt. of India declared the first important Industrial Policy Resolution on 6th April 1948. The policy accepted the importance of both private and public sectors in the industrial economy of India. Under this policy, the industries were classified in four broad categories *viz.*

a. **Strategic Industries:** Three strategics industric were included in this category. The Central Govt. had monopoly in these industries. The industries included in this category were (i) Arms and Ammunitions; (ii) Atomic Energy and (iii) Rail Transport.

b. **Key Industries:** Six key industries were included in this category Viz, (i) Coal, (ii) Iron and steel, (iii) Aircraft manufacturing, (iv) Ship building, (v) Manufacture of Telephone, Telegraph and Wireless Apparatus, and (vi) Mineral Oil. It was decided that new industries in this category will now only be set-up by the Central Govt.

c. **Important Industries:** Twenty important industries constituted this category. There would be Govt. regulation and control over these industries. Private sector was allowed to run these industries. The industries included in this category were heavy chemicals, sugar, cotton, textile and woolen industries, cement, paper, salt, machine tools, fertilizers, rubber, air and sea transport, motor electricity, etc..

d. **The Field of Private Sector:** All other industries which were not included in the above mentioned three categories were left open for the private sector, but the government. could impose controls of these industries too.

The policy had endeavoured to protect cottage and small scale industries.The industrial policy 1948 had acknowledged the significance of foreign capital and industrialization of the country. The first industrial policy of the country was a basis of the mixed economy. Both private and public sectors were given adequate importance.

Industrial Policy – 1956

The Second Industrial Policy was declared on 30th April 1956. The policy laid down the following objectives:

(i) To accelerate the rate of growth and to speed up industrialization;

(ii) To develop heavy industries;

(iii) To expand public sector;

(iv) To reduce disparities in income and wealth;

(v) To build up a large and growing cooperative sector; and

(vi) To prevent monopolies and the concentration of wealth and income.

The industries were divided into the following three categories:

(a) Schedule A – Defence, public utilities, minerals, key transport and some other industries were included in this category. The total number of industries included in schedule A was 17. The responsibility of development of these industries was to be borne by the government.

(b) Schedule B – Twelve industries were included in this category. These industries had to be brought under the control of central and state governments in due course of time. New units would be set up only by the government.

(c) Schedule C – All the remaining industries constituted this category. These industries were left open for the private sector, but the government could enter into this category if need arose.

The 1956 policy emphasized the mutual dependence of public and private sectors. The only four industries in which private sector was not allowed to function were arms and ammunition, atomic energy, railways and air transport.

Industrial Policy -1971-75

After the end of the Indo-pak was (1971), the government, on the plea that there was an urgent need for increase in the output, unveiled an industrial policy with respect of 76 priority industries. Firms were empowered to increase their output 100 percent. as against 65% permitted earlier. Without taking out a fresh license. The licensing policy was further librealised in feburary 1973 on the plia that this was necessary to implement the approved development steategy of the fifth five year plan (1974-79). The main provisions were :-

- A list of basic, critical and strategic industries was drawn up. Large houses & their Subsidiaries and branches of foreign concerns were made eligible to participate development of these industries.
- Cooperative and small and medium enterpreneurs were to be encouraged to participate in the production of mass consunrption goods.
- The central and State governments were to develop the joint sector as a promotional instrument in the prierity aears. The liberalisation of licensing policy was aimed at promoting private investment, for including that by big business and foreign capital.

Industrial Policy - 1977

In December 1977, the Janata Government, replaced the congress government at the center, and announced the Industrial policy. The policy sought to correct some of the disturb distortions in industrialisation over the previous 30 years. The main provisions were :-

(1) Emphasised the need to double the sate of industrial grouth from 3.5% to 7% P.A.

(2) It increvased the items exclusively reserved for production in the small sector from 180 to over 800.

(3) The public sector was to continue to play a leading role in industrialisation.

Industrial Policy - 1980

The return of the Congress party in power in 1980 prompted it to restate its policy framework of 1956 and 1973 and to repudiate the Janata Policy of 1977. The major elements of the 1980 policy were (1) Development of integeated and synchronised devlopment of large, medium, & small & cottage industries. Special attention was given to reviving & deep infrastructual facilities like power, teansport, communications, finance etc. The investment limits of the small-scale & ancillary units were increased substantiallyto help their modernisation.

7.4 Review of Pre-1991 Industrial Policy

• Reservation of Industries:

Future development of most of the important industries was exclusively reserved for the public sector. Manufacture of a large number (over 850 in 1991) of items was reserved for the small scale sector.

• Dominance of Public Sector

The policy of the government was to ensure that the public sector gained control over the commanding heights of the economy. The Industrial Policy Resolution of 1948 established public sector monopolyin nine industries. The Industrial Policy Resolution of 1956, bought out in the light of the adoption by parliament of the socialist pattern of society as the national goal and the Second Five Year Plan model which gave emphasis to the basic and heavy industries, further expanded substantially the role of the public sector.

• Entry and Growth Restrictions

There were number of entry and growth restrictions on the private sector (particularly on the large firms and foreign firms) even in respect of industries where the private sector was allowed. A licence was mandatory for establishing new units with investments above a specified limit for manufacturing new products and for substantial expansion of existing undertakings. Large firms (having assets, including those of interconnected undertakings, of Rs.100 crores or more) and dominant undertaking (i.e., those having a market share of 25 per cent or more) had to obtain clearance under the MRTP Act. There were also restrictions on import of capital goods too.

Restrictions on Foreign Captial and Technology

The scope of use of foreign capital and technology was limited. Even in industries where foreign capital was allowed, it was normally subject to a ceiling of 40 per cent of the total equity. Operations of foreign companies in India and issue of securities abroad by Indian companies were regulated under the Foreign Exchange Regulation Act, 1993.

7.5 New Industrial Policy 1991

The new industrial policy announced on July 24 1991, heralded the economic reforms in India. It has enormously expanded the scope of the private sector by opening up most of the industries for the private sector and substantially dismantling the entry and growth restrictions. The salient features of the new policy are following:

Objectives:

The major objectives of the new industrial policy package are:

- To build on the gains already made
- To correct the distortions or weaknesses that may have crept in
- To maintain a sustained growth in productivity and gainfull employment; and
- To attain international competitiveness.

It has been stated that the pursuit of these objectives will be tempered by the need to preserve the environment and ensure the efficient use of available resources. All sectors of industry, whether small, medium or large, belonging to the public, private or cooperative sectors will be encouraged to grow and improve on their past performance.

• Redefinition of the Role of the Public Sector

The role of the public sector was redefined and the scope of the public sector has been drastically abridged.The number of industries reserved for the public sector was reduced to eight and it was later pruned to three (atomic energy, railway transport and minerals specified in the Schedule to the Atomic Energy Order, 1953). Even in some of these industries, participation of the private sector may be allowed on a selective basis. The policy also seeks selective privatization and withdrawal of the public sector from industries which do not confirm to its redefined role.

• Dismantling of Entry and Growth Restrictions

The scope of private sector has been expanded enormously by drastically reducing the industries reserved for the public sector and by substantially dismantling the barriers to entry and growth. All 18 industries were freed from licensing. The number was later reduced to 15 and further to 14. These industries subject to industrial licensing account for only less than 15 per cent of the value added in the manufacturing sector. The list of industries subject to licensing is likely to be pruned further. Most of the provisions of the MRTP Act pertaining to concentration of economic power (i.e., those requiring prior permission for establishment of new undertaking, substantial expansion, manufacture of new items and mergers and acquisitions) were scrapped.

- **Liberalization of Foreign Investment**

The policy towards foreign capital and technology was modified very significantly. Automatic approval for foreign investment upto 51 per cent of the total equity was granted in 35 priority industries specified by the Government. These industries contributed nearly 50 per cent of the value added in the manufacturing sector. In December 1996, the number of these priority industries was increased to 48, three industries related to mining activity were made eligible for automatic approval up to 50 per cent of foreign equity and another set of nine industries related to key infrastructure sectors like, electricity, roads, bridges, ports, harbours, runways, waterways, exploration and production of Oil etc. were made eligible for automatic approval for foreign investment upto 74 per cent of the total equity. Foreign investment in other industries and foreign investment above the specified ceilings in the priority industries may also be considered by the government (but no automatic approval). Since 1992-93, the Indian stock market is open for investment by Foreign Institutional Investors (FIIs) and Indian companies satisfying certain conditions may access foreign capital market by Euro issues.

- **Worker Participation in Management**

The industrial policy document had assured to protect the interests of workers. The policy had endeavoured to encourage workers' participation in management.

- **Creation of Production Capacity**

The policy had removed administrative controls for increasing production capacity in new industries. The entrepreneurs will have to pass on only information to the government. regarding setting up new units or expansion in production capacity.

- **Promotion of Industries in Rural Areas**

The new policy contemplated to promote industries in rural areas with an objective of reducing regional disparities.

- **Related Measures**

The industrial policy reforms have been supplemented and reinforced by reforms in related areas. The import policy has been made more liberal by drastically reducing the tariff levels and quantitative restrictions and by procedural reforms. Another very significant change was the reform of the foreign exchange rate policy. The Rupee was made partially convertible on current account and later it was made fully convertible. The capital account convertibility may not be far away. Progressive integration of the Indian economy with the global economy has been acknowledged as one the objectives of the Exim Policy. The Capital Issues Control Act and the office of the Controller of Capital Issues were scrapped and policy towards capital issues and their pricing have been made liberal.Price controls have been gradually eased. Several Restrictions imposed in respect of foreign investment, like phased manufacturing programme, foreign exchange balancing etc. have been liberalized.

7.6 New Changes in Industrial Policy

The govt. had taken several steps to make the process of liberalization and globalization more effective during last decade. The new changes in this industrial policy are as follows:

- **Public Sector's Role Diluted**

In the process of liberalization the government has reduced the number of industries reserved for public sector. This number was reduced from 17 to 8 in 1991 and further reduced to 6 in 1993. At present only 3 sectors are required for the public sector these are: (i) Atomic energy, (ii) Railway transport, (iii) The substances specified in the schedule to the notification of the Govt. of India in the Department of Atomic Energy number S.0212(E). The government has announced new policy regarding the public sector, the main elements are as follows:

a) Bring down govt. equity in all non-strategic public sector undertakings to 26 per cent or lower, if necessary.

b) Restructure and revive potentially viable public sector undertakings.

c) Close down public sector undertakings which cannot be revived, and

d) Fully protect the interest of workers.

- **Disinvestment in Public Sector Undertakings**

The government has adopted the policy of disinvestment in public sector undertakings. The government. has allowed private sector's participation in the public sector of the country. In order to give thrust to the process of disinvestment in public sector units a new Department of disinvestment has been set-up. The government has announced its policy with the objective of disinvestment is to put national resources and assets to optimal use and in particular to unleash the productive potential inherent in the possible sector enterprises.

- **New Industrial Act**

In the process of review of laws, regulations and simplification of procedures an experts group constituted by government finalized its recommendations. The group has proposed enactment of a new Industrial Act which would focus on promotion and development of industry instead of regulation.

- **Foreign Exchange Management Act**

In 1998-99 budget, it was announced to replace Foreign Exchange Regulation Act (FERA) by Foreign Exchange Management Act (FEMA) aiming at removing obstacles of foreign investment in India.

- **Micro and Small Enterprises**

The process of economic liberalization and market reforms while exposing the Indian Micro and Small Enterprises to increasing levels of domestic and global competition has also opened up attractive possibilities of access to larger markets and of stronger and deeper linkages of Micro and Small Enterprises with larger enterprises. Improved manufacturing techniques and management processes can be source and adopted with greater ease. In this environment of competition and rapid technological changes, the segment can then achieve higher sustained growth by enhancing its technological capabilities improving its product and service quality to global standards and seeking ways of innovation. Initiatives and measures taken by the government to enhance their competitive strength, address the challenges of competition and avail of the benefits of the global market include:

Enactment of the Micro, Small and Medium Enterprises Development Act, 2006.

Amendment to the Khadi and Village Industries Commission Act, 1956 introducing several new features to facilitate professionalism in the operations of the commission as well as field level formal and structured consultations with all segments of stakeholders. The new commission has been constituted.

A package for promotion of micro and small enterprises has been approved recently to address most of the concerns in the areas such as credit, cluster-based development, infrastructure, technology and marketing.

After due consultation with the stakeholders 180 items reserved for exclusive manufacture in micro and small enterprises have been de-reserved. Now, only 114 items are reserved for this sector.

• **Policy towards Foreign Direct Investment**

The government has permitted Foreign Direct Investment (FDI) to facilitate industrial growth throughforeign participation, through the automatic route for all industries except a small negative list. The automatic route means that foreign investors only need to inform the Reserve Bank of India within 30 days of bringing in their investment and again within 30 days of issuing any shares. The negative list includes:

All proposal that requires an industrial licence because the activity is licensable cases where foreign investment is more than 24 per cent in the equity capital of funds, manufacturing items reserved for small scale industries and all activities that requires an industrial licence in terms of the locational policy.

All proposals in which the foreign collaborators have a previous venture/tie-up in India.

All proposals relating to acquisition of shares in an existing Indian company in favour of foreign/non-resident Indian.

FDI is prohibited only in the following sectors: (a) retail trading (except single brand product retailing), (b) atomic energy (c) lottery business and (d) gambling and betting.

The new policy in this regard is that the government is committed to a strong and effective public sector whose social objectives are met by the commercial functioning. For this purpose there is a need forselectivity and strategic focus. The government is committed to develop full management and commercial autonomyto successful profit-making companies operating in a competitive environment. Generally profit-making companies will not be privatized.

7.7 An Evaluation of New Industrial Policy

The economic reforms ushered in since 1991 are revolutionary indeed in comparison with the policy and procedural reforms hitherto attempted in India. It undoubtedly is a bold step in the direction of freeing the Indian industry from abortive and creeping controls. Although further policy changes and reforms areneeded, changes already introduced if implemented in real earnest, will certainly provide a considerable growth impetus in the Indian economy. The actual operation of the new industrial policy has been a subject of much debate and criticism. The main points of criticism are as follows:

• **Erratic and Fluctuating Industrial Growth**

The new industrial policy considerably reduced the interventionist barriers to the entry of domestic and foreign investors, resulting in what has been proclaimed as a much more competitive environment in the industrial sector. It was hoped that this 'much more competitive environment' would in itself, induce higher growth rates in the industrial sector. In fact, the rate of growth in the industrial sector declined in the post-reform period. For instance, the rate of growth of industrial production was only 5.0 per cent per annum during the period of 1997-98 to 2001-02, whereas it was 7.8 per cent per annum in the pre-reform decade (1980-81 to 1991-92). During 1990s as a whole (1990-91 to 1999-2000), the rate of growth of industry was only 5.7 per cent per annum. However, the industrial sector registered strong positive growth of 8.2 per cent per annum during the period of the Tenth Plan (2002-03 to 206-07).

• Distortion in Production Structure

The capital goods industries play a vital role in the long-run industrial development. But the rate of growth of these industries fell drastically from 9.4 per cent per annum during 1980s to only 4.7 per cent per annum over the Ninth Plan period.

• Threat from Foreign Competition

In the early euphoria of liberalization the private sector welcomed the new industrial policy 1991, but it has been realized that opening up the Indian economy to foreign competition meant more and cheaper imports. More foreign investment opportunities to the MNCs to raid and takeover their enterprises and worse their inability to meet the challenge from MNCs due to their week economic strength vis-à-vis the MNCs. In the new liberalized scenario that has emerged in the post 1991 reform phase, the Indian industries are facing unequal competition from too much protection to too little protection which may eventually result in policy-induced de-industrialization. The overall business demand is for a level playing field.

• Dangers of Business Colonalization

The various measures to promote foreign investment contained in the new industrial policy and the various concessions to such investment announced in recent years have provided opportunities to MNCs to penetrate the Indian economy and gobble up Indian enterprises.

List of industries requiring compulsory licence

With the introduction of New Industrial policy in 1991 a substantial programme of deregulation has been under taken. Industrial licensing has been abolished for all items except for a short list of five industries related to security, strategic or environmental concern. These are :-

* Distillation of alcoholic drinks.
* Cigar, cigarettes and other substitutes of prepared tobacco.
* Electronic, Aerospace and all types of defence equipments.
* Hazardous chemicals.
* Industrial exlosives.

7.8 Summary

The industrial policy of the Government of India and the regulatory measures introduced to achieve the objectives of industrialization in the economy. The industrial policy and regulation had grown more and more restrictive until about the mid seventies. The most drastic liberalization was carried out in 1991 when a new industrial policy was announced. In the process of liberalization the number of public sector was reduced to 3 sectors only, FERA was replaced by FEMA and very liberal policy had been introduced for foreign direct investment. As a result of the liberalization, the rate of growth of capital goods industries fell drastically, increasing foreign competition and business colonization trend has been increased.

7.9 Key Words

- **Deployment :-**Resources or equipment in the organization and positioning of them so that they are ready for quick action.
- **Deleterious** : Some thing that has deloterious effect on some thing has harmful effect on it.
- **Celling :** A ceiling on something such an prices or wages is an official upperlimit that cannot be broken.

- **Distortion :** Distortion is changing of something into something that is not tree or acceptable.
- **Erratic :** Something that doesnot follow a regular pattern but happens at inexpected times or moves along an irregularway.
- **Gobble up :** If someone say things so quickly that is difficult for people to understand by another .

7.10 Self Assessment Test

1. What is the industrial policy? Explain its significance for the economic development.
2. Explain the progress of industrial policies upto 1991.
3. Discuss the procedural reforms made through industrial policy 1991.
4. Explain the role of public sector in the economy before and after liberalization.
5. Discuss the policy regarding foreign direct investment in the present scenario.
6. Critically examine the new industrial policy 1991 of the Govt. of India.

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Unit - 8 : Fiscal Policy

Unit Structure:

8.0 Objectives

After reading this unit, you will be able to :

- Understand the concept of Fiscal Policy.
- Know the objectives of Fiscal Policy.
- Know the instruments of Fiscal Policy.
- Describe the importance of Fiscal Policy in Inflation and deflation.
- Describe the Fiscal Policy and its shortcomings in Indian reference.

8.1 Introduction

Fiscal policy plays a very important role to affect aggregate demand, price level, cost conditions, rate of interest, money supply, international trade, financial markets and the overall growth of the economy through the changes in the public expenditure, public debt and taxation. It is an important tool of macro economic policy which has the ability to influence key variables of the economy. A business manager uses it for making various strategic decisions.

Fiscal policy is traditionally concerned with the determination of state income and expenditure policy. However, in recent times with the expanding role of the state with particular refernece to the need for a rapid economic growth, public borrowings and deficit budgeting has also become a part of fiscal policy. The crux of an effective fiscal policy is related to the policy decision with regard to the entire financial structure of the government such as expenditures, transfers, loans, tax revenues and debt management. They all are kept in a proper balance so as to achieve the best possible results in terms of economic objectives. In short, the extent of its success entirely depends upon numerous factors such as market forces, economic stability, proper use of its tools and the flow of foreign capital and trade.

In simple words, fiscal policy concerns itself with the aggregate effects of government expenditure and taxation on income, production and employment. In other words, it refers to the instruments by which a government tries to regulate or modify the economic affairs of an economy keeping in view its objectives. Again, we can say that fiscal policy is a package of economic measures of government regarding its public expenditure, public revenue and public debt or public borrowings. It also outlines the influence of the resource-utilisation on the level of aggregate demand through affecting the level of aggregate consumption and investment expenditure in the economy.

Fiscal Policy means that policy of the Goverment through which the Goverment manages, regulates and controls its income and expenditure for fulfilment of its pre-determined objectives. In this policy Goverment decides from which sources the income may be raised and on what purposes expenditure is to be incurred and if the expenditure exceeds income how this deficit is to be managed ?

In the views of Samuelson and Nordhous, "By fiscal policy we mean the process of giving such shape to tax imposition and public expenditure which (i) helps in reducing the occurance of ups and downs of the trade cycles and (ii) contributes in making a developing economy with high employment, free from highly fluctuating inflation to sustain it".

According to Prof. Henry Murphy, "Fiscal policy means that policy in which the total amount of Government income and expenditure is so employed after considered thought that desired beneficial changes may be achieved in income, employment and prices". Prof. Boulding has highlighted two aspects of fiscal policy. First is the qualitative aspect, in which the Government decides those sectors on which tax is to be imposed or expenditure is to be incurred. Another is the quantitative aspect in which the policy is determined for collection of the taxes and for spending the collected income.

It is clear from these thoughts that fiscal policy includes all those measures, which are related to taxation, public expenditure, public debt and budget of the Goverment and the objectives of all these activities is to increase the income of people, to achieve full employment, to speed up economic development and to maintain stability in prices and economic growth.

8.2 Importance and Objectives

In earlier days, the responsibility of the Government was limited only to law and order, security and education. Hence, need of fiscal policy was felt only in periods of emergencies. But in modern age, due to continuously increasing intervention and active role of the Government in the economic field, fiscal policy has become a practical necessity. The economic depression of 1930 exposed the hollowness of free trade policy of classical economists and highlighted the importance of government intervention and fiscal policy for rapid economic development and stability in economy. Prof. Keynes has gone to the extent of writing that "The entire economic mechanism may be changed in the desired direction and the economic activities may be changed for fulfilment of the desired objectives with the help of fiscal policy. The Goverment may bring positive changes in the field of income, production, employment, savings, investments and expenditure by this policy and may effectively operate the adminitstration".

To Prof. Masgrave, "The fiscal policy has important effect on rate of economic growth, levels of employment and changes in prices"**.** The fiscal policy plays important role in proper development and exploration of natural and human resources of the developing countries, speeding up capital formation, equitable distribution of income and provides, pace, direction and guidelines for economic development. Hence, it is clear that the necessity and importance of fiscal policy for the developing countries is foremost.

The necessity and importance of fiscal policy are highlighted by its objectives also which are briefly discussed as under:

(1) Rapid Economic Development : Achieving rapid development of the economy of the country is the main objective of the fiscal policy. For that the Government paves the path of development by incurring expenditure on various developmental activities, basic industries, development of power and irrigation resources and transport and communication facilities.

(2) Economic Stability : Maintaining stability in the economy is another important objective of the fiscal policy. It is used to have control on both, the boom and the depression by way of having control over internal and external forces through policy of Government taxation and expenditure. That helps in achieving economic stability.

(3) Full Employment of Resources : Providing full employment to natural and human resources available in the country to maximum possible extent is the most important objective of the fiscal policy. For achieving this objective, Government expenditure on various development activities increases substantially and thereby opportunities of gainful employment for the resources of production are enhanced.

(4) Encouragement to Capital Formation : Increase in Government and private investments encourages capital formation. By way of taxation Government encourages productive investments and creates basic infrastructure by making investments.

(5) Stability in Prices : Heavy ups and downs in prices have ill effects on economic activities and cause imbalances in income, employment and distribution. Hence, the Government resorts to the fiscal policy of taxation, Goverment expenditure and public debts for maintaining stability in prices.

(6) Sufficient Income to Government : The Government has to raise sufficient sources of income to fulfil its responsibilities relating to development, security and administration. This objective of fiscal policy is also important because other objectives may remain incomplete without it.

(7) Balanced Development of the Economy : This objective of fiscal policy is also considered to be important because private persons tend to make investment in consumer industries having low risk element and quick gains. Hence, the Government itself has to incur expenditure for basic and infrastructure industries which require heavy investment and have high risk element.

(8) Control on Inflation : Fiscal policy also aims at keeping effective control on inflation so that adverse effects of inflation may be reduced. It is done by reducing Government expenditure, increasing taxes, encouraging savings and controlling deficit financing.

(9) Control of Trade Cycles : Checking economic booms and despressions for reducing their ill effects are also important objectives of the fiscal policy. During economic depression, income and production decline due to unemployment, low prices and declining investments. Such situation of depression is brought under contro, by increasing Government expenditure and investments and by incurring expenditure on relief works.

(10) Reduction in Economic Disparities : Reducing disparities in income and wealth of people is also an important objective of the fiscal policy. Progressive taxation is levied on rich sections of the society and economic assistance, free of cost availability of social services and higher employment opportunities are arranged for upliftment of poor sections of the society.

(11) Reduction in Regional Imbalances : Poverty and backwardness in any area of the country is the biggest threat for the prosperity of other areas. Hence, fiscal policy aims at encouraging balanced economic development in almost all areas of the country. For that, the Government increases expenditure for industrial development of backward areas, provides concessions in taxes, provides grants and subsidies to encourage private investment in the backward areas and imposes heavy taxes in developed areas and the income of those taxes are utilised for economic development of backward areas.

(12) Increase in Investment Rate : Encouraging public and private investments in the economy is an important objective of fiscal policy. Government itself also makes investments. Providing concessions in taxes and providing subsidies encourage larger investment in private and public sectors.

(13) Maximun Welfare of the People : The last, but the most important objective of fiscal policy is to ensure maximum welfare of all sections of the society in the country. For that, the Government tries to materialise the principle of maximum social welfare in public finance. It becomes clear from the above description that rapid development of economy achieving full employment, control of trade cycles, maintenance of price stability and maximisation of public welfare are the main objectives of the fiscal policy.

8.4 Constituents of Fiscal Policy

(1) Policy of Taxation :

It includes various types of direct taxes and indirect taxes and their principles, effects and burdens are also analysed in the taxation policy. Taxation policy has special importance in the developing countries, from economic development point of view, as by this policy unnecessary consumption is curbed, capital formation is encouraged and savings are also encouraged for diverting them towards productive activities. Progressive taxation policy is followed to reduce economic disparities. Efforts are also made to make the taxes diversified, progressive and wider in scope.

The impact of income taxation on the growth of private business in general and on private investment in particular, may be examined through its effects on (i) people's work-efforts; (ii) saving of the households in general and private firms in particular and (iii) incentive and ability to invest.

• Effects of Income Taxation on Work Efforts : The effect of taxation on private enterprise depends, among other things, on how income tax affects people's desire to work. The additional work efforts depends, in fact, on people's choice between lesiure and work. Leisure gives a kind of satisfaction (pleasure) while work yields income which yields another kind of statisfaction.Taxation of personal income reduces return from labour and, therefore, it alters people's choice between leisure and work. When a tax is imposed or income tax rate is increased, wage income decreases. As a result, the reward for an additional labour and the price of additional leisure, i.e., opportunity cost of leisure, are both lowered. Under this condition, 'the worker will tend to substitute leisure for work.' Thus, taxation reduces the supply of labour. But, at the same time, increase in tax rate reduces the total income from given hours of labour. It makes the worker poorer but poor workers normally wish to enjoy fewer hours of leisure in order to earn more. The workers would, therefore, like to work more to raise their income. Thus, taxation has both negative and positive effects on labour supply. The net effect of taxation on work effort (or labour supply) depends on the relative strength of the two effects.

• **Effects of Taxation on Savings :** The effect of taxation on private enterprise depends on the effects of taxation on private savings. The three most important sources of funds for private enterprises are: *(i)* household savings, *(ii)* banks and financial institutions and *(iii)* internal savings of the firms. Household savings are the source of equity and debt capital. The growth of the private sector depends, given other factors, on the supply of funds from both external and internal savings. Let us now examine the expected effects of taxation on savings :-

• **Effect of Income Taxation on Personal Savings :**As a matter of law, saving is a function of disposable income. The higher the income the higher the average propensity to save. This law states that when income increases the marginal propensity to consume decreases and marginal propensity to save increases. This implies that the households in higher income brackets save more and supply a major proportion of savings to the capital market. Households in the lower income brackets also save but the major proportion of their savings flows into house construction, bank deposits, insurance policies-not directly into the capital market. Thus, major part of equity and debt capital is supplied by the households in higher income classes. Therefore, the supply of external capital to the private firms depends on how taxation affects savings by the upper-income households.

(2) Policy of Public Expenditure :

The principles and the effects of public expenditure, its role in economic welfare are analysed, in this policy. The Government incurs expenditure on defence, development and welfare activities, as also on administrative functions to fulfil certain pre-determined objectives. While incurring the expenditure, it is kept in view that it may result into sustained rapid economic development, employment and income levels may go up. For rapid economic development, the government pays adequate attention on heavy capital industries, development of institutions, power and irrigation projects, development of transport and communication facilities, to develop basic infrastructure in the country. Govt. also increases expenditure on education and social services for human capital formation. In those areas, where private investment is lacking either the Govt. itself invests the capital or attracts private investment by giving grants. Expenditure is also incurred for defence and maintenance of peace in the country.

Public expenditure, in modern government finance, is regarded as a means of securing social ends rather than just being a mere financial mechanism. In present times, Wagner's law of increasing public expenditures - both extensively and intensively-has universal application. Public expenditure is siginificant in a modern economy because it produces many direct and indirect socio-economic effects. A brief account of these effects may be given as under :-

• **Effect on Consumption:** On account of public expenditures, the size of consumption tends to increase in the economy. Since public expenditure tends to redistribute income in favour of the poor people and their marginal propensity to consume being high, the overall level of consumption tends to improve.Public expenditure provides social goods for consumption such as public parks, playgrounds etc..Public expenditures provides free medical care, education, etc. so that the real income of the beneficiaries improves and their capacity to consume and save also improves.

• **Effects on Production:** Dalton rightly states that: "Just as taxation, other things being equal, should reduce production as little as possible so public expenditure should increase it as much as possible."

• **Effects of Public Expenditure on Distribution:** An important objective of the modern State policy has been the reduction of inequality in the distribution of income and wealth. For a socialistic pattern of society like ours this has been a major goal of public policy. Public expenditure is considered to be an important instrument by which inequalities in income and wealth can be reduced. Dalton, states, "That system of public expenditure is best which has the strongest tendency to reduce the inequality of income."

Public expenditure which is in the form of money grants, supply of social goods and services free ofcost or subsidied, certainly affects the distribution of income in a socially desriable way. The effect of public expenditure on distribution depends upon the nature of spending made by the government. There are certain types of public spendings which benefits a few individuals or sections only while others confer benefits on the society as a whole. Expenditures which are specially incurred to benefit the low-income strata of the society, such as those on social services like free medical aid, free education, unemployment relief, etc. will obviously benefit the poor more than the rich, thus bringing about re-distribution of income when the rich are taxed more to finance this type of public spending. Expenditures which bring benefits to the society as a whole are those relating to general improvement such as good roads, highways, railways, electrification, water supply, defence, police, courts etc.. This does not bring about any appreciable re-distribution of income, since all are eqally benefited, or sometimes the rich are benefited more than the poor. Police and courts, for instance, are very useful to the rich who have money and property to protect, while the poor have no such worries, so they get the least benefit from these.

According to Dalton, public expenditure may be: (i) regressive (ii) proportional, and (iii) progressive in effect.

(i) Regressive Expenditure- A grant or government expendtiure is regressive when the smaller the beneficiary's income, the smaller is the proportionate addition made by the grant. 'Under the regressive government expenditure, evidently, the income inequalities would increase, as it would confer proportionately more benefit on the upper income groups than the low-income people. For instance, interest on public debt or subsidy on private savings is regressive in effect.

(ii) Proportional Expenditure- The public expenditure is said to be proportional when whatever may be the size of the recipient's income, the proportionate addition made by a grant is the same. For instance, if a fixed rate of house allowance, say 10 per cent of a salary, is paid to all the government servants it is a proportional expenditure. In the case of proportional expenditure inequality does not reduce, nor does it increase (in a relative sense).

(iii) Progressive Expenditure- Expenditure is progressive when the proportional addition made by the government grant is larger, the smaller the recipient's income. In progressive expenditure, thus, the benefits decrease at an increasing rate with a rise in income. In fact, expenditure which is incurred on such items which add to the real income of the low income groups is progressive in effect. For instance, free education, subsidised housing, free medical care, fair price shops etc. provided for the poor people only, will be a progressive expenditure.

A progressive system of expenditure, thus, tends to reduce the inequality of income. The steeper the progression, the stronger is the tendency to narrow down the gap of income and wealth inequalities. Hence, a government pursuing a goal of reduction in income inequalities has to resort to a progressive type of expenditure.Progressive expenditure is undertaken in many forms, some of which may be illustrated as under:

(a) Cash Grants- For old-age pension, unemployment relief, accident benefits etc. payment is made by the government is cash. The recipients get such payments or help when they are most needed. Cash payments given under the Social Security Schemes in the UK, under the Employment Act in the U.S.A., and under the Employees' State Insurance Act in India are living examples of such progressive public expenditure. They re-distributed income in favour of the low income groups.

(b) Free or Cheap Goods and Services- Free primary education, freeships to the economically backward classes for higher education, subsidies to food and housing, the provision of free milk and meals to school childern of poor sections, etc. are provided by the State. These social goods are either free or low priced, intended to benefit the poorer sections of the community and not the rich so that the real income for the former would be raised to minimise the gap of inequalities between the rich and the poor.

The provision of such social services removes the greatest economic evil by improving the standard of living of the poor masses. Similarly the provision of public parks, libraries etc., may also be undertaken for the amenities of the low-income groups. In the case of menacing inequalities, there is a plea for progressive transfer of expenditure in the form of food subsidies, clothing etc., as the expenditure on food and clothing claims relatively a large share of the total expenditure of the poor income group people. All such measures would have a greater and socially desirable re-distributive effect. In short, though growth and welfare objectives seem to be conflicting, a public policy should reconcile and balance them appropriately through a wise spending policy, based on the ability to receive criterion and a sound taxation policy based on the principle of ability to pay.

(3) Public Debt Policy :

When the income of the Government received from tax revenue and non-tax revenue falls short to fulfil its economic, political and social objectives and very high amount of internal and external debts are required for future economic development of the country, then this main component of fiscal policy gets reflected. In this policy, nature of public debts, their principles, their effects on present and future generation and their role in economic prosperity are well analysed and efforts are made to adopt suitable policy. In developing countries, tax paying capacity of the people is low, due to poverty saving are also quite low and pace of capital formation is very slow. Level of investments is low due to lack of enterpreneurship. In such situation it becomes a compulsion for the Government to take loans in very heavy quantity from the foreign countries to meet the expenditure of ambitious development plans. Internal loans are also resorted too.

There are two major sources of public borrowings: Internally, the goverment may borrow from citizens, commercial banks, other financial institutions in the money market and from the central bank. The State may also borrow from external sources from individuals and banks of foregin countries, foreign governments and international institutions.

A public debt in moderm times constitutes an important part of the total assets (public and private) created in the economy. For financing the ever-increasing public expenditures, huge loans (internal as well as external) are floated by the governments from time to time, with the result that a huge national debt has become a prominent feature of modern public finance. Now the public debt policy has been universally accepted as a method of financing the economic development of the country.

In modern economics, the public debt ceration is perfectly justified in the following situations:

- **(i) During War Period -** Modern war is very costly and cannot be entirely financed through taxation measures. If taxes alone are used production will be adversely affected under heavy direct taxes and fixed income groups will be hit hard when indirect taxes are enhanced. Public borrowings will not have such desired consequences. Creation of public debt is, thus, a better and easier method of collecting revenue and transferring resources from the civilian to the military sector.
- **(ii) In Times of Depression -** Public debt creation is considered very significant to overcome a depression. During depression increase in taxes will have an adverse effect on incentive to work and invest. But if the government takes up public investments, financed by borrowing, especially

from the banking sector, employment, income and level of effective demand will have a cumulative expansion. Moreover, during depression loanable fund is in excess supply which can be fruitfully exploited through government borrowings which would also help in sustaining the capital markets.

(iii) To Meet Unprecedented Expenses - A government may have to borrow for financing a sudden rise in its expenditure required to meet certain fortuitous events like floods, famines, epidemics etc. necessitating relief works.

(iv) To Curb Inflation - Public borrowing may be regarded as a means to relieve the pressure of inflationary spiral in the economy, as by raising public loans the government absorbs the excessive spending power from the subscribers. But, as many modern economists rightly feel, taxation would be a better anti-inflationary measure as compared to public debts, because in public borrowing, the liabilities of the government increase if the government does not use the borrowed sums. But the surplus of tax revenues can very well be left idle in the state treasury to curb inflationary pressure in the economy.

(v) Development Finance - Mostly the developing countries in view of the low taxable capacity of the economy and less domestic resources available for development purpose, resort to internal and external borrowings as an important source of development finance. For effecting rapid capital formation and accelerating the tempo of industrialisation India, for instance, has resorted to public loans to a greater extent in recent years. Under economic planning, public borrowing, constitutes an important financial resource. In advanced countries, too the governments resort to borrowings for constructing capital equipments and public works programmes such as development of roads, irrigation, power houses, etc.. In this way, public loans are being productively used.

(4) Government Budgetary Policy:

This is that constituent of fiscal policy by which the government formulates the budgets of its income and expenditure, every year to fulfil its objectives. Budget includes estimates of incomes from various sources including tax revenue and non-tax revenue, as also the items of expenditure, on which the income is to be spent to meet the requirements of development, public welfare, defence and administration, etc. If the estimated income exceeds estimated expenditure, in the budget, such budget is called **surplus budget.** But if the estimated expenditure exceeds extimated income, such budgets are known as **deficit budgets.**

8.4 Fiscal Policy in Inflation

Fiscal policy is budgetary policy in relation to taxation, public borrowing and public expenditure. To combat inflation fiscal measures would involve increase in taxation and decrease in government spending. During inflation the government is supposed to counteract an increase in private spending. Obviously, during a period of full-employment inflation, the aggregate demand in relation to the limited supply of goods and services is reduced to the extent that government expenditures is curtailed.

As we know when more taxes are imposed, the size of the disposable income diminishes. Inflationary pressure is significantly weakened by the simultaneous curtailment of government expenditure and an increase in taxation because more resources are released for expanding the productive capacity in the private sector. The supply curve of aggregate goods and services shifts upwards with a contraction of monetary demand due to a decline in disposable income with people.

It has been argued that a tax policy can be directed towards restricting demand without restricting production. For instance, excise duties or sales tax on various commodities take away the buying power from the consumer goods market without discouraging the expansion of production capacity. On the other hand, this may lead to a further rise in prices of such commodities and inflation can spread from one sector to another and from one commodity to another. But during an inflation a progressive direct tax is considered best. It is also justified in the interest of social equity.

Briefly a reduction in public expenditure and an increase in taxes produces a cash surplus in the budget. Keynes, however, suggested a programme of compulsory savings, such as “deferred pay” or “forced savings” as an anti-inflationary measure. Deffered pay means that the consumer defers a part of his pay by buying savings bonds (which is a sort of public borrowing) which are redeemable after some time. Such a scheme of compulsory savings is expedient during wartime or during a post-war hyperinflation, but is hardly practicable in peacetime in a democratic state.

Private savings have a strong disinflationary effect on the economy and an increase in these is an important measure for controlling inflation. Government policy should, therefore, include devices for increasing savings. A strong savings drive reduces the spendable income of the people without any harmful effect of the kind associated with higher taxation.

Moreover, the effects of a large deficit budget, which is mainly responsible for inflation, can be partly counteracted by covering the deficit through public borrowings. It should be noted that it is only government borrowing from non-bank lenders that has a disinflationary effect. Further, public debt may be managed in such a way that the supply of money in the country may be controlled. The governement should avoid paying back any of its past loans during inflation in order to prevent an increase in the circulation of money. Anti-inflationary debt management also includes cancellation of public debt held by the central bank out of budgetary surplus.

Briefly, fiscal policy alone may not be very effective. An effective programme for combating inflation should combine fiscal and monetary tools in a manner complementary to one another.

8.5 Fiscal Policy in Deflation

Broadly speaking deflation can be checked by making attempts to raise the level of aggregate effective demand. Effective demand can be uplifted partly by inducing the people to spend more on consumption and partly by stimulating investment expenditure in the economy. Marginal propensity to consume in an economy can be raised by a redistribution of income from the rich to the poor classes. Thus, anti-deflationary measures involve a progressively high income-tax and other forms of direct taxation and a subsidies programme to poor people. Similarly, measures should be taken to induce investment. In this context, a lowering of the rate of interest by increasing money supply, provision of adequate tax relief to corporation’s programme of public investment to provide social overhead capital, and public projects which do not compete with private enterprise and rendering all facilities to raise marginal efficiency of capital in the private sector, are very essential. As an anti-deflationary measure, a programme of public investments should be financed by borrowing rather than taxation. Deficit financing may also be helpful in this context.

During deflation, there is a tendency for the prices to fall. Hence, following measures can be adopted to control deflation.

1. **Increase in Public Expenditure:** Under depression public expenditure must increase. As a result demand will increase. Increased demand will check the tendency of the prices to fall.

2. **Decrease in Taxes:** During depression taxes should be decreased. As a result of decrease in direct taxes like income tax, corporation tax etc., investors will prompt for more investment and spend more on consumption. Thus, the aggregate demand will increase and depression be brought under control.

3. **Increase in Social Welfare Expenditure:** Government should spend more on such social welfare activities as education, public health and medical services, social security, grants roads, canals etc., which in turn raise public welfare.

4. **Prices Support Policy:** Another method to control deflationary forces is the price support policy. It is because prices generally fall heavily. Therefore, government has to pursue price support policy. During this period, government buys itself and stocks/essentials at a fixed price called support price. By this method, tendency of the falling prices is controlled.

5. **Deficit Financing:** The additional doses of deficit financing can help to increase aggregate demand. This will push the prices upward.

6. **Pump Priming:** Pump priming means to increase private investment through an injection of freshing purchasing power into the income stream. As we know that private investment is at lowest ebb during depression. To increase it, public investment is essential which set in motion a process of recovery and move itself at a satisfactory level.

8.7 Fiscal Policy of India

Fiscal Policy of India has been very broad and development-oriented after independence. This policy has played very significant role in speeding up the pace of planned economic development providing full employment to the physical and human resources and in materialising the dream of sustained economic development. This policy has also been used to control inflation in the country and to reduce economic disparities. Fiscal policy has encouraged the government to raise adequate income from taxation and to incur expenditure on development activities and defence. Intensive efforts have also been made to raise public debts and the level of capital investment. All this becomes clear from the following facts :

(I) Policy of Taxation :

This is an important constituent of fiscal policy in India through which the government raises the resources by levying various types of direct and indirect taxes. Due to federal financial system of India the taxes are levied by Central Government, State Governments and Local Self Governments. The tax system of India has been fabricated according to the cannons of taxation. The multiple tax system of India has been made progressive to the maximum possible extent. Although, the objectives of taxation policy in India are to increase the Government income, to speed up the pace of capital formation, to maintain stability in prices and to establish economic equality and social justice it has just become imagination. Out of the total population of 121 crores of India, only 2.5 crore persons are the tax payers which accounts to about 2.4% of the total population. The tax revenue in Britain is 35% of the national income. It is 26% in America and 25% in France. But it is only about 11.7%, in India.

Indian tax system was dominated by indirect taxes. Still Indian tax system may be termed to be development-oriented, progressive and diversified. Tax revenue is increasing continuously and the percentage of tax revenue in total revenue has increased which over previous years, as is clear from the following table :

Table : 1 Revenue Receipts of Central Govt. from Direct and Indirect Taxes

(Rs. in crores)

Years	Revenue from Direct Taxes	Revenue from Indirect Taxes	Total Tax Revenue	Ratio of direct and Indirect Taxes
1950-51	230	430	660	35 : 65
1970-71	1,010	3,590	4,600	22 : 78
1980-81	3,268	16,576	19,844	16.5 : 83.5
1990-91	12,269	75,464	87,723	14 : 86
2001-02	68,306	1,18,681	1,88,603	36.2 : 63.8
2003-04	1,05,090	1,47,294	2,54,348	41.3 : 58.7
2005-06	1,65,202	1,99,348	3,64,551	45.1 : 54.4
2006-07	2,30,174	2,41,536	4,71,512	48.8 : 51.2
2007-08	2,67,490	2,79,190	5,48,122	48.8 : 50.9
2009-10	3,87,008	2,46,087	6,33,095	61.13 : 38.87
2010-11	4,30,000	3,16,651	7,46,651	57.60 : 42.40

Source : Budget Estimates 2010-11. Govt. of India and Pratiyogita Darpan, April, 2010.

Main Trends of Taxation of Central Government :

In India, constitution provides maximum financial powers to the Central Government. That is why main sources of taxation are with the Central Government. Briefly following are the main trends of taxation of Central Govenment :

(1) **Tax System is in Accordance with Canons of Taxation :** As far as possible tax system of Government of India is in accordance with the canons of taxation. By this system efforts have been continuously made to ensure that the burden on tax payer may be only in accordance with his tax paying capacity. Tax system incorporates elasticity, uniformity and diversity. Principles of adequancy and productivity have been enforced in this system.

(2) **Trend Towards Multi-Tax System :** Government of India is continuing to change its tax system in the form of multi-tax system so as to obtain more and more tax revenue. During last few years many new taxes, like service tax, capital gains tax, dividend tax, professional tax, Securities Transactions tax, commodity transaction tax etc. have been levied on expansion of new areas. By doing so, the Central Government gets sufficient revenue from taxes, it also proves useful for achieving social equality and justice, and helps in removing economic disparities, encourages capital formation, savings and capital investment for infrastructural development in the selected areas.

(3) **Progressive Taxation :** The taxes of the Central Government have the tendency of being sufficiently progressive. In all central taxes the rate of taxation on rich persons have been kept much higher than the rates applied for poor sections. Tax rates on luxury goods have been kept high whereas tax rates on essential commodities are either very low or these have been completely exempted from taxes. Income tax rates in India is also progressive in nature.

(4) **Ever Increasing Trend in Gross Tax Revenue and Net Tax Revenue:** There has been ever increasing trend in the gross tax revenue of Central Government. The gross tax revenue in 1990-91 was Rs. 57,513 crores. It went upto Rs. 88,604 in 2000-01 and is expected to be Rs. 7,46,651 crores in 2010-11, according to the budget estimates. Net tax revenue of Central Government (by subtracting share of states) was Rs. 9,358 crore in 1980-81, which increased to Rs. 42,978 crores in 1990-91, to Rs. 1,36,658 crores in 2000-01 and is estimated to be Rs. 5,34,094 crores in 2010-11.

(5) Increasing Trend in Direct and Indirect Taxes : Tax revenue of the Central Goverment both from direct and indirect taxes have shown increasing trends. However, the increasing trend is much steep in direct taxes as compared to indirect taxes, I is clear from the following table :

Table 2 : Direct and Indirect Tax Revenue of Central Government

(Rs. in Crores)

Tax Revenue	1990-91	1995-96	2000-01	2010-11 (Budget Estimates)
(i) Direct Taxes	11,024 (19%)	33,563 (30%)	68,305 (36%)	4,30,000 (57.60%)
(ii) Indirect Taxes	46,489 (81%)	77,661 (70%)	1,20,299 (64%)	3,76,651 (42.40%)
Gorss Tax Revenue	57,513	1,11,224	1,88,604	7,46,651

Source : R.B.I. Annual Reports and Pratiyogita Darpan, April, 2010. (Figures in brackets represent percentage to total tax revenue)

(6) Decling Dominance of Indirect Taxes in Tax Revenue of Central Government is Decreasing Now : Still indirect taxes continue to have dominance in the gross tax revenue of the Central Government. However, during last 12-15 years, the share of direct taxes in the tax revenue is also increasing continuously. In 1990-91 the share of indirect taxes was as high as 81% in the gross tax revenue of Central Government, the share of direct taxes was 19% only. However, in 1995-96, the share of direct taxes increased to 30% and share of indirect taxes reduced to 70% only. For the year 2007-08 and 2008-09 it estimated the ratio of direct taxes and indirect taxes will be 52 : 48 and 53 : 47 respectively as shown in table above. Gradually efforts are being made to reduce the dominance of indirect taxes which is indicative of reducing tax burden on the poor sections.

(7) Expansion of Tax- net : In the taxation system of Government of India efforts are being made continuously to bring more and more citizens in the ambit of taxation. For that purpose, alongwith diversifying taxes, attempts are continuing to impose taxes on more and more people, of course, according to their tax paying capacity, so as to raise sufficient revenue from taxes. "Any one of the six" scheme and levying of service tax are the new steps, in this direction. The number of income tax payers which was 75.65 lakhs in 1990-91, increased to 100 lakhs in 1997-98 and to about 400 lakhs by March 2004. However, due to raising the exemption limit to Rs. one lakh for personal income tax, in the budget proposals of 2004-05, the number of income tax payers was likely to reduce, by 1.4 crores. The provision of "any one of six" had also been withdrawn, in the budget of 2006-07. In the budget of 2009-10, the income tax exemption limit for individuals has been raised to Rs. 1.60 lakhs. This limit is Rs. 1.80 lakhs for women and Rs. 2.40 lakhs for senior citizens.

(8) Reduction in High Tax Rates : The trend of reduction in high tax rates is getting reflected clearly. Low tax rates aim at controlling the tendency of tax evasions and to motivate the tax payers to pay taxes. This trend is an important component of tax reforms. Earlier income tax rates were high even upto 97.5%, which was reduced to 77% in 1975 on the recommendation of Wanchoo Committee and now it has been lowered down to 30%. Similarly, efforts continue to reduce the rates of indirect taxes. Rates of corporate tax has also been reduced to 30%. Excise duty and customs duty rates have also been substantially reduced. In new Tax code, the rate of Tax likely to be reduced to 10% upto income of 10 Lacs.

(9) Continuous Efforts for Tax Reforms : Efforts continue to reform the tax system of Government of India so as to make it easy, productive and efficient, and also to effectively control tax evasions. In 1953, Taxes Enquiry Committee was constituted, under the chairmanship of **Dr. John Mathai.** In 1956, **Prof. Kaldor** committee recommended for expansion of direct taxes to control tax evasion. **Direct Tax Enquriy Committee** was constituted, under the chairmainship of Shri Mahavir Tyagi in 1958. **Bhootlingam Committee** was set up in 1967, for suggesting innovations and simplification in tax system. **Jha Direct Taxes Committee** was constituted in 1976. In 1977 **Chauksi Committee** was constituted for examming direct taxes. Again in 1991, Central Government constituted a high level committee of specialists, under the chairmainship of **Prof. Raja J. Chalaiya** to examine tax structure in the country, which submitted its final report in January, 1993. Its main recommendations were : (i) to abolish expenditure tax; (ii) to raise the exemption limit of gift tax to Rs. 30,000 from Rs. 20,000; (iii) to abolish zero rate of import duty and (iv) to reduce the highest rate of import duty from 110% to 50% etc.

Kelkar Committee was constituted for direct and indirect taxes. It submitted its reports to the Government on December 27, 2002. The main recommendations of this committee were: (i) to raise the exemption limit of personal income tax to Rs. one lakhs, (ii) to abolish surcharge on income tax, (iii) to abolish most of the rebates on Income tax including standard deduction, (iv) tax relief to senior citizens and widows, (v) abolition of tax on dividends and long-term capital gains on listed shares, (vi) to reduce corporate tax to 40%, (vii) wide expansion of service tax, (viii) comprehensive changes in composition of excise duty and customs duty etc.. Several tax rebates have been abolished in accordance with the recommendations of Shom Committee set up by planning commission. Six important aspects have been emphasised in tax reforms, proposed in the central budget :

(i) To enforce value added tax- VAT for the states.

(ii) Integration of Services in tax ambit.

(iii) To improve tax administration by better use of information technology.

(iv) Reduction in custom duty.

(v) Rationalisation in exise duty.

(vi) Fiscal Consolidation by reprioritisation of expenditure and increase in revenue.

(10 Dominance of Few Taxes in Tax-Structure : In tax revenue of Central Govt. Income Tax and Corporate tax have dominance among direct taxes. Similarly, customs duty and excise duty are dominant among indirect taxes. Share of Personal Income Tax in total tax revenue from direct taxes is about 30% whereas share of corporate tax is 70%, The share of both these taxes in gross tax revenue is 16.15% and 40.36% respectively. Among indirect taxes the share of Custom duty and Excise Duty is 36.3% and 41.7% respectively in the total revenue from indirect taxes. In gross revenue from taxes, the share of the custom duty in 15.4% and the share of excise duty is 17.7%. It becomes clear from the following table :

Table : 3 Share of Main Taxes in Tax Revenue

(Rs. in Crores)

Particulars	1990-91	1996-97	2000-01	2010-11 (Budget Estimates)
(A) Direct Taxes	**11,024**	**38,891**	**68,305**	**4,30,000**
Personal Income Tax	5,371	18,231	31,764	3,01,331
Corporate Tax	5,335	18,567	35,696	1,20,566
(B) Indirect Taxes	**46,489**	**88,919**	**1,18,681**	**3,16,651**
Custom Duty	20,644	42,851	47,542	1,15,000
Union Excise Duty	24,514	45,008	68,526	1,32,000
Service Tax	-	-	-	68,000
Gross Tax Revenue*	**57,513**	**1,28,762**	**1,88,604**	**7,46,651**

Source : Economic Survey : 2009-10 and Pratiyogita Darpan, April, 2010.

(11) Very Low Percentage of Central Tax Revenue in Gross Domestic Product : Tax revenue from central taxes was 10.11% of gross domestic product in 1990-91, in India. It reduced to 8.97% only in 2000-01. According to Revised estimates, it was 12.47% in 2007-08. The share of total tax revenue in gross domestic product is 35% in Britain, 26% in America and 25% in France. As compared to these developed countries, the share of gross tax revenue of central and states in India, in the gross domestic product of the country is 15.1% only. Central Tax Revenue as percentage of GDP is estimated 11.5% in 2009-10 (Bedget Estimates).

(12) Large Scale Tax Evasion and Strict Measures to Control : Evasion of the taxes of central government is very heavy. Broadly it is estimated that every year, this tax evasion is about 20% to 25%. During last few years, high tax rates have been reduced to check tax evasions. For heavy financial transactions, PAN and GIR number have been made compulsory, tax deduction at source (TDS) has also been implemented and Income Tax Department is taking action for search operations and confiscations also, to have control on tax evasions. During financial year 2000-01, property of Rs. 512-36 crores was confiscated in 5,321 search operations, 235 cases were filed. Inspite of all these measures, tax evasion takes place.

(13) Central Tax System is Development Oriented : Tax system of Government of India is development oriented. It has adequate provisions to provide encouragement for balanced development of agriculture, industries and trade, alongwith encouraging capital formation and capital investment. The tax system is capable of raising sufficient financial resources required for economic development and encouraging production, employment and investment in the country. Thus, several important trends are visible in the taxation system of Government of India.

(II) Policy of Public Expenditure :

Under this component of fiscal policy, the public expenditure has also been designed to be development- oriented and in accordance with the objectivies of maximum social welfare. Highest priority has also been accorded to the defence of the nation. Development expenditure is increasing, quite continuously during years of planned development, whereas non-development expenditure has increased with relatively slow place. Development expenditure includes compensatory assistance provided to Panchayati Raj Institutions and local self bodies.

(A) Development Expenditure : It includes all that public expenditure, which is incurred by the Government for economic, social and community services.

(B) Non-Development Expenditure : This is that component of public expenditure which does not help directly in production and development but on which very heavy expenditure is incurred usually. It has six main components : (i) Defence Services, (ii) Organs of the State, (iii) Fiscal services, (iv) Public Debt Servics, (v) Administrative Services, and (vi) Pension and Miscellaneous General Services.

Main Trends of Public Expenditure in India : The main trends of public expenditure in India, after independence are briefly, as follows, mainly due to adopting of policies aiming at economic development, security and peace and welfare activities :

(1) Increasing Public Expenditure : After independence public expenditure is showing trend of continuous increase in India. During 1950-51 the total expenditure of the Central Government was about Rs. 530 crores, which increased to Rs. 24,170 crores in 1980-81, to Rs. 3,25,592 crores in 2000-01 and to Rs. 8,83,956 crores in 2008-09. According to budget estimates, it is likely to be 11,08,749 crores, during 2010-11. Thus, the public expenditure has become double, during a short period of last 7-8 years will be clear from the following table :

Table : 4 Public Expenditure of Central Government in India

(Rs. in crores)

Year	Revenue Expenditure	Capital Expenditure	Total Expenditure
1950-51	350	180	530
1980-81	14,540	9,630	24,170
1990-91	73,516	24,756	98,272
2000-01	2,77,839	47,753	3,25,592
2005-06	4,40,295	65,410	5,08,705
2007-08	5,88,586	1,20,787	7,09,373
2008-09	7,93,798	90,158	8,83,956
2009-10	9,06,355	1,15,192	10,21,547
2010-11	9,58,724	1,50,025	11,08,749

(Budget Estimates)

Source : Partiyogita Darpan, April, 2010

(2) Increasing Expenditure on Defence : After independence defence expenses have increased, continuously, owing to the needs to safeguard the country against external attacks. The defence expenditure, which was Rs. 168 crores only in 1950-51, increased to Rs. 474 crores in 1962-63, due to attack by China in 1962 and to Rs. 855 crores in 1965, due to attack by Pakistan. It reached to Rs. 1410 crores in 1971-72 due to attack by Pakistan, again in 1971. Even thereafter, defence expenditure is having ever increasing trend. In 1980-81 expenditure on defence was Rs. 3,800 crores. It increased to Rs. 49,622 crores in 2000-01 and is estimated to be Rs. 1,47,344 crores in 2010-11.

(3) Decreasing Trend in Development Expenditure : The nature of public expenditure has become development oriented in India, after adopting the process of planned development. Whereas, during First Five Year Plan, public expenditure on development activities was Rs. 1960 crores, during sixth plan, development expenditure of public sector was Rs. 1,10,467 crores and during nineth plan, the provision was of expenditure of Rs. 8,59,200 crores. However, in percentage terms the share of development expenditure in public expenditure is reducing continuously, since 1980-81. It was 66% in 1980-81, but declined to 60% in 1990-91 and 52% in 2000-01 and 51% in 2003-04. However, it has increased to 51% in 2008-09 B.E. This trend of decreasing share of development expenditure in public expenditure is not a good indication for future economic development.

(4) **Rapid Increase in Non-Development Expenditure :** After 1980-81, non-development expenditure has increased, very rapidly due to several reasons, like increasing interest payments on public debts, increase in defence expenditure, increasing expenditure on tax collection and rapid increase expenditure on police and general administration. Non-development expenditure was Rs. 118 crores in 1950-51 which increased to Rs. 12,419 crores in 1980-81. In 1950-51 non-development expenditure of Government of India was 82% of its total public expenditure. However, it had reduced to 34% in 1980-81. It again increased to 51% in 2002-03. During 2005-06 it declined to about 48%. Unexpected increase in non-development expenditure has proved to be an obstacle in the way of economic development of the countriy. It is heartening that since 2004-05 it has been under control. Share of non-development expenditure is likely to be 49% in 2008-09.

(5) **Increasing Burden of Interest Payments on Public Debts :** Due to rapid increase of public debts of centre and states the burden of their repayment, as also of interest payment is increasing very fast. In 1950-51, the burden of payment of interests on public debts was about Rs. 37 crores only, which increased to Rs. 3,600 crores in 1980-81 and to Rs. 21,496 crores in 1990-91. After 1991, the public debts of Central Government increased very rapidly and hence, the burden of interest payments on public debts of Central Government reached to Rs. 99,314 crores in 2000-01. According to revised estimates, the burden of interest payments is expected to be Rs. 1,71,971 crores in 2007-08. In budget of 2010-11 it is estimated that this amount may reach to Rs. 2,48,664 crores.

(6) **Increasing Expenditure on Subsidies :** The amount of State assistance provided by Central Government for food grains subsidy, domestic L.P.G. and kerosene supplied through public distribution system, subsidy on chemical fertilisers etc. is also ever increasing. In 1990-91, the total expenditure or economic assistance by the Central Government was Rs. 9,581 crores which reached to Rs. 26,838 crores in 2000-01 and Rs. 1,31,025 crores in 2009-10. According to budget estimates, it is likely to be Rs. 1,16,224 crores in the year 2010-11.

(7) **Higher Share in Taxes and increasing Grants-in -aid to the States :** Due to federal financial system in India the expenditure of Central Government has increased rapidly as a result of providing higher share to the states in the central taxes and increasing amount of grants-in-aid to the states, on the recommendations of Finance Commissions. During First Five Year Plan Share of States in taxes was Rs. 344 crores and the amount of grants-in-aid was Rs. 288 crores. This amount increased to Rs. 49,465 crores and Rs. 42,005 crores respectively during seventh plan. In the year 2000-01 alone the share of states in taxes increased to Rs. 51,688 crores and the amount of grants-in-aid reached to Rs. 36,789 crores. Eleventh Finance Commission had recommended Rs. 3,76,318 crores as the share of the states in taxes for the period 2000-05 and also for transfer of Rs. 58,587 crores as grants-in-aid, for the same period. Twelveth Finance Commission has recommended Rs.

6,13,112 crores as the state share in central taxes and Rs. 1,42,639 crores as grants-in-aid to the states, during the period 2005-10. In budget 2010-11 the share of states in central taxes is estimated to be Rs. 2,08,997 crores as against Rs. 1,64,832 crores in the year 2009-10.

(8) **Increase in Tax Collection Expenditure :** Due to levying of several taxes by the Central Government and State Governments the tax collection expenses are also increasing fast. During 1950-51 this expenditure was almost negligible. However, it increased to Rs. 504 crores during 1980-81 to Rs. 1973 crores in 1990-91 and to Rs. 7,233 crores in 2000-01. It estimated to be Rs. 12,349 crores in 2007-08. It is expected to increase 15000 crores now.

(9) **Ever-increasing Trend in Police and Administrative Expenditure :** After achieving independence heavy expenditure is being incurred due to increasing number of various ministers and ministries, as the requirement of democratic system of Government, ever-increasing salaries and allowances of the employees and police, foreign visits of the ministers and officers, expenses of the embassies etc. Heavy expenses are also being incurred on inaugrations, seminars,workshops and entertainments. The administrative expenditure in 1950-51 was Rs. 21 crores only which increased to Rs. 648 crores in 1980-81 and to Rs. 2,100 crores in 1990-91. The expenditure of centre and states on police was Rs. 1,163 crores in 1980-81 which reached to Rs. 5,657 crores in 1990-91 and to Rs. 23,009 crores in 2000-01. It reached to Rs. 40,691 crores in 2007-08. Expenditure has further increased after 2007-08 also. This addition in expenditure has increased total public expenditure quite substantially.

Thus, it is clear that serveral trends are becoming visible in public expenditure in India. These trends have resulted into continued increase in fiscal deficit and burden of public debt on the centre and the states.

Causes of Increase in Public Expenditure in India :

In India various economic, social and political causes have contributed to unexpected increase in public expenditure after independence which are briefly discussed as under:

(A) Economic Causes of Increase in Public Expenditure

- **Heavy Expenditure on Planned Development :** Heavy expenditure has been incurred on planned development programmes for rapid economic development of the country. During First Five Year Plan expenditure in public sector was Rs. 1,960 crores only. As against it the provision of spending was Rs. 8,59,200 crores on Ninth Five Year Plan. Broadly speaking, on each subsequent five year plan the expenditure doubled or even more. It is substantiated by the fact that during Tenth Five Year Plan, provision was of Rs. 15,25,639 crores for public sectors plans of the Centre and the States and a provision of Rs. 36,44,718 crores has been made for the Eleventh Five Year Plan (2007-12) of India.

- **Heavy Expenditure on Defence :** The expenditure on Defence has increased very rapidly. It was only 168 crores in 1950-51, Rs. 1410 crores in 1971-72, Rs. 3800 crores in 1980-81, Rs. 49,622 crores in 2000-01. It has increased to Rs. 80549 crores in 2005-06 and the budget estimate for 2010-11 is Rs. 1,47,344 crores.

- **Expenditure on Public Enterprises :** Government of India and the State Governments have incurred heavy expenditure on the establishment and operations of several public sector enterprises, to develop strong basic infrastructure required for rapid economic development of the country. The number of enterprises of Central Government in 1950-51 was five only, having capital investment of Rs 29 crores only. As against it, the number of Central Government enterprises during Ninth Five Year Plan (1997-2002) reached to 234 having capital investment of Rs. 3,30,649 crores. Now this amount is estimated to be Rs. 4,50,000 crores on 244 PSUs. The State Governments have also heavily increased the expenditure on establishment and operation of their public sector enterprises.

- **Increasing Interest Payments on Public Debts :** Due to unexpected increase in public debts of central and state Government interest payments on them have also increased very heavily. Whereas in 1950-51 burden of interest on public debts was Rs. 37 crores only, it reached to Rs. 3,600 crores in 1980-81, Rs. 21,496 crores in 1990-91 and Rs. 1,92,204 crores in 2008-09. According to budget estimates the figure is likely to reach to Rs. 2,48,664 crores in 2010-11.

- **Increase in Economic Assistance :** Economic assistance and grants for various sectors like industries, transport, agriculture, trade and public distribution systems, etc. by the Central Government and State governments have increased substantially. Total economic assistance by the Central Government was Rs. 9,581 crores in 1990-91 which increased to Rs. 26,838 crores in 2000-01 and is likely to increase to Rs. 1,16,224 crores in 2010-111 according to budget estimates.

- **Inflation and Stability :** Trend of price increase continues in India ever since achieving the independence. Due to rapid increase in the prices of all commodities and services increase in public expenditure is natural. Besides the government has to incur expenditure from time to time for maintaining economic stability in the country so that stability may be maintained, in employment, production and income.

(B) Social Causes of Increase in Public Expenditure :

- **Increasing Expenditure on Social Security Schemes :** To provide social security services to people in the country is also the prime responsibility of the Government so that they may be saved from five human enemies namely diseases old age, unemployment, hunger and calamities. Due to prevalence of poverty, unemployment and hunger in the country, the central and state Governments have to incur heavy expenditure on providing social security services, to fulfil their responsibilities of being welfare states.

- **Population Explosion :** The increase in population in India after independence has been quite explosive. The population, which was 36 crores only in 1951 reached to 54.8 crores in 1971 and 102.7 crores in 2001. By the end of 2010-11, it has reached to 121 crores. Whereas on one side the Government has to incur heavy expenditure on family planning programmes to have control on the populations it has also to incur very high expenditure on education, medical and health services and social welfare programmes, required for ever increasing population. About Rs. 40,000 crores have been spent on family planning, during last 55 years of planned development and in future the trend of increase in this expenditure is clearly visible.

- **Increasing Expenditure on Social Welfare, Education and Medical Facilities :** Various Governments have to incur heavy expenses on social welfare, education and medical facilities with the objectives of establishment of welfare state. Due to democratic system, every Government tends to continuously increase expenditure in an attempt to increase popularity among the public. As a result unexpected increase in public expenditure is natural.

(C) Political Causes of Increase in Public Expenditure :

- **Increasing Expenditure on Defence :** Frequent attacks on India by China and Pakistan forced the Government to continuously increase expenditure on defence to safeguard the country against foreign attacks and to strengthen the defence system of the country. During 1950-51, total expenditure on defence was Rs. 168 crores which increased to Rs. 3,800 crores in 1980-81 to Rs. 49,622 crores in 2000-01 and to Rs. 1,14,223 crores in 2008-09. Provision to spend Rs. 1,47,344 crores had been made in the budget of 2010-11. Thus, increase in defence expenditure several times has also significantly caused increase in the public expenditure.

- **Democratic System of Government :** Democratic System of Government in India has also been a major cause of unexpected increase in public expenditure. Large sized cabinets, multiplicity of various ministeries, large brigades of Ministers in Coaliation Governments, politics for Vote Catching, etc. have certainly contributed towards significant increase in public expenditure. In India, average expenditure on elections used to be Rs. 100 crores. But now, it is reaching between Rs. 1,200 to 1,500 crores. For a nation like India, this system of Government is quite costly. But it is satisfying that India is the biggest democracy of the world.

(D) Other Causes :

(1) **Increasing Expenditure on Police and Administration :** Heavy expenditure on police to maintain peace and internal security in the country and fast increase in administrative expenses required to operate the activities of democratic system of Government and increasing burden of salaries and allowances of the Government officers and employees have continuously increased public expenditure of the Central Government and all State Governments. During 1980-81, expenditure on police was Rs. 1,163 crores which increased Rs. 23,006 crores in 2000-01. Similarly, the administrative expenditure of Central Government, which was Rs. 21 crores in 1950-51 increased to Rs. 648 crores in 1980-81, to Rs. 2,100 crores in 1990-91 and to Rs. 40,691 crores in 2007-08. Now it has still increased mainfold. However, now it has started showing declining trends.

(2) **Increasing Expenditure on Relief during Natural Calamities :** In a large country like India heavy losses of life and wealth are quite frequent in one or another part of the country, due to natural calamities, like famines, floods, earthquakes, winds and storms. and the Government has to incur heavy expenditure to provide relief against natural calamities. This is also a major cause of public expenditure of the Central and State Governments.

(3) **Expenditure on Control of Terrorism :** Since last few years Government of India is required to incur heavy expenditure to control the events of terrorism. Also Pakistan motivated terrorism in Jammu & Kashmir, naxalite attacks in Andhra Pradesh, insurgency in Nagaland, Assam and Mizoram have compelled the Governments to increase expenditure on control of terrorist activities.

(4) **Increasing Expenditure on Rehabilitation of Refugees :** Refugee problem has continued in India, since independence in one form or the other and the Government has to incur heavy expenditure on rehabilitation of refugees. Besides, the Government is also required to spend heavy expenditure for rehabilitation of the persons displaced from the water acquisition areas, due to construction of dams. Such expenditure has also resulted into increasing the public expenditure.

(III) Public Debt Policy:

Indian Constitution provides for obtaining public debts by the Central and State Governments to fulfil the excess of their expenditure. These debts may be both the internal debts and the external debts. After independence the trend has been of ever increasing public debts. By now, the liability of repayment of public debts and their interest has increased substantially, as it is clear from the following table :

Table : 6 Increasing Burden of Public Debts on Government of India (1950-2010)

At the end of Financial Year	Internal Debts	External Debts	Total Debts
1950-51	2,022	32	2,054
1960-61	3,978	761	4,739
1970-71	7,464	6,577	14,041
1980-81	30,864	11,298	42,162
1990-91	1,54,004	31,525	2,90,619
2000-01	8,03,678	65,945	8,69,643
2005-06	13,89,758	1,94,078	15,83,836
2007-08	18,08,359	2,10,083	20,18,442
2008-09	20,14,451	2,64,076	22,78,527
2009-10	23,56,940	2,80,122	26,37,062

(Budget Estimates)

Source : Economic Review, 2009-10 and others

It becomes clear from this table that burden of public debts on Govt. of India has increased heavily after 1980-81. Unexpected increase in external debts in the decade of 1980, is indicative of increasing dependence of the country on external debts. During 1990-91, external burden, at prevailing exchange rates was of Rs.1,63,001 crores which became equivalent to Rs. 11,66,217 crores i.e. 242.822 billion dollars at the end of Sept.2009.The per capita burden of external debts in India works out to about Rs. 1,000.

When loans are taken from the public, under public debt policy, the amount of loans affect consumption, savings, private investments and accumulation, which in turn effect employment, income and investment in the economy. The Government has diverted the accumulated money towards productive activities through small savings and issuing of bonds. Debts affect the consumption, which helps in controlling the inflation. The Government has taken loans from the banks and used it for various development activities, which has paved the path of growth in production, employment and income.

Foreign debts help in resolving the problem of disequilibrium in payments. Heavy loans from International Monetary Fund and World Bank during recent years helped India in facing foreign exchange crisis, maintaining stability in exchange rates and in settling foreign payment liabilities. It has also made essential imports possible, like those of raw materials, foreign machinaries, medicines and advanced technology. External debts have also helped in developing international co-operation and strengthening political relations. Investment of foreign capital in the country has paved the path of rapid industrialisation.

(IV) Budget Policy and Indian Economy :

Budget policy in India has been used for security of the country, economic development, price stability, growth of employment, stability in foreign exchange rates and estabilising economic equality. Briefly, it may be said that budget policy of India has been motivated by the objective of **"development with stability".**

Adopting budget deficit in the budgets has helped in mobilising the financial resources for economic development. Economic activities have been harnessed by increase in prices. Progressive taxation has helped in reducing economic inequalities. Due to high volume of Government expenditure through budgets, employment has increased, in both the rural and the urban areas. Expenditure on relief programmes has helped in facing the calamities. Concessions provided for agriculture and industries have helped in their development. Small industries have developed very fast in the country.

Increase in budget deficit has created the problem of inflation and have enhanced difficulties in imports and exports. The principle of surplus in budget has not been able to flourish in India. The problem of deficits in the budgets has increased over years as it is clear from the following table :

Table : 6 Budget Deficit and Fiscal Deficit in India 1965-2010

Particulars	Budget Deficit 1965-66	Budget Deficit 1980-81	Budget Deficit 1990-91	Fiscal Deficit	
				2001-02	2010-11
Budget Deficit (Rs. in Crores)	173	3,451	11,486	1,40,255	3,81,408

Source : Budget 2010-11 of Government of India and Economic Review, 2009-10.

Till now the highest budget deficit was in the year 1992-93 when it was at a high level of Rs. 12,540 crores. Thereafter efforts have begun to reduce budget deficit, under the pressure of terms and conditions of International Monetary Fund for providing loans. In the budget proposals of the Central Government for 2010-11 the estimated fiscal deficit is Rs. 3,81,408 crores, whereas for 2009-10 it is estimated to be Rs. 4,14,041 crores. Now the tax base is being made wider by introducing new taxes and the burden of indirect taxes is being reduced by reducing customs duties and excise duties in the budgets and also by various reforms in the tax structure. Fiscal deficit of Central Govt. in 2009-10 is estimated 6.7% of the G.D.P.

8.7 Limitations of Fiscal Policy

Fiscal policy has the following limitations :

1. It is inappropriate to deal with problems that require structural adjustments.
2. It cannot adjust the distribution of money flows.
3. It has operational limitation due to the involvement of time lags. There may be delays in diagnosing recessions and inflations and then devising and pursuing appropriate fiscal measures.
4. It is also difficult to decide the magnitude of fiscal action and the optimum size of budget.
5. Theory of fiscal policy assumes operation of the multiplier effect. But in reality it cannot be easily estimated on account of many leakages involved.
6. Its efficiency depends on strict financial discipline on the part of government and its correct value judgment.

8.8 Main Drawbacks of Fiscal Policy of India

Although Fiscal Policy has been improved, to the maximum possible extent, but still following drawbacks are visible in it :

(1) Degressive Nature : Indirect taxes dominated the taxation policy of India and hence, more and more burden of taxes were on the poor sections, whereas the burden on rich sections was relatively low. It has increasing economic disparities in the country and the life of poor persons is becoming difficult.

(2) **Lack of Co-ordination among Centre and State Governments :** In Indian tax system, main sources of taxes are with the Central Govt. and the states have to depend upon the centre to fulfil their increasing responsibilities. Due to lack of co-ordination differences between centre and states have also increased.

(3) **Lack of Elasticity in Taxation :** Due to lack of elasticity in taxation system in India, the revenue from taxes is not adequate, inspite of increase in tax rates.

(4) **Increasing Burden of Non-development Expenditure :** Increasing expenditure on defence, administration and unproductive activities in the public expenditure policy of India neglects development activities. This is the most important drawback of fiscal policy of India. Now share of development expenditure is increasing.

(5) **Inefficiency and Corruption in Tax Administration :** High volume of Tax evasion is a result of inefficiency and corruption in Indian tax system. It encourages black money and revenue proceeds of the Govt. do not increase to the desired extent. Black money also has serveral ill effects on the economy of the country.

(6) **Extravagent Expenditure of Public Revenue :** Public expenditure in India is distinctly marked by extravagence and wastages. Public leaders and the bureaucrats spend Govt. money, quite mercilessly, to serve their self interests and even in that expenditure, bribery, corruption and inefficiency are rampant. Hence, the people are not able to have the desired benefits of public spending and the path of development also gets obstructed.

(7) **Increasing Expenditure on Tax Collection :** Several types of taxes are levied in India. The multiple-tax system is going on to increase the expenditure on tax collection. Annual expenditure on tax administration which was Rs. 509 crores, during 1980-81 increased to Rs. 12,349 crores in 2007-08.

(8) **Small Share of National Income :** The gross income received from taxes is a very small share of national income, in India. During 1951-52 income received from taxes was just 7% of the national income. It has increased to 9.2% in 2003-04 and likely to increase to 11.5% in 2009-10.

(9) **Dependence on Deficit Financing :** High dependence on deficit financing is also a big drawback of Indian fiscal policy. Although, now it is declining, but the fiscal deficit was about 2.7% of national income in 2007-08 but due to recession the deficit is likely to increase to 6.8% of GDP in 2009-10.

(10) **Heavy Expenditure on Defence :** Ever increasing expenditure on defence is also an important drawback of fiscal policy, in India. This expenditure which was Rs.168 crores in 1950-51 increased to Rs.3,800 crores in 1980-81 and to Rs.49,622 crores in 2000-01. During 2009-10, it is likely to be Rs. 1,41,703 crores, according to budget estimates. The heavy expenditure on defence reduces expenditureon development activities.

(11) **Increasing Burden of Public Debt and Interest :** Public debt in India is increasing continuously at a faster speed and interest burden on it is also increasing rapidly. During 1950-51, burden of interest payments on Central Government was of Rs. 37 crores only which increased to Rs. 99,314 crores in 2000-01. It is estimated to be of Rs. 2,48,664 crores during 2010-11.

(12) Unexpected Increase in Foregin Debts : Unexpected increase in foreign debt of India after 1991 is also a main drawback of its fiscal policy. Debt burden in March, 1991 was equivalent of Rs. 1,63,001 crores which has reached to equivalent of Rs. 11,66,217 crores i.e. 242.822 Billion dollars by September, 2009. This is a matter of very serious concern for the nation.

8.9 Summary

Fiscal policy has quantitative as well as a qualitative aspects. Changes in tax rates, the structure of taxation and its incidence, influence the volume and direction of private spending in the economy. Similarly, changes in government's expenditure and its structure of allocation will also have quantitative and redistributive effects on income, consumption and aggregate demand of the community. As a matter of fact all government spending is an inducement to increase the aggregate demand (both volume and component) and has an inflationary bias in the sense that it releases funds for the private economy which are then available for use in the course of trade and business. Similarly, a reduction in government spending has a deflationary bias and it reduces the aggregate demand (its volume and relative components in which the expenditure is curtailed). Thus, the composition of public expenditure and composition of public revenue not only help to mould the economic structure of the country, but may also be expected to exert certain effects on the economy at certain times and a quite different impact at other times.

8.10 Key Words

- **Capital Expenditure** : are intended for the creation of net productive assets in the economy.
- **Public Debt :** obligation of governments particularly those evidenced by securities to pay certain sums to the holders at some future date.
- **Surplus Budgets :** spending less than the public revenue obtained.
- **Direct Tax :** one which is demanded from the very persons who, it is intended or desired, should pay it.
- **Indirect Tax** : is a tax, the burden of which can be shifted to others.
- **TDS :** Tax Deduction of Source

8.11 Self Assessment Test

1 How will you justify the increase in public expenditure ? What causes are responsible for the recent increase in public expenditure ? Explain

2 For what purposes does the government contract for public debt ? Explain

3 Discuss the role of Fiscal Policy in developing country.

4 What do you understand by Fiscal Policy ? Explain its objectives and importance.

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Unit - 9 : Monetary Policy

Unit Structure:

9.0 Objectives

After reading this unit you will be able to:

- To have knowledge about money supply.
- To study monetary policy and its instruments.
- Role of monetary policy in economic growth.
- To know the process of formulation of monetary policy.

9.1 Introduction

Monetary policy is primarily concerned with the management of supply of money in a growing economy. It is a part and parcel of economic policy and consists of all those measures through which central bank of a country controls the supply of money to attain general economic objectives. This policy determines the rate and direction of economic development of the country. It deals with the distribution of credit between uses and users and also with both the lending and borrowing rates of interest of the banks. The past three decades have seen an extraordinary transformation in the conduct of monetary policy. In the 1970s, inflation had risen to very high levels with most countries, including the United States, experiencing inflation rates in the double digits. In developed countries the monetary policy has been used for overcoming deflation and inflation as anti cyclical policy. In developing countries it plays a significant role in promoting economic growth. Monetary policy involves changes in the base rate of interest to influence the growth of aggregate demand, the money supply and price inflation. Monetary policy works by changing the rate of growth of demand for money. Changes in short term interest rates affect the spending and savings behavior of households and businesses and therefore feed through the circular flow of income and spending. It is defined as the policy of a country's central bank through which the availability of money and credit, cost and use of various monetary measures. The policy is traditionally announced twice a year through which the Reserve Bank of India (RBI) seeks to ensure a prime stability for the economy. Monetary policy operates through varying the cost availability of credit. The variations affect the demand for and the supply of credit in the economy, and the nature of economic activities. The monetary policy has now become dynamic in nature as RBI reserves the right to alter it from time to time depending on the state of economy to attain the desired social goals of economic stability and equity.

9.2 Definition

According to Prof. Harry Johnson, "A policy employing the central banks control of the supply of money as an instrument for achieving the objectives of general economic policy is a monetary policy". According to Paul Einging, "Monetary Policy includes all monetary decision and measures irrespective of whether their aims are monetary or non-monetary and all non monetary decisions and measures that aim at affecting the monetary system." According to Prof. R.P. Kent, "Monetary policy is the management of the expansion and contraction of the volume of money in circulation for the implicit purpose of attaining a specific objective such as full employment."

Thus, Monetary Policy is one of the tools used to influence its economy. Using its monetary authority to control the supply and availability of money a government attempts to influence the overall level of economic activity in line with its political objectives. Usually this goal is "**macro-economic stability**" Which includes low unemployment, low inflation, economic growth and a balance of external payments. Monetary policy is administered by a government appointed central bank which in our country is **"Reserve Bank of India"**. It affects through monetary and non-monetary measures, the quantity of money supply and composition, size and distribution of credit, level and structure of interest rated and various policy objectives in the country. Through the direct and indirect monetary factors, it affects savings and investments and consequently output, income and price level as directed in a desirable direction in an economy.

It is clear now that it is the process by which the monetary authority of a country regulates (i) the supply of money, (ii) availability of money and (iii) cost of money or rate of interest in order to attain a set of objectives oriented towards the growth and stability of the economy.

9.3 Objectives of Monetary Policy

Monetary policy is a part of economic policy and it is an important instrument to have state interference and necessary direction in economic activities of a country. The objectives are to maintain price stability and to ensure an adequate flow of credit to the productive sectors of the economy. According to Professor J.M. Keynes to attain price stability is the only objective of Monetary Policy but the period and environment of a country brings the changes in the objectives of the policy. However some of the important objectives of the policy are:

- **Price Stability :** The most important objective of monetary policy is to maintain price stability in the country. RBI makes efforts to control price stability through various monetary measures. In the absence of price stability prices generate inflationary and deflationary situation in an economy which affects the various sectors of economy and different sections of the society. Under price stability fluctuations in prices are to be controlled and regulated in such a way that it can have desirable effects on production, income and employment generation.

- **Exchange Stability :** Foreign exchange rate stability is one of the traditional objectives of monetary policy because for the development of international trade exchange stability is an essential condition. Exchange rate instability will lead to outflow of money and encourage speculative tendencies in the country. Through controlled policy the unfavorable balance of payments can be controlled.

- **Neutrality of Money :** The objective of neutrality means to make ineffective the effect of change in the quantity of money on various elements like; price income, employment etc.. The quantity of money is kept perfectly constant so that the effect on price level is zero. Neutrality of money does not mean that the supply of money is perfectly inelastic and fixed but it means to control the effectiveness of money.
- **Full Employment :** The primary objective of monetary policy is to attain full employment. does not mean unemployment situation but the situation in which the resources are utilised to the optimum level and thereby higher level of national income is attained.
- **Economic Development :** The objectives of monetary policy differ in developed and developing countries. In a developing country monetary policy is an important instrument of economic stability. Environment of economic development is encouraged to attain equilibrium between aggregate money supply and demand through monetary policy. Economic development and capital formation are closely related and monetary policy affects the savings, investment and capital formation for the rapid economic development of a country.

9.4 Role of Monetary Policy

Monetary policy cannot directly influence economic growth but it can provide a conducive environment that encourages growth i.e. low and stable prices. When prices are stable people can effectively plan to invest, save and consume. When there are indications of excess demand and rising inflationary pressures the banks can increase the Repo rate to reduce domestic demand. This is called restrictive monetary policy. On the other hand, through expansionary monetary policy banks can reduce the Repo rate to increase money supply in order to stimulate domestic demand. This will contribute to increased economic growth.

Economic growth implies the expansion in productive capacity or capital stock in the economy so that increase in real national output or income are attained. The accelerated rate of savings and investment in the economy through economic growth requires the following steps:

a) Increase in aggregate rate of savings in the economy.

b) Mobilization of these savings so that they are made available for the purpose of investment and production.

c) Increase in the rate of investment.

d) Allocation of investment funds for productive purposes and priority sectors of the economy.

The average growth rate of the Indian economy over a period of 25 years since 1980-81 (India's fiscal year is from 1st April to 31st March) has been about 6.0 per cent, which is quite a significant improvement over the annual growth rate of 3.5 per cent over the previous three decades from 1950-51 to 1979-80. In the more recent period, the Indian economy has entered what one might call a high-growth phase, the growth rate averaging 8.6 per cent per annum in the last three years. In the last two years, the growth rate has averaged 9.1 percent. While the GDP growth has accelerated, the population growth rate has moderated.

Since the 1990s the per capita income has been growing at an average rate of around 4.0 per cent, implying that a person's income will double in nearly 18 years. A person with a life expectancy of, say, 72 years could thus see his income doubling at least three times. If the current GDP growth rate of around 9 per cent is maintained than the standard of living can be multiplied by almost five times. A noteworthy feature of Indian growth process over the last one and a half decades has been its stability. This is evident from the substantially lower coefficient of variation of real GDP growth during the post-reform period as compared to that during the pre-reform period. It is also important to note that India's growth is driven by domestic consumption, contributing on an average to almost two-thirds of the overall demand, while investment and export demand are also accelerating. As consumption is less volatile component of demand, this has also contributed to reducing the volatility of GDP.

9.5 Measurement of Money Supply in India

The four components to calculate money supply in India known as money stock measures of monetary aggregates are:

$$M : M_1 + M_2 + M_3 + M_4$$

M_1 = Currency with the public i.e. coins and currency notes + demand deposits with banks + other deposits with RBI.

$M_2 = M_1$ + Post Office savings

$M_3 = M_1$ + time deposits of public with banks, also known as broad money.

$M_4 = M_3$ + saving and time deposits with the post office.

Out of the four concepts of money supply RBI emphasis only on two concepts M_1 & M_3. As M_3 is broader in scope it is taken as measure of money supply in India and is also referred as broad money or aggregate monetary resource of the people.

Monetary Policy and Money Supply

The budgetary operations of the government considerably affect the money supply. The supply of money has a direct impact on inflation, level of investment and employment generation interest rate. It is clear that supply of money has an effect on every aspect of the economy and has a close relationship with development and so every country manages supply of money in the national interest through monetary policy. Supply of money is directly related with inflation too. It is based on simple fundamental of demand and supply. The value of a currency is defined by its purchasing power. As the supply of money increases its value interest rate etc. It is clear that supply of money has an effect on every aspect of the economy and has a close relationship with development and so every country manages supply of money in the national interest through monetary policy. Supply of money is directly related with inflation too. It is based on simple fundamental of demand and supply. The value of a currency is defined by its purchasing power. As the supply of money increased its value decreases. Decrease in purchasing power means increase in inflation. The monetary policy through its various tools regulates such a situation by increasing or decreasing the supply of money in the market.

9.6 Instruments of Monetary Policy

The central bank of a country formulates and implements the monetary policy of a country. The objectives of monetary policy are attained through its tools. Implementing monetary policy, a central bank can act directly using its regulatory powers or indirectly, using its influence on money market conditions as the issuer of reserve money (currency in circulation and deposit balances with the central bank). The term "direct" refers to the one-to-one correspondence between the instrument (such as a credit ceiling) and the policy objective (such as a specific amount of domestic credit outstanding). Direct instruments operate by setting or limiting either prices (interest rates) or quantities (amounts of credit outstanding) through regulations, while indirect instruments act through the market by, in the first instance, adjusting the underlying demand for, and supply of, bank reserves. The greater use of indirect monetary instruments can be seen as the counterpart in the monetary area of the widespread movement toward enhancing the role of price signals in the economy. Both aim to improve market efficiency. In addition, the adoption of indirect instruments is taking place in an increasingly open economic environment characterized by widespread adoption of current account convertibility and progress in moving to full external account convertibility. In such an environment, direct instruments have become increasingly ineffective leading to inefficiencies and disintermediation. The most common direct instruments are interest rate controls, credit ceilings, and directed lending (lending at the behest of the authorities, rather than for commercial reasons). The three main types of indirect instrument are open market operations, reserve requirements, and central bank lending facilities. The tools or instruments of monetary policy are broadly classified into two categories:

1. Quantitative Techniques –

The total supply of credit is regulated by these methods of credit control in an economy. These techniques either increase the credit or decrease the credit known as expansion of credit and contraction of credit. The various techniques of quantitative credit control are: -

i) **Bank Rate**: The rate at which the commercial bank borrows from the central bank is known as bank rate. It is also called as discount rate as the central bank discounts bill or the first class securities of commercial banks. If the bank rate is changed by RBI commercial banks also change the interest rates and so the cost of borrowing is affected. When bank rate is raised credit becomes costly because the commercial bank also changes interest rates and so the cost of borrowing is affected. When bank rate is raised credit becomes costly because the commercial banks also charge high rate on the loans and advances given to different sector of the economy and society. It discourages investment, output and employment. Income of people decreases and the price level can be controlled to some extent. Contrary to it when the bank rate is reduced the credit becomes cheaper. The commercial banks can borrow from RBI at lower rate of interest and consequently they also charge lower rate of interest on their loans and advances which encourages investments, production increases, income and purchasing power of people increases with the rise in price level. Economic activities are revised with the lowering of bank rate.

(ii) **Open Market Operations**: Operations under which bank securities are bought and sold by the central bank are known as open market operations. When government securities are purchased by the public and commercial banks purchasing power is transferred from public to the central bank. It leads to contraction of credit contrary to it when governments securities are sold by the public and commercial banks it increase the purchasing power of public and banks. It increases the deposits which leads to expansion of credit. Thus, when RBI purchases government securities there will be expansion of credit and sale of securities will lead to contraction of credit. This tool of monetary policy as an instrument of credit control is used to make bank rate more effective.

(iii) **Cash Reserve Ratio (CRR)** : Commercial banks have to keep a part of their time and demand deposits with the RBI on which commercial banks get interest RBI can contract or expand credit with the increase or decrease in CRR by adopting clear money policy or cheap money policy. The credit creation capacity of commercial banks is affected by CRR.

(iv) **Statutory Liquidity Ratio (SLR)** : It is that portion of total deposits of commercial banks which it has to keep with itself in the form of liquid assets. The ratio can be lowered or raised by RBI. Raising rates leads to reduction in the lending capacity of commercial banks by a multiple depending on the reserve requirement which influences the velocity of circulation of credit money. When the central bank adopts cheap money policy in order to make available more resources, then the SLR is reduced.

2. Qualitative Techniques –

Techniques Quantitative methods of credit control either lead to contraction of credit or expansion of credit. The RBI takes the decision, taking into consideration the inflationary and deflationary condition and consequently follows the policy of clear money policy (contraction of credit) and cheap money policy (expansion of credit) in a country.

Qualitative or selective credit control measures affect the use and direction of credit. These measures of credit control regulates the flow of credit from non essential uses to essential uses and from non-priority sectors to priority sectors. Some of selective credit control measures are –

i) **Rationing of Credit** – A tool of credit control which fixes the limit of credit quantum for the borrower. When there is shortage of money RBI uses the rationing of credit measures to restrict the limit of loans and advances and also to identify priority sectors where special loans and advances are made by the banks.

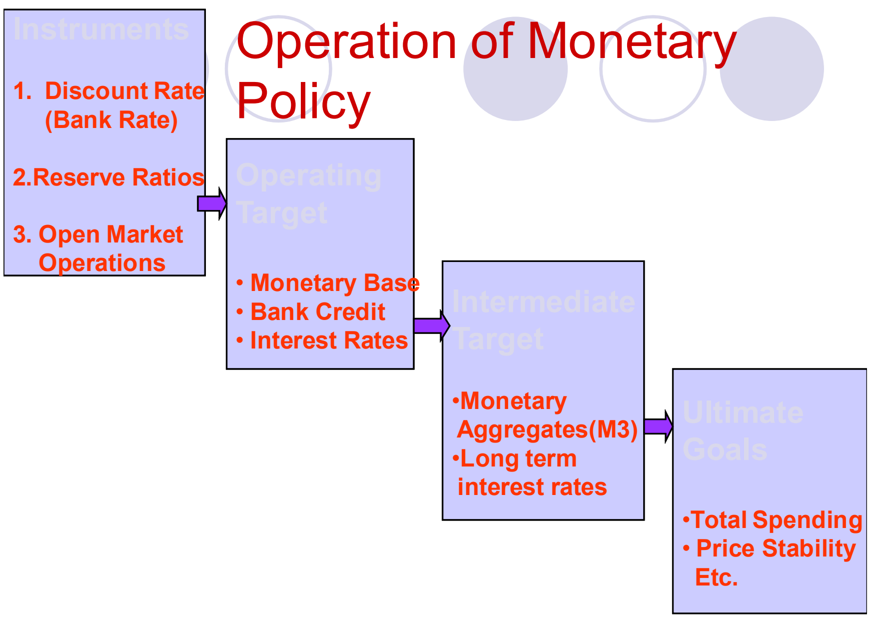
ii) **Margin Requirements Against Security** – Margin is the difference between amount of borrowings and the price of security. This selective credit method controls the use of credit for speculative proposes. RBI has been empowered to increase or decrease the margin requirements and it diverts the flow of credit with margin requirements for attaining social objectives.

iii) **Regulation of Consumer Credit** – It regulates the credit on which consumers purchase various consumer goods. Under this measures of credit control restrictions are imposed on the purchase of consumer goods or the payment time is fixed and the installments are reduced.

iv) **Direct Action** – If the commercial banks do not follow the directions given by the RBI, it can take action against the particular banks. Under this method of credit control central bank can refuse the discounting facility of bills and can also change the penal rates of interest from the banks.

v) **Moral Persuasion** – RBI uses moral persuasion to pressurize indirectly the working of commercial banks in place of direct action. Through this measure of credit control bank can seek the active and desired co-operation from the commercial banks in a country.

9.7 Operation of Monetary Policy



Repo and Reverse Repo Rates

Repo rate is the interest rate charged by the Central bank when banks borrow money from it against pledging its securities. If the RBI wants to make it more expensive for the banks to borrow money, it increases the repo rate; similarly, if it wants to make it cheaper for banks to borrow money, it reduces the repo rate.

The rate at which RBI borrows money from the banks (or banks lend money to the RBI) is termed the reverse repo rate. If the reverse repo rate is increased it means the RBI will borrow money from the bank and offer them a lucrative rate of interest. As a result banks would prefer to keep their money with the RBI (which is absolutely risk free) instead of lending it out (this option comes with a certain amount of risk). Consequently banks would have lesser funds to lend to their customers. This helps to slow the flow of excess money into the economy. Reverse repo rate signifies the rate at which the central bank absorbs liquidity from the banks while repo signifies the rate at which liquidity is injected.

Repo and Reverse Repo are tools available in the hands of RBI to manage the liquidity in the system. It either injects liquidity into the market if the conditions are tight or sucks out liquidity if the liquidity is excess in the system through the Repo and Reverse Repo mechanism, besides a host of other measures. Now in REPO rate RBI injects liquidity into the system i.e. it purchases the securities from the banks and lends money to them to ease their liquidity crunch. The rate charged by it for lending money is the REPO rate. Reverse REPO is the opposite of REPO: When liquidity is excess in the system. RBI sucks it out by Reverse REPO by lending securities and taking out money from banks. The rate charged for it is the Reverse Repo rate. These rates, form the bottom and the top of the Call money lending/borrowing of the banks. The call money rates generally fall in between this corridor. The reverse repo rate is the rate at which banks park their short-term excess liquidity with the Central Bank while the repo rate is the rate at which the Central Bank pumps in short-term liquidity into the system.

9.8 Monetary Policy in India

The term monetary policy is also known as the credit policy or called Reserve Bank of India's money management policy in India. It is related to the demand and supply of money in the market. It is clear that a monetary policy is related to the availability and cost of money supply in the economy in order to attain certain broad objectives. The objectives of monetary policy in India have gone through a process of gradual evolution and have included price stability ensuring adequate flow of credit to various productive sectors of the economy and achieving financial stability. The policy stance is based upon the assessment of the macroeconomic and financial conditions and monetary measures. The statements reflect the changing circumstances and priorities of the RBI and a thrust for the future.

Reserve Bank of India announces Monetary Policy every year in the month of April which is followed by three quarterly reviews in July, October and January but RBI at its discretion can announce the measures at any point of time.

The annual monetary policy is made up of two parts –

Part A : Macroeconomic and monetary developments.

Part B : Actions taken and fresh policy measures.

There are four main channels which the RBI looks at –

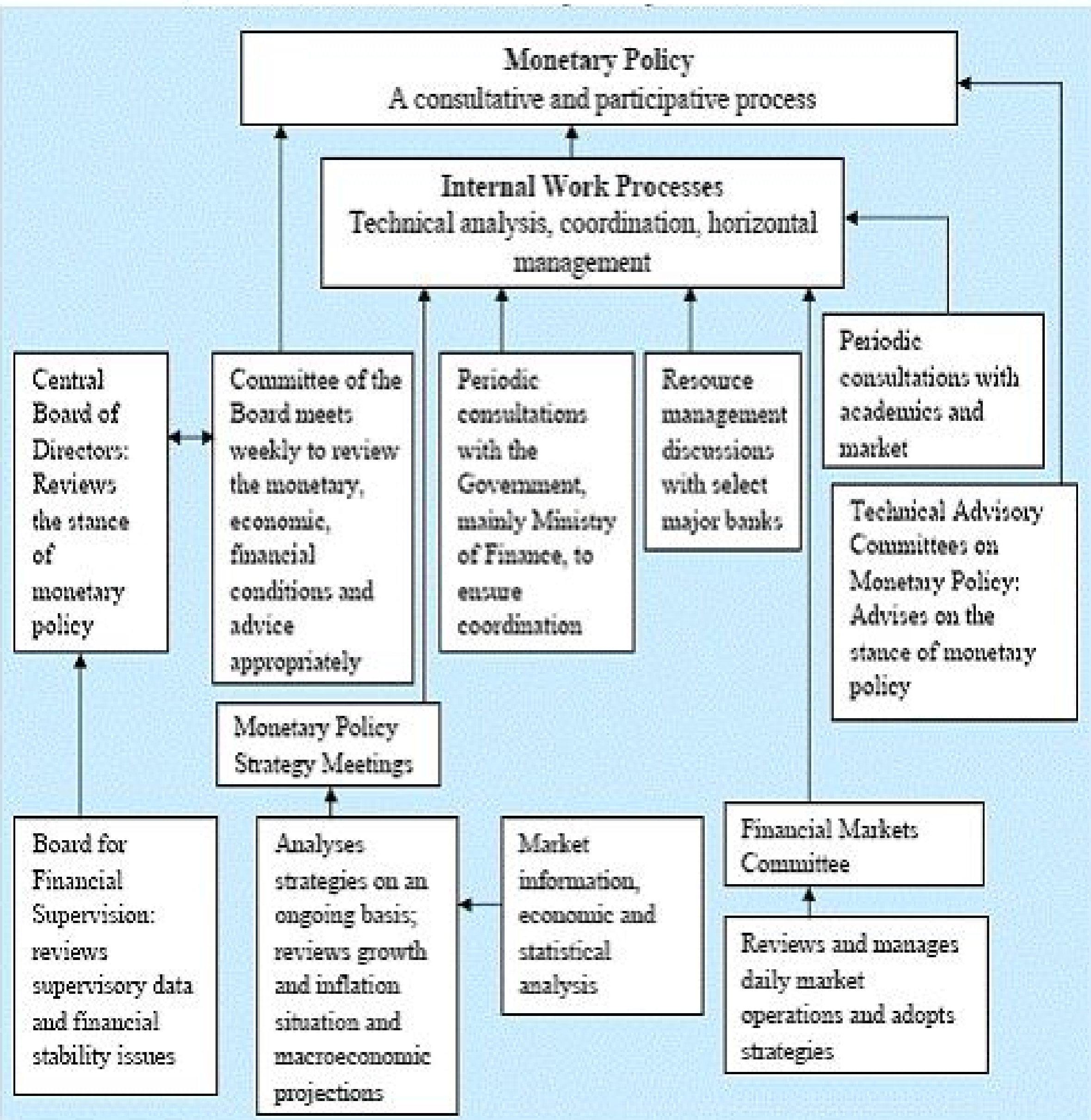
- Quantum channel : money supply and credit (affects real output and price and through changes in reserves money, money supply and credit aggregates.

- Interest rate channel
- Exchange rate channel
- Asset price

Policy Formulation Processes

The process of monetary policy in India had traditionally been largely internal with only the end product of actions being made public. The process has overtime become more consultative, participative and articulate with external orientation. The internal work processes have also been re-engineered to focus on technical analysis, coordination, horizontal management and more market orientation. The process leading to monetary policy actions entails a wide range of inputs involving the internal staff, market participants, academics, financial market experts and the Bank's Board (Chart 1).

Chart - 1 : The process of monetary policy Functions

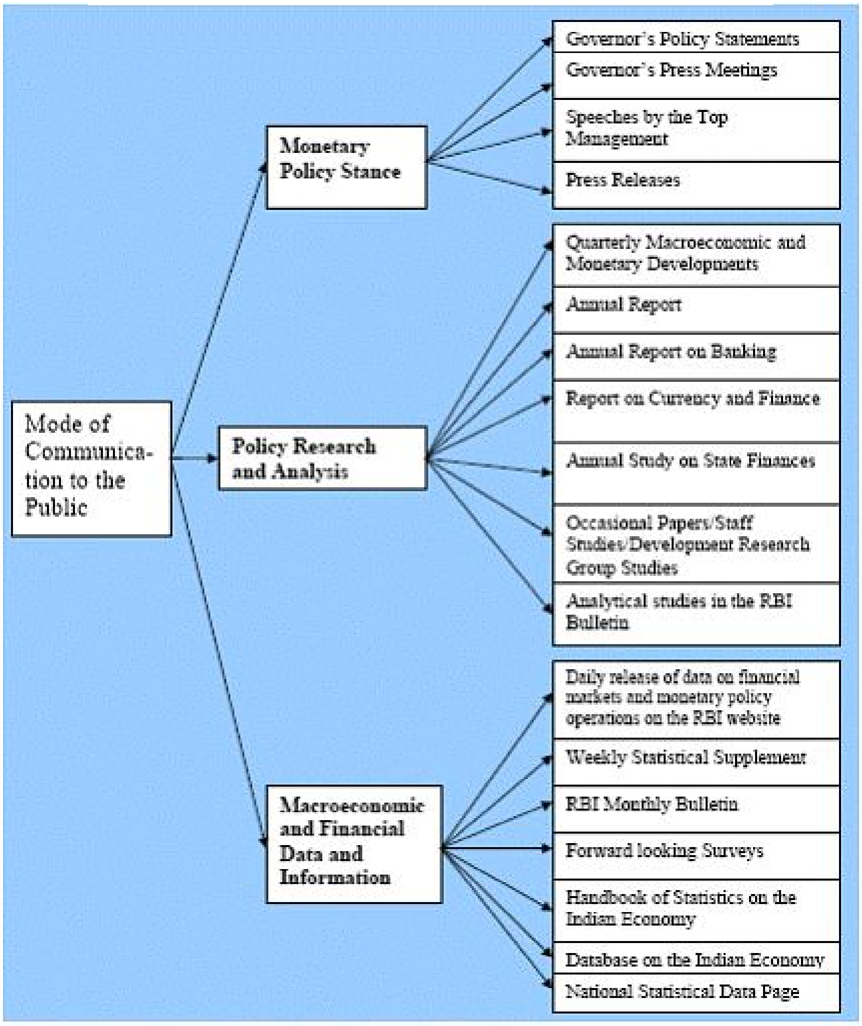


Several new institutional arrangements and work processes have been put in place to meet the needs of policy making in a complex and fast changing economic environment. At the apex of the policy process is the Governor assisted closely by Deputy Governors and guided by deliberations of the Board of Directors. A Committee of the Board meets every week to review the monetary, economic and financial conditions and renders advice on policy. There are several other standing and ad hoc committees or groups which play a critical role with regard to policy advice. An interdepartmental Financial Markets Committee focuses on day-to-day market operations and tactics while periodic monetary policy strategy meetings analyze strategies on an ongoing basis.

Information Dissemination and Policy Communication

It is generally believed that greater information dissemination and policy communication could lead to better policy outcome. The stance of monetary policy and the rationale are communicated to the public in a variety of ways, the Governor's most important being the quarterly monetary policy statements. Further the policy measures are analysed in various statutory and non-statutory publications, speeches and press releases. Information on areas relating to the economy, banking and financial sector is released with stringent standards of quality and timeliness. Dissemination of information takes place through several channels (Chart 2). The Reserve Bank has also developed a real time database on the Indian economy, which is available to the public through its website.

Chart 2: Information Dissemination and Policy Communications



9.9 Highlights of Annual Monetary Policy Statement for the year 2011-12

Highlights of the monetary policy for this fiscal unveiled by the Reserve Bank of India (RBI) Governor D. Subbarao:

- The Repo rate hiked by 50 basis points to 7.25 percent
- The Reverse repo hiked by 50 basis points to 6.25 percent
- The Saving bank deposit rates increased by 50 basis points to 4 percent
- Other policy rates such as statutory liquidity ratio and cash reserve ratio unchanged
- Henceforth the repo rate will be the only one independently varying policy rate
- The Reverse repo rate to be no longer independent, will be pegged at a fixed 100 basis points below the repo rate
- Global commodity prices are a significant risk factor for both domestic growth and inflation
- Fiscal target set in the budget could be challenged by higher subsidy burden stemming from higher international crude oil prices
- Slackening in global recovery could impact economy through trade, finance and confidence channels
- Stance of monetary policy will be to ensure balance in liquidity flow

RBI CURRENT RATES

Rates	%	w.e.f.
Bank Rate	6.00%	29.04.2003
Repo Rate	8.50%	25.10.2011
Rev. Repo Rate	7.50%	25.10.2011
C R R	6.00%	03.11.2010
S L R	24.00%	18.12.2010
Base Rate	9.50-10.75 %	--------
PLR	12-15 %	--------
Deposit Rate	8.50-9.50%	--------
Saving Bank	Deregulated	25.10.2011

9.10 Limitations of Monetary Policy

Monetary policy has the following limitations:

- Monetary policy is ineffective in solving the complicated business situation in recent years.
- Generally the attitude of people regarding consumption & savings depend on the services of their income and institutional framework.
- Investment decisions are affected by many factors.

- Underdeveloped money markets in most of the developing countries.
- Funds are made available not only by commercial banks and so selective credit control measures become ineffective.

9.11 Summary

Monetary Policy is about supply of the currency in the country regulated by the RBI. Though the RBI does it in the light of the final policy and macro objectives of the government it is in this sense that final policy and monetary policy are complementary. There are various factors affecting money supply in India some of them are as follows : net bank credit to the bank, bank credit to the commercial sector, net foreign exchange assets of the banking sector, government currency liabilities to the public, non-monetary liabilities of the banking sector. There is direct relationship between supply of money and inflation. As the supply of money increases its value goes down and inflation increases, supply of money goes has also an impact on the interest rate and level of investment. It is the RBI which regulates the supply of money in India. The RBI has various tools which can be used to control the supply of the money in the economy. Some of them are open market operations bank rate, direct regulation of interest rates, cash reserve ratio, statutory liquidity ratio and other selective credit control methods.

9.12 Key Words

- **Open Market Operations :** Operations under which bank securities are bought and sold by the Centrel Bank. This is the tool of monetary policy as instrument of credit cantrol.
- **Bank Rate :** The rate at which commereial Bank borrows from the central Bank is known as Bank rate. It is also called discount rate.
- **Cash Reserve Ratio :** The credit creation capacity of commercial Bank is affected by cash reserve ratio. A part of the deposits of commercial Banks have to keep with RBI on which they get interest this amount is according to CRR.
- **Statutory Liquidity Ratio (SLR) :-** SLR is the portion of total deposits of commercial Banks which they here to keep with itself in the form of liqund assests. this ratio can be lowered or rased by RBJ.
- **Selective Credit Control :** SCC measures affect the use and direction of credit. There measures of credit contorl regulates the flow of credit from non-essential uses to essential uses and from nonpriority sectors to priority sectors.
- **Repo :** Repo rate is the intrest rate charged by central Bank when commerial bank borrow money from it against pledging its securities.
- **Reverse Repo :** The rate at which RBI borrows money from the Banks is termed as Reverse Repo Rate.

9.13 Self Assessment Test

1 What do you mean by monetary policy? Discuss its objectives and importance.

2. Discuss how the RBI regulates the supply of money in our country.

3. Discuss how Monetary Policy influences inflation.

4. What are the various instruments of Monetary Policy? Explain.

5. Discuss the highlights of Annual statement of Monetary Policy 2011-12 announced by RBI.
6. What do you mean by CRR, SLR, Repo and Reverse Repo? Discuss.
7. What are the current rates of CRR, SLR, Repo, Reverse Repo, saving and deposit rate? Explain.

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Unit - 10 : Financial Markets

Unit Structure

10.0 Objectives

After studying this unit you should be able to understand:

- The concept of Financial Markets
- The objectives, underlying values and salient features of Financial Markets
- Types of Financial Markets
- The process of Financial Markets
- The issues in Financial Markets

10.1 Introduction

A **financial market** is a market in which people and entities can trade financial securities, commodities, and other fungible items of value at low transaction costs and at prices that reflect supply and demand. Securities include stocks and bonds and commodities include precious metals or agricultural goods. There are both general markets (where many commodities are traded) and specialized markets (where only one commodity is traded). Markets work by placing many interested buyers and sellers including households, firms and government agencies, in one "place", thus making it easier for them to find each other. An economy which relies primarily on interactions between buyers and sellers to allocate resources is known as a market economy in contrast either to a command economy or to a non-market economy such as a gift economy.

Financial Markets facilitate:

- The raising of capital (in the capital markets)
- The transfer of risk (in the derivatives markets)
- Price discovery
- Global transactions with integration of financial markets
- The transfer of liquidity (in the money markets)
- International trade (in the currency markets)

Typically a borrower issues a receipt to the lender promising to pay back the capital. These receipts are securities which may be freely bought or sold. In return for lending money to the borrower the lender will expect some compensation in the form of interest or dividends. This return on investment is a necessary part of markets to ensure that funds are supplied to them.

In economics, typically, the term *market* means the aggregate of possible buyers and sellers of a certain good or service and the transactions between them.The term "market" is sometimes used for what are more strictly exchanges, organizations that facilitate the trade in financial securities e.g., a stock exchange or commodity exchange. This may be a physical location (like the NYSE, BSE, and NSE) or an electronic system (like NASDAQ). Much trading of stocks takes place on an exchange; still corporate actions (merger, spinoff) are outside an exchange, while any two companies or people, for whatever reason, may agree to sell stock from the one to the other without using an exchange. Trading of currencies and bonds is largely on a bilateral basis, although some bonds trade on a stock exchange, and people are building electronic systems for these as well, similar to stock exchanges.

10.2 Types of Financial Markets

The financial markets can be divided into different types:

- Capital markets which consist of primary market and Secondary markets.
- Stock markets which provide financing through the issuance of shares or common stock, and enable the subsequent trading there of.
- Bond markets which provide financing through the issuance of bonds and enable the subsequent trading thereof.
- Commodity markets which facilitate the trading of commodities.
- Money markets which provide short term debt financing and investment.
- Derivatives markets which provide instruments for the management of financial risk.
- Futures markets which provide standardized forward contracts for trading products at some future date.
- Insurance markets which facilitate the redistribution of various risks.
- Foreign exchange markets which facilitate the trading of foreign exchange.

The capital markets may also be divided into primary markets and secondary markets. Newly formed (issued) securities are bought or sold in primary like markets initial public offerings. Secondary markets allow investors to buy and sell existing securities. The transactions in primary markets exist between issuers and investors while in secondary market transactions exist among investors.

Liquidity is a crucial aspect of securities that are traded in secondary markets. Liquidity refers to the ease with which a security can be sold without a loss of value. Securities with an active secondary market mean that there are many buyers and sellers at a given point in time. Investors benefit from liquid securities because they can sell their assets whenever they want; an illiquid security may force the seller to get rid of their asset at a large discount.

10.3 Relationship between Lenders and Buyers

Financial markets attract funds from investors and channel them to corporations—they thus, allow corporations to finance their operations to achieve growth. Money markets allow firms to borrow firms on a short term basis while capital markets allow corporations to gain long-term funding to support expansion.

Without financial markets borrowers would have difficulty in finding lenders themselves. Intermediaries such as banks help in this process. Banks take deposits from those who have money to save. They can then lend money from this pool of deposited money to those who seek to borrow. Banks popularly lend money in the form of loans and mortgages.

More complex transactions than a simple bank deposit require markets where lenders and their agents can meet borrowers and their agents, and where existing borrowing or lending commitments can be sold on to other parties. A good example of a financial market is a stock exchange. A company can raise money by selling shares to investors and its existing shares can be bought or sold.

The following table illustrates where financial markets fit in the relationship between lenders and borrowers:

Relationship between lenders and borrowers			
Lenders	**Financial Intermediaries**	**Financial Markets**	**Borrowers**
Individuals	Banks Insurance Companies Pension Funds Mutual Funds	Interbank Stock Exchange Money Market Bond Market Foreign Exchange	Individuals Companies Central Government Public Corporations

These are discussed as under:

Lenders:

Who have enough money to lend or to give someone money from own pocket at the condition of getting back the principal amount or with some interest or charge is called the Lender.

***Individuals*:** are lenders. Almost everybody does lend money in many ways. A person lends money when he or she:

- puts money in a savings account at a bank;
- contributes to a pension plan;
- pays premiums to an insurance company;
- invests in government bonds; or
- Invests in company shares.

Companies tend to be borrowers of capital. When companies have surplus cash that is not needed for a short period of time, they may seek to make money from their cash surplus by lending it via short term markets called money markets.There are a few companies that have very strong cash flows. These companies tend to be lenders rather than borrowers. Such companies may decide to return cash to lenders (e.g. via a share buyback.) Alternatively they may seek to make more money on their cash by lending it (e.g. investing in bonds and stocks.)

Borrowers:

Individuals borrow money via bankers' loans for short term needs or longer term mortgages to help finance a house purchase.

Companies borrow money to aid short term or long term cash flows. They also borrow to fund modernization or future business expansion.

Governments often find their spending requirements exceed their tax revenues. To make up this difference, they need to borrow. Governments also borrow on behalf of nationalized industries, municipalities, local authorities and other public sector bodies. In the UK, the total borrowing requirement is often referred to as the Public sector net cash requirement (PSNCR).

Governments borrow by issuing bonds. In the UK, the government also borrows from individuals by offering bank accounts and Premium Bonds. Government debt seems to be permanent. Indeed the debt seemingly expands rather than being paid off. One strategy used by governments to reduce the *value* of the debt is to influence *inflation*.

Municipalities and local authorities may borrow in their own name as well as receiving funding from national governments. In the UK, this would cover an authority like Hampshire County Council.

Public Corporations typically include nationalized industries. These may include the postal services, railway companies and utility companies.

Many borrowers have difficulty raising money locally. They need to borrow internationally with the aid of foreign exchange markets. Borrowers having similar needs can form into a group of borrowers. Theycan also take an organizational form like Mutual Funds. They can provide mortgage on weight basis. The main advantage is that this lowers the cost of their borrowings.

10.4 Derivative Products and Currecy Markets

During the 1980s and 1990s, a major growth sector in financial markets is the trade in so called **derivative products**, or **derivatives** for short.In the financial markets, stock prices, bond prices, currency rates, interest rates and dividends go up and down, creating *risk*. Derivative products are financial products which are used to *control* risk or paradoxically *exploit* risk. It is also called financial economics.

Derivative products or instruments help the issuers to gain an unusual profit from issuing the instruments. For using the help of these products a contract has to be made. Derivative contracts are mainly three types:

1. Future Contracts
2. Forward Contracts
3. Option Contracts

Seemingly, the most obvious buyers and sellers of currency are importers and exporters of goods. While this may have been true in the distant past,when international trade created the demand for currency markets, importers and exporters now represent only 1/32 of foreign exchange dealing, according to the Bank for International Settlements.

The picture of foreign currency transactions today shows:

- Banks/Institutions
- Speculators
- Government spending
- Importers/Exporters
- Tourists

10.5 Indian Financial Market

What does the Indian Financial market comprise of? It talks about the primary market, FDIs, alternative investment options, banking and insurance and the pension sectors, asset management segment as well. With all these elements in the Indian Financial market, it happens to be one of the oldest across the globe and is definitely the fastest growing and best among all the financial markets of the emerging economies. The history of Indian capital markets spans back 200 years, around the end of the 18th century. It was at this time that India was under the rule of the East India Company. The capital market of India initially developed around Mumbai with around 200 to 250 securities brokers participating in active trade during the second half of the 19th century.

The financial market in India at present is more advanced than many other sectors as it became organized as early as the 19th century with the securities exchanges in Mumbai, Ahmedabad and Kolkata. In the early 1960s, the number of securities exchanges in India became eight - including Mumbai, Ahmedabad and Kolkata. Apart from these three exchanges there were the Madras, Kanpur, Delhi, Bangalore and Pune exchanges as well. Today there are 23 regional securities exchanges in India.

The Indian stock markets till date have remained stagnant due to the rigid economic controls. It was only in 1991, after the liberalization process that the Indian securities market witnessed a flurry of IPOs serially. The market saw many new companies spanning across different industry segments and business began to flourish. The launch of the NSE (National Stock Exchange) and the OTCEI (Over the Counter Exchange of India) in the mid-1990s helped in regulating a smooth and transparent form of securities trading.

The regulatory body for the Indian capital markets is the SEBI (Securities and Exchange Board of India). The capital markets in India experienced turbulence after which the SEBI came into prominence. The market loopholes had to be bridged by taking drastic measures.

Financial Market helps in promoting the savings of the economy by helping to adopt an effective channel to transmit various financial policies. The Indian financial sector is well-developed, competitive, efficient and integrated to face all shocks. In Indian financial market there are various types of financial products whose prices are determined by the numerous buyers and sellers in the market. The other determinant factor of the prices of the financial products is the market forces of demand and supply.

10.5.1 Features of the Financial Market in India

- Indian Financial Indices - BSE 30 Index, various sector indices, stock Quotes, Sensex charts, Bond Prices, Foreign Exchange, Rupee & Dollar Chart
- Stock News - Bombay Stock Exchange, BSE Sensex 30 index, S&P, CNX-Nifty, company information, issues on market capitalization, corporate earnings statements etc..
- Fixed Income - Corporate Bond Prices, Corporate Debt details, Debt trading activities, Interest Rates, Money Market, Government Securities, Public Sector Debt, External Debt Service
- Foreign Investment - Foreign Debt Database composed by BIS, IMF, OECD and World Bank Investments in India and Abroad
- Global Equity Indices - Dow Jones Global indices, Morgan Stanley Equity indices
- Currency Indices - FX & Gold Chart Plotter, J. P. Morgan Currency indices
- National and Global Market Relations.

If an investor has a clear understanding of the Indian financial market then formulating investing strategies and tips would be easier.

10.6 What is Investment?

The money you earn is partly spent and the rest saved for meeting future expenses. Instead of keeping the savings idle you may like to use savings in order to get return on it in the future. This is called Investment.

Why should one invest?

One needs to invest to: Earn return on theri idle resources generate a specified sum of money for a speciûc goal in life Make a provision for an uncertain future. One of the important reasons why one needs to invest wisely is to meet the cost of inflation ***inflation*** is the rate at which the cost of living increases. The cost of living is simply what it costs to buy the goods and services you need to live. Inûation causes money to lose value because it will not buy the same amount of a good or a service in the future as it does now or did in the past. For example, if there was a 6% inûation rate for the next 20 years, a Rs. 100 purchase today would cost Rs. 321 in 20 years. This is why it is important to consider inûation as a factor in any long-term investment strategy.

What care should one take while investing?

These are called the Twelve Important Steps to Investing.

Before making any investment, one must ensure to:

- . Obtain written documents explaining the investment.
- Read and understand such documents.
- Verify the legitimacy of the investment.
- Find out the costs and benefits associated with the investment.
- Assess the risk-return profits of the investment.
- Know the liquidity and safety aspects of the investment.
- Ascertain if it is appropriate for your specific goals.
- Compare these details with other investment opportunities available.
- Examine if it suits in with other investments you are considering or you have already made.
- Deal only through an authorized intermediary.
- Seek all clarfications about the intermediary and the investment.
- Explore the options available to you if something were to go wrong, and then, if satified, make the investment.

What factors determine interest rates?

When we talk of interest rates, there are different types of interest rates - rates that banks offer to their depositors, rates that they lend to their borrowers, the rate at which the Government borrows in the Bond/

Government Securities market, rates offered to investors in small savings schemes like NSC, PPF, rates at which companies issue fixed deposits etc.. The factors which govern these interest rates are mostlyeconomy related and are commonly referred to as macroeconomic factors. Some ofthese factors are:

- Demand for money
- Level ofGovernment borrowings
- Supply of money
- Implation rate
- The Reserve Bank of India and the Government policies which determine some of the variables mentioned above

10.7 Financial Investment Options

Broadly speaking, savings bank account, money market/liquid funds and fixed deposits with banks maybe considered as short-term financial options.

Savings Bank Account is often the fixed banking product people use, which offers low interest (4%-5% p.a.) making them only marginally better than fixed deposits.

Money Market or Liquid Funds are a specialized form of mutual funds that invest in extremely short-term fixed income instruments and thereby provide easy liquidity. Unlike most mutual funds, money market funds are primarily oriented towards protecting your capital and then aim to maximize returns. Money market funds usually yield better returns than savings accounts but lower than bank fixed deposits.

Fixed Deposits with Banks are also referred to as term deposits and minimum investment period for bank FDs is 30 days. Fixed Deposits with banks are for investors with low risk appetite, and may be considered for 6-12 months investment period as normally interest on less than 6 months bank FDs is likely to be lower than money market fund returns.

Post Office Savings Schemes, Public Provident Fund, Company Fixed Deposits, Bonds and Debentures, Mutual Funds etc. are long term financial options.

Post Office Savings

Post Office savings is a monthly Income Scheme. It is a low risk saving instrument, which can be availed through any post ofüce. It provides an interest rate of 8% per annum which is paid monthly. Minimum amount which can be invested, is Rs. 1,000/- and additional investment in multiples of 1,000/-. Maximum amount is Rs. 3, 00,000/- (if Single) or Rs. 6, 00,000/- (if held jointly) during a year. It has a maturity period of 6 years. A bonus of 10% is paid at the time of maturity. Premature withdrawal is permitted if deposit is more than one year old. A deduction of 5% is levied from the principal amount if withdrawn prematurely.

Public Provident Fund

Is a long term savings instrument with a maturity of 15 years and interest payable at 8% per annum compounded annually. A PPF account can be opened through a nationalized bank at any time during the year and is open all through the year for depositing money. Tax benfits can be availed for the amount invested and interest accrued is tax-free. A withdrawal is permissible every year from the seventh financial year of the date of opening of the account and the amount of withdrawal will be limited to 50% of the balance at credit at the end of the 4th year immediately preceding the year in which the amount is withdrawn or at the end of the preceding year whichever is lower the amount of loan if any.

Company Fixed Deposits

These are short-term (six months) to medium-term (three to five years) borrowings by companies at a fixed rate of interest which is payable monthly, quarterly, semiannually or annually. They can also be cumulative fixed deposits where the entire principal along with the interest is paid at the end of the loan period. The rate of interest varies between 6-9% per annum for company FDs. The interest received is after deduction of taxes.

Bonds: It is a fixed income (debt) instrument issued for a period of more than one year with the purpose of raising capital. The central or state government, corporations and similar institutions sell bonds. A bond is generally a promise to repay the principal along with a fixed rate of interest on a specified date, called the Maturity Date.

Mutual Fund:

A Mutual Fund is a body corporate registered with SEBI (Securities Exchange Board of India) that pools money from individuals/corporate investors and invests the same in a variety of different financial instruments or securities such as equity shares, Government securities, Bonds, debentures etc. Mutual funds can thus, be considered as financial intermediaries in the investment business that collect funds from the public and invest on behalf of the investors. Mutual funds issue units to the investors. The appreciation of the portfolio or securities in which the mutual fund has invested the money leads to an appreciation in the value of the units held by investors. Mutual Funds invest in various asset classes like equity, bonds, debentures, commercial paper and government securities. The schemes offered by mutual funds vary from fund to Fund. Some are pure equity schemes; others are a mix of equity and bonds. Investors are also given the option of getting dividends, which are declared periodically by the mutual fund, or to participate only in the capital appreciation of the scheme.

10.8 Summary

A financial market is a market in which people can trade in financial securities and commodity . the financial markets can be divided into different types- capital markets, stock market, bond markets commodity markets and insurance markets short term financial investment options are savings Banks account and fixed deposit accounts which long term financial investment options are post office saving. Public provident fund and company fixed deposits.

12.9 Key Words

- **NSE –** National Stock Exchange
- **OTCEI –** Over the Counter Exchange of India.
- **SEBI –** Securities and Exchange Board of India.
- **Financial Market –** It is a market in which people and entities can trade financial securities and commodities.
- **Mutaul Fund –** It collect funds from the public and invest on behalf of the investors.

10.10 Self Assessment Test

1 What do you understand by Financial Markets? Explain the objectives of Financial Markets.

2 Discuss the types of Financial Markets.

3 Elaborate the long term options available for investment.

4 Explain Indian Financial Market.

5 Describe the process of a typical Financial Market.

6 Discuss the peculiar features of Indian Financial Market.

7 Give the definitions of basics of Financial Markets, like investment, Interest rates etc.

10.11 References

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Unit- 11 : Legal Environment

Unit of Structure:

11.0 Objectives

After studying this unit, you should be able to understand:

- The concept of Legal Environment.
- The objectives, underlying values and salient features of Legal Laws.
- Various Legal Laws and Policies of our nation.
- The process of legal environment.
- The issues in legal environment.

11.1 Introduction

The government, in every country regulates the business according to its defined priorities. Legal system of a country is framed by the government. The laws which are passed by the government for business operations is called legal environment. The limits for business operations are decided by regulatory environment and this is also called legal environment. Legal environment in a country has a dominating position on all decisions of organization. As all business policies are highly influenced by government the organization should have thorough knowledge of these policies because non-implementation of legal policies results in heavy fines, penalties and punishment.

The legal systems of most of the non-socialist countries can be grouped into common law and code law. Common law is generally based on precedents or past practices while a code, which is a comprehensive set of volumes having statutory force and covering virtually the whole spectrum of the country's law, isestablished by arbitrary methods e.g. a speed limit of 80 kph.

11.2 International Laws

Buyers and sellers are at times also subject to international law which may be defined as that body of rules which regulates relationships between countries or other international legal persons. There is neither an 'international parliament' empowered to create international law nor an 'international police force' to enforce it. The principal sources of international law are treaties and conventions. These are created when several countries reach agreement on a certain matter and bind themselves to it by authorising their representatives to sign a document embodying that agreement. Essentially they have entered into a contract that obliges them to do something or to refrain from doing something Failure to comply is the equivalent of breach of contract.

Other sources of international law are customs (i.e. international practice that is accepted as law) and the general principles of law recognised by civilised nations or natural law (the basis of human co-existence). Although there is no organised body to 'enforce' international law, there is an International Court of Justice situated at Hague in Netherlands. This court decides any matter which the parties regard as suitable for submission to it for adjudication. This means that a country approaches the court voluntarily; it cannot be 'brought' to the court involuntarily.

Before a country is liable to comply with the provisions of a treaty or a convention, it must have signed the original protocol (i.e. the original treaty document or minutes of the convention). Once a country has signed the protocol, the method of enforcement depends on the terms of the treaty or convention. A common way of bringing a defaulting country to heel is by imposing sanctions against it. Sanctions may take many different forms and can be applied with varying degrees of severity. Obviously, the more parties there are to the protocol, the easier it is to enforce by virtue of the weight of opinion and the efficacy of any measures that can be taken against an offender.

There has been no treaty or convention whereby countries have bound them to the use and meaning of Incoterms. The Incoterms have been published merely as an aid to international trade. Some countries have incorporated the Incoterms in their domestic laws by legislation but, in most cases, they are merely a guide. However, their usage has, largely, become a norm in international trade.

Another area in which international law plays an important role is in controlling the use of the sea and the environment outside the territorial waters of countries. The control of international air travel by organizations such as IATA (International Airline Transport Association), or structures such as The Hague-Visby Rules in relation to ocean freight may also be regarded as part of international law.

Exporters need to be able to recognize the legal significance of their actions in the general course of marketing and export-related activities both in the country and abroad. Potentially costly errors will be avoided and should develop greater confidence in conducting negotiations at both a domestic and international level.

Most controls or regulations revolve around export and import controls, transfer pricing, taxes, regulation of corrupt practices, embargoed nations, antitrust, expropriation and distribution of equity, patents and trademarks. The following touches on a number of these issues and in particular the import/export regulations (terms of access).

a) FCN (Friendship, Commerce and Navigation) and Tax Treaties primarily US based and concerned with giving protection of trading rights and avoiding double taxation.

b) IMF and GATT are concerned with member nation's international trade restrictions and dumping.

c) UNCITRAL (UN) international trade law commission set up with the intent to provide a uniform commercial code for the whole world, particularly international sales and payments, commercial arbitration and shipping legislation. Works with international chambers of commerce and Governments.

d) ISO (International Standards Organisation) often works with ILO, WHO etc. and contains technical committees working on uniform standards.

e) For Patents and Trademarks there is no such thing as international patent. The most important patent agreement is the International Convention for the Protection of Industrial Property, first signed in 1983 and now honored by 45 countries.

f) A Patent Cooperation Treaty (PCT) and a European Patent Convention are also in effect. The PCT has 39 countries including the USA, Japan and Brazil. The EU convention covers 15 countries and gives patent protection in all 15 if signified in one.

g) Air transport is covered mainly by IATA (International Air Transport Authority), ICAA (International Civil Aviation Authority) and ITU (International Telecommunication Company).

h) Codes of conduct, like those in the OECP, are not technical law but important. Member countries produce guidelines for multinational enterprises covering aspects of general policy, disclosure of information, competition, financing, taxation, employment and industrial relations.

i) Recourse arbitration is an attempt to reduce disputes by consultation. Some of the most widely used are the International Chamber of Commerce, the American Arbitration Association, the London Court of Arbitration and the Liverpool Cotton Exchange.

11.3 National Laws

Following are some of the government Acts & government policies relating to legal or regulatory environment for business operations in India:-

1. Indian Companies Act, 1956.
2. Foreign Exchange Management Act, 1999.
3. The Factories Act, 1948.
4. Industrial Disputes Act, 1972.
5. Payment of Gratuity Act, 1972.
6. Industries (Development and Regulation) Act, 1951.
7. Prevention of Food Adulteration Act, 1954.
8. Essential Commodities Act, 2002.
9. The Standards of Weights & Measures Act, 1956.
10. Environment Protection Act, 1986.
11. Trade Marks Act, 1999.
12. Consumer Protection Act, 1986.
13. Competition Act, 2002.

The details of some important laws are briefly discussed in the next sections.

11.4 Foreign Exchange Management Act, 1999

The Foreign Exchange Management Act (FEMA) was an act passed in the Parliament in 1999 which replaced Foreign Exchange Regulation Act. This act seeks to make offenses related to foreign exchange civil offenses. FEMA had become the need of the hour since FERA had become incompatible with the proliberalization policies of the Government of India. FEMA has brought a new management regime of Foreign Exchange consistent with the emerging framework of the World Trade Organisation (WTO). It is another matter that the enactment of FEMA also brought with it thePrevention of Money Laundering Act 2002, which came into effect from 1 July 2005.

The buying and selling of foreign currency and other debt instruments by businesses, individuals and governments happens in the foreign exchange market. Apart from being very competitive, this market is also the largest and most liquid market in the world as well as in India. It constantly undergoes changes and innovations which can either be beneficial to a country or expose them to greater risks. The management of foreign exchange market becomes necessary in order to mitigate and avoid the risks. Central banks would work towards an orderly functioning of the transactions which can also develop their foreign exchange market.

Main Features of FEMA

- Activities such as payments made to any person outside India or receipts from them, along with the deals in foreign exchange and foreign security is restricted. It is FEMA that gives the central government the power to impose the restrictions.
- Restrictions are imposed on people living in India who carry out transactions in foreign exchange, foreign security or who own or hold immovable property abroad.
- Without general or specific permission of the Reserve Bank of India, FEMA restricts the transactions involving foreign exchange or foreign security and payments from outside the country to India – the transactions should be made only through an authorized person.
- Deals in foreign exchange under the current account by an authorized person can be restricted by the Central Government, based on public interest.
- Although selling or drawing of foreign exchange is done through an authorized person, the RBI is empowered by this Act to subject the capital account transactions to a number of restrictions.
- People living in India will be permitted to carry out transactions in foreign exchange, foreign security or to own or hold immovable property abroad if the currency, security or property was owned or acquired when he/she was living outside India, or when it was inherited to him/her by someone living outside India.
- Exporters are needed to furnish their export details to RBI. To ensure that the transactions are carried out properly, RBI may ask the exporters to comply to its necessary requirements.

11.5 The Factories Act, 1948

The main objective of the Act is to ensure adequate safety measures and promote health and welfare of the workers employed in factories as well as to prevent haphazard growth of factories. The Factories Act is meant to provide protection to the workers from being exploited and also provides for improvement of the working conditions within the factory premises.

The coverage of the Act is confined to the: -

- o Factories using power and employing 10 or more workers on any working day of the preceding twelve months;
- o Factories not using power and employing 20 or more workers on any working day of the preceding twelve months; and

- o Factories specially notified under Section 85 of the Factories Act by the State Governments/Union Territories.

(a) Factory means any premises including the precincts thereof:-

i) wherein ten or more workers are working, or were working on any day of the preceding twelve months and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or ii) wherein twenty or more workers are working or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on.

(b) Worker means a person (employed directly or through any agency includinga contractor) with or without the knowledge of the principal employer, whether for remuneration or not in any manufacturing process, or in cleaning any part of the machinery or premises used for a manufacturing process, or in any kind of work incidental to or connected with the manufacturing process, or the subject of manufacturing process (but does not include any member of the armed forces of the Union

11.6 Industrial Disputes Act, 1972

Experience of the working of the Trade Disputes Act, 1929, has revealed that its main defect is that while restraints have been imposed on the rights of strike and lock-out in public utility services no provision has been made to render the proceedings institutable under the Act for the settlement of an industrial dispute, either by reference to a Board of Conciliation or to a Court of Inquiry, conclusive and binding on the parties to the dispute. This defect was overcome during the war by empowering under Rule 81A of the Defence of India Rules, the Central Government to refer industrial disputes to adjudicators and to enforce their awards. Rule 81A, which was to lapse on the 1st October, 1946, is being kept in force by the Emergency Powers (Continuance) Ordinance, 1946, for a further period of six months; and as industrial unrest in checking which this rule has proved useful, is gaining momentum due to the stress of post industrial re-adjustment, the need of permanent legislation in replacement of this rule is self-evident. This Bill embodies the essential principles of Rule 81A, which have proved generally acceptable to both employers and workmen, retaining intact, for the most part, the provisions of the Trade Disputes Act, 1929.

The two institutions for the prevention and settlement of industrial disputes provided for in the Act are the Works Committees consisting of representatives of employers and workmen and Industrial Tribunal consisting of one or more members possessing qualifications ordinarily required for appointment as Judge of a High Court. Power has been given to appropriate Government to require Works Committees to be constituted in every industrial establishment employing 100 workmen, or more and their duties will be to remove causes of friction between the employer and workmen in the day-to-day working of the establishment and to promote measures for securing amity and good relations between them. Industrial peace will be most enduring where it is founded on voluntary settlement and it is hoped that the Works Committees will render recourse to the remaining machinery provided for in the Bill for the settlements of disputes infrequent. A reference to an Industrial Tribunal will lie where both the parties to an industrial dispute apply for such reference and also where the appropriate Government considers it expedient so to do. An award of a Tribunal may be enforced either wholly or in part by the appropriate Government for a period not exceeding one year. The power to refer disputes to Industrial Tribunals and enforce their awards is an essential corollary to the obligation that lies on the Government to secure conclusive determination of the disputes with a view to redressing the legitimate grievances of the parties thereto, such obligation arising from the imposition of restraints on the rights of strike and lock-out, which must remain inviolate, except where considerations of public interest override such rights.

The Act also seeks to re-orient the administration of the conciliation machinery provided in the Trade Disputes Act. Conciliation will be compulsory in all disputes in public utility services and optional in the case of other industrial establishments. With a view to expedite conciliation proceedings time limits have been prescribed for conclusion thereof—14 days in the case of conciliation officers and two months in the case of Board of Conciliation from the date of notice of strike. A settlement arrived at in the course of conciliation proceedings will be binding for such period as may be agreed upon by the parties and where no period has been agreed upon, for a period of one year, and will continue to be binding until revoked by a 3 months' notice by either party to the dispute.

11.7 Payment of Gratuity Act, 1972

The Act implies to every factory, mine oilfield, plantation, port and Railway Company and to every shop or establishment in which 10 or more persons are employed, or were employed, on any day of the preceding 12 months. The Act makes all persons employed in the above establishments eligible for gratuity irrespective of their wages. The Act is administered by a controlling authority appointed by the appropriate Government.

Gratuity is payable to an employee on the termination of his employment after he has rendered continuous service for not less than 5yrs. The compensation of continuous service of five years is however, not necessary where the termination of the employment due to death or disablement. Gratuity is payable at the rate of 15 days wages based on the rate of wages last drawn by the employee for every completed year of service or part thereof in excess of six months. But the amount of gratuity payable to an employee shall not exceed Rs. 3.5 lakhs.

Under the Act, gratuity is payable entirely by the employer. For this purpose he is required either

I. To obtain an insurance with the Life Insurance Corporation, or

II. To establish a gratuity fund. Thus it is his liability to pay the premium in the first case and to make contribution in the second case.

11.8 Industries (Development and Regulation) Act, 1951

Growth of the industrial sector at a higher rate and on a sustained basis is a major determinant of a country's overall economic development. In this regard, the Government of India has issued industrial policies, from time to time, to facilitate and foster the growth of Indian industry and maintain its productivity and competitiveness in the world market.

In order to provide the Central Government with the means to implement its industrial policies, several legislations have been enacted and amended in response to the changing environment. The most important being,the Industries (Development and Regulation) Act, 1951 (IDRA) which was enacted in pursuance of the Industrial Policy Resolution, 1948 The Act was formulated for the purpose of development and regulation of industries in India by the Central Government.

The main objectives of the Act is to empower the Government:- (i) to take necessary steps for the development of industries; (ii) to regulate the pattern and direction of industrial development; (iii) to control the activities, performance and results of industrial undertakings in the public interest. The Act applies to the 'Scheduled Industries' listed in the First Schedule of the Act. However, small scale industrial undertakings and ancillary units are exempted from the provisions of this Act.

The Act is administered by the Ministry of Industries & Commerce through its **Department of Industrial Policy & Promotion (DIPP)**. The DIPP is responsible for formulation and implementation of promotional and developmental measures for growth of the industrial sector. It monitors the industrial growth and production, in general, and selected industrial sectors, such as cement, paper and pulp, leather, tyre and rubber, light electrical industries, consumer goods, consumer durables, light machine tools, light industrial machinery, light engineering industries etc., in particular. It is also responsible for facilitating and increasing the foreign direct investment (FDI) inflow into the country as well as for encouraging acquisition of technological capability in various sectors of the industry.

The various provisions of the Act are:-

- Establishment of a 'Central Advisory Council' for the purpose of advising the Central Government on matters concerning the development of the industries, making of any rules and any other matter connected with the administration of the Act. Its members shall consist of representatives of the owners of industrial undertaking, employees, consumers, primary suppliers, etc.
- Establishment of a 'Development Council' for the purpose of development of any scheduled industry or group of scheduled industries. This council shall consist of the members representing the interests of the owners, employees, consumers, etc. and persons having special knowledge of matters relating to the technical or other aspects of the industries.
- The development council shall perform the following functions assigned to it by the Central Government: -

(i) Recommending targets for production, co-coordinating production programs and reviewing progress from time to time.

(ii) Suggesting norms of efficiency with a view to eliminating waste, obtaining maximum production, improving quality and reducing costs.

(iii) Recommending measures for securing the fuller utilization of the installed capacity and for improving the working of the industry, particularly of the less efficient units.

(iv) Promoting arrangements for better marketing and helping in the devising of a system of distribution and sale of the produce of the industry which would be satisfactory to the consumer.

(v) Promoting the training of persons engaged or proposing engagement in the industry and their education in technical or artistic subjects relevant thereto, etc.

- The development council shall prepare and transmit to the Central Government and the advisory council a report (annually) setting out what has been done in the discharge of its functions during the financial year last completed. The report shall include a statement of the accounts of the development council for that year, together with a copy of any report made by the auditors on the accounts.
- The IDRA empowers the Central Government to regulate the development of industries by means of licensing with suitable exemptions as decided by the Government. Accordingly, the entry into a business or the expansion of an existing business may be regulated by licensing. A license is a written permission from the Government to an industrial undertaking to manufacture specified articles included in the Schedule to the Act. It contains particulars of the industrial undertaking, its location, the articles to be manufactured, its capacity on the basis of the maximum utilization of plant and machinery, and other appropriate conditions which are enforceable under the Act.

- If an application for license is approved and further clearance (such as that of foreign collaboration and capital goods import)are not involved and no other prior conditions have to be fulfilled, an industrial license is issued to the applicant. In other cases, a letter of intent is issued, which conveys the intention of the Government to grant a license subject to the fulfillment of certain conditions such as approval of foreign investment proposal, import of capital goods, etc.
- The Government may order for investigation before the grant of license to an industrial undertaking. It can make a full and complete investigation if it is of the opinion that in the respect of any schedule industry or undertaking, there has been or is likely to be: - (i) a substantial fall in the volume of output; or (ii) a marked deterioration in the quality of output or an unjustifiable rise in the price of the output. Also, if it is of the opinion that any industrial undertaking is being managed in a manner highly detrimental to the scheduled industry concerned or to the public interest, it orders investigation.

11.9 Prevention of Food Adulteration Act, 1954

The Prevention of Food Adulteration Act 1954 that came into force on June 1, 1955 was aimed at preventing adulteration of food sold in hotels and packaged and raw food. The drawbacks PFA Act was that many of the cases filed so far have not reached a logical conclusion either because the witnesses were not traceable or other reasons like the enforcing machineries especially the health departments, municipalities/corporations, railways, Ports are overburdened with their own work. and more than 40% were filed a decade ago. The PFA also did not address the core issue of Food safety, through Consumer education and was confined to only checking of adulteration in food items. Under PFA petty offences also required a minimum of 6 months imprisonment together with a fine of Rs. 1000/- due to which a large number of unwanted cases mounted in courts. The PFA Act and other orders related with food do not have enough provisions to deal with recent developments in Food Science and Technology which has developed considerably in recent years and a whole new range of processed foods including functional food, nutraceuticals, proprietary foods, dietary supplements, genetically modified or engineered foods are hitting the market at a fast pace and remains unregulated.

Keeping close liaison with State/local bodies for uniform implementation of food laws, monitoring of activities of the States by collecting periodical reports on working of food laws, getting the reports of food poisoning cases and visiting the States from time to time arranging periodical training program for Senior Officer/ Inspector/Analysts creating consumer awareness about the program by holding exhibitions/seminars/training programs and publishing pamphlet, approving labels of Infant Milk Substitute and Infant food, so as to safeguard the health of infants are the activities of the central government under this Act.

Enforcement of the food laws primarily rests with the State/UTs. The implementation of the Act in most of the States is under the administrative control of the Directorate of Health Services, whereas, in a few States, the implementation is being combined with Drugs Administration under the Joint Food and Drug Administration. The implementation has been left to the administrative setup of the States, but it has been stressed on the States that whatever the structure be, there should be a whole-time Senior Officer duly qualified and experienced in Food Science, Food Technology, Food Analysis with other supporting officers and inspectors. State Governments are also empowered to make rules laying down details of licensing conditions of food, the establishments of food industries and prescribing license fees.

11.10 Essential Commodities Act, 1955

The Essential Commodities Act, 1955 was enacted to ensure easy availability of essential commodities to the consumers and to protect them from exploitation by unscrupulous traders. The Act provides for regulation and control of production, distribution and pricing of commodities, which are declared as essential for maintaining or increasing supplies or for securing their equitable distribution and availability at fair prices. Most of the powers under the Act have been delegated to the State Governments.

List of commodities declared essential under the Essential Commodities Act, 1955 is as under:

1. Cattle fodder, including oilcakes and other concentrates.
2. Coal, including coke and other derivatives.
3. Component parts and accessories of automobiles.
4. Cotton and woolen textiles.
5. Drugs.
6. Foodstuffs, including edible oilseeds and oils.
7. Iron and Steel, including manufactured products of Iron & Steel.
8. Paper, including newsprint, paperboard and strawboard.
9. 9 Petroleum and Petroleum products.
10. 10 Raw Cotton either ginned or unginned and cotton seed.
11. Raw Jute.
12. Jute textiles.
13. Fertilizer, whether inorganic, organic or mixed.
14. Yarn made wholly from cotton.

In the context of liberalization of Indian economy, it was decided that the Essential Commodities Act, might continue as umbrella legislation for the Centre and the States to use when warranted. Accordingly, the Central Government issued the Removal of Licensing requirements, Stock limits and Movement Restrictions on Specified Foodstuffs Order, 2002 allowing dealers to freely buy, stock, sell, transport, distribute, dispose, etc., any quantity in respect of wheat, paddy/rice, coarse grains, sugar, edible oilseeds and edible oils without requiring any license or permit therefore under any order issued under the Act. In 2006, considering the shortage of wheat, this order of removal of licensing requirements, stock limits and movement restrictions has been kept in abeyance for wheat and pulses for 6 months starting from 29th August 2006.

11.11 The Standards of Weights & Measures Act, 1976

The Standards of Weights and Measures Act, 1956 was the first enactment by which the uniform standards of weights and measures, based on the metric system were established. The standards established by the 1956 act were based on the international system of units, recognized by the General Conference of Weights and Measures (CGPM) and the International Organization of Legal Metrology (OIML). Standards of weights and measures were subsequently revised by CGPM to SI units.

In view of the revision by the CGPM of the standards of weights and measures and the changes in the law suggested by the OIML, the 1956 Act was replaced by a comprehensive legislation, The Standard of

Weights and Measures Act, 1976. Salient features of the Standards of Weights and Measures Act, 1976 are as follows:

- Establishment of the weights and measure based on the SI units, as adopted by the CGPM and recognized by the OIML;
- Provides to prescribe specification of measuring instruments used in commercial transaction, industrial production a measurement involved in public Health and Human safety. The specifications are given in the Standard of weights and Measures (General) Rules 1987;
- Regulation of inter-state trade and commerce in weights and measures and commodities sold, distributed or supplied by Weights or measures;
- Regulation of pre-packed commodities sold or intended to be sold in the course of inter-state and commerce;
- Approval (before manufacture) of models of weights and measuring instrument intended to be manufactured after the commencement of the proposed legislation;
- Control and regulation of export and import of weights and measures and commodities in packaged form;
- Establishment of an Indian Institute of Legal Metrology to provide training in legal metrology to inspectors and others;
- Surveys and collection of statistics for facilitating planning and enforcement of the proposed legislation.;
- Inspection of weighing and measuring instruments during their use to prevent fraudulent practices.
- Powers of inspectors to search, seize and forfeiture of non-standard weight or measure
- Power to file case in the court for prosecution
- Power to compound certain cases before or after the institution of the prosecution cases.
- Appeal provisions
- Prescribe fee for various service rendered
- Power to make rules for implementing the provisions of the Act.

11.12 Trade Marks Act, 1999

With the Trade Marks Act, 1999, being brought into force on September15, 2003, India has made a step towards fulfilling its international obligations. Consequently, the Indian trademark law has now become fully compatible with the International standards laid down in the TRIPS Agreement. The New Act primarily consolidates and amends the old Trade & Merchandise Marks Act, 1958 and provides for better protection of goods and services. The salient features of the New Act are the following:

- The definition of Trademark has been expanded to encompass any mark capable of distinguishing the goods and services of one, from the goods and services of another and may include any mark capable of graphical representation including aspects of shape of goods, their packaging, and combination of colours. As a result, even well known designs can now avail protection under trademark law.

- One of the most significant additions in the new Act is the provision for Service mark registrations. It is a direct effect of the amplification of the definition of trademark to include services. It is now possible for business houses and individuals offering any kind of service to register their mark. The definition of services under the Act is an inclusive one; therefore entities providing services of any description in connection with business, industrial or commercial matters can get their Service marks registered.
- Collective mark, a new concept brought into the Act makes it possible for any Association to get registration for its mark. Collective Mark is a trademark or service mark used, or intended to be used by the members of an association, indicating their membership in such Association. The Association is the owner of the mark and the members are the authorized users. For example, the Advertising Club of India can register its name and logo as collective marks and prohibit non-members from using or associating with the mark.
- The concept of well-known trademark is a milestone of the new Act. This provision is adopted to accommodate the requirement of Art 16 of the TRIPS agreement. The Registrar as per the provisions of the New Act is enjoined not to register a mark that is confusing similar with a well-known trademark. The well-known trademark is a mark used over particular goods or services that has obtained sufficient recognition among the consumers using such goods or services.

It should be noted that a trademark may be considered as a well-known trademark even if it is not, registered in India or used in India, or if such an application is pending in India or the trademark is not well known in India to public at large. The Indian Trademark law has made a remarkable provision, setting out a detailed criteria for the identification of a well-known trademark in an area where international consensus in lacking.

11.13 Consumer Protection Act, 1986

With the enactment of Consumer Protection Act, 1986 the scenario has undergone a change. Rights of consumers have been given a statutory recognition. Three-tier grievance redressal machinery at the District, State and National level has been constituted. Consumer is sought to be installed as a king.

The object of the legislation, as the Preamble of the Act proclaims, is for better protection of the interests of consumers. During the last few years preceding the enactment there was in this country a market awareness among the consumers of goods and services that they were not getting their money's worth and were being exploited by both traders and manufacturers.

Salient features of the Act are:

1) The Act aims to provide better and all-round protection to consumers.
2) In terms of geographical application, it applies to the whole of India except the State of Jammu and Kashmir.
3) It applies to all goods and services unless otherwise expressly notified by the Central Government.
4) It is indeed a very unique and highly progressive piece of social welfare legislation and is acclaimed as the magna carta of Indian consumers. The Act has made the consumer movement really going and more powerful, broad-based and effective and people- oriented. In fact, the Act and its Amendment in 1993 have brought fresh hopes to the beleaguered Indian consumer. This is the only law which directly pertains to market place and seeks to redress complaints arising from it. Even prior to 1986, there were in force a number of laws which could be interpreted in favor of the consumers. But, this Act is most powerful piece of legislation the consumer has had before 1986.

Its provisions are very comprehensive and highly efficacious. In fact, it provides more effective protection to consumers than any corresponding legislation in force even in countries which are considered to be much more advanced.

5) It provides effective safeguards to the consumers against different types of exploitation such as defective goods, unsatisfactory (or deficient) services and unfair trade practices.

11.14 Environment Protection Act, 1986

Environment has been defined as the aggregate of all external conditions and influences effecting the life and development of an organism. Development without regard to the ecological equilibrium has led to an environmental crisis in the recent past.

In fact, there is growing evidence of man-made harm in many regions of the earth, dangerous levels of pollution in air, water, earth and living beings, thereon, major and undesirable disturbances to the ecological balance of the biosphere, destruction and depletion of irreplaceable resources and gross deficiencies harmful to the physical, mental and social wealth of man in the man-made environment. Thus,the protection and improvement of human environment is a major issue which affects the well beings of the people and economic development throughout the world. It is, therefore, the urgent desire of the people of the whole world and the duty of the all Governments and the all peoples to protect environment. That is why the Articles 48A and 51A of the Constitution of India have cast a solemn duty not only on the State but also on the citizens towards the protection of the environment and conservation of the forests and the wild life. The Water (Prevention and Control of Pollution) Act was passed in 1974. It aimed at maintaining the purity of water by preventing water pollution and provided for establishment of the Pollution Control Boards at the State Level. Similarly, the Air (prevention and Control of Pollution) Act was passedin 1981 to Control Air Pollution. The act was passed for the following objects and reasons i.e. for the protection, regulation of discharge of environmental pollutants and handling of hazardous substances, speedy response in the event of accidents threatening environment and deterrent punishment to those who endanger human environment, safety and health.

11.15 Competition Act, 2002

Competition Commission of India (hereinafter referred to as the 'Commission') has been established in October 2003. Under competition Act, 2002. The Commission has one member/acting chairman and a small complement of staff. The commission besides being a quasi-judicial adjudicator will also be a regulator on issues relating to competition matters and policy.

In line with prevailing pattern of modern competition laws, the Act seeks to –

I. Prohibit anti-competitive agreements (including cartels), which determine prices or control or limit or share markets among players or result in bid rigging.

II. Prohibit abuse of dominant position through unfair and discriminatory prices or conditions (including predatory pricing) limiting or restricting production, denying market access, etc.

III. Regulate combination (acquisition, mergers and amalgamations etc.) that causes or likely to cause appreciable adverse effect on competition.

IV. Entrust the Competition Commission the responsibility of undertaking competition advocacy, awareness and training about competition issues.

Section 2(h) of the Act has defined the term "enterprise" to mean a person or a department of government engaged in all the activities of a value chain of products and services directly or indirectly. However the activity of the Government relatable to sovereign functions and the activities carried on by the departments of the government dealing with atomic energy, currency, defence and space are kept out of the purview of the Act. Even statutory authorities regulating production or supply of goods or provision of any services or any markets for these are covered within the ambit of the Act.

Section 3 of the Act deals with agreements made among enterprises or persons or association of persons which causes or likely to cause appreciable adverse effect on competition, such agreements are rendered void pursuant to this section.

11.16 Self Assessment Test

1 What do you understand by Legal Environment of a Business? Explain.

2 How and what does international law governs? Discuss.

3 What are various Business Legislations operational in a country? Discuss.

4 What are main features of Labour Legislations in India? Describe.

5 Explain main features of Companies Act in India.

6 What commodities are declared as essential commodities under Essential Commodities Act, 1955? Discuss.

7 How does Consumer Protection Act attempts to protect the rights of consumers? Explain.

8 What is the main objective of Environment Protection act, 1986? Discuss.

9 What is main purpose of Competition Act? Explain.

Unit -12 : Technological Environment

Unit Structure:

12.0 Objectives

After studying this unit, you will be able to:

- Explain the meaning of technological environment.
- Identify the features of technological environment.
- Describe the importance and role of technological environment.
- Describe the elements containing in technological environment.
- Describe the recent developments in technology and its impact on the working of business units in India.
- Explain the concept of technology transfer and issues attached with it.
- State the technology policy of India.
- Understand the present status of technology in India and future prospects.

12.1 Introduction

Understanding the environment within which the business has to operate is very important for running a business unit successfully at any place. The environmental factors influence almost every aspect of business, be it its nature, location, the prices of products, the distribution system, or the personnel policies. Hence it is important to learn about the various components of the business environment which consists of the economic aspect, the socio-cultural aspects, the political framework, the legal aspects and the technological aspects. In this unit, we shall discuss the concept of technological environment, its nature and significance. For many years, technology has taken place of manpower for performing many routine jobs and has increasingly assumed prominence in more sophisticated processes. Due to universal availability of inexpensive technology a highly competitive global marketplace has taken existence and fueled the growth of robust, like knowledge-based economies in developing countries, India and China as the prime examples. Developed countries such as the United States can no longer claim a competitive advantage based on exclusive access to advanced technology and a well-trained workforce.

12.2 Salient Features of Technology

Technology is often identified with the knowledge about machines and processes. In a broader sense, it refers to the body of "skills, knowledge and procedures for making, using and doing useful things.' Technology can be defined as the method or technique for converting inputs to outputs in accomplishing a specific task. Thus, the terms 'method' and 'technique' refer not only to the knowledge but also to the skills and the means for accomplishing a task. Technological innovation, then, refers to the increase in knowledge, the improvement in skills, or the discovery of a new or improved means that extends people's ability to achieve a given task. Technology can be classified in several ways. For example, blueprints, machinery, equipment and other capital goods are sometimes referred to as hard technology while soft technology includes management know-how, finance, marketing and administrative techniques. When a relatively primitive technology is used in the production process, the technology is usually referred to as labour-intensive. A highly advanced technology, on the other hand, is generally termed capital-intensive.

The salient features of technology are as under-

1. **It is dynamic-** Technology forces change on people whether they are prepared for it or not. In the modern society, it has brought so much change that it creates what is called future shock, which means that change comes so fast and furiously that it approaches the limits of human tolerance and people lose their ability to cope with it successfully. More ideas are being worked on, the time gap between idea and implementation is falling rapidly and the time between introduction and peak production is shortening considerably. As one wants to grow in business on, the time gap between idea and implementation is falling rapidly and the time between introduction and peak production is shortening considerably. As one wants to grow in business they must always watch out for change and developments taking place around. New developments must be adopted and new ideas explored lest the survival of business units would be at stake.

2. **Its effects are widespread-** Its effects are reaching far beyond the immediate points of technological impact. Technology flows through society until it affects every community. The shock waves push their way into even the most isolated places. People cannot escape it. Even if they travel to remote places as in Far East, technology is still represented by vapor trials from airplanes flying overhead, microwave communication signals from satellites moving at the speed of light and a haze from air pollution often preventing a view of the afar side.

3. **It is self- reinforcing-** As stated by Alvin Toffer, 'Technology feeds on itself. Technology makes more technology possible.' This self-reinforcing principle parts of society so that an invention in one place leads to a sequence of inventions in other places. Thus, invention of the wheel led rather quickly to a dozen or more applications. These applications in turn, have affected other parts of the system and led to several additional inventions that similarly influenced society as technology multiples.

4. **It is a complex set of knowledge, ideas and methods-** It is likely to be the result of a variety of activities- both internal and external. Technological process obviously tends to be a gradual process consisting of a sequence of small increments lying along a continuous path.

12.3 Technological Environment

Technological Environment refers to all the technological surroundings that influence business operations. A business may have to dramatically change their operating strategy as a result of changes in the technological environment. It consists of skills, methods, systems and equipments which make work more efficient. Technology influences organizations by bringing about changes in jobs, skills, life styles, production methods and processes. Automation, computerization, robotics, informatics, biotechnology, laser, new materials and artificial intelligence have all influenced organizations. Organizations need to be aware of technological changes to avoid obsolescence and promote innovation. Technology reaches people through organization. It is a powerful force that shapes their destiny.

Technological environment has much importance in the development and success of business. The technological environment brings changes in the form and operation of industrial and commercial activities in the following ways:-

- Changing production techniques and processes.
- Developing new equipments and tools for production.
- Developing new resources for production.
- Investing in Research and Development programs.
- New inventions to modernize the technology.
- Transfer of technology between countries.

12.3.1 Elements of Technological Environment

1) **Method of Technology:** The method of technology influences organization's functioning. It can be labour-based or capital-based.

- Labour intensive technology: is mainly used for business operations, labour is mainly used.
- Capital intensive technology: is represented by automation, computerization, robotizing, etc.

2) **Pace of Technological Change:** Technology is a dynamic force. The pace of technological changes increases as Invention, innovation and diffusion take place. Organizations should adapt to the changing technological forces. Technological change influences organizations in the following way:

- Increasing efficiently and decreasing costs.
- It can make existing industries obsolete.
- It can rejuvenate the existing industries through product improvements or cost reductions.
- It can create entirely new industries.

3) **Technological Transfer:** Technological transfer implies technology imported from technologically advanced foreign countries. The main sources of technology transfer are-

- Globalization: Global companies are the key sources of technology transfer in developing nations.
- Projects: Turn key projects based on global bidding serve as a source of technology transfer.
- Trade: This consists of sale of equipment or machines by the manufacturer.

- Technical assistance: Bilateral and multilateral donors under technical assistance provide international consultants who bring new technology with them.

4) Research and development: R&D is the essence of innovation. Ever changing preferences and needs of customers call for increase in research and development budget by organizations. Competitive pressure is also a driving force behind indulging in R&D activities. Government and industry collaboration and investing in R&D efforts is also an important element of technological environment.

12.4 Impact of Technological Change

The Impact of Technological Environment on various heads can be seen as mentioned below-

a) Impact on Economy- The most fundamental impact of technology is greater productivity in terms of both quality and quantity. As result of productivity improvements, real wages of employees tend to rise and prices of some products decline, which spreads the beneficial economic effects of technology throughout the whole social system. The result is that employees and citizens are motivated to want more technological, social and environmental effects.

b) Impact on Society- Perhaps the most striking influence of technology is found on society. Practically every area of social life and the life of every individual has been, in some sense or the other gets changed by the developments in technology. The way we cook, communicate, our lifestyle and work are affected by technology. Even the language we use is changing; new terms continue to emerge as new products are introduced or improved-always with the anticipation that there will be newer, faster, and better innovation in the market any day. Social changes are also reflected in our vocabularies. Words like telecommunicating, house-husband, surrogate mother and domestic partner all represent changes in society. When our language changes, behavior will not be far behind.

c) Impact on Marketing - Rapid technological advances make it imperative that marketers take a technology perspective. These technological trends can provide opportunities for new-product development; affect how marketing activities are performed, or both. For example, advances in information and communication technologies provide new products for firms to market, and the buyers of these products often use them to change the way they market their own products. Using these technological products can help marketers be more productive. Fax machines and cellular telephones are illustrative. New technologies can spawn new industries, new businesses, or new products for existing business. Firms at the leading edge of technological developments are in a favorable position. Thus, marketers need to monitor the technological environment constantly to look for potential opportunities that will improve their positions. To compete successfully, firms must monitor developments in specific technologies and their potential impact on how people live and work; in artificial intelligence and expert systems, and how they are used to solve problems; in superconductors and potential applications for new products; in transportation technologies, such as magnetically levitated trains, supersonic aircraft, and "smart" cars; and in communication technologies and their effects on individuals and organizations.

d) Impact on Mergers & Acquisitions- The impact of mergers and acquisitions can be seen as below:

(ι) On international mergers in two ways: i) a technologically superior firm may take acquisitions abroad in order to exploit its technological advantage, or

ii) a technologically inferior firm may acquire a foreign target with superior technology to enhance its competitive position both at home and abroad.

It is generally accepted that the acquiring firm must bring something to the target which will increase the present value of benefits; or the target firm brings something to the acquirer which enables the combined benefits of the merged firm to be greater than the sum of what the individual firms could have achieved separately- synergy.

Examples of international acquisitions to exploit a technological advantage include Swiss purchases of US drug companies for the production of such drugs as Valium and Librium.

(iii) In domestic mergers, the increased benefits often result when the superior management efficiency of the acquiring firm is applied to the target firm's assets.

Technological superiority is the most attractive advantage which may be exploited more easily without a lot of cultural baggage. The acquirer may deliberately select a technologically inferior target which because of this inferiority is losing market share and thus market value. By injecting technology into the acquired firm, the acquirer can improve its competitive position and profitability both at home and abroad.

Alternatively, one might find acquisitions by cash-rich but technologically backward companies attempting to obtain the technology necessary to remain viable as competitors on the worldwide scene.

e) Impact on Globalization-

Technological advances have massively fostered globalization. Technology has in fact been a very important facilitating factor of globalization. Several technological developments become a compelling reason for internationalization. Technological break-through is substantially increasing the scale economies and the market scale required to break-even. Global sourcing was encouraged not only by trade liberalization but also by technological developments which reduced transport costs. Technology monopoly, like possession of patented technology, encourages internationalization because the firm can exploit the respective demand without any competition.

The pace of globalization has been accelerated by several enabling technological revolution in several spheres, like transport and communication, has given a great impetus to globalization by their tremendous combustion to the reduction of the disadvantages of natural barriers like distance and cost. The IT revolution has made an enormous contribution to the emergence of the global village. The development in the field of air cargo transportation has fostered globalization by enabling quick and safe transportation of sensitive goods (like perishables and goods subject to quick changes in fashion/taste). Developments of containerization and refrigeration have also been of high significance. The steep fall in the cost of transportation and communication has considerably accelerated pace of globalization. All these have contributed to the drastic transformation of the logistical and global distribution of the value chain system. The world-wide web has a stupendous impact on globalization.

12.5 Significance of Technology in Business Environment

The history of modern technology in the Western countries starts with the industrial revolution. Once industrial revolution started gaining ground, it gave encouragement to the discovery of new inventions and innovations and soon a competition for more and more advanced technology ensued among the producers with each producer trying to outsell his competitors by presenting more sophisticated and technically superior goods to the consumers. The significance of technology can be understood with the help of its positive and negative impacts.

12.5.1 Positive Role of Technology

1. **Innovations are cost-reducing and demand increasing-** Inventions and innovations during the initial period of the industrial revolution reduced the costs of production and also brought a whole breed of new consumer goods in the market. As more and more consumers purchase the new variety of goods, the pressure of demand increases and it encourages the entrepreneurs to come forward with more new and improved products.

2. Inventions and innovations lead further inventions and innovations in other fields- As the competition increases beyond national boundaries into the field of international trade, countries trading with one another trade to outsell their competitors by presenting more sophisticated and technically superior goods. In this way rapid technological progress takes place. This, in turn, increases productivity manifold and firmly set these countries on the path of economic progress.

3. C**onstant introduction of new technologies and the capacity to generate and absorb technical change lead to business development & economic growth-** The experience of the Western countries provides an ample proof of the truth of this statement. Increased demand of the consumers in western countries played an important role in their industrial development by providing a continuously expanding market for the industrial goods. It forced numerous demand-induced innovations and helped in the continuous up gradation of technology in these countries. This gave a boost to economic growth.

4. Whether technology is indigenous or imported, it has significant impact on economic development- Technology should be in-house or imported, is a complex decision. Thorough scanning of internal and external environment can help in taking this decision. Unlike other countries, in addition to the massive importation of technology the Japanese made serious efforts to absorb, adopt and expand it according to their own requirements and also to generate their own advanced technology. Japan has adapted foreign technology to its own requirements, carried out necessary modifications in design or production planning to suit Japanese conditions, and evolved its own technology. The last factor is important because there was throughout a determination to follow the 'do-it-yourself' policy.

The rapid economic progress of the Western countries and Japan brings out clearly the importance of technology as a factor promoting business activity. Technology has led to greater output, shorter working hours, better employment opportunity in design, maintenance, and engineering, safer working conditions, production of new and better goods of standardized quality with more efficient use of raw materials, etc.

12.5.2 Negative effects of Technology

1. **Increasing unemployment-**The most terrifying negative effect of technological innovations is that they lead to displacement of labour and thus cause unemployment. Technical changes often impose great burden on the displaced workers, who may remain idle for months or even years, or eventually find employment at lower levels of skill and at lower wages. At times, because of age and immobility, they may face permanent idleness. The crux of the matter is that while "economists are prone to

stress the beneficial results of technical change. Its effect on productivity and consumption, the trade unions are likely to regard technical change from the point of view of its effect upon the employment and income of the particular group affected."

2. **Change in the socio-economic environment.** Due to abrupt technical changes, anxiety and insecurity among employees rise, and old crafts and craftsmanship declines. Man becomes a machine and gradually loses his identity in a fast changing society.

3. **Threat to human life-**Unfortunately, there is a negative side to technological progress. The introduction of nuclear weapons, for example, has made the destruction of the human race a frightening possibility. In addition, factories using modern technologies have polluted both air and water and contributed to various environmental and health-related problems.

   Despite the above mentioned disadvantage of technology which are now coming more and more to the fore in the advanced industrialized countries of the world, the developing countries are putting in their best efforts for the promotion of technological innovations (if necessary, by an import of technology from advanced countries) because to them technology seem to be the only hope for economic development. They realize, and quite rightly so, that unless technological changes are introduced into their stagnant, backward economics, the masses of the people will remain at alarmingly low levels of living.

12.6 Technology Transfer

Technology transfer is the process by which commercial technology is disseminated. This will take the form of a technology transfer transaction, which may or may not be a legally binding contract, but which will involve the communication, by the transferor, of the relevant knowledge to the recipient. Technology can be transferred from person to person, industry to industry and government to government, although the government of any country generally plays the most important role in facilitating or impeding the transfer process. Contacts amongst students from different countries are also a means of technology transfer as are journals, books, technical and professional publications, trade magazines and product pamphlets. Furthermore, multinational corporations play an important role in technology transfer by transferring information and technology from the parent company to subsidiaries in other countries, training foreign employees, etc.

Technology transfer is a complex, time-consuming and costly process, and the successful implementation of such a process demands continuous communication and co-operation between the parties involved. Furthermore, technology transfer cannot be effective if it experiences conflict with the economic and social needs of the recipient country. Technology transfer may become a serious source of conflict between donor and recipient countries. The recipient country may feel that the donor is trying to dominate it through technology, capital and production. Dependence on foreign technology can be viewed as a serious threat to economic independence. Countries that export technology may experience different problems. For the seller of technology, the technology transfer can result in unemployment in the home country and future loss of technological superiority. For example, Japan transferred modern steel production technology to South Korea in the early 1970's. As labour and production costs in Japan increased, the Korean steel industry began to take over a significant portion of the previously Japanese-controlled international market. Some Japanese executives are now complaining that the cost of technology transfer has been much greater than the income received through the sale of technology.

12.6.1 Forms of Technology Transfer

Broadly, there are two forms of TT which are as follows-

- Internalized forms refer to investment associated TT, where control resides with the technology transferor. The transferor, normally, holding the majority or full equity ownership, has a significant and continuing financial stake in the success of the affiliated, allows to use its brand names and to have access to its global technology and marketing networks, exercised control over the affiliate's investment, technology and sales decisions, and sees the affiliate as an integral part of its global strategy.
- Externalized forms refer to all other forms, such as joint ventures with local control, licensing strategic alliances and international subcontracting.

12.6.2 Levels of Technology Transfer

There are four levels of TT. These are as hereunder-

- **Operational Level**: At the bottom level, it is needed for smooth operating of a given plant: these involve basic manufacturing skills, as well as troubleshooting, quality control, maintenance and procurement skills.
- **Duplicative Level**: At the intermediate level are duplicative skills, which include the investment capabilities needed to expand capacity and to purchase and integrate foreign technologies.
- **Adaptive Level**: At this Technological self-reliance level, imported technologies are adapted and improved, and design skills for more complex engineering learned.
- **Innovative Level**: This level is characterized by innovative skills, based on formal R & D, that are needed to keep pace with technological frontiers or to generate new technologies

12.6.3 Issues in Transfer of Technology

1. **High cost**- In many cases, the developing countries obtain foreign technology at unreasonably high prices. In a number of cases of foreign direct investment associated with technology transfer, the net outflow of capital by way of dividend, interest, royalties and technical fees has been found to be much higher than the corresponding inflow.
2. **Suitability-** The appropriateness of the foreign technology to the physical, economic and social conditions of the developing countries is an important aspect to be considered in technology transfer. It has been argued that there are a large number of cases where the foreign technology transferred has been irrelevant or inappropriate to the recipient country's socio-economic priorities and conditions.
3. **Dependence on foreign technologies-** Heavy reliance on foreign technology may lead to technological dependence. It is pointed out that the import of modern sophisticated technology has tended to displace the traditional indigenous technologies which have been improved under a different set of policies. The steady stream of new products and processes introduced by multinationals into developing countries has been unfavorable to the promotion of domestic technological capacities and has discouraged local scientists and technicians from devoting themselves to practical development problems. It creates an attitude of subservient dependence, which may inhibit the capacity to do even relatively minor adaptive research or to adopt processes which are developed locally.
4. **Obsolescence-** It has also been observed that there is a tendency to transfer outdated technology to the developing countries. Thus, they would not enjoy the advantages of the latest technology and would still technologically lag behind. It is unfortunate that the owners of modern technology view

the developing countries as a mean to salvage technology that is obsolescent in the advanced countries, even when they possess more advanced technology.

5. **Negative attitude-** In previous years, several countries, like India did not have a favorable attitude towards foreign technology. The overemphasis on the development of technology indigenously had led to high costs and distorted developments. Again, the policy bias in favor of small business has resulted in production units of uneconomic size in a number of industries. Further, the reservation of certain products exclusively for the small scale sector promoted several companies, including multinational, to resort to such strategies as franchising and contract manufacturing in some of these industries in India. The reservation of products for the small scale sector sometimes comes in the way of adoption of modern technology if it involves capital investment higher than the specified.

12.7 Technology Policy of India

Objectives

i. To ensure that the message of science (and technology) reaches every citizen of India.

ii. To utilize domestic available resources optimally to become technologically strong and self-dependent.

iii. To provide employment to all categories of population specially to weaker sections of the society and women.

iv. To use skill with a view to make above categories able in all science and technology activities and ensure their full and equal participation.

v. To vigorously foster scientific research in universities and other institutions.

vi. To identify old technology and ensure modernization of technique and instruments.

vii. To develop technology of international level for export.

viii. To minimize use of power, specially less use of non-renewable sources of energy.

ix. To ensure food, agriculture, nutritional, environmental, water health and energy security of the people on a sustainable basis and improve standard of living.

x. Re-use of waste products by re-cycling.

In the present status of economic backwardness in India, it is obvious that technology must attend to the basic problems of food, clothing, health and housing of people. At the same time, rapid industrial development through latest technology is necessary to catch up with the advanced countries.

With these objectives in mind, Government of India has set-up Research and Development establishments, space research centers, medical research centre agricultural research establishment oil exploration centers, power development projects and the Council of Scientific and Industrial Research. Besides, several universities and institutes have been setup to provide higher education in science, technology and management. There is also the department of science and technology, an administrative wing of the government, to coordinate the activities of all research and technical activities in the country.

On August 1996, Indian primeminister released a paper entitled "Technology vision 2020." for ensuring the optimistic goal of making India a developing nation. This paper highlights the outlines of making country self-reliant in agriculture, indestry, health, food, power energy, civil aviation etc. It also highlights the measures to be adopted for promoting per capita income in the country.

12.8 Future Prospects

India needs a National Technology Policy to create a high-tech industrial infrastructure. A country which aspires to play the role of a major power must have autonomous technological capabilities of the highest levels. Instead, India imports the bulk of its high-tech requirements in the defense equipment, aerospace, electronics, telecommunications, and machine tools sectors. Its technology deficit is reflected in its yawning trade gap, which, projected by the Indian Commerce Ministry at 12-13 per cent by 2014, is clearly unsustainable.

As a beginning, India could elaborate a Technology Index to gauge where it stands in the international pecking order. The Index could comprise: the percentage of high-tech requirements met indigenously; the number of internationally recognized indigenous research institutes devoted to basic and applied research; the number of patents filed by Indian nationals internationally and nationally; the number of international scientific awards to domestic nationals and firms, etc. It could then elaborate a National Technology Policy to address the deficits that would come to light.

A unique opportunity has recently presented itself following major reforms in defense production and procurement policies, and the announcement on easing of restrictions on high-tech transfers to India by western countries.

Further vocational training, setting up of internationally recognized research institutes and science academies and in a chain of Universities of Applied Sciences on the German model, yielding massive welfare benefits could also be considered for investment in technological development. Offsets could also be extended to other sectors, with every major purchase attracting offsets.

Ironically, western announcements pertaining to easing restrictions on transfers of high technologies actually carry the risk of deepening India's import dependence on high-tech items, unless India simultaneously puts in place capabilities to absorb incoming technologies. India therefore urgently needs a Vision for an Integrated Science & Technology Advancement Strategy ('VISTAS') which encompasses both Policy and Implementation.

Today China is far ahead of us — mainly because of well thought out official state guidelines and reforms which emphasize CMI, technology absorption, and re-engineering of government structures into a synergized entity directing technology indigenization.

We need to look at other country models and merge the plethora of ministries and departments dealing with science and technology indigenization into one focused agency which directs the effort on a national basis. Progress should be measured in annual percentage decreases in import dependence in high-tech sectors.

12.9 Summary

Technological innovation or change refers to the increase in knowledge, the improvement in skills, or the discovery of a new or improved means that extends people's ability to achieve a given task.Technology is often characterized as ever changing, wide spread, self reinforcing and complex set of knowledge, ideas, and methods.Technology must attend to the basic problems of food, clothing, health and housing of people to remove the economic back wardness in. india rapid industirial development through latest technology is necessary to catch up the advanced countries.

12.10 Key Words

- **Technology** – It refers to the body of skills, knowledge and procedures for marking, using and doing useful things.

- **Technology Transfer –** It implies technology imported from more advanced technology based foreign countries.
- **VISTAS –** Vision for integrated science and technology advancement strategy.

12.11 Self Assessment Test

1. What do you understand by technology Environment? Discuss
2. Explain the significance of Technology in Business Environment.
3. What are the major forms of Technology Transfer? Explain
4. Write a note on National Technology policy of India.

12.12 References

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- The International Business Environment Sunderam and Black
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Unit - 13 : Ecological Environment

Unit Structure:

13.0 Objective

After completing this unit, you would be able to :

- Describe the influence of environmental concerns on organisations.
- Describe the nature of ecological environment management.
- Understand meaning of ecology
- Understand Business Ecology and Business Eco-system.
- Understand the relation between ecology and environment.
- Explain meaning of Industrial Ecology.
- Study the implication for business on ecology.
- Know different eco-products and process.
- Understand the concept of Sustainable Development.

13.1 Introduction

It is undoubtly a fact that urbanization and Industrialization is increasing at the cost of environment. Industries has important role in environmental degradation, which is directly or indirectly damaging eco-system or ecology. In the desire of high living standard, more and more industries are coming due to which problem would be too acute to be manageable. Human being, animals and plants are part of eco-system, which may be affected by Urbanization. It is not possible to stop the Industrialization or Urbanization, but there is a urgent need to change production process so that we can sustain our eco-system for long period of time. To increase that life cycle of this eco-system, industries should produce eco-friendly products and services.

The natural resources are limited. Some can be renewed while others cannot be renewed. Therefore, those natural resources have to be conserved and used judiciously. Increasing population, life style, rate of consumption and disposal of waste have created problem for in air quality, water cycle and other environmental problems.

In earlier days, man used live a harmonious life with nature by using the bare minimum natural resources to meet his everyday needs. So, the development in earlier days was not a burden on the environment. In present days of science and technology and due to the pressure of the increasing population, man is using up the natural resources at a very fast rate. Though development is also taking place rapidly but at the some time, this has led to the degradation of the natural environment. In present context, the rate at which natural resources are harnessed for rapid development are not revenred at the same rate. Hence natural imbalances takes place. In the name of development,old villages hills and beaches etc. have been converted into hig towns and cities A network of roads and railway lines has been established, Agricultural land is beving used for constructing hotels for promotion tourism). Industries & big dams are developed for generating hydro-electric ower. All this is disturbing the ecosystem of the area. In present condition it is quite diffecult to breathe fresh air, drink pure water and eat nutritional foods etc.

In fact, whenever development in any area taken place, one or the other part of the environment is affected. This does not mean that there should be no development. The only thing that we have to keep in mind is that development should be at a pace which is in tune with the environment is affected. This does not mean that there should be no development. Such a development which can be maintained for a long time without under damage to the environment is called sustainable development. Thus, to maintain a balance between environment and development, it is necessaryto strive for sustainable development to meet the need of the present generation as well as of the future generations. In order to achieve the sustainable development, man has to live in harmony with nature. This can be done by conserving the non-living environment (like air, water and soil), as well as the living components of environment.

The man should make all efforts to keep the environment safe. The conservation of enviornment is different from the preservation of environment, Preservation means maintaining the environment as it is. It is not possible to preserve envoironment as it is, because then no development can take place. We can only conserve the environment. the natural resources of the earth are getting depleted very fast and the environmental problems are increasing day by day. It is therefore necessary and in our own interrst to conserve and protect our environment.

The various practices which can help in conserving and protecting our environment are as follows :-

(1) The practice of crop rotation helps in consurving soil The practice of crop rotation is useful, because it restores the feetility of the soil and hence consesnes it.

(2) A judicious use of fretilisers, intensive corpping, proper irrigation and drainage helps in the conservation of soil.

(3) The treatment of sewage prevents pollution of water bodies like rivers and lakes and hence helps in conserving fish and other aquatic life .

(4) National parks and wildlife sanctuaries should be establised throughout the country. This will protect and conserve wild animals, birds and plant species.

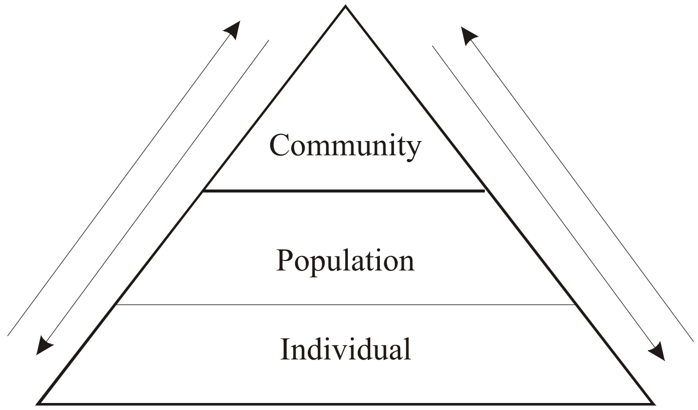
(5) New trees should be planted in place of those cut for various purposes. Planting of more tres reduices the level of carbonSdioxide in the air.

13.2 Ecology

To understand the ecological environmental management and its impact on business, it is firstly important to discuss fundamental concept of ecology. The word Ecology comes from the Greek, Oikos, meaning 'house' or 'place to live'. The study of organism viz. land, oceans, fresh water, and air in their natural habitat is known as ecology. Ecology can also be defined as the study of structure and function of nature.

In other words it is the study of the interrelation between living organisms and their environment. Ecology proceeds at three levels :

(1) The individual organism, (2) The population (consisting of individuals of the same species), and (3) The Community (consisting of groups of number of population.)



The above diagram exhibits how individual, population and community are inter-related and inter dependent on each other. At individual level, ecology deals with inter relation between individual and environment and vice-versa. Secondly, at population level, composition of population (various species) and their increase or decrease is analysed i.e. is there any fluctuation in the number and make up of population. At top level, the community is regularly changing because of the interaction between population and disturbances caused by various climate, geographics and human inference.

Business, industry and environment are inter dependent and closely linked with each other. It is very important for business units and industries to minimize waste and preserve resources for eco-friendly environment. For sustainable development, business houses, industries and multi-national companies have to understand the role of ecological environment and its effect. Some of industries and business leaders are following certain policies that show environmental concern viz. Environmental Impact Assesment (EIA), Environment Audit and design for environment but most industries are not. They are least concerned about the damage to the environment. There is a need to change this attitude for sustainable environment. In present era, marketers will only sustain or create wealth if they respond to sustainable development. The 'Earth Summit' did suggest programs that would promote environmentalprotectionand resource conservation for business.

13.3 Industrial Ecology

Industrial ecology is the study of industrial process that extract natural resources from the earth and transform these resources in useful commodities which may be marketed, used for satisfaction of consumer's needs or wants. It is a study of raw material and energy flow through industrial systems.Some experts were of the opinion that there is a need to develop such industrial production methods that would have considerably less impact on the natural environment.

The modern industrial system should follow the biological system to develop and sustain in the environment. In biological system, plants synthesise nutrients that feed herbivores, and these herbivores are fed by carnivores and the wastes and the decayed body parts of carnivores serves as fertilizer for plants, enventually making a food chain.

Similarly, in industrial eco-system an activity or process takes raw-material for producing products and then the wastes is transformed in a more useful way by producing and manufacturing eco-friendly or green products which may be re-cycled, thus making an industrial ecosystem.

The distribution of energy and material in industrial eco-system should be cyclical rather than linear. Industrial ecology is concerned with how much we understand and know the natural eco-system and how we design our industrial activities and systems to suit the natural eco-system.

Erkman has suggested three elements of industrial ecology, they are :

(a) It is a collective and integrated aspect of all the dimensions of the industrial economy and its relationship with the biosphere.

(b) It does not suggest the current appoarches of industrial economy i.e. monetary flow, rather it emphasize the complex patterns of material flows.

(c) It suggest viable industrial eco-system rather than unsustainable industrial system.

Therefore, industrial eco-system works according to the biological system i.e. redesigning production system. It means cyclic production system, which is the operational aspect of industrial ecology, must be considered for sustainable development. Hence, each and every output of production should either be reproduced or recyled for further production or sent back to eco-system or nature. The objective of industrial eco-system is to reduce the adverse impact of industry or business on environment by adopting proper ecological life cycle for production system i.e. starting from extraction of the raw materials, to the consumption of the finished goods by the consumer and proper waste management during every step of production process.

Activity A

What do you mean by industrial ecology? Explain by taking examples from any industry around you.

13.4 Business Eco-System

The broader discipline of industrial ecology is business ecology or business eco-system. Business eco-system includes all the relevant aspects of business, viz. environmental economics, sustainable development, quality management, marketing manangment and strategic management from ecological point of view. It is a environmental as well as social responsibility of business or industry to think and adopt natural system.

For example, Du Pont gets most of the polyester films back from the consumers after use and recyles it into new films. In most of the countries of the world, manufacturers, by law, have to produce such products which can be recycled. Germany is best example. Another best example of industrial ecology is the 'Interface' American carpet maker and floor material manufacturing company which has found a new floor covering material 'Selenium' which can be completely remanufactured into similar new products by utilizing same or common resources. The quality of 'Selenium' is much higher than ordinary carpet in maintainance and life. Innovation adopted by Interface in 'Selenium' is that it is chlorine free and company promises that 'Selenium' can be maintains and cleaned up much easier than any other carpet of any company or brand. As we know chlorine is a one of the toxic element and very harmful for the environment. Interface has started solar-power factory in place of fossil fuel as a successful business strategy to conserve the resource and to prevent damage of the environment.

The interaction between organization and an individual in the business world is supported by economic community. Final goods and services are produced by this economic community for the consumer or customer, who are the members of the eco-system. The business ecosystem includes supplier, producer, manufactures, competitors, mediators, agents and shareholders and for a healthy business ecosystem each and every member has an important role to maintain, conserve, recycle and prevent environmental damage by performing their respective operation in manner in which nutrients are recycled and rich growth of environment is sustained. The companies having leadership role may change overtime, but the function of ecosystem leader is always valued by the community because it enables members to move towards shared visions to align their investments and to find mutually supportive roles.

Ecological environment refers to all those living and non-living things surrounding us in which we all live and sustain. Business ecology is the study of inter-relationship between business, organisms and their environment. We have two way relationship amongst us i.e. ecological environment in which we are living and at the same time ecological environment which is affected by us. Business is an activity carried out by different small and big groups. Thus business and ecological environment influence each other in much bigger way than individuals.

From last few decades, business units are using fossil fuel energy as a power and releasing harmful dangerous effluents and fumes, which are more dangerous for the environment and damaging ecosystem due to which life has become difficult and in sustainable by phenomenon like global warming.

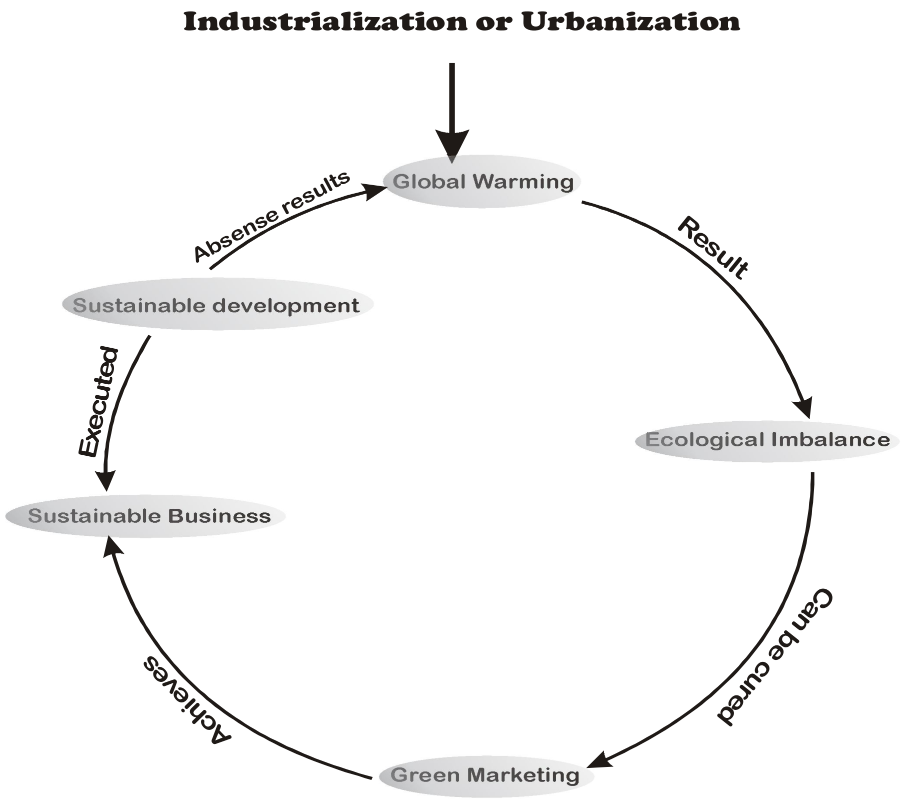
Industrialization has improved the life style of people and at the same time has a great impact on environment. Urbanization is at the cost of deforestation. Some industries like paper, furniture, infrastructure and super structure development led to substaintially depleted forests and hence contributing in global warming, which further destroy many varieties of flora and fauna.

Activity B

Give an example of any business unit which is operating on the principles of ecological management.

13.5 Implications for Business

To understand the implications for business and for sustainable development following model should be adopted



Implication for a business

13.5.1 Global Warming

The raising of average temperature of the earth's atmosphere and oceans is known as Global Warming. There are many reasons which are responsible of global warming like industrialization, urbanization, automobiles, telecommunication and many different types of pollution.

For Example : Electricity is a source of energy and causes pollution in many ways. Fossil fuels are made of dead plants and animals and they are burned to create and generate electricity. Most used sources of energy is petroleum and LPG. It is used in automobiles for transportation, in making electricty for industrialization and for making many other things but it produces lot of pollution. Many pollutants (Chemicals that pollute the air, water and land) are sent into the air when fossil fuels are burned and these chemicals are called greenhouse gases.

Pollution due to industrialization, urbanization, automobiles and many other has been found to be widely present in the environment and effect the ecological system is following manner :

(a) Heavy metals (toxins) extracted as fumes from various industries passing through tropic levels, are becoming exponentially more concentrated in the process.

(b) Carbon mono-oxide (CO) emission from automobiles and industries causes ocean acidification, i.e. the on going decrease in the pH of the earth's oceans as CO become dissolved.

(c) The emission of greenhouse gases from industries energy power stations and automobiles leads to global warming which effects eco-system in many ways.

(d) Invasive species can not compete with native species and reduce biodiversity. Invasive plants can contribute debris and biomolecules (allelopathy) that can alter soil and chemical compositions of an environment, often reducing native species competitiveness.

(e) Nitrogen oxides are removed from the air by rain which fertilise land and can change the species composition of eco-system.

(f) Smog and haze extracted from the industries can decrease the amount of sunlight received by plants to carry out photosysnthesis and thus, leads to the production of tropospheric ozone which harm plants.

(g) Due to solid pollution, land can become infertile and unsuitable for plants. This will affect other organisms in the food web.

(h) Sulpher dioxide and nitrogen oxide emission from industries causes acid rain which lowers the pH value of soil and causes soil pollution and multiple effect on food web that directly and indirectly effects the eco-system.

There are many other examples which are using different source of energy and causing different pollution, which effect the ecological environment -

- Turning off light.
- Watching and listening Television.
- Listening High watts stereos and sound systems.
- Washing and drying clothes by using chemical detergents through electric washing machines.
- Automobiles and Airlines.

- Telecommunication radars extracting dangerous rays.
- Using mobiles and head phones
- Using airconditioners, and heaters in rooms and in cars.
- Playing video games.
- Using dish washers.

By adopting the concept of green we can stop global warming. It is very important to create awareness among the people to know what kind of business to open, what kind of companies to launch, and what kind of product to produce, so that they are best for enviroment. There are different ways by which companies or industries protect environment viz. some of the companies are making products that help the environment to keep them green, some are having eco-packaging or eco labelling, and some of them prefer such a mode of transportation that causes less damage to the environment.

Companies which are manufacturing and selling eco-friendly products are helping the environment. When the consumer prefer to purchase and use eco-friendly products, they are contributing in saving the earth and to balance eco-system for healthy livelihood.

For Example : Some products save the amount of electricity used to help the environment like CFL. CFL light bulbs last longer and are more energy efficient.

Activity B

Name the various other products which are emiting polluted gases and preventing green house effect.

13.5.2 Green Marketing

Marketing of those products which are safe for the environment or ecology is known as green marketing. According to the American Marketing Association, green-marketing is the marketing of products that are presumed to be environmentally safe. Wide range of marketing activities, including product modification to produce eco-friendly products, adopt eco-friendly production process, eco-friendly packaging, as well as eco-friendly advertizements.

It is a social responsibility of the business to produce and market those products which are eco-friendly and have less negative impact on ecology. Marketing of those products which can be easily recyled, reproduced and support the environment to keep green and healthy is known as green marketing. It is the group of approaches which seeks to address the lack of fit between marketing as it is currently practiced and the ecological and social realities of a wider marketing environment. Green marketing, ecological marketing, eco marketing and environment marketing are all similar and they are part of modern marketing approach which do not just focus on consumer satisfaction but these concepts work beyond the traditional marketing approaches and seek to challenge those approaches and provide a substantially different perspective. These marketing concepts ascertain satisfaction of consumer with healthy, green and safe environment by offering eco-friendly products.

Green marketing or ecological marketing are much broader or wider concepts, it not only includes terms like phosphate free, recyclable, refillable, ozone friendly and environmentally friendly but it also facilitates and consists of all activities to generate exchange intended to satisfy consumer needs or wants, with minimal harmful impact on the natural environment by offering green and eco-friendly products and process like :

Eco-Label

Labels or stickers used by companies for their product, indicating eco-friendly ingredients is known as eco-label or green stickers. Mostly this types of labels are used for foods and consumer products. Green stickers are mandated by law in some of the countries like North America for electronic appliance and automobiles. Government of India instituted Bharat Stage Emission standards to regulate the extraction of air pollutants from automobiles.

The standards, based on European regulation and the timeline for implementation are set by the Central Pollution Control Board under the Ministry of Environment & Forests. All new vehicles manufactured after the implementation of the norms have to comply with the regulations. Since October 2010, Bharat Stage III norms have been enforced across the country. In 13 major cities, Bharat Stage IV emission norms are in place since April 2010.

Another good example of eco-label is BEE (Bureau of Energy Efficiency) 'Save energy for benefits of self and nation'. The objectives of standards & labeling program is to provide the consumer an informed choice about the energy saving, and there by the cost saving potential of the marketed household and other equipment. Adopting such standards by companies for electrical and electronic products have a great impact on energy savings in medium and long run while at the same time it will position domestic industry to compete in such markets where norms for energy efficiency are mandatory. BEE standards are invoked for electrical or electronic equipment and appliances like television, LCD, LED, lamps, refrigerator, air conditioners, water pumps, hot water geysers and ceilling fans.

Eco-labelling pattern is adopted by food as well as consumer products both. Organic labelling in is same as eco-labelling. Many certification standards exist for sustainable food production and good social and environmental performance.

Eco-Packaging

Packaging is most important and essential part of the marketing as it makes products more attractive and it is a better way to make product smaller and good in the eyes of the consumer, especially when it is eco-packaged. For easily recyled, reused, streamlined, bio degradable products there is a need for eco-friendly packaging. A green packaging company can cater to the needs of target consumer without sacrificing on environment or ecology.

Eco-Furniture

Eco-friendly furniture is a good substitute for wooden furniture. This type of furniture requires less wood and normally is made up of waste materials and products.

Eco-Fans

The thermoelectric module works on a small generator to power the fan without need of electricity and external batteries is known as eco-fans.

Eco-Paints

Paints make up of naturally derived raw materials, non-toxic elements and have lesser chemical elements are known as eco-friendly paints. These paints are good for healthy environment.

Solar Products

Solar products are good alternative for electricity or LPG and give a positive boost to save our environment and conserve energy.

Hand Made Papers

By using hand made papers we helps in saving trees. Hand made papers are made up of non-wood raw materials. It also provides employment in form of small scale industry.

Hand Made Paper Bags

These bags are best alternative to plastic bags, which are very dangerous for ecology, and these plastic bags are not recycled and are even dangerous for animals.

Eco Shoes

Materials used such as recycled rubber, recycled plastic, reused textiles and other synthetic products and all those waste which can be recyled for manufacturing of shoes is known as eco-shoes. These type of shoes are eco-friendly and safe for environment.

Eco Wheels

The use of eco-wheels, such as electric vehicles (EVs) can help greatly in reducing air pollution and also it can come handy in decreasing the energy consumption by 20%.

Herbal Medicines

The study of medicines derived from natural sources in known as pharmacognosy. Medicine traditional or folk medicine practice is based on the use of plants and plant extracts. The scope of these medicine is extended to include fungal and bee products, as well as minerals, shells and certain animal parts.

Ethno Botany

Ethnobotany is the scientific study of the relationships that exist between consumers and plants. To focus primarily on how plants are used, managed and perceived across human socities and to describe and explain complex relationships between cultures and (use of) plants is the main objective of Enthnobotanists.

Vermicopost

Vermicompost is the product or process of utilizing various species of worms, usually red wigglers, white worms, and earthworms to create a heterogeneous mixture of decomposing vegetable or food waste, bedding materials, and vermicast. Vermicast, similarly known as worm castings, worm humus or worm manure, is the end product of the break down of organic matter by a species of earthworm containing water soluble nutrients. Vermicopost is an excellent, nutrient - rich organic fertilizer and soil conditioner. The process of producing vermicompost is called vermicomposting.

Activity D

What is green marketing? Name the different green product which you are using.

13.5.3 Sustainable Business

The business which has less or minimum negative impact on environment, ecology, community, culture, society and economy is known as green business, eco-friendly business or sustainable business. Any business is green business when it follows the following criteria :

1. When all the business decisions are taken keeping sustainability of environment in mind.
2. When business is producing eco-friendly products which have less negative impact on environment in comparison to the other general products.
3. When industry is manufacturing those product which can be easily re-cycled, reused or refilled.
4. It is eco-friendly in comparison to traditional competition and marketing.
5. These business units are commited for maintaining environmental principles.

In sustainable business, organization participates in environment protection activities, green activities, eco-friendly production processes, manufacture eco friendly products while maintaining the concern of both environment and profit.

Therefore, sustainable business is a business which caters to the needs of the consumer by following the norm for environment safety without compromising on the ability of the future generations to meet their needs. It is a big challenge in front of companies to compete in market by taking care of environment and trying to manufacture such products which is renewable or can be recyled.

13.5.4 Sustainable Development

Ecological environment management is closely associated or linked with development, economic and social growth and life support system. Being that it is most neglected discipline in management here we have to decide either development or environment. Most of the developed countries have achieved high level of infrastructure and superstructure development and decent standard of living at the cost of environment and depletion of natural resources. On the other hand developing countries are putting their full efforts to attain minimum standards of living at, cost of the environment. These developing countries are speedly following the developed countries to achieve their living standards, their industrial growth and lifestyle by damaging the environment due to which environment is suffering from pollution thus causing health problems. There is a need to create a balance between development and enviornment which underscores the rate of consumption or use of natural resources and help approximate the rate at which these resources can be substitued or replaced. It is a responsibility of a nation to satisfy requirement by adopting sustainable development not at the cost of environment. It is believed that too much use of natural resources will not continue for longer period of time. We should realize that nature today is fragile and has limited and finite resources. Eco-scientists have sufficient proof that earth has almost reached a critical threshold beyond which ecological decline would lead to disaster. Now, there is need for sustainable development by producing eco-friendly or re-cycled products.

Another aspect of sustainability is about system analysis i.e. how economic, social and environmental system interact at various scales of operation in a way that would lead to sustainable development that strikes optimal balance among the three sub-system, consumers, industries and environment.

Therefore, sustainable development means development of the country by protecting environment, ecology by using renewable resources, and eco-friendly development process.

Activity E

What is your contribution in sustainable development? Explain

13.6 Case Study - Mobile Towers Damaging Biological Systems

According to Telephone Regulatory Authority of India (TRAI) around 4 lakhs mobile towers and with 3G mobile telephony, an additinal 1 lakh towers will be needed to provide services to consumer. The mobile towers consume a large amount of energy - about 2.7 crore units of electricity and over 200 crore litres of diesel daily. Electromagnetic Field (EMF) radiation emiting from mobile base stations mounted on cellular phone towers are feared to pose health hazards. These electromagnetic radiation (EMR) from mobile towers are interfering with the biological system of living beings, and flora and fauna. The radio frequency pollution appears to constitute a potential cause for the decline of animal populations. Still, there is no government laboratory to check radiation being emitted by mobile phone or telecom towers.Mobile phone radiation concentrates only on an individual. It is very close to individual's heart, and brain. So radiation from such close distance is more harmful than the radiation from towers.

Following steps are required to overcome the above problem :

1. Harmful electro-magnetic frequency (EMF) radiation emitting from mobile handsets, an interministenal committee recently reduced the Specific Absorption Rate (SAR) level for mobile handsets to 1.6 watts/kg average over a six minute period and taken over a volume containing a mass of 1 gram of human tissue.

2. The new radiation norms issued by Department of Telecommunication (DoT) also lowered limit of emission from telecom towers by one-tenth compared to earlier adopted levels.

3. Strictly control installation of mobile towers near wild life protected areas.

4. New-technology low power transmitters will be installed with inbuilt solutions for future expansion of the mobile network.

5. Uniform guidelines to enforce restrictions on setting up BTS (Base Transceiver Station) towers. along with an appropriate framework to ensure structural safety clearance from towers set up on rooftops of buildings.

13.7 Summary

The need of the time is to understand the environment degradation and resource wastage due to rampant human activities. To study and analyze the relationship between ecological destruction and worse human conditions is of prime importance. We must know how to manage our environment, usage of resources & their allocations. Various communities of the eco-system have to be vulnerable to environment. Also, these communities should know the outcome of their habits, actions and attitudes. If we do not take these issues seriously, it would ultimately result in eco logical suffering including plants, animals and human beings as a whole we know the problem but we are locking in solution. If eco logy suffers, then human survival is impossible. Without natural habitat nobody can live. And if the habitat is destructed, life is adversely affected. Since the raw-material used for producing goods and services is provided by environment, the responsibility of industry is of paramount consideration. Industry's concern should not only limit to project making, maintaining quality standards, conferring to rules and regulations but it also has to think beyond it is a 'Concern for Environment.'

13.8 Key Words

- **Ecology:** The Study of organism viz. land, oceans, fresh water, and air in their natural habitual is known as Ecology.
- **Industrial Ecology:** It is the study of industrial process that extract natural resources from the earth and transform these resources in useful commodities.
- **Global warming:** The raising of overage temperature of the earth's atmosphese and oceans is known as global warming.
- **Green Marketing:** Marketing of those products which are safe for the environment or ecology is known as green marketing.
- **Sustainable business:** The business which has minimum impact on environment is sustainable business.

13.9 Self Assessment Test

1. What is ecology? Discuss
2. What do you mean by ecological environment? Explain
3. Explain Industrial Ecology.
4. What is green marketing and how it is different from ordinary marketing? Explain
5. Explain the importance of eco-packaging in mordern marketing concept. Give examples.
6. What do you mean by sustainable development? Discuss
7. Write a short note on :

   a) Eco-labelling.

   b) Sustainable Business.

   c) Eco-products.

13.10 References

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Unit - 14 : Global Environment

Unit Structure:

14.0 Objectives

After studying this unit, you will be able to :

- Describe the concept of globalization
- Discuss the features of current global environment
- Explain the significance of global environment
- Describe the stages of global environment
- Analyse the essential conditions for global environment
- Discuss the factors favouring globalisation
- Describe the global environment and world economy
- Explain emerging trends in global environment

14.1 Introduction

Globalization is the process by which an activity or undetaking becomes worldwide in scope. It refers to the absence of boarders and barriers to trade between nations. Globalization is defined as increased perme-ability of traditional boundaries of almost every kind, including physical borders such as time and space, nation, state and economies, industries and organisations and less tangible borders such as cultural norms. As a consequence of increased global operation, the gobal economy is becoming more integrated than ever before. This gradual integration leads to the emergence of global village.

UNCTAD defines globalization at the macro level as follows : "The concept of globalization refers to both an increasing flow of goods and services and resources across national borders and to the emergence of complementary set of organisational structure to manage expanding network of international economic activity and transaction. Strictly speaking, a global economy is one where firm and financial institutions operate transnationally i.e. beyond the confines of national boundaries. In such a world of goods, factors of production and financial assets would be almost perfectly substitutes everywhere and it would no longer be possible to consider nation states as distinct economic identities with autonomous decision making power in the pursuit of national objectives. The public goods that are needed to maintain an open market system, such as secure property rights and stable monetary system would become a global responsibility"

The IMF defines globalisation as "The growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows, and also through the more rapid and widespread diffusion of technology." As Mitchell succinctly puts it, "Globalisation for better or worse, has changed the way the world does business. Though still in its early stages, it is all but unstoppable. The challenge that individuals and businesses face is learning how to live with it, manage it, and take advantage of the benefits it offers."

In his *Management Challenges for the 21st Century,* Peter Drucker cautions: "All institutions have to make *global competitiveness* a strategic goal. No institution, weather a business, a university or a hospital, can hope to survive, let alone to succeed, unless it measures up to the standards set by the leaders in its field, any place in the world."

We may consider globalisation at two levels, viz., at the macro level (i.e., globalisation of the world economy) and at the micro level (i.e., globalisation of the business and the firm). Globalisation in its true sense is a way of corporate life necessitated, facilitied and nourished by the transnationalisation of the world economy and developed by corporate strategies. Globalisation is an attitude of mind- it is a mind-set which views the entire world as a single market so that the corporate strategy is based on the dynamics of the global business enviornment. International marketing or international investment does not amount to globalisation unless it is the result of such a global orientation.

A tuly global corporation views the entire world as a single market. It does not differentiate between domestic market and foregin markets. In other words, there is nothing like a home market and foreign market. There is only one market, the global market.

As Kenichi Ohame observes in his well-known book, *The Borderless Truly World,* a global corporation develops a genuine equidistance of perspective. Managers with a turly global orientation consciously try to set plans and build organisations as if they view all key customers equidistant from the corporate centre. For example, the managers of Honda, which has operations in several parts of the world, do not think or act as if the company were divided between Japanese and overseas operations. Indeed, the every word "overseas" has no place in Honda's vocabulary because the corporation sees itself as equidistant from all its key customers. At Casio, the top managers gather information directly from each of their primary markets and then sit down together once a month to lay out revised plans for global product development.

Multinationals developed integrated international production logistics and marketing system. The production sharing between various units in different countries. For example, about two- thirds of Toyota's total business is outside Japan. More than half of its vehicles sold overseas is manufactured overseas and the remaining exported from Japan. Toyota has established integrated manufacturing systems in all three of its main markets- North America, Europe and Asia. Plants in China, Indonesia, Malaysia, Philippines, Taiwan and Thailand turned out nearly a third of the company's overseas production.

These manufacturing units are inter-linked by flows of components/ parts, production planning etc. To cite a different example, Mazda's sports car, MX-5 Miata, was designed in California, had its prototype created in England, was assembled in Michigan and Mexico, using advanced electronic components invented in New Jersey and fabricated in Japan, financed from Tokyo and New York, and marketed globally.

14.2 Current Global Environment

Globalisation, of course, is not a new phenonmenon. The period 1870 to 1913 experienced a growing trend toward globalisation. The new phase of globalisation which started around the mid 20th century became very widespread, more pronounced and overcharging since the late 1980s by gathering more momentum from the political and economic changes that swept across the communist countries, the economic reforms in other countries, the latest multilateral trade agreement which seeks to substantially liberalise international trade and investment and the technological and communication revolutions. Features of current global environment can be outlined as under:

New Markets

Growing global markets in services- banking, insurance, transport etc.

New financial markets- deregulated, globally linked, working around the clock, with action at a distance in real time, with new instruments such as derivatives.

Deregulation of antitrust laws and proliferation of mergers and acquisitions.

Global consumer markets with global brands.

New Area in Global Environment

Multinational corporations integrating their production and marketing.

The World Trade Organisation- the first multilateral organisation with authority to enforce the national governments compliance with their rules.

Booming international network of NGOs.

Regional Blocs and their importance- European Union, Association of South-East Asian Nations, Mercosur, North American Free Trade Association, Southern African Development Community, among many others.

Some policy coordination groups- G-7, G-40, G-22, G-77, OECD. etc..

New Rules and Norms

Market economic policies spreading around the world, with greater privatization and libralisation than in earlier decades. There is widespread adoption of democracy as the choice of political regime of many of countries.

Human rights conventions and instruments building up having very good significance signatories- and growing awareness among people around the world. Consensus goals and action agenda for development of entire world especially for LDC's.

Various Conventions and agreements on the global environment related to biodiversity, ozone layer, disposal of hazardous wastes, desertification, climate change are organized time to time by nations .

Multilateral agreements in trade with on agenda of environmental and social conditions are discussed.

Multilateral agreements for services, intellectual property, comunications. Now more binding on national governments than earlier.

New (Faster and Cheaper) Tools of Communication

Internet and electronic communications linking many people simultaneously. Cellular phones, Fax machines, Faster and cheaper transport by air, rail and road, Computer-aided design are examples.

14.3 Significance of Global Environment

Global environment has server benefits. While developing countries which, in the past, were against globalisation, have wide opened their doors for globalisation. In developed countries also like USA are angry against globalisation. American jobs and wage levels are serverely affected by the influx of cheap imports and shifting of production to low cost overseas locations. According to BusinessWeek/Harris poll in early 2000, more than two-thirds of American believe that globalisation drags down US wages. A strong majority of the Americans feel that trade policies have not adequately addressed to the concerns of American workers, international labour standards, or the environment issues. The important pros and cons of globalisation according to the above survey were the following.

Productivity grows more quickly when countries produce goods and services in which they have comparative advantages. Living standards can go up faster.

- Global competition and imports keep a lid on pices, so inflation is less likely to derail economic growth.
- An open economy supress innovation with fresh ideas from abroad.
- Export field jobs often pay more than any other jobs.
- Unfettered capital flows give the US access to foregin investment and keep interest rates low.

Globalisation can benefit the developing countries in several ways. It is, however, apprehended that unregulated globalisation will cause serious problems for developing countries. These point are elaborated under:

The global dominance of industries by MNCs is on the increaseing. Many countries are indiscriminate in liberalising the foreign investment. Pepsi, Coke and "junk foods" are allowed even in countries like China. Now a number of countries allow high foreign stake even in industries where that is not really required. This is affecting domestic enterprieses of developing countries.

There has been a large number of cases of takeover of national firms by foreign firms. In some of these cases, the domestic firms are driven to a situtation of having to hand over the majority or complete equity to the foreign partners of joint ventures because of the inability of the Indian partners to bring in additional capital or some other incapability. Replacement of traditional and indigenous products by modern products, resulting in the ruin of traditional crafts and industries and the livelihood of people employed in these sectors.

One common criticism has been seen that MNC's bring many new technologies, but may not be the suited to the host country. It suits the objectives of the MNC. It is more true in the liberalised environment of today, Another problem, the dumping of outmoded technology to the developing world is not as valid today as in the past and in future. In the past of because of the entry restrictions and resultant absence or lack of competition, developing countries could be used as a dumping ground of obsolete products, including technology. The business environment today, however, is vastly different. The competition between MNCs (and national firms) of made possible by the dismentling of entry barriers (and freely inport of technology by national firms and added thrust on R&D by them), Technological edge is an important determinant of success. The evolution of the motor car market in India, for example, give some indication of this.

The developing countries in general have been disadvantaged by the international trading system. The adverse terms of trade led to economic loss for the developing countries.The least developed countries have been the most deprived. It is noted that one of the reasons for the adverse terms of trade of the developing countries is the demand-supply factor. It is also estimated that the least developed countries stand to lose up to $600 million a year and sub-Saharan Africa $1.2 billion as a result of the Uruguay Round Agreement, while the developed countries are expected to gain very substantially. Multilateral trade liberalisations were mostly in respect of goods traded between industrial economies and those exported from developing to the developed nations did not benefit so much. While developing countries as a group now face tariffs 10 per cent higher than the global average, the least developed countries face tariffs 30 per cent higher, because tariffs remain high on the goods with greatest potential for the poorest countries, such as textiles, leather and agricultural commodities.

Number of developing countries have improved their export performance and several of them figure in the list of the top 20 exporters. Despite the different problems and discriminations, there are various chances to developing countries benefiting from trade. Basic trade theory argues that poor people gain from trade liberalization. Developing countries have a comparative advantage in abundant natural resources , low-cost and unskilled labour. If they concentrate on goods whose production is simple and labour intensive, greater integration into global markets they can increase their exports and output, and also raising the demand for unskilled labour and raising the incomes of the poor relative to those of the non-poor countries.

The countries move up the trade ladder, exporting more sophisticated products, leaving space on the ladder below for later-industrialising countries. All this helps reduce poverty. The countries on the higher rugs benefit most, but even those on the lower rugs should see poverty fall. There should also be benefits for employment from a liberal financial regime. Removing restrictions on capital flows should attract more FDI, creating more jobs for the poor by integrating them into international systems of production."

It is criticised that developed nations receive most of the FDI. A very small number of the developing countries, which are the relatively developed or large or fast growing in the developing world account for the lion's share of the FDI flows. The foreign investment flows are based on economic rational, it is unrealistic to expect the pattern of flow.

Another criticism is that the liberalisation increases the economics inequality. Even in China, the liberalisation has created many island of affluence. If inequality increases because of the worsening of the living conditions of the poor, it certainly is unjustifiable. But, if the increases in inequality is the result of improving the economic conditions, while there is no economic deterioration of any section, or because of the disproportionate benefits, the question is whether the economic progress of some sections should be curbed. So that there will not be a widening of the inequality.

The liberalisation may increase inequality. Further, several sectors and sections may not directly and immediately benefit from liberalisation. There may also be shocks and other adverse effects on the weaker sections. It is, therefore, necessary that there should be real socio-economic reforms rather than only liberalisation. Targeted poverty eradication programmers and social safety net are very important.

The fast growth and overall development resulting from liberalisation could have a major impact on poverty. Naisbitt points out that there were an estimated 200 to 270 million Chinese living in absolute poverty in 1978 (the year in which the liberalisation began) and their number came down to 100 million by 1985. Foreign capital has significantly boosted investment and economic growth in China. China has leaped forward on the export front too. Foreign funded enterprises contribute a substantial chunk of the exports from China. Other countries which carry out proper reforms in real earnest should also be expected to reap such gains in varying degrees. But, half-hearted and confused measure and implementational problems may create more problems than they solve.

Although the MNCs, by the virtue of their size and resources, have certain advantages. They may also have limitations or disadvantages in certain spheres or aspects of business. Small and medium flims often have some edge over the very large ones in respects standardised products or technologies like greater flexibility and adaptability, lower overheads, intimacy with the customers, etc. Lower costs is a great advantage which flims from developing countries enjoy. It may be noted that the major component of growth of several Indian pharmaceutical firms is the foreign market. They are relying mostly on bulk drugs and generics.

What is often ignored in while discussing the impact of the product patent is that patented drugs account for only about 15 per cent of the Indian drug market. There are several more products which would go off patent in the coming years which can also be taken upey the Indian firms.

The new patent regime should be expected to help the Indian industry by prompting it to give added thrust to R&D and thereby enabling Indian firms to develop patented products. Positive signs are already there on the horizon. There are also many evidences of the better technology brought in by the MNCs inducing or provoking Indian firms to absorb similar technology leading to their enhanced competitiveness and market expansion.

14.4 Stages of Global Environment

A firm passes through different stages of development before it becomes a truly global corporation. Typically a domestic firm starts its international business by exporting. Even enter into joint ventures or subsidiaries abroad. From an international firm it may then develop into a multinational firm and finally into a global one.

Ohmae indentifies five different stages in the development of a firm into global corporation.

The first stage is the arm's length service activity of essentially domestic company which moves into new overseas markets overseas by linking up with local dealers and distributors.

In stage two, the company takes over these activities on its own. In the next stage, the domestic based company begins to carry out its own manufacturing, marketing and sales in the key foreign markets.

In stage four, the company moves to a full insider position in these markets, supported by a complete business system including R & D and engineering. This stage calls on the managers to replicate in a new environment the hardware, systems and operational approaches that have worked so well at home, It forces them to extend the reach of domestic headquaters, which now has to provide support functions such as personnel and finance, to all overseas activities. Althrough stage four, the headquaters mentality continuses to dominate. Different local operations are linked, their relation to each other established by their relation to the centre.

In the fifth stage, the company moves toward a genuinely global mode of operation. In this context Ohmae points out that a company's ability to serve local customers in markets around the globe in ways that are truly responsive to their needs as well as to the global character of its industry depends on its ability to strike a new organisational balance. What is called for is what Akio Morita of Sony has termed global localisation, a new orientation that simultaneously looks in both directions.

Ohmae argues that to make this organisational transition a company must denationalize their operations and create a new & roper system of values shared by corporate managers around the globe to replace the glue, a nation based orientation once provided.

Ohame further observes that today's global corporations are nationality less because consumers have become less nationalistic. True global corporations serve the interest of customers not for Govt. They do not exploit local situations and then repatriate all the profits back home, leaving each local area poorer for their having been there. They invest, they trained, they pay taxes, they build up infrastructure and they provide good value to customers in all the countries where they do business. IBM Japan, for instance, has provided employment to about 20,000 Japanese and over the past decade has provided three times more tax revenue to the Japanese Govt. as comparision to Japanese company Fujitsu.Many firms across the world has ambitious plans to become global.

14.5 Essential Conditions for Global Environment

There are, however, some essential conditions to be satisfied on the part of the domestic economy as well as the firm for successful globalisation of the business. They are:

Business Freedom: There should not be unnecessary Govertnment restrictions which come in the way of globalisation, like import restriction, restrictions on sourcing finance or other factors from abroad, foreign investments etc. That is why the economic liberalisation is regarded as a first step towards facilitating globalisation.

Government Support: Although unnecessary government interference is a hindrance to globalisation, govt. support can encourage globalisation, Govt. support may take the form of policy and procedural reforms, development of common facilities like infrastructural facilities, R& D support, financial market reforms and so on.

Resources: Resources is one of the important factors which often decides the ability of a firm to globalise. Resourceful companies may find it easier to thrust ahead in the global market. Resources include finance, technology, R&D capabilities, managerial expertise, company and brand image, human resource etc. It should, however, be noted that many small firms have been very successful in international business because of one or other advantage they possess.

Competitiveness: The competitive advantage of the company is a very important determinant of success in global business. A firm may derive competitive advantage from any one or more of the factors such as low costs and price, product quality, product differentiation, technological superiority, after sales service, marketing strength etc. Sometimes small firms may have an edge over others in certain aspects or times of business.

14.6 Factors Favouring Globalisation

There are also a number of favourable factors for globalisation of Indian business.

Human Resources: Apart from the low cost of labour, there are several other aspects of humanresources to India's favour. India has one of the largest pool of scientific and technical manpower.The number of management graduates is also surging. If there is right environment in India the scientists and technical personnel can do excellent. Similarly, although the labour productivity in India is generally low, but the right environment if prouided then it will be enriching our producting. While several countries are facing labour shortage and may face diminishing labour supply, India present the opposite picture.

Wide Base: India has a very broad resource and industrial base which can support a variety of business.

Growing Enterpreneurship: Many of the established industries are planning to go international in a big way. Added to this is the considerable growth of new and dynamic enterpreneurs who could make a significant contribution to the globalisation of Indian business.

Growing Domestic Market: The growing domestic market enables the Indian companies to consolidate their position and to gain more strength to make foray into the foreign market or to expand their foreign business.

Niche Markets: There are many marketing opportunities abroad present in the form of niche market . (A Niche is a small segment of a market ignored or not properly served by large players). Such niches are particularly attractive for small companies. Several Indian companies have become very successful by niche marketing.

Expanding Markets: The growing population and disposable income and the resultant expanding internal market provides enormous business opportunities.

Transnationalisation of World Economy: Transnationalisation of the world economy i.e., the integration of the national economies into a single world economy as evinced by the growing interdependence and globalisation of markets is an external factor encouraging globalisation of India business.

NRIs: The large number of non-resident Indians who are resourceful in terms of capital, skill, experience, exposure, ideas etc.- is an asset which can contribute to the globalisation of Indian business. The contribution of the overseas Chinese to the recent impressive industrial development of China may be noted here.

Economic Liberalisation: The economic liberalisation in India is an encouraging factor of globalisation. The delicensing of industries, removal of restrictions, opening up of industries, which ware earlier reserved for the public sector, import liberalisations, liberalisation of policy towards foreign capital and technology etc. could encourage globalisation of Indian business. Further, liberalisation in other countries increases the foreign business opportunities for Indian business.

Competition: The growing competition, both from within the country and abroad, provokes many Indian companies to look to foreign markets seriously to improve their competitive position and to increase the business. Sometimes companies enter foreign market as a counter-competitive strategy, i.e., to fight the foreign company in its own home market to weaken its competitive strength.

14.7 Global Environment and World Economy

The world economy has been emerging as a global or transnational economy. A global or transnational economy is one which transcend the national borders unhindered by artificial restrictions like Govt. restricitions on trade and factor movements. Globalisation is a process of development of the world into a single integrated economic unit.

The Transnational economy is different from the International economy. The international economy is characterised by the existence of different national economies the economic relations between them being regulated by the national Governments. The transnational economy is a borderless world economy characterised by free flow of trade and factors of production across national borders.

Drucker in his *New Realities* observes that in the early seventies- with OPEC and President Nixon's floating of the dollar- the world economy changed from being international to transnational. According to Drucker the transnational economy is characterised by, inter alia, the following features.

1. The transnational economy is shaped mainly by money flows rather than by trade in goods and services. These money flows have their own dynamics. The monetary and fiscal polices of sovereign governemnts increasingly react to events in the international money and capital markets rather than actively shape them.

2. In the transnational economy management has emerged as the decisive factor of production and the traditional factors of production, land and labour, have increasingly become secondary. Money and capital markets too have been increasingly becoming transnational and universally obtainable. Drucker, therefore, argues that it is management on which competitive position has to be based.

3. In the transnational economy the goal is market maximisation and not profit maximisation.

4. Trade, which increasingly follows investment, is becoming a function of investment.

5. The decision making power is shifiting from the national state to the region (i.e., the Regional Blocs like, the Europeon Union, North American Free Trade Agreement, etc.).

6. There is a genuine and almost autonomous world economy of money, credit and investment flows. It is organised by information which no longer knows national boundaries.

7. Finally, there is a growing pervasiveness of the transnational corporations which see the entire world as a single market for production and marketing of goods and services.

A growing proportion of the world output is traded internationally and the faster growth of trade, than the GDP, is bringing about world economic integration. This economic integration is reinforced by the massive cross-border capital flows. The progress of the regional blocs increasingly integrate the regional economies.

Drivers of Globalisation

In general, globalization represents the increasing integration of the world economy, based on five interrelated drivers of change:

- International trade (lower trade barriers and more competition)
- Financial flows (foreign direct investment, technology transfers/licensing, portfolio invest ments, and debt)
- Communications (traditional media and the Internet)
- Technological advances in transportation, electronics, bioengineering and related fields
- Population mobility, (especially of labour).

14.8 Emerging Trends in Global Environment

There are several emerging trends in global environment some of them are discussed below:

- **Business Ethics**

A very complex and controversial issue is that of ethics. The varying ethical norms and social values many a time make the international business environment very intricate and perplexing. The term business ethics refers to the system of moral principles and rules of conduct applied to business.

In this connection, Peter Drucker very appropriately remarks: There is neither a separate ethics of business nor is one needed. For, men and women do not acquire exemption from ordinary rules of personal behaviour because of their work or job. Nor, do they cease to be human beings when appointed vice president, city manager, or college dean. And there have always been a number of people who cheat, steal, lie, bribe or take bribes. The problem is one of moral values and moral education of the individual of the family, and the school.

Bribery, pay offs or kickbacks are common in business in many countries. However, the extent and intensity of it vary from country to country. In some countries it is a common practice with government officials and other employees. The law in respect of such practices also varies among countries. According to the regulation in some countries, while bribing is ilegal within the country, bribing by the nation's firms in foreign markets to get or conduct business is not illegal because of the feeling that is inevitable in some markets. The position appears to be that "morality only exists within a culture. and it is not for us to say what is moral in someone else's culture.

Another issues is whether it is ethical to sell products which are banned in some countries because of their harmful effects in other countries (often in developing countries). One issue is that if the govt. of a country permits the marketing of such a product should a company give up the sale of the product on its own. If the harmful effects of a product outweigh the benefits, a company with sound ethics will not do business in that product even if there is no legal objection.

• **Social Responsibility of Business**

Besides being ethical in business, companies, particularly the large ones, have some social responsibilities. Social responsibility of business refers to what the business does over and above the statutory requirement for the benefit of the society. The word responsibility connotes that the business has some moral obligations to the society. The term corporate citizenship is also commonly used to refer to the moral obligations of business to the society. This implies that just as individuals corporates are also integral part of the society and that their behaviour shall be guided by certain social norms.

In the environment of modern economic development, the corporate sector no longer functions in isolation. If the plea of the companies that they are performing a social purpose in the development of the country is to be accepted, it can only be judged by the test of social responsiveness shown to the needs of the community by the companies. The company must behave and function as a responsible member of society, like any other individual. It cannot shun moral values nor can it ignore actual compulsions. The real need is for some focus of accountability on the part of the management which is not limited to shareholders alone. In modern limes, the objective of business has to be the proper utilisation of resources for the benefit of others. A profit is still a necessary part of the total picture but it is not the primary purpose. This implies that the claims of various interests will have to be balanced, not on the narrow ground of what is best for the shareholders alone but from the point of view of what is best for the community at large. The company must accept its obligation to be socially responsible and to work for the larger benefit of the community.

There has been a growing acceptance of the plea that business should be socially responsible in the sense that the business enterpries, which makes use of the resources of society and depends on society for its functioning, should discharge its duties and responsibilities in enhancing the welfare of the society of which it is an integral part.

Singhania has classified the nature of the social responsibility of business into two categories.

> The manner in which a business carries out its own business activity. This involves the acceptance of the fact that business is not merely a profit-making occupation but a social function which involves certain duties, and requires that appropriate ethics which must be followed. For example, a business must obey all the laws, even when they are disagreeable; it should produce the maximun goods quality, ensure smooth supplies at competitive prices, pay taxes, shun malpractices, pay a fair wage to employees and a reasonable dividend to shareholders.
>
> The welfare activity that it takes upon itself as an additional function. In addition to its commercial activity, business also plays a role in promoting social welfare activity, even directly.

George Goyder, in his famous book, *The Future of Private Enterprise: A Study in Responsibility,* mentions the following as the principal objectives of a responsible company:

•. The extension, development and improvement of the company's business and the building up of its financial independence.

•. The payment of fair and regular dividends to the shareholders.

- The payment of fair wages under the best possible conditions to the workers.
- The reduction in the prices to be charged to consumers.

In other words, the primary objectives of a socially responsible business should be to strengthen itself with due regard to the interests of the shareholders employees and consumers.

There is a growing recognition that the business should pay due attention to the long-term welfare of society. The marketing concept which has gained tremendous popularuty, indicates that the key to staisfying organisational goals is customer staisfaction. The societal marketing concept, which has been gaining popularity over the marketing concept, however, calls for generating customer staisfaction and long-run consumer welfare as the key to attaining a long-run profitable volume. As Philip Kotler points out, “the addition of long-run customer welfare asks the businessman to include social and ecological considerations in his product and marketing planning. He is asked to do it not only to meet his social responsibilities but also because failure to do this may hurt his long-run interests.”

The enormus resources at the disposal of large business corporations enable them to carry out extensive research and development. They should also devote their R&D efforts to the social needs of the developing countries, rather than being completely guided by profit maximization.Because of their resources position, they should also be expected to make a significant contribution to social welfare. An amount equivalent to the annual expenditure on entertainment by some MNCs can go a long way to improve the social welfare is some small poor economies.

The multinationals shall show as much social responsibility in the foreign countries as they do in the home country: one criticism against the MNCs is that they adopt duble/multiple standards with different norms/ stands for developing countries compared to the home country or developed countries.

There are some models which endeavour to describe the evolution and extent of social orientation of companies. Notables ones include Carroll’s model, Hala’s model and Ackerman’s model. Archie B. Carroll, who defines corporate social responsibility as the entire range of obligations business has to society, has proposed a *three-dimensional conceptual model of corporate performance.* According to Carroll, a firm has the following four categories of obligations of corporate performance:

The firm being an economic entity, its primary responsibility is economic, i.e., efficient operations to satisfy economic needs of the society and generation of surplus for rewarding the investors and further development.Legal responsibilities are also fundamental in nature because a company is bound to obey the law of the land.Ethical responsibilities are certain norms which the society expects the business to observe though they are not mandated by law. For example, a company shall not resort to bribing or unethical practices, unfair competitive practices etc.. Discretionary responsibilities refer to the voluntary contribution of the business to the social cause, like involvement in community development or other social programmes. Carroll points out that these four categories are not mutually exclusive and the boundaries between them are difficult, if not impossible, to define. Further, these terms are not value-free and they may be interpreted differently by different people.

- **Globalisation and Environment Problems**

There is close association the pattern of economic growth and environmental problems. Globalisation, by accelerating certain types of economic activities, causing unscrupulous exploitation of natural resources and using ecologically unfriendly technologies and operations, makes the problem more serious.

Rostow's theory of economic growth tells us that after a certain stage growth will become 'self-sustainnig.' But the trends of ecological damages associated with economic growth seem to tell us that if the present style of growth is pursued for long, economic growth will become 'self-defeating', and not self-sustaining. For, the seeds of destruction are present in the process of growth itself. Destruction of ecological balance seems to have become a concomitant of rapid growth. The environmental problems become more acute with increase in the level of industrialisation, urbanisation and intensification of agricultural activities with the modern pollution-prone technology.

The fouling of water by industries and other sources cause destruction of fish wealth, thus fouling the daily bread of tens of thousands of pool fishermen. The crop damages caused by air, water and air pollution are severe. Environmental pollution has been regarded as the root caused of most of the diseases. Due to the fouling of the environment many diseases increase and new ones emerge. If a realistic estimate of the cost of human health and life on account of pollution is made including the loss of life, medical and public health expenditures, loss of production and productivity due to ill health and other associated problems created by pollution, we will get an astounding figure. As the United States President's Council on Environmental Quality rightly points out, "the present levels of pollution and environmental degradation result in costs to society in the form of increased health services, lost productivity and direct damage to crops, materials and other property. The loss of scenic values and recreational areas, destruction of valuable ecological systems and the loss of pleasant surroundings do not enter traditional economic calculus directly but they are no less economic costs."

One of the relationships between economic affluence and the fouling of environment is very well implied in the statement that the affluent society has been becoming an "effluent" society. Alvin Toffler in his famous *Future Shock* characterises the modern industrial society and as "the throw away society." Napkins, towels, non-returnable containers, cans, toys, plastic packs, pastry tins etc. create mounting solid disposal problems. In many developing countries there is no effective arrangement for their disposal and this causes a very serious damage to the echology and poses an alarming threat to the future generations.

Globalisation increases theses problems because of the indiscriminate increase in the consumption of such throw way categories of products in societies which are environment conscious. The impact of globalisation on environment is further indicated in the following sub-sections of this section.

The problem of environmental degradation is thus assuming more and more serious proportions. It is high time comprehensive long term measures were taken to combat the problem. The Stockholm Conference on Human Environment, held decades ago, suggested a number of measures towards this end. The following are the main principles of the Stockholm declaration:

(a) The natural resources of the earth including the air, water, land, flora and fauna and especially repre sentative samples of natural ecosystem must be safeguarded for the benefit of present and future generations through careful planning or management as appropriate.

(b) The capacity of the earth to produce vital renewable resources must be maintained and wherever praticable restored or improved.

(c) The non-renewable resources of the earth must be employed in such a way as to guard against the danger of their future exhaustion and to insure that benefits from such employment are shared by all mankind.

(d) States shall take all possible steps to prevent pollution of the seas by substances that are liable to create hazards to human health, to harm living resources and marine life, to damage amenities or interfere with other legitimate uses of the sea.

(e) For the developing countries, stability of prices and adequate earnings for primary commodities and raw material are essential to the environment management since economic factors as well as ecologi cal processes must be taken into account.

(f) Resources should be made available to preserve and improve the environment, taking into account the circumstances and particular requirements of developing countries and any costs which may emanate from their incorporating environmental safeguards into their development planning and the need for making available to them upon their request, additional international technical and financial assistance for this purpose.

(h) States have, in accordance with the charter of the United Nations and principles of International law, the sovereign right to exploit their own resources pursuant to their own environmental policies, and the responsibility to insure that activities within their jurisdiction or control do not cause damage to the environment of other states or of areas beyond the limits of national jurisdiction.

(j) International matters concerning the protection and improvement of the environment should be handled in a cooperative spirit by all countries, big or small, on an equal footing. Cooperation through multilateral or bilateral arrangements or other appropriate means is essential to prevent, eliminate or reduce and effectively control adverse environmental effects resulting from activities conducted in all speheres, in such a way that due account is taken of the sovereignty and interests of all states.

(k) States shall ensure that international organisations play a coordianted, efficient and dynamic role for the protection and improvement of environment.

(l) Man and his environment must be spared the effects of nuclear weapons and all other means of mass destruction. States must strive to reach prompt agreement, in the relevant international organs, on the elimination and complete destruction of such weapons.

• **Disadvantaged for Developing Countries**

As in the case of some other social issues, the environmental issues are raised mostly and those which are disadvantages for the developing countries, ignoring or relegating to the background several serious issues which hold the developed nations or firms from such nations guilty. Some countries prohibit the import of goods which cause ecological damage. For example, the US has banned the import of shrimp harvested without turtle excluder devise because of its concern for the endangered sea turtles. Countries like India are affected by it.

Developing countries are affected by the relocation of polluting industries from the developed to the developing ones. Similarly, several products which are banned in the developed nations are marketed in the underdeveloped world. The dumping of nuclear and hazardaous wastes in developing countries and the shifting of polluting industries to the developing countires impose heavy social costs on them. The exploitation of the natural resources of the developing countries to staisfy the global demand also often cause ecological problems.

When the multinationals employ in the developing nations polluting technologies which are not allowed in the developed countries or do not care for the ecology as much as they do in the developed nations, it is essentially a question of ethics. Another serious problem is that developed nations sometimes raise environmental issues as a trade barrier or a coercive measure rather than for genuine reasons.

• Trade and Environmental Issues

The debate has intesified in recent years on the links between trade and the environment and the role the WTO should play in promoting environment friendly trade. A central concern of those who have raised the profile of this issue in the WTO is that there are circumstances where trade and the pursuit of trade liberalization may have harmful environmental effects.Three main arguments are forwarded as to how this might occur.

First, trade can have adverse consequences on the environment when property rights in environmental resources are ill-defined or prices do not reflect scarcity. This situation results in production or consumption "externalities" and can lead to the abuse of scarce environmental resources and degradation, which is exacerbated through trade. Some of the pollution can be purely local, such as a very noisy factory. Other pollution can have global repercussions, for example, the excessive emission of green-house gases, the destruction of rainforests, and so on. Critics argue that trade liberalization which encourages trade in products creating global pollution is undesirable.

The second argument linking trade and the environment is related to the first one. If some countries have low environmental standards, industry is likely to shift production of environment-intensive or highly-polluting products to such so called pollution havens. Trade liberlization can make the shift of "smoke-stack" industries across borders to pollution havens even more attractive. If these industries then create pollution with global adverse effects, trade liberalisation, indirectly, promote environmental degradation. Worse, trade induced competitive pressure may force countries to lower their environmental standards. The argument, in other words, is that trade liberalisation leads to a "race to the bottom" in environmental standards.

The third concern by environmentalists about the role of trade relates more to social preferences. Some practices may simply be unacceptable for certain people or societies, so they oppose trade in products in which encourage such practices. These can include killing dolphins in the process of catching tuna, using leg-hold traps for catching animals for their furs, or the use of polluting production methods which have only local effects.

On the other hand, it has also been pointed out that trade liberalization may improve the quality of the environment rather than promote degradation. First, trade stimulates economic growth, and growing prosperity is one of the key factors in societies' demand for a cleaner environment. Growth also provides the resources to deal with environmental problems at hand resources which poor countries often do not have. Second, trade and growth can encourage the development and dissemination of environment friendly production techniquies as the demand for cleaner products grows and trade increase the size of markets. International companies may also contribute to a cleaner environment by using the most modern amd environmentally clean technology in all their operations. This is less costly than using differentiated technology based on the location of production and helps companies to maintain a good reputation. Finally, the costs of meeting environmental regulations often accounts for only a small fraction of total production costs, so that this factor is unlikely to be at the basis of relocation decisions other factors such as labour costs and the adequacy of infrastructure are much more important.

• Labour Issues

One of the important social issues in the developed countries in respect of business with the developing countries pertains to ill-treatment of labour and childern. Child labour used in the manufacture of exports from the developing countries is widely criticised by people in the developed countries. There is protest against this in the developing countries too. For example, it is alleged that child labour is used by the carpet industry in India and some other countries and social activists in the developed nations demand ban on the import of goods embodying child labour. Consumers are called upon to boycott such goods.

A similar issue is the sweat labour. The argument here is that goods are manufactured by labour, working in unhealthy working conditions, not getting fair wages should be banned or boycotted. Certain important developing country exports, like garments, are alleged to be suffering from such problem.

Some multinationals are criticised for sourcing products from developing countries benefiting from the sweat labour.

According to an ILO Report, it is a regrettable feature of many export processing zones that both male and female workers are trapped in low wage and low skill jobs and labour relations and human resource development remain two of the most problematic aspects of zone functioning. The frequent absence of minimal standards and poor labour-management relations have predictable outcomes, such as high labour turnover, absenteeism, stress and fatigue, low rates of productivity, excessive wastage of materials and labour unrest which are still too common.

Another important issue is trade union rights. Absence of trade union rights in some countries provides them a cost advantage. Should the products of such countries be permitted in other countries? It may be noted that many multinationals are taking advantage of the absence of trade union rights in some countries. According to the WTO, the debate on the interaction between trade and labour standards is in many ways similar to the debate on trade and environmental standards. A concern expressed in some industrial countries is that excessively low standards in certain countries will impose downward pressure on standards, or give the low-standard countries as unwarranted competitive advantage. Developing countries, on the other hand, fear that this argument may be used as a surrogate form of protection. As with environmental standards, the WTO was not designed to set labour standards. This was made clear in the Singapore Ministerial Declaration of December 1996, which also acknowledged the competence of the International Labour Organisation (ILO) in the matter of labour standards. Specifically, the Singapore Ministerial Declaration concluded that (i) Members are committed to the observance of internationally recognized core labour standards, (ii) these standards should be addressed in the ILO, whose work the Members support, (iii) standards are promoted by growth and development, fostered through trade liberalization; and (iv) Members reject the use of labour standards for protectionist purposes, and agree that the comparative advantage of countries must in no way be put into question. Members of the ILO recently agreed on a "Declaration of Fundamental Principles and Rights at Work", in which ILO Members agreed to increase the scrutiny of adherence to core labour rights and reiterated the commitment in the Singapore Declaration not to use labour standards for protectionist purposes.

The WTO points out that the debate on labour standards distinguishes between so-called basic labour rights and less commonly accepted standards. Basic labour rights are part of the ILO Conventions on human rights and labour standards and include the prohibition of forced labour, the freedom of association, the right to organise and bargain collectively, the elimination of child labour exploitation and the non-discrimination in employment. Other less common accepted standards include minimum wages, limits on the hours worked and occupational safety and health standards.

The arguments of those favouring inclusion of basic labour standards in the WTO framework are very similar to those in the trade and environment debate. Trade could have adverse consequences on labour rights if individual countries disregard labour standards. Trade it is argued, increases the demand for products roduced with labour that does not enjoy adequate labour standards, and thereby encourages such practices. If poor working conditions are the main reasons for a country's competitiveness, then international competition will induce companies to relocate to countries with weak, non-existent or unenforced labour standards. Countries with higher labour standards may be forced to relax their own standards in a "race to the bottom." Value judgements also play a role, when people argue that they are not willing to accept exchange of products which have been produced under morally unacceptable conditions. If trade has such adverse consequences on labour standards, critics argue, labour standards should become an integral part of the WTO framework.

On the other hand, a number of arguments suggest that trade can contribute to more stringent labour standards and their enforcement. Trade promotes economic growth, which in turn increases people's demand for better working conditions. Growth and prosperity also provide the means to finance improvements in labour standards, and to send childern to school instead of factories. International companies are reluctant to provide in human, working conditions or to use child labour for the fear of their reputation and boycotts. Finally, the production of exportable products today increasingly requires people with some skills, and safe and clean working conditions.

14.9 Summary

Globalization is defined as increased flow of goods and services and resoureses across national Boards and to the emergence of complementary set of organizational structure to mange expanding network of international economic activity and transition. Global corporation view the entire wold as a single market. It does note differentiate between domestic market and foreign market. In this chapter following about globalization have been discussed in detail:

14.11 Self Assessment Test

1 Define global environment. Explain the significance of global environment.

2 Describe the elements of global environment.

3 Discuss the emerging trends of global environment.

14.12 References

- Economics Environment of Business – S.K. Misra, V.K. Puri
- Global Business Environment – Rosi Joshi
- Export Marketing – Michal Viz

Unit - 15 : Export-Import Policy

Unit Structure:

1.0 Objectives

After reading this unit, you should be able to learn:

- Meaning of Exit policy objectives of exim polcy.
- Main objectives of Exim policy
- Various exim policies of India

15.1 Introduction

Whether international trade contributes to the economic development of underdeveloped and developing countries is an old and debatable question. Mercantilists in the 16^{th} century, classical economists in the 19^{th} century and neo-classical economists in the 20^{th} century along with many modern economists viewed international trade as most beneficial and significant for economic development. These people were of the view that world trade had made tremendous contribution to the development of less developed countries in the 19^{th} and 20^{th} centuries and would hopefully, make equal contribution in the future also. In Contrast to this, many economists were of the view that international trade had proved to be most beneficial for the developed countries but it had not made any noticeable contribution for the development of under-developed countries. Some people go extreme by saying that the economies of underdeveloped countries had suffered disequilibrium because international Trade.

Development economists of the forties and fifties pointed out that the colonial powers had the best of both worlds, both as consumers of primary commodities and as the producer of manufactured articles while the colonies (the underdeveloped countries) have had the worst of both worlds, as consumer of manufacture and producer of raw materials. This was due to the declining prices of the primary goods and increasing prices of manufactured goods causing the term of trade to deteriorate considerably over time for the underdeveloped countries (which were exporters of primary goods).Therefore, many underdeveloped countries that got independence in the post World War II period viewed foreign trade and investment with a certain amount of suspicion. They turned their economies and reduced their dependence for manufactured goods on developed countries and the emphasis was on ‘inward oriented’ policies. As far as foreign trade is concerned, this meant large-scale import substitution (thorough extensive protection of domestic industries), direct control on imports and investments and overvalued exchange rate. As far as export sector is concerned, it was marked by extreme pessimism. For Instance, after independence, the widely prevalent view of the Indian Government circles was that Indian exports faced a stagnant world demand and nothing much could be done increase them.

However, things have now radically changed. Many developing countries adopted programmes of import liberalisation and export promotion in the sixties and achieved remarkable success. The success of these economies has prompted many economists and international agencies (most prominent being the IMF and World Bank) to advocate import liberalisation and export promotion as a panacea for many economic ills facing developing countries like India. Acting upon their advice, the government of India opted for a policy of trade liberalisation in the 1990s and has been increasingly dismantling import controls over the last few years.

15.2 Objectives of EXIM Policy

The main objectives of India's EXIM policies are as follows :-

* To strengthen the base for export production.
* To place special emphasis on exports which generates high net foreign exchange.
* To simplify and stream line procedures for import licensing and export promotion.
* To promote import substitution and self-reliance.
* To provide export incentives so as to encourage the exporteis.
* To import continuity and stability in export Inpoit policy.
* To facilitate technological upgradation and modernisation of export based industries.

15.3 Export Policy Resolution

It was during the fourth five year plan when Government of India formulated a positive policy draft named "Export Policy Resolution 1970" The main features of this draft are :-

* Importance of export earnings :- The resolution stressed the importance of high export eainings for financing fourth five year plan and to reduce dependence on external assistance.
* Export promotion measures :- The measures can be in respect of incentives and facilities to exporters and to simplify the procedures.
* Classification of industries :- The products havijng long term potential in exports in of the classified industries are to be indentified and special miasures and programmes are to be undertaken to promote exports of such products .
* Traditional products :- Attention and assistance to be provided to traditional products such as tea, cotton, textiles, jute, etc. so as consolidate their export position.
* Labour Intensive Products :- There was a growing demand for such products in industrially developed countries.
* Capital Goods :- Special encouragement was intended to be provided to the producers and exporters of capital and equipment who export to the developing countries.
* Handicrafts :- To provide special encouragement to promote exports of handicrafts as there was a good demand for such products in the would markets.
* Quality control :- The need to enforce compulsory quality control and pre-shipment inspection was also felt in this resolution.
* Marketing Research :- The resolution stressed the importance of marketing sesearch and training of export personnel.

* Publicity :- Strengthening of commercial publicity of Indian export products through participation in trade fairs and exhibitions in Indian and abroad and also through other promotional techniques including advertising .
* Export Finance :- RBI was to frame rules and reguletions isn respect of export finance. ECGC and RBI to support financial institutions to provide finance to exporters.
* Agreements :- Negotiations through bilateral and multilateral agreements at GATT,UNCTAD and other forums.
* Tourism sector :- It was felt that Indian cna earn a good amount of foreign exchange through tourisn.
* Other features :-
  – Modernization of shipping Industry was envisaged
  – Earmarking of production for exports was intended.

15.3.1 Highlights of Exim Policy (1992-94)

- Period of policy :- For the first time in India, the EXIM policy is announced for five years to bring stability & continuity in exim plicy.
- Imports :- Negative list of imports is the smallest ever, Import of 3 items bonned, 65 items sestricted, 7 items canalised.
- Exports - Negative list of exports shortened, 10 items banned, 31 items subject to sestriction, 6 items canalised.
- Capital Goods:- Import of capital goods liberalised, Second hand capital goods allowed, EPCG scheme liberalised, EPCG Scheme extended to components of capital goods.
- Import of Raw Materials :- The import of raw material liberalised. Barring a few items, no longer in-ve list of imports.
- Scheme of export Houses/Trading houses/Star trading house :- The scheme of EH/FH/STH is modified in this policy.
- Special import licences :- Three categories eligible for special import licences
  (a) Deemed exports
  (b) EH, TH and STH
  (c) Manufactures with ISO 9000 or BIS 14000 certification
- Quality :- National compaign for quality owareness to be launched Laboratives/ testing houses to be upgraded & accrediated
- OGl List :- The open general licence list have been expanded by inclusion of more itnems to facilitate easy access to imported equipments and drugs which are not available in our country.
- Abolition of CCS & Rep Licence :- This is because export subsidy under CCS was severly creticised and it was a big burden on the exchequer.
- Liberalization of foreign investment :- This policy has substantially simplified and libevalised the foreign investment in India. This is an encouragement for the foreign investors to invest in India.
- Other Highlights :-

* Value based advance license (VABAL) introduced.
* EOV scheme & EPZ scheme liberalised.
* Inter-unit transfers allowed.
* EOV/EPZ units may export through EH/TH/STH.

15.3.2 Export-Import Policy 1997-2002

The principal objectives of this EXIM policy are as follows :-

- To derive maximum benefits from expanding global market opportunities.
- Providing access to essential raw materials, intermediates, components, consumables and capital goods.
- To provide consumers with good quality products at reasonable prices.

Highlights :-

- Period of the policy :- This policy is valid for five years. It is effective from April 1, 1997 to march 31,2002.
- Imports :- The import have been liberalised.

  542 items from the restricted list have been transfered to SIL and OGL list. 392 items have been placed on the OGL list and 150 items can be imported against SIL list.
- Export Promotion capital goods scheme :- The duty on capital goods import under this scheme has been reduced from 15% to 10%.
- Advance Licence Scheme :- Earlier, the export obligation was valid for a period of 12 months. This has now been made 18 months. Further extension for 6 months will be on payment of 1% of the value of unfulfilled exports.
- Duty Entitlement Pase Book (DEPB) Scheme :- The Value based advance licensing (vabal) scheme and the old pase book scheme have been replaced by a new scheme called the DEPB scheme.
- Special Import license (SIL) :- The SIl has been liberalised and enlarged. 150 items from the restricted list have been transferred to SIL. SIL on export of Products of small scale industries (SSIs) has been increased from 1% to 2%.
- Export Houses and Trading Houses :- The criteria for recognition of export houses and all farms fo trading houses has been modified.
- Agricultrue sector :- The present EXIM policy has given a boost to agriculture & allied sectors. In a major boost to agro sector, doble weightage will be given for agro exports in calculating the eligibilety for export houses & all forms of trading houses.
- Deemed Exports :- Deemed exorts facilitates have been extended to oil and gas sectors in addition to power sector.
- Export Oriented units (EOUs) :- Gems & jewellery in EOUs/EPZs permitted to sell 10% of their output in DTA against SIL on payment of duty.
- Saftware :- Software units can undertake exports using data communication link or in the form of physical exports through the courier service alsee.
- Depreciation Norms :- Special depreciation norms have been provided for electronic goods upto

70% in 3 years also permission geanted for disposal, on poymevd of applicable duty.

- Computerisation of DGFT offices :- This will not merely reduce paper work, but also bad to quick disposal of applications.
- SSI units :- Speical incentives have been provided for exports of SSI units. SIL on export of products of SSIs has been increased from 1% to 2%.

15.3.3 Foreign Trade Policy (2009-2014)

The Foreign Trade Policy, 2009-2014, effective from August 28, 2009 lays down that exports and import shall be free, except in case where they are regulated by the provisions of this policy and or any other law for the time being in force. Restrictions are called when necessary for the protection of public morale; protection of human, animals or plant life or health, patents, trademarks, copyrights and the prevention of deceptive practices, prevention of use of prison labours, protection of national treasures of artistic, historic or archaeological value, conservation of exhaustible natural resources, protection of trade of fissionable material or material from which they are derived, and prevention of traffic in arms, ammunition and implements of war. The policy also envisages that exporters, business and industry as partners of government in the achievement of its stated objectives and goals.

Objectives of the Policy

1. To arrest and reverse declining trend of exports is the main aim of the policy. This aim will be reviewed after two years.
2. To Double India's exports of goods and services by 2014.
3. To double India's share in global merchandise trade by 2020 as a long term aim of this

   policy.India's share in Global merchandise exports was 1.45% in 2008.
4. Simplification of the application procedure for availing various benefits
5. To set in motion the strategies and policy measures which catalyse the growth of exports
6. To encourage exports through a "mix of measures including fiscal incentives, institutional changes, procedural rationalisation and efforts for enhance market access across the world and diversification of export markets.

The policy aims at developing export potential, improving export performance, boosting foreign

trade and earning valuable foreign exchange. FTP assumes great significance as India's exports have been battered by the global recession. A fall in exports has led to the closure of several small- and medium-scale export-oriented units, resulting in large-scale unemployment. The Export target for the year 2010-11 has been $200 and the Export Growth target has been 15% for the starting 2 years and 25% for the years there after.

Major Highlights

EPCG Scheme:

- Obligation under EPCG scheme relaxed.
- To aid technological upgradation of export sector, EPCG Scheme at Zero Duty has been introduced.
- Export obligation on import of spares, moulds etc. under EPCG Scheme has been reduced by 50%.

Refixation of Annual Average Export Obligation:

Taking into account the decline in exports, the facility of Re-fixation of Annual Average Export Obligation for a particular financial year in which there is decline in exports from the country, has been extended for the 5 year Policy period 2009-14. Support for Green products and products from North East is extended.

Announcements for FPS, FMS, MLFPS:

- 26 new markets added in this scheme.
- Incentives under FMS raised from 2.5 % to 3 %
- Incentive available under Focus Product Scheme (FPS) raised from 1.25% to 2%.
- Extra products included in the scope of benefits under FPS
- Market Linked Focus Product Scheme (MLFPS) expanded by inclusion of products like pharmaceuticals, textile fabrics, rubber products, glass products,autocomponents, motor cars, bicycle and its parts.etc. (However , benefits to these products will be provided, if exports are made to 13 identified markets (Algeria, Egypt, Kenya, Nigeria,South Africa, Tanzania, Brazil, Mexico, Ukraine, Vietnam, Cambodia, Australia and New Zealand).
- Focus Product Scheme benefit extended for export of 'green products' and some products from the North East.
- A common simplified application form has been introduced to apply for the benefits under FPS, FMS, MLFPS and VKGUY.

Announcements for MDA & MAI

Higher allocation for Market Development Assistance (MDA) and Market Access Initiative (MAI) has been announced.

Towns of Export Excellence (TEE)

The following cities have been recognized as towns of export excellence (TEE)

- Handicrafts : Jaipur, Srinagar and Anantnag
- Leather Products : Kanpur,Dewas and Ambur
- Horticultural Products: Malihabad

Scheme for Status Holders

- Additional Duty Credit Scrips shall be given to Status Holders @ 1% of the FOB value of past exports accelerate exports and encourage technological upgradation.
- This facility shall be available for sectors of leather (excluding finished leather), textiles and jute, handicrafts, engineering (excluding Iron & steel & non-ferrous metals in primary and intermediate form, automobiles & two wheelers, nuclear reactors & parts, and ships, boats and floating structures), plastics and basic chemicals (excluding pharma products).
- Transferability for the Duty Credit scrips being issued to status holders under VKGUY Scheme permitted only for the procurement of **cold chain equipments.**

Extension of Income Tax Exemption to EOU and STPI :

Income Tax exemption to 100% EOUs and to STPI units under Section 10B and 10A of Income Tax Act, has been already extended for the financial year 2010-11 in the Budget 2009-10.

Extension of ECGC :

The adjustment assistance scheme initiated in December, 2008 to provide enhanced ECGC cover at 95%, to the adversely affected sectors, is continued till March, 2010.

Announcements For Marine sector :

- Fisheries exempted from maintenance of average EO under EPCG Scheme (along with 7 sectors) however Fishing Trawlers, boats, ships and other similar items shall not be allowed for this exemption.
- Additional flexibility under Target Plus Scheme (TPS) / Duty Free Certificate of Entitlement (DFCE) Scheme for the marine sector.

Announcements for Gems & Jewellery Sector:

- Duty Drawback is allowed on Gold Jewellery exports to neutralize duty incidence.
- Plan to establish "Diamond Bourse (s) with an aim to make India and International Trading Hub announced.
- Introduction of a new facility to allow import on consignment basis of cut & polished diamonds for the purpose of grading/ certification.
- 13 value limits of personal carriage have been increased from $ 2 million to US$ 5 million in case of participation in overseas exhibitions.
- The limit in case of personal carriage, as samples, for export promotion tours, has also been increased from US$ 0.1 million to US$ 1 million.
- Time limit of 60 days for re-import of exported gems and jewellery items, for participation in exhibitions has been extended to 90 days in case of USA.

Announcements for Agro Exports:

- Introduction of a single window system to facilitate export of perishable agricultural produce with an aim to reduce transaction and handling cost.
- This system will involve creation of multi-functional nodal agencies. These agencies will be accredited by APEDA.

Announcements for Leather Exports :

On the payment of 50 % applicable export duty, **Leather sector shall be allowed re-export of unsold imported raw hides and skins and semi finished leather** from public bonded ware houses.

Announcements for Tea Exports:

- The existing Minimum value addition under advance authorisation scheme for export of tea is 100 %. **It has been reduced from the existing 100% to 50%.**
- DTA (Domestic Tarriff Area) sale limit of instant tea by EOU units increased from 30% to 50%.
- Export of tea has been included under VKGUY Scheme benefits.

Announcements for Pharma Exports :

- Export Obligation Period for advance authorizations issued increased from existing 6 months to 36 months.
- Pharma sector included under MLFPS for countries in Africa and Latin America & some countries in Oceania and Far East.

Announcements for Handloom Exports:

The claims under Focus Product Scheme, the requirement of " Handloom mark" was required earlier. This has been removed.

Scheme for Export Oriented Units:

- EOUs have been allowed to sell products manufactured by them in DTA (Domestic Tariff Area) upto a limit of 90% instead of existing 75%, without changing the criteria of 'similar goods', within the overall entitlement of 50% for DTA sale. (This means that instead of 75% these units can sell up to 90 % of their products in the domestic markets)
- EOU allowed to procure finished goods for consolidation along with their manufactured goods, subject to certain safeguards.
- Extension of block period by one year for calculation of Net Foreign Exchange earning of EOUs kept under consideration.
- EOU allowed CENVAT Credit Facility.

Announcements for Value Added Manufacturing (VAM)

To encourage Value Added Manufactured export, a minimum 15% value addition on imported inputs under Advance Authorization Scheme.

Announcements for Project Exports:

Project Exports and a large number of manufactured goods covered under FPS and MLFPS.

Fuel included in DEPB Scheme:

Custom duty component on fuel where fuel is allowed as a consumable in Standard Input- Output Norm included in factoring.

Easy Import of samples:

Number of sample pieces has been increased from the existing 15 to 50. This will facilitate the the duty free import of samples by exporters.

Convertibility of Shipping Bills

Greater flexibility has been permitted to allow conversion of Shipping Bills from one Export Promotion scheme to other scheme. Customs shall now permit this conversion within three months, instead of the present limited period of only one month.

Reduction in Transaction Costs:

- Dispatch of imported goods directly from the Port to the site has been allowed under Advance Authorisation scheme for deemed supplies. (Presently the duty free imported goods could be taken only to the manufacturing unit of the authorisation holder or its supporting manufacturer.

- Maximum applicable fee for 18 Authorisations/ licence applications (except those mentioned in Chapter 3 of FTP) has been reduced to Rs. 100,000 from the existing Rs 1,50,000 (for manual applications) and Rs. 50,000 from the existing Rs.75,000 (for EDI applications).
- No fee shall now be charged for grant of incentives under the Schemes in Chapter 3 of FTP.

Disposal of Manufacturing Wastes:

Disposal of manufacturing wastes / scrap will now be allowed after payment of applicable excise duty also before fulfillment of export obligation under Advance Authorisation and EPCG Scheme. Earlier it was allowed after fulfillment of export obligation.

Announcements for Medical Devices

To solve the problem of medical device industry, the procedure for issue of Free Sale Certificate has been simplified and the validity of the Certificate has been increased from 1 year to 2 years.

Announcements for Automobile Industry

Those Automobile industries which have their R&D establishment will be allowed free import of reference fuels (petrol and diesel), upto a maximum of 5 KL per annum, which are not manufactured in India. Simplification in EPCG for automobile industry.

15.4 Summary

Countries have started realising the benifits of free trade and are slowly moving away from quotas and embargo towards positive and growth criented economic polocies to encash one's own unique potential/ cempetency vis-a-vis the treading pattern. our recent EXIM policy is a pointer in teh direction. The major thurst of new EXIM policy is the acceleration of India's expert. The EXIM policy also issues trade regulations governing export and imports. It lays down the trade procedurcs to be followed by exporters and importers. Because of benifits that acrue from experting, government of must countries offer competative assistance to domestic exporters in the form of subsidied credit that can be extended to importers.

15.5 Key Words

- **Actual user :-** means an actual user who may be either industrial or non-industvial.
- **Capital Goods :-** means any plant machinery, equipment or accessories required for manufacture or production, either directly or indirectly, of goods or for sendening seenices, including those required for replacement modernization, technological upgradation or expansion.
- **Canalisation :-** means exports & imports to be done only through the agencies designateo by the central Government.
- **Conoumer Goods** :- means any conoumption goods which cna direclty satisfy humen needs without furthes processing.
- **Counter Trade :-** means any arrangemeut under which exports/imports frome / to India are balanced either by direct imports/ exports from the importing/exporting country.
- **Drawback :-** means the rebate of duty chargeable on any imported materials or exciseable matrials used in the manufactive of such goods in India.

- **Deemed Exports :-** means those transactions in which the goods supplied do not leave the country & the payment for the goods. is received by the supplier in India.
- **Export Obligation :-** means the obligation to export the product or products covered by the lecinse or permission in terms of quantity.

  Licensing Year :- means the period begining on the 1st April of a year & ending on the 31st March of the following year.
- **Negative list** :- means the list which contains items which cannot be freey imported or exported.
- **Open General Licince (OG2) List :-** means the list which cantains those items which can be imported or exported without restuctions.
- **Registration -cum-Membership Certificate (RCMC)** :- means the certificate of registration & membership granted by export promotion council or by any other concerned authority under the policy.
- **SIL :-** means freely transferable special import licenses issued under the EXIM plicy.

15.6 Self Assessment Test

1. Discuss the implications of EXIM policy 1992-97.
2. Discuss the objectives and highlights of the New EXIM policy.
3. The EXIM policies aims at boosting India's exports. State and comment on its features.
4. What is counter trade ?
5. Write short notes :
   (a) open General licence
   (b) Negative list of exports

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Unit - 16 : Globalisation and WTO

Unit Structure:

16.0 Objectives
16.1 Introduction
16.2 Globalisation: Conceptual Frame Work
16.3 Corporation in Global Environment
16.4 General Agreement on Tariffs and Trade (GATT)
16.5 Intellectual Property : Protection and Enforcement of Rights
16.6 World Trade Organisation(WTO)
16.7 Summary
16.8 Key Words
16.9 Self Assessment Test
16.10 References

16.0 Objectives

This chapter enables students to have knowledge of global business environment and all the issues which affects the business at international level. It also explains about GATT, GATA, WHO and FEMA.

16.1 Introduction

Business Environment varies from place to place and from time to time. Competitive business environment is an essential characteristic of globalization. Nature of competition varies in different economic systems. Corporate concern for global business environment can be understood with the globalization of business. Environmental contrasts are most decisive in the global business arena. The Japanese business environment is entirely different from Indian systems, values, cultural factors, socio-economic background and so on. On account of their higher productivity and marketing success, Japanese systems and methods have been subjected to intensive analysis and appreciation for collectivism; lifetime employment, stability, total integration of workforce with the organization, homogenously and the notable aspects of the organizational culture in Japanese corporations. In contrast to this, we find individualism, one man decision making, frequent turnover of employer mobility, abnegation of the workforce and coercion of the management by trade unions in the business organization of India. To sum up, one may observe that the global environment of business is complex and it differs substantially in developing and developed market economies. Companies which operate in the global environment must consider such environmental differences before they formulate policies. So the managers who operate in a global environment must have a global approach with a local strategy according to their operational strategies and business policies which is mostly different in different economic systems.

16.2 Globalisation: Conceptual Framework

Globalisation means the formation of a global village-closer contact between different part of the world, with increasing possibilities of personal exchange, mutual inderstanding and friendship between "world citizen".According to Charles U.L. Hill defines globalizatn as " The shift towards a more integrated and interdependent world economy. Globalisation has two main components-the globalization of markets and globalisation of production."

Need of Globalisation

- Globalisation helps free flow of capital from one country to the other. It helps the investor to get a fair amount of interest & the global compainies to acquire finance at lower cost of capital.
- Globalisation helps free flow of technology from advanced countries to the developing countries.
- Globalisation reduces prices & thereby enhances consumption & living standards of living in all the countries of the world.
- Increase in industrialization on balanced lines in the zlobe, improves the skills of people of developing countries.
- Globalisation of production leads to spread up to manufacturing facilities in all the global countries depending upon the location & various factors of production.
- Increased industrialization in the globe leads to increase in production.
- Globalisation reduces the physical distance among the countries and enables people of diff countries to acquire the lifestyles of other countries.

Measures Towards Globalisation :-

- Permitting Indian companies to collaborate with foreign companies in the form of joint ventures.
- FERA has been scrapped and in its place Foreign Exchange Management act (FEMA) has been passed by deleting the clauses that restricted the entry of MNCs.
- Bringing the corporate tax rates closer to the relatively low level prevailing in other devp. & developing countries.
- Dechannelise oil and agricltural trade.
- Counter anti dumping measures.
- Resolve market access issues in services.
- Reformulate Export orocessing Zone (EPZs) & Export oriented unitly policy.
- Removal of export subsideis replacing licensing of export with duties.
- Reduced import tariffs to 15%.
- Allowing the rupee to determine its own exchange eate in the international market.
- Libralise the inflow of FDI, offering incentives to MNCs and NRIs to invest in India.

16.3 Corporations in Global Environment

Corporations are today changing their strategies and are reorganizing their functions to cope up with the changed scenario. Whether it is their Production Process Product strategy, Marketing, Finance, HR policies etc. organizations have incorporated the following changes:

i) Designing in Global Environment

If managing product development processes was a challenge before, it is not as easier for companies continue to adopt global design strategies. Global designing has cost benefits that are very attractive to today's manufacturer, but it also adds new product lifecycle management (PLM) challenges and intensifies existing problem areas like that of protecting intellectual property.

ii) Production Location

Implementing a production strategy that is intended to arbitrage cost differences by concentrating manufacturing operations – and ultimately, other activities – wherever in the world they could be carried out most cost effectively.

iii) Rationalized Production

Companies produce different components or different portions of their product line in different parts of the world to take advantage of low labor costs, capital, and raw materials. This is rationalized production. In a new, global world, rationalized production is easier. Now organizations can outsource or can establish their own production units in those areas where it is more economical.

iv) Vertical Integration: Vertical Integration is a company's control of the different stages in a value chain of production from raw material to production to final distribution of the product. As international trade barriers are becoming less relevant organizations can combine resources located in more than one country.

v) Product Strategy: Standardisation provides advantages in the production and distribution of products and services. Cost is the decisive factor for most commodities. Through economies of scale and through standardisation an organization can fulfill the demand of many nations through one plant.

Product adaptation increases the cost. Sometimes when the product is new to the market, the issue of adaptation and standardisation become crucial. Sales volumes do not justify the adaptation and the standard product doesn't suit the local requirement. This happened a few years back when the electric shaver came to the Indian market.

But organizations have to choose tradeoff between standardization and product adaptation. Besides, globalisation has influenced all aspects of organizations; Sales Promotion, Research, Market Research, Distribution Strategies, Product development strategies, etc.

16.4 General Agreement on Tariffs and Trade (GATT)

The General Agreement on Tariffs and Trade (GATT) had its origin in 1947 at a conference in Geneva. It was founded in the wake of the Second World War in order to prevent the recurrence of protectionist policies of the then industrialised states which resulted in a prolonged recession in the West prior to the war. When GATT was signed in 1947, only 23 nations were members of it.

GATT was transformed into the World Trade Organization (WTO) with effect from January 1995. Thus, after nearly five decades, the original proposal of an international trade organization took shape as the WTO. The WTO, which is a more powerful body than GATT, has a larger role too than GATT. India is one of the founder members of GATT and WTO.

The primary objective of GATT was to expand the international trade by liberalization of trade so as to bring about an all-round economic prosperity. The preamble to the GATT mentioned the following as its important objectives:

- Raising the standard of living.
- Ensuring full employment and a large and steadily growing volume of real income and effective demand.
- Developing full use of the resources of the world.
- Expansion of production and international trade.

GATT embodied certain conventions and general principles governing international among countries that adhered to the agreement. The rules or conventions of GATT required that any proposed change in the tariff or other type of commercial policy of a member country should not be undertaken without any consultation with the other parties of the agreement. The countries that adhere to GATT should work towards the reduction of tariffs and other barriers to international trade, which should be negotiated within the framework of GATT.

For the realization of its objectives, GATT adopted the following principles:

- **Non-discrimination:** The principle of non-discrimination requires that no member country shall discriminate between themselves in the conduct of international trade. To ensure non-discrimination, the members of GATT agreed to apply the principle of "most-favoured nation" (MFN) to all import and export duties.

- **Prohibition of Quata & Restriction:** GATT rules seek to prohibit QRs as far as possible and limit restrictions on trade to the less rigid tariffs. However, certain exceptions to this prohibition are granted to countries that are confronted with BoP difficulties and to developing countries.

- **Consultation:** By providing a forum for continuing consultation, GATT sought to resolve disagreements through consultation. Eight rounds of trade negotiations were held under the auspices of GATT. Each round took several years. The Uruguay round, took more than seven years to conclude as against the originally contemplated four years. This shows the complexity of the issues involved in the trade negotiations. And after this round the WTO has been established.

16.4.1 General Agreement on Trade in Service (GATS)

The General Agreement on Trade in Services (GATS) is the first-ever set of multilateral, legally enforceable rules which cover international trade in services. It was negotiated in the Uruguay Round. It operates at three levels. First is the main text which contains the general principles and obligations. Then there are annexures that are dealing with rules for specific sectors. Finally, the commitments to provide access to the markets of individual countries form a part of agreement.

The general principles and obligations of GATS are very similar to those for trade in goods. Examples include MFN treatment and national treatment, as well as transparency obligations and commitments to the development of developing countries. Market-access commitments, like the tariff schedules under GATT, are an integral part of the agreement.

The scope of the GATS agreement is particularly broad. It covers all measures affecting internationally traded services. In fact, it was important in practical terms for negotiators to define what was meant by the term "trade in services". The definition which was finally adopted its particularly wide in scope

The negotiators decided that "trade in services" was far more than that crossed the border as is the case in trading of goods. Under GATS, "trade" includes all the different ways of providing an international service. GATS defines four such methods of providing an international services it calls them "modes of deliver".

Firstly, there are services supplied from one country to another, such as international telephone calls. In the Jargon of the agreement, this is known as the "cross-border supply" of a service. Secondly; the situation of consumers or firms making use of a service in another country such as tourism known as the "consumption abroad". Thirdly, a foreign company may set up subsidiaries or branches to provide services in another country, such a foreign banks operating in a foreign country. This is known as the "commercial presence". Finally, individuals travelling from their country to supply services in another country, such as fashion models or consultants travelling abroad to work. This is referred to as the "presence of natural persons".

Key Rules of GATS

- **MFN Treatment:** As the rules are concerned, with GATT, if you favour one weentry, you have to favour them all of. The MFN treatment means treating trading partners equally. Under GATS, if a country allow foreign competition in a particular sector, equal opportunities in that sector should be given to service providers from all other WTO members. Unlike in goods however, GATS has a special element. It has list showing where the countries are temporarily not applying the MEN principle of non-discrimination.

• **National Treatment:** An equal treatment or national treatment for foreigners and nationals is given a different dimension for services when compared to goods. For merchandise trade, it is a general principle. In GATS, it applies only where a country has made a specific commitment to offer national treatment, and in such cases, special conditions may be imposed.

• **Transparency:** Under GATS, the governments published all relevant laws and regulations and set up enquiry points within their bureaucracies. Foreign companies and governments can then use these enquiry points to obtain information about regulations in the service sector. And they have to notify the WTO of any change in regulations that apply to the services that come under specific commitments.

• **Regulations and Objective:** Domestic regulations are the most significant means of exercising influence or control over the services trade. Thus, the agreement says that the governments should regulate the services reasonably, objectively, and impartially. When a government makes an administrative decision that affects a service, it should also provide an impartial means, such as a tribunal, to review the decision.

• **Specific Commitments:** The commitments of individual countries to open markets in specific sectors and how open those markets will be are the outcome of negotiations. The commitments appear in schedules that list the sectors being opened. The schedules record the extent of market access being given in those sectors; for example, whether there are any restrictions on foreign ownership. The schedules also show if there are any limitations on national treatment; for example, whether some rights granted to local companies will not be granted to foreign companies.

Binding Market Access. These commitments are bound, like bound tariffs, they can only be modified or withdrawn after negotiations with the affected countries. This would probably lead to compensation being paid. Since "unbinding" is difficult, the commitments are virtually guaranteed conditions for foreign exporters and importers to do business in the sector.

16.5 Intellectual Property : Protection and Enforcement of Rights

Knowledge and ideas are important part of trade and like. Most of the value of new medicines and other high-technology products lies in the amount of inventions, innovation, research, design and testing involved. Films, music recordings, books, invention, computer software and on-line services are bought and sold because of the information and creativity they contain. Their value does not lie in the plastic, metal or paper used to make them. and the protection of these ideas must be required. These can be possible with the help of IPR. Like copyright, patents, Trade mark, Design (Industrial and Layout Design) are very powerful tool for protection.

It is important that creators have the right to draw advantage from their inventions, designs and other creations. These rights are known as "intellectual property rights". They take a number of forms. For example, books, paintings and films come under copright protection; inventions can be patented; and brand names and product logos can be registered as "trademarks".

In the past, the extent of protection and enforcement of these rights varied widely around the world. As intellectual property became more important in trade, these differences became a source of tension in the international economic relations. New internationally agreed trade rules for intellectual property rights were seen as a way to introduce more order and predictability, and for disputes to be settled more systematically.

16.5.1 TRIPS Agreement

The TRIPS Agreement was construed as an attempt to narrow the gaps in the way these rights are protected around the world, and to bring them under common international rules.

TRIPS – What does it Cover?

The agreement covers five broad areas as follows:

1. How basic principles of the trading system and other international, intellectual property agreements should be applied.
2. How to give adequate protection to intellectual property rights.
3. How countries should enforce those rights.
4. How to settle disputes on intellectual property among members of the WTO and
5. Special transitional arrangements during the period when the new system is being introduced.

It is important to recognise that there are various interests involved. When an inventor or creator is granted patent or a copyright protection, he or she obtains the right to stop other people from making an unauthorised use of the invention. The society at large see this temporary intellectual property protection as an incentive to encourage the development of new technology and creations. These will eventually be available to all. The TRIPS Agreement recognises the need to strike a balance. It says intellectual property protection should contribute to technical innovation and transfer of technology. According to the agreement, producers and users should benefit, and economic and social welfare should be enhanced.

The TRIPS Agreement ensures that adequate standards of protection exist in all member countries. Here, the starting point is the obligations found in the main international agreements of the World Intellectual Property Organisation (WIPO). Having intellectual property laws is not enough. They have to be enforced. According to the Agreement, the governments have to ensure that the intellectual property rights can be enforced under their national laws and the penalties for infringement are very tough enough to deter further violations. The procedures must be fair and equitable and not unnecessarily complicated or costly.

16.6 World Trade Organisation (WTO)

The eight round of multilateral trade negotiations held under GATT and lasting for seven years (1986-93), named the Uruguay round, resulted in new legal agreements for trade and strengthening the settlement system. Following this, there was Ministerial Conference in Marrakesh, (Mor-occo), in April 1994, attended by 125 government representatives from across the world to sign the establishment of a new successor institution to GATT, It is an embodiment of the Uruguay Round results. WTO came into force on January 1, 1995, with all assets and liabilities of GATT transferred to the former. Geneva was to be its headquarters. All GATT committees were superseded by WTO committees. Initially there were four sub-committees which are as follows:

1. Budget, finance and administration,
2. Institutional, procedural, and legal matters,
3. Trade and environment, and
4. Services.

WTO ensured that each member country negotiates with its trading partners, its terms of entry into the multilateral trading system and a market access schedule for goods and services. All the contracting parties (member countries) pledged to make every effort to quickly conclude a domestic rectification of the WTO agreement.

Objectives

WTO is the only international body dealing with the rules of trade among nations. WTO define legal ground for international commerce and trade policy. The agreements have some main objectives, which are as follows:

1. To help trade flow as freely as possible.
2. To achieve further libarlisation gradually through negotiations.
3. To set up an impartial means of settling disputes.

To recognize need for positive efforts to ensure developing countries and specially the least developed countries, to recue better share of the growth in international trade. In short WTO is expected to

- Administer WTO trade agreements
- Provide a forum for trade negotiations.
- Handle trade disputes.
- Monitor national trade policies.
- Provide technical assistance and training for developing countries.
- Cooperate with other international organizations.

16.7 Summary

The chapter gives an insight to the global business environment and the institutions such as GATT and WTO, who play an important role in the functioning of business at global level. The various issues like development of MNC, LPG, have changed the global scenario of business.

16.8 Key Words

- **DSB-** Dispute settlement Body
- **TPRB -** Trade Policy Review Body.
- **TRIPS -** Trade Related Intellectual Property Rights. It ensures that adequate standards of protection exist in all member countries
- **FEMA -** Foreigh Exchange Management Act.

16.9 Self Assessment Test

1. What do you mean by Global Business Environment? Explain
2. Explain the different factors that affect business at global level.
3. What do you mean by Globalisation? Give its merits and demerits
4. Write short notes on –

- o GATT
- o WTO

5. Describe the evolution of GATT and formation of WTO.
6. Write a note on TRIPS.
7. What is the role of WTO In international trade?

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Unit - 17 : Foreign Capital

Unit Structure:

17.0 Objectives

After studying this unit you will be able to:

- Identify Need for foreign capital
- Describe Foreign Direct investment and development
- Describe Infrastructure development and Technology Tranfer
- Describe Foreign Direct Investment and Growth.
- Describe Market risk and credit risk.

17.1 Introduction

Foreign capital refers to the investment of capital by a foreign government, institution, private individual, and international organization in a country. Foreig capital is needed as under:

- Domestic capital is inadegnate for purpose of economic growth and consequently foreign capital in needed.
- For want of experience, domestic capital and Interpreneurship may not flow into certainlines of production. Foreign capital will supplement to demestic capital.
- Potential saving in India can be mobilised at higher level of economy activity and foreign capital can be speed up economic activity in first instance.
- It is difficult to mobilise domestic savings for the financing of projects needed for economic development because of under developed capital market and consequently foreign capital is essential as temporary measure.
- Foreign capital brings technical knowhow business experience and knowledge which are lacking int he initial stage of development in the country.

Foreign capital includes: a) Foreign aid b) Commercial borrowings and c) Foreign investment Foreign aid includes foreign grants concessional loans etc. Foreign capital is invested in the form of foreign currency, foreign machines and foreign technical know-how. Foreign capital has many forms, like foreign collaboration, loan in the form of foreign currency, investments in equity capital, etc. Many foreign institutions and government give grants. The main difference between foreign grants and loans is that loans are repaid with interest, whereas grants are not repaid.

Major Sources of foreign capital are as follows:

- Foreign Direct Investment (FDI)
- Direct Investment by Residents in Joint Venture/wholly owned subsidiaries
- External Commercial Borrowings (ECB)
- Euro Issues (FCCB/GDR/ADR)
- Foreign Currency Exchangeable Bonds
- Foreign Institutional Investor Investment (FIIIs)
- Off-shore Funds
- Overseas Venture Capital Investments

17.2 Foreign Institutional Investors (FIIs)

The FII investment is primarily routed through the capital market. A FII means an institution established/ incorporated outside India that proposes to make investment in securities in India. A domestic asset management company/portfolio manager who manages funds raised/collected brought from outside India for investment in India on behalf of a sub-account is deemed to be a FII. A sub account means any person outside India on whose behalf investments are proposed to be made by a FII and who is registered as a sub-account with the SEBI.

To buy/sell/otherwise deal in securities, a FII must be registered with SEBI. The major elements of the registration framework are:

1. Eligibility criteria
2. Payment of fee
3. Code of conduct
4. Conditions for registration
5. Registration of sub-accounts

Any FII can invest in securities in India in primary and secondary markets including shares, debentures, warrants of listed/unlisted/to the listed companies; units of mutual funds; dated Government securities; and commercial papers and so on. A FII/sub-account can also lend securities through an approved intermediary. At least 70% of the aggregate investments of a FII/sub-account should be in equity related instruments.

17.3 Foreign Direct Investment (FDI)

Foreign Direct Investment (FDI) is now recognized as an important driver of growth in the country. Government is, therefore, making all efforts to attract and facilitate FDI and investment from Non Resident (NRIs) including Overseas Corporate Bodies (OCBs) that are predominantly owned by them, to complement and supplement domestic investment. To make the investment in India attractive, investment and returns on them are freely repatriable, except where the approval is subject to specific conditions such as lock -in period on original investment, dividend cap, foreign exchange neutrality, etc. as per the notified sectorial policy.

Foreign direct investment is freely allowed in all sectors including the services sector, except a few sectors where the existing and notified sectorial policy does not permit FDI beyond a ceiling. FDI for virtually all items/activities can be brought in through the Automatic Route under powers delegated to the Reserve Bank of India (RBI), and for the remaining items/activities through Government approval. Government approvals are accorded on the recommendation of the Foreign Investment Promotion Board (FIPB). There are two types of foreign private equity capital flows:

1) Portfolio investment (an investor holds shares in a firms in a developing country but is not involved in its management) and

2) Foreign direct investment (investment where the investor participates in the management of the firm in which he owns shares);

FDI comprises a larger proportion of foreign private capital flows to developing countries than portfolio investment.

17.4 Multinational Corporations

Most multinational corporations are headquartered in North America, Japan, and Europe, but some of the largest ones are based in Brazil, South Korea, and India. MNCs can be large relative to the economies of some Least Developed Countries (LDCs) (measured by the ratio of sales by the MNC to the GDP of the developing country

For example, in 1998 the largest MNC, General Motors, had US$161.3 billion of sales, which was larger than the entire GDP of Poland (US$149 billion), Algeria (US$29.6 billion), and Kenya (US$11.1 billion), the 10th, 25th, and 50th largest LDCs by GDP, respectively although China had a population of 1.2 billion people, its GDP (US$960.9 billion) was only about six times as great as General Motors' sales, an alternative method to illustrate the size of MNCs could compare the assets of MNCs to the wealth of a citizens in a country the large size of MNCs relative to some LDC economies might be a cause for concern because an MNC's substantial bargaining power possibly could allow it to create an exploitative arrangement with a developing country. FDI tends to be concentrated among a few countries, such as China (US$44 billion), Brazil (US$19 billion), and Mexico (US$12 billion); some developing countries are more successful at attracting FDI than others.FDI as a proportion of GDP varies from 12.5% to less than 1%

17.4.1 Benefits for LDCs of MNC investment:

MNCs used to be considered exploitative and developing countries used to adopt policies to keep them out and nationalize their assets; the 1990s, however, developing countries were competing with each other to attract MNCs. MNCs can be considered to bring a "package" of 5 benefits with their investment in a developing country as under:

i. Transfer of Capital

The foreign funds MNCs bring is not necessarily their most important contribution – Only about 20-25% of the total investment funding of poor countries is of foreign origin. The MNCs often borrow some of the funds they use in the developing country by issuing bonds, borrowing from local banks, etc.; thus, because LDCs are capable of saving sufficiently, foreign saving is only supplementary and not a primary benefit of MNCs. The returns to foreign private funds are repatriated to owners abroad, limiting their benefit to the LDC. however, the host country still benefits from foreign funds because the additional capital created from foreign investment raises the marginal productivity of domestic labor (by increasing the amount of capital per worker) and of other domestic resources.

ii. Employment Creation:

MNCs do not create much employment in the host developing countries; this could be because MNCs have a tendency to use capital-intensive technology developed in an industrialized country MNCs offer wages that are high relative to other wages in a developing country. However, MNCs are often criticized because these wages are still very low relative to the wages they offer in their home country MNCs might offer high wages for political reasons (so they are not accused of exploitation) and/or for efficiency-wage reasons (that is, better workers can be attracted and motivated to work harder at higher wages)

iii. Technology Transfer:

Although MNCs might use technology best-suited to a developing country (the technology. used in their country might be too capital-intensive or the skills required to use the technology might not be available in the LDC), technology transfer is a significant benefit of investment by MNCs. Developing countries have tried to catch-up technologically with industrialized countries; for example, when China found it was technologically falling behind its neighbors in the late 1970 it moved toward a market system and tried to bring in technology from abroad . Whether technological know-how will transfer to local nationals or continue to be dominated by foreign companies and its expatriates is a concern; to aid the transfer of technical skill, a developing country could implement clauses in contracts/agreements with MNCs requiring the proportion of employees that are domestic nationals to increase over time or requiring the MNC to train domestic nationals. Developing countries have had varied experiences capturing the benefits of MNCs, which depends on both a country's policies and its ability to absorb technological knowledge; for example, China was able to significantly benefit from MNC's technological transfer because of its high level of education – countries that do not have such high levels of education might not be able to absorb technological knowledge as quickly

iv. Managerial Capability:

This is a transfer of managerial ability (this is similar to the transfer of technology, only for managerial skills) This is one of the main benefits of investment by MNCs in LDCs.

v. Access to World Markets:

Developing countries have had difficulty breaking into world markets because they lack connections and knowledge of how the markets work .Using their connections and knowledge of international markets, MNCs have helped developing countries enter International trade.

17.5 FDI and Development

Foreign Direct Investment (FDI) is an integral part of an open and effective international economic system and a major catalyst to development. Yet, the benefits of FDI do not accrue automatically and evenly across countries, sectors and local communities. National policies and the international investment architecture matter for attracting FDI to a larger number of developing countries and for reaping the full benefits of FDI for development. The challenges primarily address host countries, which need to establish a transparent, broad and effective enabling policy environment for investment and to build the human and institutional capacities to implement them.

With most FDI flows originating from OECD countries, developed countries can contribute to advancing this agenda. They can facilitate developing countries' access to international markets and technology, and ensure policy coherence for development They can use overseas Development assistance (ODA) to leverage public/private investment projects; encourage non-OECD countries to integrate further into rules-based international frameworks for investment; actively promote the OECD Guidelines for Multinational Enterprises.

Stimulation

FDI is thought to bring certain benefits to national economies. It can contribute to Gross Domestic Product (GDP), Gross Fixed Capital Formation (total investment in a host economy) and balance of payments. There have been empirical studies indicating a positive link between higher GDP and FDI inflows however the link does not hold for all regions, e.g. over the last ten years FDI has increased in Central Europe whilst GDP has dropped. FDI can also contribute toward debt servicing repayments, stimulate export markets and produce foreign exchange revenue. Subsidiaries of Trans-National Corporations (TNCs), which bring the vast portion of FDI, are estimated to produce around a third of total global exports. However, levels of FDI do not necessarily give any indication of the domestic gain. Corporate strategies e.g. protective tariffs and transfer pricing can reduce the level of corporate tax received by host governments. Also, import of intermediate goods, management fees, royalties, profit repatriation, capital flight and interest repayments on loans can limit the economic gain to host economy. Therefore the impact of FDI will largely depend on the conditions of the host economy, e.g. the level of domestic investment/savings, the mode of entry (merger & acquisitions or Greenfield (new) investments) and the sector involved, as well as a country's ability to regulate foreign investment (UNCTAD 1999).

Stability

FDI inflows can be less affected by change in national exchange rates as compared to other private sources (portfolio investments or loans). This is partly because currency devaluation means a drop in the relative cost of production and assets (capital, goods and services) for foreign companies and thereby increases the relative attraction of a "host" country. FDI can stimulate product diversification through investments into new businesses, so reducing market reliance on a limited number of sectors/products (UNCTAD 1999). However, if international flows of trade and investment fall globally and for lengthy periods, then stability is less certain. New inflows of FDI are especially affected by these global trends, because it is harder for a foreign company to de-invest or reverse from foreign affiliates as compared to portfolio investment. Companies are therefore more likely to be careful to ensure they will accrue benefits before making any new investments. Examples of regional stability are mixed, whilst FDI growth continued in some Asian countries e.g. Korea and Thailand, during the 1996/97 crisis, it fell in others e.g. Indonesia. During Latin America's financial crisis in the 80's many Latin American countries experienced a sharp fall in FDI (UNGA 1999), suggesting that investment sensitivity varies according to a country's particular circumstances.

Social Development

FDI, where it generates and expands businesses, can help stimulate employment, raise wages and replace declining market sectors. However, the benefits may only be felt by small portion of the population, e.g. where employment and training is given to more educated, typically wealthy elites or there is an urban emphasis, wage differentials (or dual economies) between income groups will be exacerbated. Cultural and social impacts may occur with investment directed at non-traditional goods. For example, if financial resources are diverted away from food and subsistence production towards more sophisticated products and encouraging a culture of consumerism can also have negative environmental impacts. Within local economies, small scale and rural businesses of FDI host countries there is less capacity to attract foreign investment and bank credit/loans, and as a result certain domestic businesses may either be forced out of business or to use more informal sources of finance.

Infrastructure Development and Technology Transfer

Parent companies can support their foreign subsidiaries by ensuring adequate human resources and infrastructure are in place. In particular "Greenfield" investments into new business sectors can stimulate new infrastructure development and technologies to host economies. These developments can also result in social and environmental benefits, but only where they "spill over" into host communities and businesses. Investment in research & development (R&D) from parent companies can stimulate innovation in production and processing techniques in the host country. However, this assumes that in-house investment (in R&D, production, management, personnel training) will result in improvements. Foreign technology/organizational techniques may actually be inappropriate to local needs, capital intensive and have a negative effect on local competitors, especially smaller business who are less able to make equivalent adaptions. Similarly external changes in suppliers, customers and other competing firms are not necessarily an improvement on the original domestic-based approaches.

"Crowding in" or "Crowding out"

"Crowding in" occurs where FDI companies can stimulate growth in up/down stream domestic businesses within the national economies. Whilst "Crowding out" is a scenario where parent companies dominate local markets, stifling local competition and entrepreneurship. One reason for crowding out is "policy chilling" or "regulatory arbitrage" where government regulations, such as labor and environmental standards, are kept artificially low to attract foreign investors, this is because lower standards can reduce the short term operative costs for businesses in that country. Exclusive production concessions and preferential treatment to TNCs by host governments can both restrict other foreign investors and encourage oligopolistic (quasi-monopoly) market structure.

Empirical data for these scenarios is variable, but crowding out is thought to be more common in specific sectors. For example, in industries where demand or supply for a product or service is highly price elastic (market sensitive) and capital intensive. Hence regulation brings additional costs of compliance and is therefore much more likely to influence a company's decision to invest in that country.

17.6 Scale and Pace of Investment

It may be difficult for some governments, particularly low income countries, to regulate and absorb rapid and large FDI inflows, with regard to regulating the negative impacts of large-scale production growth on social and environment factors (WWF 1999). Also a high proportion of FDI inflows in developing economies are commonly aimed at primary sectors, such as petroleum, mining, agriculture, paper-production, chemicals and utilities. Primary sectors are typically capital and resource intensive, with a greater threshold in economies of scale and therefore slower to produce positive economic "spill over" effects (OECD a). Thus, in the short term, low income economies will have less capacity to mitigate environmental damages or take protective measures, imposing greater remediation costs in the long term, as well as potentially irreversible environmental losses.

FDI inflows are still highly concentrated in certain countries and regions (Figure 2.). TNCs are the largest source of FDI (about 95% of total inflows) and the majority of these are based in industrialized countries. The vast proportion of FDI flows go to other developed countries, especially the "Triad" of USA, UK, Japan, but also countries such as Germany, France, Canada, Netherlands.

In 1998, 92% of total FDI outflows came from developed countries and 72% of the total inflows returned to these economies (UNCTAD 1999). Of the proportion that went to low-middle income countries, the highest percentage went to Asia and Latin America (42% and 38% respectively), 14% to Central Europe & East Asia, whilst only 6% was invested in Africa (World Bank 1999). Over half of the FDI that does reach developing countries is concentrated in 5 countries. This is also true transitional countries, for example in Eastern Europe 75 % of FDI inflows is directed toward 5 countries.

17.7 Automatic Route

(a) New Ventures

All items/activities for FDI/NRI/OCB investment up to 100% fall under the Automatic Route Whenever any investor chooses to make an application to the FIPB and not to avail of the automatic route; he or she may do so. Investment in public sector units as also for EOU/EPZ/EHTP/STP units would also qualify for the Automatic Route. Investment under the Automatic Route shall continue to be governed by the notified sectorial policy and equity caps and RBI will ensure compliance of the same. The National Industrial Classification (NIC) 1987 shall remain applicable for description of activities and classification for all matters relating to FDI/NRI/OCB investment. Areas/sectors/activities hitherto not open to FDI/NRI/OCB investment shall continue to be so unless otherwise decided and notified by Government. Any change in sectorial policy/sectorial equity cap shall be notified by the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion.

(b) Existing Companies

Besides new companies, automatic route for FDI/NRI/OCB investment is also available to the existing companies proposing to induct foreign equity. For existing companies with an expansion program, the additional requirements are that (i) the increase in equity level must result from the expansion of the equity base of the existing company without the acquisition of existing shares by NRI/OCB/foreign investors, (ii) the money to be remitted should be in foreign currency and (iii) proposed expansion program should be in the sector(s) under automatic 11 route. Otherwise, the proposal would need Government approval through the FIPB. For this the proposal must be supported by a Board Resolution of the existing Indian company.

For existing companies without an expansion program, the additional requirements for eligibility for automatic approval are:

(i) That they are engaged in the industries under automatic route.

(ii) The increase in equity level must be from expansion of the equity base and

(iii) The foreign equity must be in foreign currency.

The earlier SEBI requirement, applicable to public limited companies, that shares allotted on preferential basis shall not be transferable in any manner for a period of 5 years from the date of their allotment has now been modified to the extent that not more than 20 per cent of the entire contribution brought in by promoter cumulatively in public or preferential issue shall be locked-in.

The automatic route for FDI and/or technology collaboration would not be available to those who have or had any previous joint venture or technology transfer/trade mark agreement in the same or allied field in India.

Equity participation by international financial institutions such as ADB, IFC, CDC, DEG, etc. in domestic companies is permitted through automatic route subject to SEBI/RBI regulations and sector specific cap on FDI. In a major drive to simplify procedures for foreign direct investment under the "automatic route", RBI has given permission to Indian Companies to accept investment under this route without obtaining prior approval from RBI. Investors are required to notify the Regional Office concerned of the RBI of receipt of inward remittances within 30 days of such receipt and file required documentation within 30 days of issue of shares to Foreign Investors. This facility is available to NRI/OCB investment also.

17.8 Composition of Capital Inflows in India

International capital flow such as direct and portfolio flows has huge contribution to influence the economic behavior of the developing countries positively. capital inflows play a very important role in capturing the benefits of globalization. Various studies revealed that it is not so much the quantity but the quality of money that is making the difference. Whereas, the old two-gap theory suggests that it is quantity of money that counts. Now researchers are conscious about the technological and managerial skills, the work culture, and the synergies accompanying capital flows that seem to give a lot more contribution to growth. Even with regard to portfolio flow from Foreign Institutional Investors (FIIs), the way in which FIIs assess market practices in stock exchanges have enhanced our own practice and skill among participants to global standards. So, one has to look at the capital flows in a broader sense rather than as mere numbers and in any case the issue has to be evaluated in the country context.

India is a developing country, like many other developing countries, international capital flows has significant potential benefit on the Indian economy. Under the liberalized foreign exchange transactions regime, the results were dramatic. The liberalization of the portfolio investment led to a surge in inflow of capital for investment in the primary and secondary market (Dash and Sumanjeet, 2005) for Indian equity and corporate (and subsequently sovereign) bond market. The composition of capital inflow has changed significantly over the years (Gopinath, 2004). Dependence on aid has vanished and foreign direct investment (FDI), foreign portfolio investment (FPI), external commercial borrowings (ECB) and nonresident Indians (NRI) deposits dominate the capital flows. Among these again, there has been a gradual shift away from debt components to equity flows. (The proportion of non-debt has gone up from about 5% in the second half of the 1980) But, the period of 1990s show a radical transformation in the nature of capital flow into India. From a mere absence of any capital flow till 1992 (expect those by Non Residents Indian), today such inflows represent a dominant proportion to total flows (Chakraborty, 2001). The official flow shows an external assistance, i.e. grants and loans from bilateral and multilateral sources represented 75-80 percent flow till 1991. By 1994, this has come down to about 20 percent and has further fallen to below by 5 percent by late 1990’s. About 460 FIIs have been allowed to enter the Indian market and together have brought in more than US $ 14 billion GDR (Global Depository Receipts) and ADR (American Depository Receipts) floated by Indian corporate sector brought in the remaining portfolio inflows.

The government of India must make polices that will help bringing in huge amounts of foreign direct investment into the country, for this will lead to the growth of the Indian economy. Ever since the dismantling of the Soviet Union and the regime have changed in the socialist bloc countries, the Communist Party of India (Marxist) has been trying to evolve policy and tactical approaches on the new, emerging world situation marked by globalization and neoliberal economic policies. The effort had a special significance for the party, because it was participating in elections within what the party calls a bourgeois set-up, and had the responsibility of running State governments, including the West Bengal government which has completed a record 28 years in power.

The governments led by the party were confronted with several questions relating to the pursuit of neoliberal policies within the larger structure in which they were functioning. Hence, evolving the correct tactical approach was of paramount importance. This effort took a concrete shape at the 18th party congress with the release of the document “On Certain Policy Matters”.

The document made it clear that “the struggle for an alternative socialist order has to be based on revolutionary transformation of the existing order” and that this requires “an engagement of the revolutionary forces with existing world realities with the sole objective of changing the co-relation of forces in favor of socialism”. It also added that the "process of revolutionary transformation has to be based on such an engagement and not on the wishful thinking of escaping from existing realities". Political observers are of the view that the document constitutes a first ever acknowledgement by a third world communist party that globalization cannot be wished away.

Elaborating further, the document adds: "Under globalization, the neoliberal policies reduce State governments to extreme penury, by reducing capital transfers to them and by charging usurious interest on loans." It also pointed out that imperialist agencies use this situation to make "offers of help" with strings such as structural adjustment attached to them. What the document visualizes is not an outright rejection of these maneuvers of neoliberal economic interests, but a tactical engagement with them.

With this premise, the document has also delineated its position on the flow of foreign capital into the country. It says that the flow of foreign capital (Foreign Direct Investment) must be regulated on the basis of two stipulations. First, FDI should augment the existing productive capacities in the economy. Secondly, it should upgrade the economy.

FDI and Growth

Beyond the initial macroeconomic stimulus from actual investment, FDI influences growth by raising total factor productivity and, more generally, the efficiency of resource use in the recipient economy. This works through three channels: the linkages between FDI and foreign trade flows, the spillovers and other externalities vis-à-vis the host country business sector, and the direct impact on structural factors in the host economy.

Trade and investment

While the empirical evidence of FDI's effects on host-country foreign trade differs significantly across countries and economic sectors, a consensus is nevertheless emerging that the FDI-trade linkage must be seen in a broader context than the direct impact of investment on imports and exports. The main trade-related benefit of FDI for developing countries lies in its long-term contribution to integrating the host economy more closely into the world economy in a process likely to include higher imports as well as exports. In other words, trade andinvestment are increasingly recognized as mutually reinforcing channels for cross-border activities. However, host-country authorities need to consider the short and medium-term impacts of FDI on foreign trade as well, particularly when faced with current-account pressures, and they sometimes have to face the question of whether some of the foreign-owned enterprises' transactions with their mother companies could diminish foreign reserves.

FDI generally occurs in tandem with greater international trade integration, which may reflect increasing vertical integration as well as the establishment of transnational distribution networks. As countries develop and approach industrialized-nation status, inward FDI contributes to their further integration into the global economy by engendering and boosting foreign trade flows. Apparently, several factors are at play. They include the development and strengthening of international networks of related enterprises and an increasing importance of foreign subsidiaries in MNEs' strategies for distribution, sales and marketing. In both cases, this leads to an important policy conclusion, namely that a developing country's ability to attract FDI is influenced significantly by the entrant's subsequent access to engage in importing and exporting activities.

This, in turn, implies that would-be host countries should consider a policy of openness to international trade as central in their strategies to benefit from FDI, and that, by restricting imports from developing countries, home countries effectively curtail these countries' ability to attract foreign direct investment. Host countries could consider a strategy of attracting FDI through raising the size of the relevant market by pursuing policies of regional trade liberalization and integration.

17.9 Risks to Developing Countries

Capital flows are most helpful when the magnitude of those flows is steady and stable, and when the types of investments are suitable to meet the development needs of the economy. Although the useful purpose of foreign capital is to augment domestic savings in order to raise investment, the volatility of those flows sometimes results in the opposite. Savings averaged 23.4% of GDP for developing countries between 1981 and 1996, while investment averaged 25.7% - - thus foreign investment contributed 1.3% of GDP towards investment on average each year. However, since 1998 the savings rate has exceeded that of investment because of the net outflow of capital from developing countries. Trend is predicted to continue through the near future.

There are many motivations for international capital investment, and generally it is the pursuit of a higher rate of return. Some particular motivations that raise grave concerns are the outflanking of labor standards and environmental protections in the home country. In addition, FDI seeks out special natural resources and opportunities to acquire newly privatized assets. Foreign lending, through bank loans or bonds, helps developing countries adjust gradually to external shock such as an oil price hike or natural disaster, and provides the lenders some geographical diversification of their assets.

While these motivations can be identified and accounted for, the actual behavior of financial markets sometimes appears less rational or dependable than these economic factors would indicate. The consequences of this include unstable or undependable international capital flows. A surge of capital inflows into a developing country can be triggered by the lifting of restrictions on the capital account, known as capital account liberalization, and by a policy to privatize what were formerly publicly owned assets such as the telephone or railway system.

Foreign capital can also be "pushed" from abroad when the rates of return on capital decline in the advanced capital market economies. When investment managers of large funds such as pension funds, mutual funds, hedge funds, trusts and insurance companies engage in "herding" or trend investing, this can lead to a surge of capital into a country.

The consequences of this rush or excessive capital inflow can be devastating. It puts upward pressure on the developing country's exchange rate and if it is not sterilized through central bank intervention then it appreciates the currency and reduces the competitiveness of the country's traded goods. The capital inflow can also lead to speculative booms in the price of local assets such as real estate and equity shares. Thailand experienced a boom and bubble in its real estate and stock markets before they burst during the financial crisis in 1997.

The rapid movement of capital, like a speeding bullet, can do more damage through the exit wound it creates. Capital flight is generally the cause of the collapse of fixed exchange rate systems as was the case for Mexico in 1994, the five crisis countries of East Asia in 1997, and Russia in 1998. The massive outflows depress the prices of real estate, equity shares and other domestic assets, and they cause a loss of bank deposits that leads to lending constraints and tight credit conditions. The result is a rise in unemployment and poverty, and the weight of these social dislocations has proven to fall disproportionally on women and the poor. Women are often the targets for lay-offs during an economic contraction, and families respond to following incomes by increasingly sending wives and daughters into the labor force.

Making matters even worse is the tendency for international capital markets to spread the effects of a financial crisis in one country to others in a process known as contagion. In this way, financial market disruptions in one country inflict severe costs on other countries that played no role in the cause of the original crisis. Similarly, foreign debt is also subject to changes in interest rates when it is rolled-over at maturity or according to a regular schedule if it is variable rate debt. Hence an increase in interest rates in the US will lead to higher debt repayments costs, and if the higher interest rates also lead to a higher valued US dollar then the debt costs will raise that much more.

This situation puts a great deal of pressure on fixed exchange rate systems in the developing world. Investors and speculators alike know the consequences of a general US dollar appreciation on the ability of a smaller, poorer country to maintain its peg to the rising dollar.

This makes parallel appreciation of the pegged currency reduces the competitiveness of the developing country exports and harms the trade balance. If the central bank finds it necessary to raise interest rates in order to maintain the peg, then it also dampens the developing economy.

Alternatively, if the central bank tries to avoid raising interest rates by intervening in the foreign exchange market in order to defend the peg, then investors and speculators alike will watch the level of foreign reserves closely for signs of weakness in the central bank's ability to maintain the peg.

17.10 Recent Trends

Major trends of foreign capital in India are as under:

a) Around US$ 48 billion of FDI has been pumped in the Indian economy in the last two years.

b) Research anticipates that India could attract FDI worth as much as US$ 80 billion in next 1-2 years.

c) FDI inflow rose by 50% to US$ 20.76 billion during January-August 2011.

d) Services, telecom, housing and real estate, construction and power were the sectors that attracted maximum FDI during the first eight months of 2011.

e) Mauritius, Singapore, the US, the UK, the Netherlands, Japan, Germany are the major investors in India.

f) Forex reserves of India have increased by US$ 858 million to US$ 318.4 billion for the week ended October 21, 2011.

The following table elaborates some of the major roles and responsibilities of various institutions in country from the foreign capital point of view:

Looking at the rate financial investors are moving across the globe, one can say that the foreign capital in any country will keep on increasing and this will ultimately result in the growth and development of that country. The future of foreign capital investment in India is very good and we keep on hearing about the increased percentage of investment and liberalization in policies. The key to growth and development is FDI and FIIs and in near future they will surely unlock the treasure chamber in our country. Only time will tell whether there are any effects on the exchange rate and on competitiveness, as well as, whether this phenomenon is sustainable, so all conclusions that we draw from this whole episode need to be tentative.

Table1. Examples of Key Institutional Roles and Responsibilities

Institutions	Examples of activities
Government	Governments should be committed to stimulate FDI in low income or heavily indebted countries. Developing and developed country partnerships can promote stable, predictable, non-discriminatory and transparent systems of investment and regulation. Governments can raise consumer/shareholder awareness of good FDI practices and have a vital role in influencing wider implementation of sustainable practice, fair competition and business standards. Host governments can encourage better investment strategies with incentives, e.g. business awards, premiums on export credit insurance, and regulatory mechanisms,
NGOs & civil society groups	NGOs can help address the linkages between FDI and environment, welfare, poverty and inequality, because of their direct experience "on-the-ground" e.g. micro-credit projects and consumer associations. They can contribute to the process of development, implementation and monitoring of business performance, strategies and benchmarks. They can also inform consumers/shareholders and wider society about companies' investment policies and standards.
Industry	Parent companies can support more sustainable forms of technology transfer and skill sharing in subsidiaries to encourage self-regulation of FDI. Standards for good practice and codes of conduct can enhance corporate transparency and accountability, and encourage equivalent levels of good practice in both parent and host countries e.g. OECDs "Guidelines for Multinational Enterprises" which sets standards for MNEs. However, whilst useful, voluntary codes are subject to interpretation and free riders, therefore incentives are needed to back up good practice. Parent companies can provide frameworks to support subsidiaries developing strategies to implement monitor and enforce standards of good practice, encouraging trans-national standards. Benchmarking of performance and independent monitors, using performance measures such as Sustainability Impact Assessments (broader than EIA), would also enhance the credibility of businesses codes.
International Institutions	International development and finance institutions can mitigate some of the risks of investment for small to medium enterprises and developing economies seeking to attract and stabilize FDI flows, through equity loan finance and other insurance provisions to protect against currency transfer, expropriation of profits, and economic disturbances, such as war. Those countries failing to meet criteria for credit / loan programs need assistance to link them with alternative sources of insurance to attract foreign investors' e.g. bilateral aid, multilateral development banks. Other important roles include the assessment & monitoring of FDI within developing countries, dissemination of information about global FDI trends and the impacts to technology and trade, finance, investment and economic growth, as well as raising international awareness of investment conditions of sidelined economies e.g. UNCTAD and ICC guidelines. They can assist the mainstreaming environment finance into financial markets.

17.11 Summary

Foreign capital contributes in anany important ways to process economic growth and industrialization. There are different types oforeign capital investiments viz. drrect foreign investment, foreign collaboration, inter Government Loans, Loans from International Institutions etc. In this chapter Least developed Countries (LDC), multi national corporations & their investiment benifits have been explaned. Foreign direct investment is an integral part of an open and effective internatrenal economic system and major catalyst to development. In this unit social development infrastructue development, technology transfer and development due to foreign Direct Investment have been expained in detail. Recent trends in FDI have been highlighted.

17.12 Key Words

- **Foreigon Capital :-** Investment of capital by a foreign Government, institutors, private Indvidnal and international organization.
- **Foreign Direct Investment (FDI):** Foreign capital can enter India in the foriegn direct Investments. Advanced Countries formed companies with specific purpose of operating in India.
- **Collaboration : T**here has been joint partrcipotion of foreign and domestic capital. This type of foreign capital has been encouraged in our country.

17.13 Self-Assessment Test

1 What do you understand by foreign capital?

2 Discuss the types of foreign capital.

3 What is the role of FDI in development of a nation?

4 Discuss the role of government in FDI?

5 What are the benefits of FDI?

6 What do you mean by Automatic Routes in FDI

17.14 References

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Unit - 18 : Public Private Partnership

Unit Structure

18.0 Objectives

After studying this unit, you should be able to :

- Describe the concept of PPP.
- Discuss the stages of PPP process.
- Explain the issues in PPP.
- Describe govt. policy towards PPP.
- State the PPPs in india.
- Role of PPPs so far.
- Recommandation regarding PPPs.

18.1 Introduction

Public Private Partnership (PPP) means an arrangement between a government / statutory entity / government owned entity on one side and a private sector entity on the other for the provision of public assets and/ or public services, through investments being made and/or management being undertaken by the private sector entity, for a specified period of time, where there is well defined allocation of risk between the private sector and the public entity and the private entity receives performance linked payments that conform (or are benchmarked) to specified and pre-determined performance standards, measurable by the public entity or its representative.

The above definition puts forth only the essential conditions for an arrangement to be designated as a Public Private Partnerships (PPP). In addition to these, some of the desirable conditions or good practices for a PPP include the following:

a. Allocation of risks in an optimal manner to best suited to manage the risks;

b. Private sector entity receives cash flows for their investments in and/or management of the PPP either through a performance linked fee payment structure from the government entity and/or through user charges from the consumers of the service provided;

c. Generally a long term arrangement between the parties but can be shorter term dependent for instance on the sector or focus of PPP;

d. Incentive and penalty based structures in the arrangement so as to ensure that the private sector is benchmarked against service delivery;

e. Outcomes of the PPP are normally pre-defined as output parameters rather than technical specifications for assets to be built, though minimum technical specifications might be identified. Such a structure is expected to leave room for innovation and technology transfer in project execution / implementation by the private sector entity.

The models where ownership of the underlying asset remains with the public entity during the contract period and project is transferred back to the public entity after the termination contract are the preferred forms of Public Private Partnership models. The final decision on the form of PPP is a determinant of the Value for Money analysis. Some of the commonly adopted forms of PPPs include management contracts, build-operate-transfer (BOT) and its variants, build-lease-transfer (BLT), design-build-operate-transfer (DBFOT), operate-maintain-transfer (OMT), etc.

Build-own-operate (BOO) model is normally not the supported form of Public Private Partnership in view of the finite resources of the Government and complexities in imposing penalties in the event of non-performance and estimation of value of underlying assets in the event of early termination. Government of India does not recognise service contracts, Engineering-Procurement-Construction (EPC) contracts and divestiture of assets as forms of PPP.

Government commits to the spirit of partnership amongst all the stakeholders public, private, end users and community. While the current initiatives on having a strong public community private partnerships would continue, with the growing capacity and maturity of the stakeholders concerned under a PPP arrangement, Government would in due course selectively consider newer models of partnerships which would be simpler, flexible and engage increased participation amongst the contracting parties.

PPP is a broad term that can be applied to anything from a simple, short term management contract (with or without investment requirements) to a long-term contract that includes funding, planning, building, operation, maintenance and divestiture. PPP arrangements are useful for large projects that require highly-skilled workers and a significant cash outlay to get started. They are also useful in countries that require the state to legally own any infrastructure that serves the public. The term “public-private partnership” describes a range of possible relationships among public and private entities in the context of infrastructure and other services. Other terms used for this type of activity include private sector participation (PSP) and privatization. While the three terms have often been used interchangeably, but there are differences:

PPPs present a framework that—while engaging the private sector the role for government in ensuring that social obligations are met and successful sector reforms and public investments achieved. A strong PPP allocates the tasks, obligations, and risks among the public and private partners in an optimal way. The public partners in a PPP are government entities, including ministries, departments, municipalities, or state-owned enterprises. The private partners can be local or international and may include businesses or investors with technical or financial expertise relevant to the project. PPPs may also include nongovernment organizations (NGOs) and/or community-based organizations (CBOs) who represent stakeholders directly affected by the project.

Effective PPPs recognize that the public and the private sectors each have certain advantages, relative to the other, in performing specific tasks. The government's contribution to a PPP may take the form of capital for investment (available through tax revenue), a transfer of assets, or other commitments or in-kind contributions that support the partnership.

The government also provides its help in social responsibility, environmental awareness, local knowledge, and an ability to mobilize political support. The private sector's role in the partnership is to make use of its expertise in commerce, management, operations, and innovation to run the business efficiently. The private partner may also contribute investment capital depending on the form of contract. The structure of the partnership should be designed to allocate risks to the partners who are best able to manage those risks and thus minimize costs while improving performance.

Need for PPP

Development of infrastructure and provision of basis services has always been considered a very important public sector activity for the following reasons:

a. Governments have recognised the very crucial role of infrastructure in fostering economic growth and reducing poverty.

b. Because of its 'public good' and 'essential' nature, Governments have attempted to ensure availability of basic services irrespective of market conditions.

c. For a number of economic, social and political reasons, private sector involvement in these important areas was slow to develop and thus uneven. Provision of public services and infrastructure has traditionally been the exclusive domain of the government. However, with increasing population pressures, urbanisation and other developmental trends, government's ability to adequately address the public needs through traditional means has been severally constrained. This has led the Government's across the world to increasingly look at the private sector to supplement public investments and provide public services through Public Private Partnerships.

18.2 The PPP Process

To make the proper decisions there is needed to plan, develop, and execute successful PPPs, the process can be divided into four phases, viz., identification stage, development stage, procurement stage and contract management and monitoring stage.

Phase I: PPP Identification

Covers activities such as strategic planning, project pre-feasibility analysis, Value for Money analysis, PPP suitability checks, and internal clearances to proceed with PPP development. Some of the critical drivers are discussed below:

• **Strategic Planning:** To make efficient use of existing assets and new investments for greater efficiency, the Government shall set out, a long term vision and plan documents for each sector which defines the role of public and private participation. For each financial year, based on a pre-determined and envisaged level of public services to be rendered, different agencies would set out an annual PPP Plan which would identify a shelf of projects flowing from the overall vision and specify the extent of private investment for each project in the Plan.

• **Pre-feasibility** analysis would be undertaken by the project proponents to assess broad viability of every project envisioned to be procured on a PPP mode. Identification of the key risk factors for the project shall also be undertaken to establish the likely cost and revenue streams of the projects.

• **Value for Money Drivers :-** Value for Money assessment plays a central role in decision around investment prioritization and in the selection and presentation of the choice of procurement approach. This is particularly relevant to annuity based payment schemes, where a framework is needed to assess whether or not it is the appropriate procurement route given the alternative of more traditional procurement approaches.

i. Value for Money (VfM) analysis shall be undertaken to support key decisions. At the outset, VfM analysis shall be undertaken to establish whether to develop a project as a PPP project. Subsequently, the VfM analysis should be undertaken to affirm whether to award a PPP contract on the basis of the bids received or not. A VfM analysis is most eminent for structuring a PPP by comparing a shadow bid resulting from the financial analysis with a public sector comparator (or costs in case of conventional procurement).

ii. VfM analysis should be conducted for every project in order to ascertain whether the Project being procured as a PPP is in a way offers good Value for Money to the public sector. VfM analysis would be conducted even if no fiscal support is required, as the costs may be recovered through user charges (as there is an obligation to ensure that charges which users pay are fair and reasonable).

iii. VfM assessment would be based on the efficiency savings that can be realized by utilizing the private sector managerial skills, integration and synergy between the design, service operation, optimal risk allocation, whole of life costing, innovation, focus on outputs and a robust competitive process to elicit the best bids.

iv. It is recognized that information availability is a constraint in the formulation of VfM analysis and also that sectors have different characteristics that influence the VfM outcomes.

• **Conformance with State and Sector Legislation** :- Before structuring a PPP project, an assessment would be carried out to ascertain whether private participation in the delivery of a public service is permissible under the extant legislations. If the same is not allowed but it is deemed prudent to adopt a PPP framework, suitable modifications/amendments would be made to the legislations.

• **Adherence to Processes** :- Project would be deemed suitable for PPP, only if risks could be allocated in such a manner that maximizes the stakeholder benefits and the implementing agency commits to adhere to the process of development, procurement and post award governance of the project. If a project is found not suitable after the PPP suitability assessment, the implementing agency would consider alternative methods of taking up the project including EPC contracts, corporate sponsor, community participation, etc.

Phase II: Developement Stage

Development Stage covers project preparation (including technical feasibility and financial viability analysis), project structuring, preparation of contractual documents and obtaining of project clearances and approval. During this stage, activities would be undertaken with the following objectives:

a. Articulate the scope of the project, implementing agencys requirements and set forth rolest responsibilities of the parties;

b. Establish that the revenue model is robust and sustainable over the project life;

c. Ensure that the underlying risks are defined and appropriately allocated between the contracting parties;

d. Ensure that the contractual arrangements and documentation accurately reflect the scope of the project, roles and obligations of parties, performance standards, monitoring arrangements, penal provisions, reporting requirements, dispute resolution mechanism and termination arrangements as well as & and effective post award governance mechanisms;

e. Ascertain that contractual arrangements are permissible under the policy, legal and regulatory regime; and

f. Establish stakeholder buy-in and commitment is ensured throughout the process;

As part of the project development activities, implementing agencies would undertake studies and investigations relatied to technical, market analysis, financial, legal aspects, with the assistance from advisors/ consultants wherever required. The output of the project development activities, to the extent feasible, would be made available to the potential bidders during bid process. Some of the core activities critical at this stage are discussed below:

• **Economic, Financial and Affordability Assessment**

i. To structure the projects optimally, the implementing agency would evaluate the project from an economic perspective (to ascertain whether the project is warranted public need), then whether the project generates positive value to the private sector (financial viability), and finally ascertain whether defined viable PPP is better than conventional procurement or which of the defined viable PPPs is most attractive (VfM analysis). All these analyses would be based on the same valuation methodology calculation of net present value where future benefits (revenues), and costs (capital, O & M), are discounted to reflect the current value.

ii. Economic analysis would form a key input for decisions regarding the (public) need for a project, and would encompass, in addition to the cash flows and items that have financial impact, other external costs and benefits to the stakeholders, regardless of whether they have any financial impact. The future economic benefits and costs will be assessed and discounted using a discount rate that reflects the systematic risk of the projects.

iii. Financial analysis would assess whether the project generates sufficient revenues for the capital providers to generate an acceptable rate of return. The future financial benefits and costs (in terms of cash flows) are discounted, using a discount rate reflecting the cost of capital, and which also takes into account the systematic risk of the project.

iv. Affordability analysis, with respect to both the implementing agency (viz., committed and contingent liabilities, such as land acquisition costs, rehabilitation and resettlement costs, annuity payments, management fees, etc.) and the likely users (tariffs, user charges, etc) would be a critical determinant in addition to the VfM analysis, on whether to take up the project on the PPP mode. It is also an effective tool to establish the reasonableness of assumptions underlying the financial analysis.

v. Bankability assessment would also be carried out to assess the debt service capabilities of the proposed project structure. A Debt Service Coverage Ratio (DSCR) (a ratio of cash flow available for debt servicing divided by the amount of debt service) is a key measure to assess the credit worthiness of a project . In case the analysis suggest that the project is not bankable, the implementing agency might consider developing credit enhancement mechanisms, such as viability gap funding, capital grant or maintenance grant, alternative revenues structures, including shadow user fees, etc. Such credit enhancement structures would be facilitated through institutional and contractual provisions.

vi. Existing loans, guarantees, other statutory and contractual liabilities and contingent liabilities affect the fiscal resources of the project proponents and would be considered while structuring PPP contracts.

• **Value for Money Analysis**

A similar (as adopted for economic and financial analysis) methodology would be utilized for quantitative assessment of Value for Money. The future benefits and costs of applying PPP in comparison with conventional procurement are assessed and discounted using a discount rate reflecting the systematic risk of the project.

• **Management of Risks**

i. The Government, through the implementing agencies, shall identify different types and degree of risks during the project life cycle, and configure appropriate mitigation measures. The objective would be to optimally allocate the project risks, rather than maximize their transfer to the private sector. The attempt would be to allocate risks, taking into account the legitimate concerns of the stakeholders, to the entity that is best suited to manage the same.

ii. The public sector would not retain the risk that the private sector has better ability to bear. However, risks that the public sector is more competent to mitigate/bear in the normal course of its business, such as ensuring availability of unencumbered land for the project or obtaining mandatory clearances of regulatory authorities prior to commencement of the project, would be retained by the public sector.

iii. The allocation of risk shall be enshrined in the contract document and under normal circumstances shall not be subject to modification after the award of the project. Contractual documentation would provide adequate protection to the lenders against non-commercial risks related to force majeure, regulatory changes, contract termination etc. The contract would also prescribe the key performance indicators and output parameters to ensure that the delivery of services adheres with the aspired levels.

iv. To ensure that the projects conform to the guiding principles of PPPs, the Government has notified the Guidelines for Formulation, Appraisal and Approval of Central Sector PPP Projects. The procedure enshrined in these guidelines shall continue to be observed for all central sector projects.

Phase III: Procurement Stage

Procurement stage would cover procurement and project award. Transparent, accountable, non-discriminatory, competitive and timely procurement processes would be followed so as to encourage maximum participation by private sector and to imbibe public confidence in the procedure. The PPP rules notified by the Government would define the norms and procedures for procuring PPP projects.

The bid documents used for procurement of private sector entities may comprise one or more of expressions of interest, request for qualifications, and request for proposals. Technical proposals would be invited, depending on the complexity of a project, to assess the ability of the private entity of their appreciation of the desired outcomes. Financial proposals would ideally be in the form of a single objective parameter.

The Government has prescribed the bid process and the model bidding documents (viz., model Request for Qualification and model Request for Proposal) for PPP projects in infrastructure sector, through notifications issued from time to time. A web based market places, including e-tendering and auction would be promoted based on the project requirements to promote wider participation and transparency in the process. Draft contract agreement containing provisions on the roles and obligations of the parties, performance standards and monitoring arrangements, reporting requirements, penalty conditions, force majeure conditions, dispute resolution mechanism and termination arrangements, shall be provided to the prospective bidders as part of the bid documents.

Timelines to be followed during the procurement process would be indicated by the procurement entity in the bidding documents. In order to minimize delays, the procurement entity would endeavor to obtain all necessary approvals for a project from the agencies concerned in a timely manner. Procuring entities would, on best efforts basis, facilitate all necessary clearances for speedy implementation of a PPP project.

Phase IV: Contract Management and Monitoring Stage

PPP contract management and monitoring stage, covers project implementation and monitoring over the life of the PPP project. Contract management is not a passive box ticking/reporting exercise: it is an active process that involves a wide range of skills. Projects are not static, conditions change and the capability of the public authority at the interface with the private sector party is therefore crucial. The contract manager needs to be empowered to take action responsively and effectively only escalating up the chain issues that cannot be managed at the project interface. This calls for effective and efficient governance processes and people with the right mix of skills (or at time access to skills) including project management, commercial expertise and negotiation skills;

The Government and the implementing agencies shall endeavor to ensure timely and smooth implementation of the project. The implementing agency shall put in place a suitable contract administration framework for monitoring project performance milestones over the contract period.

The project implementing agency shall establish appropriate mechanisms for project monitoring such as Project Monitoring Unit (PMU) and inter-department committees that would oversee project implementation, facilitate coordination between departments and render assistance during events of dispute resolution or arbitration. The contract management teams identified would be well prepared and resourced in advance of the contract management stage. In particular, those charged with managing the contract would have a close knowledge and understanding of the relevant terms of the contract.

The dispute resolution mechanism would be in accordance with contract conditions and applicable legislation. The implementing agency shall endeavor to speedily resolve and dispose disputes during the contract period through appropriate mechanisms including mediation processes. The Government recognizes that appropriate capacity is critical to effectively undertake project monitoring and, therefore, appropriate human resources and management systems would be established for the above.

- **Management Information Systems**

In order to continuously monitor the performance of the PPP projects over the project life cycle, the Government would establish the MIS for PPP projects. The evaluation of the PPP projects would also be tabulated and summarized so as to utilize the same for improving the quality of service delivery levels and sustainability of PPPs in the future. The database of the projects would not only contain information on the ongoing projects but also set out frameworks for monitoring them during various stages of the project cycle. The database would be so developed so as to generate information for undertaking VfM analysis. PPP Cells would be responsible to set up MIS systems and disseminate information to Government agencies from time to time so as to effective suitable policy changes based on the previous experience of managing PPP projects.

- **Post Project Award Negotiations**

It is acknowledged that including conditions in a PPP contract that allow a party to negotiate post award and execution is not advisable, and to the extent possible, the contract must cover all possible aspects that would required subsequent adjustments. The implementing agency must justify that risk sharing at allocation stage has significantly changed due to rare circumstances beyond the control of the parties. Any such post award negotiations would be undertaken in the spirit of adhering to the VfM analysis established during the project development process. The implementing agency would obtain prior approval of the sector regulator (if any), the appraising entity and the authority granting approval to the investment decision in the project before effecting any change in the contract. All negotiations shall be undertaken in a transparent manner aimed at generating awareness among the stake holders about the original bid and contractual conditions, the proposed changes and justifications, thereof. The transparency herein would include mandatory disclosure by both parties. All such negotiations and contractual modifications would be subject to audit, including stage audit, by the authorities.

18.3 Issues in PPPs

(a) Major Issues

The private sector has long provided goods and services to the public sector. However, a trend seems to be developing in a number of countries, notably the United Kingdom, towards increasing involvement of the private sector in the provision of goods and services traditionally provided by, and seen as a function of, the public sector. This entails a shift in the role of the public sector from supplying to buying services, with private firms designing, constructing, financing, operating and maintaining infrastructure, and the public sector paying for these services. Such arrangements are called public private partnerships (PPPs). Contracting out differs from PPPs in that the latter usually entail a combination of services (for example, design, construction and maintenance) whereas contracting out is usually for one or relatively simple services.

The private sector invests in infrastructure and provides related services to the government The government retains responsibility for the delivery of core services, and Arrangements between the government and the private sector are governed by long-term contract. It specifies the services the private sector has to deliver and to what standards. Payment depends on the private partner meeting these standards.

PPPs take many forms such as design, construct and maintain, and build, own, operate and transfer. The choice of form depends on factors such as the government's objectives, the nature of the project, the availability of finance, and the expertise that the private sector can bring. The main applications (by value) of PPPs in Australia and overseas are transport-related. However, PPPs are increasingly being used in social infrastructure such as hospitals and schools.

Governments are attracted to PPPs because they may provide value for moneyat least in the short term. The ability to transfer risk to whichever of the public or private partner is better able to manage the risk is a source of value for money. PPPs often involve the private sector providing a 'bundle' of heading is missing. Bundling can provide value for money that contracting services separately cannot. PPPs can contain incentives for the private sector party to perform well. For example, under a contract to construct a road, the developer has an incentive to do the minimum necessary to meet the contract terms. However, under a design, construct and maintain arrangement, the developer has an incentive to build the road to the standard necessary to provide services for the period of the contract. For heavily indebted governments, an attraction of having the private sector finance infrastructure is that it obviates the need to borrow, and can allow projects to be brought forward. But even if the private sector finances a project, the government has to fund payments to the private partner for the services provided. Assessment of whether a PPP offers value for money entails the preparation of a 'public sector comparator'. This is an estimate of what the proposed project would cost if the public sector were to undertake it, based on 'best-practice' assumptions. The shift from supplying to buying services changes demands on the public service towards output specification and contract management including specification of the measures by which the performance of the private sector partner is assessed.

Advocates of private sector finance claim that it provides incentives for the private partner to deliver projects to time and budget, and operate infrastructure soundly. Critics of PPPs claim that public sector finance is cheaper than private sector finance and so the latter should not be used. But critics of this argument claim that the government's ability to borrow cheaply is a function of its capacity to levy taxes. They say that what determines the real cost of finance for a project is its risks. The private sector explicitly prices these risks into the cost of finance. When the public sector finances a project, taxpayers bear the risks and implicitly subsidise the cost of the project because the risks are not factored into the government borrowing rate.

The often short-term focus of government budgeting decisions and delays in making decisions are particular difficulties for private firms. Standardisation of some contract documentation, procedures and definitions can reduce bid costs and accelerate project timetables. But the fact that each project is different limits scope for contract standardisation.

(b) Other Issues

The traditional contracting out of activities to the private sector means that some of the benefits of private sector involvement in the provision of public goods and services have already been obtained. PPPs potentially may offer additional value for money especially if services are bundled to incorporate design, build, and lifetime operation and maintenance of assets, and through appropriate risk transfer. And the use of comparators and other considerations helps to ensure that PPPs offer value for money.

However, PPPs are potentially fraught with difficulty. The design and implementation of PPPs are usually very complicated. The essence of the business relationship between the public and private sectors is contractual. This requires that the services to be delivered have to be specified in great detail. Assessment of whether a PPP would offer value for money is often difficult to determine. Some risks are difficult to identify alone quantify, and it is difficult to assess to what extent the transfer of risk is deemed optimal.

In areas like infrastructure, where large-scale investment is needed, so-called public private partnerships (PPP) may be an option, where private investors design, build, own, maintain and operate facilities like highways under long-term contracts.By deferring payment and by making it contingent on facilities being operable through the contract period, PPP contracts transfer investment risks to the private investors, such as those arising from delays in construction projects, and ensure a life-cycle perspective on costs. Private contractors may be better equipped than government for managing construction projects, especially where there is considerable scope for reducing maintenance and operation costs through innovative design. However, PPP usually entails a higher cost of capital than, if the risks were carried by the general government budget and investment were financed via public lending. Moreover, complex financial contracts, involving commitments to future payments, may reduce transparency, requiring strong institutional checks. And while PPP contracts shift investments off the government's balance sheet, the commitments to pay for future service-flows have largely the same macroeconomic effects as public debt. Most importantly, the inherent long-term character and complexity of PPP contracts may pose a number of problems. It may have adverse effects on the effectiveness of competition, as fewer firms are able to make a bid, and contracts must be able to accommodate changes in future need which are inherently difficult to foresee. As far as large-scale infrastructure is concerned, achieving co-ordination among alternative routes and means of transport is crucial and having a range of different private owners may entail complicated and costly negotiations to accommodate changes. Furthermore, insofar as the government may ultimately be held responsible for outcomes, the transfer of risks to private contractors may be partial, with the government having to step in if something goes wrong.

The specificity of assets (such as a hospital building or an IT-system) implies that the private and public partners become mutually dependent in a way that may stifle competition. When the contract expires, other potential contractors may be reluctant to undertake the effort necessary to make a bid in a renewed tender process, knowing that the incumbent will have a considerable cost advantageother things being equal.

18.4 Policy Framework

Both the center and some of the states have had in place for some time policies on private participation for specific sectors: in ports, for example the center issued "Guidelines on Privatization" for the major ports in 1996 and Gujarat preceded this with a ports policy in 1995.

New policy initiatives would however be useful in an effort to scale up and broaden the PPP program, both at the central and state level. Importantly, this would have the government concerned set out clearly why PPPs are being pursued and the benefits sought; and indicate that they will only be pursued where these benefits can realistically be expected. As noted in Section 3, one of the gaps in PPP frameworks in India compared to many other countries is the emphasis on PPPs as raising additional capital, rather than only being pursued where services will improve and taxpayers and consumers will get value-for money. This could be addressed by a clear policy statement which would make clear both the rationale and also the limits to the use of PPPs. This would help to give the PPP program a clearer political mandate.

Broad policy initiatives would also enable governments to announce more clearly the institutional framework for PPPs. This could include the regulation, oversight and evaluation of PPPs, all areas which need strengthening, as well as the role of any new cross-sectoral units in developing and implementing PPPs. Another important area to be addressed would be procedures for the procurement of PPPs, in particular the use of competitive processes, and approaches to be adopted towards unsolicited projects.

Broad policies provide an important signal of political commitment, it may also be necessary to translate this into action plans and policies for individual sectors. These could provide a more precise orientation to encourage line ministries and agencies to pursue and implement PPP programs.

18.5 Key Government Initiatives

India had a few notable PPPs as early as the nineteenth century. The Great Indian Peninsular Railway Company operating between Bombay (now Mumbai) and Thana (now Thane) (1853), the Bombay Tramway Company running tramway services in Bombay (1874), and the power generation and distribution companies in Bombay and Calcutta (now Kolkata) in the early 20th century are some of the earliest examples of PPP in India.

Early experience. Since the opening of the economy in 1991 there have been several cautious and tentative attempts at PPP in India. However, most PPPs have been restricted to the roads sector. Large-scale private financing in water supply has so far been limited to a few cities like Visakhapatnam and Tirupur. Most PPPs in water supply projects have been through municipal bonds in cities such as Ahmadabad, Ludhiana, and Nagpur.

West Bengal has recorded significant success in housing and health sectors. The housing projects coming up on the outskirts of Kolkata City are a good example of what a PPP model can deliver in terms of quality housing and quality living conditions to the lower middle class and the middle class. Gujarat and Maharashtra have had success especially in ports, roads, and urban infrastructure. Karnataka also has done well in the airport, power, and road sector. Punjab has had PPPs in the road sector. However, successfully working PPP models are a more recent phenomenon. The Tirupur project in Tamil Nadu is a promising example in this regard. It is a BOOT project, the first privately financed water and sewerage project in India, executed through an SPV.

The project took more than ten years from concept to financial closure. The US$100 million Delhi-NOIDA Bridge Project, implemented on a BOOT framework on the basis of a 30-year concession, is the other major PPP initiative.The NOIDA toll bridge, Tirupur water supply project, national highways, port development, and telecom industry are some notable examples of successful PPPs. Many of these projects took a long time between concept and financial closure and commissioning. Nevertheless, the lessons on how not to handle PPPs seem to have been internalized well. However, water supply and sanitation projects are yet to demonstrate their commercial viability to the public. Absence of regulatory authorities and the desired legal framework in the water supply and sanitation sector are some of the hurdles in the way.

State governments have identified a whole range of sectors for PPP, including roads/highways, ports (air, sea, container),telecommunication, water supply, waste management, tourism, power, industrial infrastructure, township development, leisure, and health. States have also identified the potential PPP projects that could be developed over the next few years. Many of the projects are already in the bidding stage using both memorandum of understanding (MOU) and competitive bidding procedures. Not many of these projects would require VGF funding.

No clear link between institutional structure and success of PPP is apparent. State/UT governments have indicated marked differences in the process of PPP development, including variations in existence of infrastructure legislation and policies, institutional arrangements for identifying and approving PPPs, project development funds and companies, financial structuring, procurement procedures, etc.

States like Andhra Pradesh, Gujarat, and Punjab have legislation which clearly defines what infrastructure is and how these infrastructure projects are going to be executed by the private sector. Some other states have administrative frameworks in place for decision-making. Despite these frameworks, in the last five years the number of successful projects has not increased substantially.

Madhya Pradesh and Maharashtra have exhibited the possibility of developing a PPP program in a single sector (roads) by building up capacities in line departments. However, they have no PPPs in other sectors, possibly in part because of the absence of platforms to transfer acquired skills to other departments. Gujarat, Andhra Pradesh, and Punjab have developed cross-sector enabling legislation and dedicated agencies but have not had a very successful track record in taking PPPs to the market. Some other states, such as Tamil Nadu, have developed a few PPPs across a wide range of sectors, without explicit cross-sector PPP units or legislation.Rajasthan has a cross-sector policy/regulatory framework and a project development company but has concluded only one tourism project and a few road projects. Therefore, there seems to be no clear link between institutional structure and success of PPP. One possible reason for this is the non availability of sufficient skilled staff in the Govt. of India as well as in the states,who could actually look at how PPP projects should be structured.

GOI has published several key documents on Rail Road Connectivity of Major Ports; Guidelines for Financial Support to Public Private Partnerships in Infra- structure; Guidelines on Formulation, Appraisal and Approval of Public Private Partnership Projects; Scheme for Financing Infrastructure Projects through the India Infrastructure Finance Company; Financing of the National Highway Development Programme (NHDP), and Model Concession Agreement for PPP in Highways.

A consultation paper on 'Approach to Regulation of Infrastructure: Issues and Options' has also been prepared. This paper surveys the existing regulatory institutions with respect to their role and scope, and identifies the principles and policy options which are basic to their institutional design. A conference of Chief

Secretaries on PPPs was held on May 20, 2006, at Delhi. GOI is planning more conferences on the challenges and opportunities of building infrastructure in India.

More recently, GOI has taken several additional measures for facilitating PPPs. The key ones are the VGF scheme, IIFCL to provide long-term capital, and capacity building and other assistance. These initiatives are aimed at covering PPP projects where the private sector provides infrastructure for a fee under a concession agreement. Concession is granted on the basis of a transparent bidding process. The bidder is asked about the quantum of subsidy required and is assured a stable environment through concession agreement.

- **Viability Gap Funding (VGF) Scheme:**

VGF is a special facility to support PPP projects. This facility is housed in the DEA. Infrastructure projects are often economically justifiable but not viable commercially, at least in the initial years, due to long gestation periods and economic externalities. In large-scale infrastructure projects, the commercial viability is difficult to establish, especially at the beginning of the project. Therefore, there is a need for providing some upfront assistance to make the project commercially or financially viable, if it is otherwise economically viable or desirable for the state. The GOI therefore has operationalized VGF to provide grant support to such PPP projects.

Financing: The VGF scheme provides funding for state or central PPP projects implemented by the private sector developer on a BOT basis (selected through a process of competitive bidding). Funding is available for 20% of the project cost. If required, an additional 20% can be made available by the sponsoring Ministry/agency or it can come from the state government or any sponsoring statutory agency like local bodies. An Empowered Committee has been set up for quick processing of cases. In- principle approval has been granted for twelve projects.

Eligible Sectors: Sectors eligible for VGF are Transportation (roads, railways, seaport, airport); Power/ Energy; Urban Infrastructure (water supply, sewerage, solid-waste disposal); Tourism (internationalconvention centers); and special economic zones. Any other sector can be added with the prior approval of the Finance Minister. A wide variety of PPP proposals have been provided by the states under the VGF scheme. These include Roads and Bridges, Airports and Seaports, Commuter Rail, Urban Transit and Parking; Water Supply and Wastewater System; Electricity and Gas Distribution; Municipal Solid Waste/Biomedical Waste Collection and Disposal; Convention Center; and Waterfront Redevelopment.

Eligibility Criteria: To avoid shortcomings in project proposal and thereby avoid delays in the approval process, the VGF has the following criteria:

(i) Govt. or a statutory entity should make the proposal and not the private party. The key to making PPPs acceptable is to create an environment where PPPs are seen to be a way of attracting private money into public projects, not putting public resources into private projects.

(ii) The proposal should be made to the PPP cell of the DEA in prescribed proforma.

(iii) The project needs to be implemented, i.e. developed, financed, constructed,maintained, and operated for the project term, which is the concession period, by the private sector company.

(iv) The private sector company is to be selected by govt. or a statutory entity through a transparent and competitive bidding process; which means that the project has to be identified by the state as desirable and then bid out.

(v) The project should provide service against a predetermined tariff or user charge.

(vi) The government/statutory entity concerned should certify within reason that (1) the tariff/user charge would not be increased to eliminate or reduce the viability gap; (2) the project term will not be increased to reduce the viability gap; (3) the capital costs are reasonable and based on standard and specifications usually applicable to such projects; and (4) the capital costs will not be further restricted to reduce the viability gap.

Approval mechanism and process. An Empowered Committee has been set up for quick processing of cases. The expectation is to build up a good pipeline of projects by providing approvals quickly. The approval mechanism being followed is: (i) VGF funding up to Rs 100 crore for each project will be sanctioned by the Empowered Institution, which is chaired by the Additional Secretary, Economic Affairs; (ii) proposals up to Rs 200 crore will be sanctioned by the Empowered Committee, which is chaired by Secretary, Economic Affairs; and (iii) amounts exceeding Rs 200 crore will be sanctioned by the Empowered Committee with the approval of the Finance Minister.

Knowledge management and capacity building. The central government is also working on a number of initiatives to assist and encourage capacity building at the state and central level. An Inter-Ministerial Group (IMG), under the Finance Secretary, has been formed to determine prequalification of bidders under PPP to avoid fly-by-night operators. A PPP Cell has been established in the DEA to administer various PPP proposals and coordinate various activities to promote PPPs. The GOI is also working to streamline the approval process for PPPs in the central sector.

A committee under Joint Secretary (Infrastructure), DEA, is preparing PPP toolkits for various sectors. The toolkit comprises model concession agreements and prequalification criteria for different sectors, standard terms and conditions, and project preparation manual.These guiding documents and manuals are aimed at the use of standardized procurement and appraisal procedures, resulting in increased transparency and stable policy environment for the private sector. GOI is also building a centralized database and a website on PPP projects in India to address the lack of authentic and credible information relating to PPPs.

It will be a dynamic database, with monitoring of ongoing projects. The public sector PPP agencies will be required to provide data inputs to keep the database updated. The format is being finalized and the project is being outsourced to a database management agency. The database and the website will together act as an information clearing house/exchange for all public and private sector stakeholders to access information related to GOI policies and initiatives, standard documentation, best practices, database of PPPs, monitoring information, business opportunities, global vendors, project development facilities, consulting firms, PPP lenders/financial institutions, and other investors.

A key reason for the slow pace of generation and submission of PPP project proposals from the states has been lack of expertise in the project sponsoring agency to structure and evaluate PPP proposals. The government has also recognized that there is a dearth of viable PPP projects. To overcome this constraint, GOI has been targeting states for capacity building efforts and is providing assistance for the creation of PPP cells in various state governments as a nodal agency. The PPP toolkit, information database, and training workshops are directed at rapidly building up states' capacity to mobilize PPP projects. GOI, through the regional workshops and other interactions, is also identifying the capacity building needs of state governments and is geared to supporting any state initiatives on building their capacity on PPP. An Inter-Ministerial Group (IMG), chaired by the Additional Secretary, DEA, is working on providing assistance to state governments in building capacity for PPPs. Arrangements are being finalized under which state governments would be able to avail of consultancy support for developing PPP projects. Institutions like the IDFC and the ADB could take a lead in this.

• **India Infrastructure Finance Company Limited (IIFCL)**

In January 2006, the GOI established IIFCL under the Companies Act, 1956, as a wholly government-owned company with an authorized capital of Rs 1000 crore and paid-up capital of Rs 10 crore. The SPV was set up following the announcement by the Finance Minister in February 2005, and Cabinet approval in November 2005. The IIFCL has been set up to fill the gap for long-term infrastructure finance that banks are not in a position to address. It caters for the burgeoning gap in long-term financing of infrastructure projects in the public sector, PPP, or the private sector.

Infrastructure projects have a long gestation and often need long-term debt (+10 years) which financial institutions are unable to provide due to asset-liability mismatch, and the long-term debt funds being at a nascent stage. IIFCL will ease this asset-liability mismatch through refinance; lower long-term debt cost due to sovereign guarantees; and set benchmarks for market borrowings by other organizations. It will borrow long-term funds on GOI guarantees from multilateral organizations and others and lend to identified infrastructure projects, either directly or through refinance of long-term debt.

The sectors eligible for IIFCL funding are: Roads and bridges, railways, seaports, airports, inland waterways, and other transportation projects; Power; Urban transport, water supply, sewerage, solid-waste management, and other physical infrastructure in urban areas; Gas pipeline infrastructure projects in SEZs; and international convention centers and other tourism infrastructure projects. Any project awarded to a private sector company for development, financing, and construction through PPP will have overriding priority under the scheme. IIFCL will not ordinarily undertake any appraisal, which would be done by the lead bank.

The loan assistance from SPV will not exceed 20% of the project cost. All disbursements and recoveries would be undertaken through the lead bank. IIFCL may render financial assistance through direct lending to eligible projects or refinance to banks and financial institutions for loans with a tenure of ten years or more.

GOI is working at streamlining. The approval process for PPPs on the lines of its notification. 'Infrastructure' and 'PPP' are being entered as subjects in the Rules of Business Transaction and assigned to one Department for focus. PPP Cells are being created at state level. A Secretary-level officer is to be declared the 'Nodal Officer' for dealing with the subject and coordinate with GOI. Legal and institutional framework is being promoted by working towards an Infrastructure Act. Infrastructure departments are to set own financial targets of attracting private investment through PPP. These will be monitored and reviewed as 'Plan outside of Plan'—as part of the Eleventh Plan. The government will promote finality in government decision-making as revisiting decisions regarding PPP erodes credibility.

The states are urged to extend support to the GOI initiative on database management and website. The Finance Ministry has also begun consulting state governments and central ministries and departments to create a 'shelf of projects' which could be taken up for execution under PPP and VGF schemes. There is a massive scope for expansion of the use of PPPs in nearly every sector. And India is in a position to build on its successes in the transport and communications sectors. The role of PPP, as another way of promoting better services, is not limited to infrastructure. In health, education, and even in poverty reduction programs, there is potential to use this approach.

18.6 PPPs in India

In the 12 states and 3 central agencies surveyed there are at least 86 PPP projects in our sectors of focus for which a contract has been awarded and projects are underway (in the sense that the projects are either operational, have reached construction stage or at least construction/implementation is imminent). The estimated project cost of these PPPs is Rs 339.5 billion. There has been considerable innovation in the design of these, with different structures now being developed to attract private participation. But at the same time it is clear that this has been uneven – there are islands of progress, with some states having undertaken far more PPPs than others, and a much heavier use of PPPs in some sectors (roads by number of projects and ports by project size) than others. While there are a number of successful projects, there have also been a number of poorly conceptualized PPPs brought to the market that stood little chance of reaching financial closure.

Some states have made more attempts to develop a broad framework for PPPs, including cross-cutting legislation and the development of cross-sectoral units that play a role in the identification and preparation of PPPs. While progress to date has probably been driven as much by fundamentals such as political commitment, the lack of a cross-sectoral pool of knowledge makes it harder to transfer experiences across sectors.

Compared to other countries, some of the gaps in PPP frameworks and approaches in India are: the tendency for the policy rationale for PPPs to be limited to the use of PPPs as a source of investment capital when the public sector lacks funds; little systematic compilation and dissemination of information, even within the public sector, on PPPs implemented to date, including contractual approaches and their results; and not much use of rigorous ex-ante or ex-post assessments of the performance of PPPs versus traditional public options.

There is the potential for PPPs to play a greater role in the provision of infrastructure services in India. A number of issues have to be addressed, however, including basic questions such as the extent to which these projects will be paid for by taxpayers or by users, and if so whether the resources are available, and whether it will be possible, commercially and politically, to charge the required user fees. Improving capacities to identify potential PPPs will be critical, to bring them to the market properly structured, have accounts for 48 percent of total project costs due to its four large port projects. NHAI (17%) and MOSRTH (12%) are the other significant players. Karnataka accounts for 7 percent of total project costs given that its one awarded PPP project, the Bangalore-Mysore road corridor (currently under construction) had a reported project cost of Rs 22.5 billion.

In terms of main types of PPP contracts, almost all contracts have been of the BOT/ BOOT type or close variants. While it may be appropriate for central, state or municipal governments to promote PPPs that can be paid for by users if they are priorities, they may be missing out on other opportunities for more efficient private sector service delivery supported by ongoing public payments over time. Some examples of such other types of PPP contracts used to-date in India include the annuity contracts awarded by NHAI for roads, a small number of affermage-type (O&M with private investment) contracts, and a long lease in Maharashtra for the Mumbai-Pune expressway.

Anecdotal comments from the private sector suggest that a considerable number of unbankable and unrealistic PPP projects are brought to the market by state governments.Its nonetheless suggests that there may be significantbenefits from capacity building in identification and preparation of PPPs to ensure that more bankable projects are brought to market. them efficiently and competitively procured, and to monitor their performance and cost.

Both experience to date in India and internationally shows that there is no unique formula for developing a sound PPP framework. However, successful programs are characterized by clear policy and legal frameworks for PPPs, competent and enabled institutions that can appropriately identify, procure and manage PPPs, and efficient oversight and dispute resolution procedures. The center's role in developing capacities for sub-national PPPs needs careful consideration taking into account the size of the country, center-state fiscal and other relations, as well as the variety of experiences so far, with some states having made considerable strides and others having made very little progress.

Oversight of the fiscal costs of PPPs.: Regardless of other actions, if there is to be an increase in the use of PPPs, the center should work to strengthen oversight of the fiscal costs of PPPs. A priority need would be for the development of guidance on how states should approach the issues posed by PPPs. This should be supplemented by enhancing analysis of the fiscal costs of PPPs in central government, including the monitoring of the impact by PPPs on the fiscal position of the states. Capacity-building efforts should be led by the Government of India (GoI) Finance Ministry, with involvement from the Reserve Bank of India (RBI) as necessary.

Policy rationale : A policy statement covering both the rationale and also the limits to the use of PPPs would help to give the PPP program a clear political mandate and could also be used to announce more clearly the institutional framework for PPPs. These would be useful at both the national and state level. While broad policies provide an important signal of political commitment, it may also be necessary to translate this into action plans and policies for individual sectors to provide a more precise orientation to encourage line ministries and agencies to pursue and implement PPP programs.

Legal frameworks : Cross-cutting PPP laws do not seem to be needed in India to permit central or state governments to enter into PPPs. Both the center and many states have done so without such laws. Sector specific legislation has of course been used to restructure industries and set up new institutions such as sector regulators. Cross-cutting legislation could however be beneficial by consolidating relevant legal provisions into one law, and legislating the use of certain processes for the procurement, development and regulation of PPP projects which may be better enforced if given the force of law. This might be more important at the state level, where checks and balances and oversight are not as strong as at the center. The legislation already passed by Gujarat, Andhra Pradesh and Punjab provides possible models for other states. The development and passage of legislation also promotes an open debate about the rationale for PPPs and their expected benefits, and thereby can help increase the public legitimacy of PPPs.

Information dissemination and guidance materials: Despite the fact that there are nearly 90 PPPs in India under construction and operation, there is no publicly accessible database providing even the most straightforward information on them.There is also relatively little available in terms of information on the actual contracts used, and little guidance available to government officers on appropriate clauses and conditions to be included in PPP contracts. A number of practitioners in PPPs in India have argued that the lack of standard contracts or standard clauses makes bureaucrats more reluctant to sign off on PPP deals.

There is considerable scope for improving the flow of information regarding PPPs and for providing guidance materials to government officials on the development and implementation of PPPs. Guidance could cover issues related to contract design, procedures for identifying, procuring and managing PPPs, and even model PPP legislation.could cover issues related to contract design, procedures for identifying, procuring and managing PPPs, and even model PPP legislation.

Information dissemination could cover a publicly-accessible database on PPPs at the national, state and local levels; training materials as well as workshops and other mechanisms to reach politicians, consumers and other stakeholders, so that they are better informed about the nature and structure of PPPs. Information on PPPs could be extended to analysis of successes and failures, case studies and a database on performance of projects.

Information dissemination and guidance should be led from the center, given the public good nature of these activities. A single central ministry with crosscutting responsibilities could take the lead in this. Specialized tasks would be contracted out and done by others under the oversight of this unit – for example the development and delivery of training materials would be undertaken by a specialized training institute.

Standardization and models have the potential to reduce transactions costs and diffuse good practices. There is however a risk that centrally sponsored model contracts could reduce the needed room for flexibility and innovation even where these models are advisory and not mandatory. This risk could be reduced by having guidance provide a range of options where appropriate and also by being guided by a public private group containing representatives from state as well as central agencies.

A national PPP unit:- Most countries engaged in a broad-based PPP program have felt the need to develop a cross-sectoral PPP unit although the role that this unit plays is sometimes restricted to information dissemination and the preparation of guidance material. The design response to two key issues – the role of a cross-sectoral unit vis-à-vis line ministries and the role of a national unit in sub-national PPPs – will be driven by the business practices within governments and the fiscal, and other, relations between the center and the states. This means that some models which are more centralized, such as those in theUK and South Africa where national level units have a prominent role in sub-national PPPs, will not be workable approaches in India.

At the state level, a dedicated PPP unit can both broaden the PPP program by transferring lessons and experiences across sectors, as well as improve the quality of PPPs by bringing to bear better transactions skills. Particularly where there is not a track record of PPPs, skills are probably best brought in from the private sector to supplement available capacities in the state government.

At the national level, a PPP unit could undertake the information dissemination and guidance roles described above. It could also undertake a transaction advisory role by identifying areas where PPPs could beundertaken by central agencies and ministries, and working with these agencies toconceptualize and bring to themarket individual PPPs. However, this role would not be well-suited for sub-national PPPs. A hands-on transaction role in state and municipal PPPs would directly substitute for the development of state-level capacity and would be challenging to do for a large number of deals. Capacities should be developed at the state level, strengthened by the guidance and information provided by the national level unit.

A national level unit undertaking information dissemination, guidance and transactions support to central agencies could be established as a unit within a ministry or agency with cross-cutting functions. This would allow it to be integrated into existing governmental processes of review, and needed transactions skills could be contracted in by hiring consultants on long-term contracts. If the center were to provide additional funding for PPPs then the national unit could take on the additional mandate of reviewing these PPPs to assess whether the contractual structure proposed is robust, that risks are efficiently allocated and that projects to be supported by the center are sound. The unit would need to provide clear guidance on what it viewed as being acceptable contract structures, approaches to risk allocation, assessment of affordability and value-for-money, and provider selection criteria.

Additional resources for PPPs.:- A catalytic role by the center is likely to be needed to expand the usage of PPPs, particularly in states and sectors where they have been less used so far. This would consist, in addition to information dissemination and guidance, of financial resources both to develop PPP frameworks and contracts and to fund government commitments under PPPs. This would help address important constraints to further development of PPPs in the country – namely, weak capacities to identify realistic PPPs and bring them to the market; a lack of willingness to pay for project development; and a lack of creditworthiness on the part of states to provide their financial contribution to PPPs.

A number of PPP units manage funds which defray some of the costs of developing PPPs. There are two arguments for the use of these funds. The first is that many governments new to PPPs do not appreciate the need to spend more on preparation of PPP projects than was spent on developing procurement documents for civil works projects in the same sector. The second is that since PPPs are relatively new, the costs of preparing initial projects may be higher and that with learning some of these will come down. One important issue is the terms on which this fund would be accessed – a matching grant scheme which combines central grant funding with contributions from the state government provides some form of commitment by both parties and can focus resources on projects viewed as priorities by the state government.

The use of PPPs for the delivery of basic services by state and municipal governments would be encouraged by the provision of central funds to support their payments under PPPs. A substantial matching contribution from the government contracting for the PPP would also be important here to provide commitment to the project.

The detailed design of such a PPP fund is beyond the scope of this report and a significant effort would have to go into this to ensure that it is well targeted and efficiently used. It would be important both to ensure that projects supported by the fund are priorities, and that competition for subsidies is used to reduce the demands on public funds. On this last point, it would be far more difficult to size subsidies – and also less transparent – were projects first awarded by state governments and then subsequently the chosen developers approached the fund for support.

As noted above, project design, risk allocation, affordability and value-for-money should also be assessed for these projects to ensure that the center is supporting well-designed PPPs and this could be done by the national PPP unit. There might however be conflict of interest concerns if this unit received a success fee from working on transactions, in which case the involvement of others would be necessary in clearances.

18.7 PPPs in India: Islands of Progress

There is now over 10 years of experience in India in the development and use of PPPs for delivering infrastructure services. Policies in favor of attracting private participation have met with varying degrees of success, but real progress has been made in some sectors, first in telecommunications, and now in ports and roads, and with individual projects in other sectors. There has been considerable innovation with different structures now being developed to attract private participation. But at the same time progress has been such use uneven: there are islands of progress, with some states having undertaken far more PPPs than others, and a much heavier use of PPPs in some sectors than others.

There are a number of successful projects to the present date, there have also been a number of poorly conceptualized PPPs brought to the market that stood little chance of reaching financial closure. In terms of frameworks for PPPs, some states have made more attempts to develop this, including cross-cutting legislation and the development of cross-sectoral units that play a role in the identification and preparation of PPPs. Others however have worked within the bounds of their existing organizational structure.

Lack of existing database on PPPs in India, a survey was undertaken both to provide information on the current usage of PPPs as well as the frameworks developed for their implementation. The main sectors of focus are the basic public services excluding power: transportation (ports, airports, roads, and rail), water and sanitation, and other urban infrastructure (solid waste management, light rail, bus terminals). This represents the present areas of focus of many state governments in India. The survey covered 12 states regarded to have been most active in the development of PPPs, as well as the 3 central agencies undertaking PPPs in the areas of focus. The survey also provides some indication of the possible pipeline of PPP projects in India.

Across states and central agencies, the leading users of PPPs by number of projects have been Madhya

Pradesh and Maharashtra, with 21 and 14 awarded projects respectively, all in the roads sector, and the National Highways Authority of India (NHAI), with 16 projects. The other states or central agencies that have been important users of PPPs are Gujarat (9 projects) and Tamil Nadu (7), Karnataka (4) and Ministry of Shipping, Road Transport and Highways (MOSRTH) (4). However, looking at a breakdown by estimated project size, we see that MP becomes significantly less prominent due to the large number of relatively small-sized projects in its portfolio, falling to 3 percent of total project costs. Gujarat accounts for 48 percent of total project costs due to its four large port projects. NHAI (17%) and MOSRTH (12%) are the other significant players. Karnataka accounts for 7 percent of total project costs given that its one awarded PPP project, the Bangalore-Mysore road corridor (currently under construction) had a reported project cost of Rs 22.5 billion.

18.8 Institutional Framework for PPPs in India

A wide range of institutional structures and capacity approaches have been adopted for conceptualizing and procuring PPPs across states and central agencies, different variants of which have had some degree of success. At the state level, the three main approaches have been: (1) combining dedicated institutions with cross-cutting legislation; (2) establishing and using cross-sectoral PPP advisory units to help line departments in the absence of overarching legislation; and (3) relying on line departments and sectoral agencies to build capacities. Table 2 provides a summary of state-level approaches.

Gujarat, AP and Punjab have developed specialized institutions and legislation. Each of these states has constituted an agency (respectively the Gujarat Infrastructure Development Board, the AP Infrastructure Authority and the Punjab Infrastructure Development Board) and passed acts to promote private sector participation in infrastructure projects across sectors. As an illustration, the Gujarat Infrastructure Development Act, 1999, gives force of law to the provision of entering into a concession agreement with a private sector developer, provides transparent procedures for selection of the developer, and provides for levying user charges for the facilities provided by the developer.

A second category of states, including Karnataka, Rajasthan, Uttaranchal and West Bengal, have developed cross-sectoral facilitation entities, but have not passed comprehensive legislation. In Karnataka, the Infrastructure Development Corporation of Karnataka (iDeCK) is a joint venture between the state government and IDFC modeled on Partnerships UK, providing advisory services such as enabling frameworks, project development and structuring, and management of a Project Investment Fund. The Rajasthan Project Development Corporation (PDCOR) is similar in structure, a joint venture between the state government and IL&FS to facilitate private investment in infrastructure, including policy advisory services to the state government, and institutional support to structure and implement PPPs. The ICICI – West Bengal Infrastructure Development Corporation Limited (IWIN) is a joint venture between ICICI Bank Group and Government of West Bengal formed with the objective of accelerating the development of infrastructure.

A third category of states, including MP, Maharashtra and Tamil Nadu, have relied on sectoral and line agencies to develop and implement PPPs. In Madhya Pradesh (MP), for example, initially the MP Public Works Department (PMMWD) and then the specially-created MP Road Development Corporation (MPRDC) act as the agency for development of road projects on a BOT basis. In the process of developing projects, MPRDC has developed policy, guidance materials and skills. In Maharashtra, the State Road Development Corporation (MSRDC) and Mumbai Metropolitan Region Development Authority (MMRDA) have developed policies for infrastructure development through private sector participation, including a “Policy on implementation of Road & Bridge Projects through private sector participation”.

At the central level, the NHAI has developed and modified standard concession agreements, and has developed different approaches for extending government financial support for PPPs. The capacity building measures under way at NHAI focus on improving human resources, financial systems, bid process management and include internal training, study tours and the development of a robust MIS system. However, it is understood that a number of personnel are on deputation and they leave once their tenure is over. Though this is not an unusual situation for public agencies, it does of course lead to a loss of expertise and knowledge. For the rail sector, a special purpose vehicle called Rail Vikas Nigam Limited (RVNL) has been floated to develop, mobilize resources and implement PPPs. There are no obvious structures in place at the central level to transfer expertise and knowledge built up in one agency – for example NHAI – to a second that is just embarking on PPPs.

There is no clear link between institutional structures and success in developing PPPs in India. It would seem clear from the experience of MP and Maharashtra in the development of PPPs for roads that it is possible to develop a PPP program in a single sector by building up capacities in line departments. Gujarat, AP and Punjab have all developed cross-sectoral enabling legislation and dedicated agencies but have had very different track records in terms of taking PPPs successfully to the market. Some other states – such as Tamil Nadu – have also developed a few PPPs across a wide range of sectors, without explicit cross-sectoral PPP units or legislation.

Fundamentals such as political commitment towards the use of PPPs, sufficient trained India: Building Capacities for Public Private Partnerships staff, and strong links between built-up capacity and implementation responsibility in the respective line departments are probably the most important ingredients of success.

18.9 Gaps

While some states in India have made important progress towards developing the frameworks needed for broad and robust PPP programs, others have developed policies and approaches in a single sector only, and most other states are yet to seriously commence PPP programs. As a result, there is considerable diversity in both the strength of policy and legal frameworks in place, and the level of transactions capacities and experiences.

Even taking this diversity into account, there are some common areas where frameworks in India need to be developed. As noted earlier, the policy rationale for PPPs is often limited to the use of PPPs as a source of investment capital when the public sector lacks funds. As a result, there is not much championing of PPPs on the grounds that they will lead to more efficient service delivery and better value for consumers and taxpayers. There is limited systematic compilation, analysis and transfer with in the public sector of knowledge and experiences between PPP projects, sectors and different governments; to the extent that there is a lack of confidence in civil servants to undertake PPPs, greater awareness of good examples and established procedures can help make it more acceptable to follow, with the best antidote to inaction being precedence. Capacities for evaluation and oversight in particular need to be built up: there is little evidence so far that there has been much progress in developing capacities to decide which projects are best done through PPPs, and ex-post evaluation of the performance of PPPs versus expectations has been limited so far. Finally, the processes for identifying and procuring PPPs are often not clearly laid out.

Nonetheless it is important that the right frameworks and capacities are further developed in the states and agencies where PPP programs are going to be pursued.

18.10 Funding of PPPs

The use of PPPs for the delivery of basic services by state and municipal governments would be stimulated by the provision of central funds to support their payments under PPPs. Any additional funding of PPPs should be complemented by a more rapid development of capacities to monitor the fiscal costs of PPPs.

The detailed design of such a PPP fund, including the type of support, project eligibility criteria, selection mechanism and how the quantum of support for a project is determined is beyond the scope of this report. A significant effort would have to go into this to ensure that it is well targeted and efficiently used.There is considerable experience internationally with the use of subsidy funds for the expansion of infrastructure services such as telecommunications and power, where government funds complement user fees.

A fund that spans different sectors and also allows for different structures (for example where governments are the sole purchasers of PPPs under contracts rather than government funds being used to supplement user fees) would be more challenging to implement. Consultation with lenders, sponsors and state governments will be an important step in improving the design whilst at the same time ensuring that key central government concerns are met.

It will be important to ensure that projects supported by the fund are priorities for the contracting governments. A substantial matching contribution from the state/municipal government contracting for the PPP would be important to provide commitment to the project and indicate that the project was a priority. It would however be important to clarify what, out of different possible forms of government support (e.g. land grants, tax breaks, risk-bearing, cash subsidies), would represent a matching contribution.

It will be equally important to ensure that competition is used to reduce the demands for public funds. It would be far more difficult to size subsidies – and also less transparent – were projects first awarded by state governments on the basis of particular criteria and then subsequently developers approached the fund for support. Otherwise a promoter could “low-ball” on the tariffs for a project to succeed in getting a project awarded, and then access monies from the PPP fund to make up the difference.

Project design, risk allocation, affordability and value-for-money should also be assessed for these projects to ensure that the center is supporting well-designed PPPs, as noted above. This could be done by the central PPP unit – though there might be conflict of interest concerns if this unit received a success fee from working on transactions, in which case the involvement of others would be necessary in clearances.

18.11 Recommendations

There are a number of steps the center can take to expand the role that PPPs play in basic service delivery at both the national, state and municipal levels. The main components of a strategy to catalyze the broader use of PPPs would be:

- A clearly articulated policy statement on the use of PPPs at the national level, including their rationales and the benefits expected, backed up by concrete plans Developing and Strengthening Capacities for PPPs in India and targets for increasing the use of PPPs in national programs.
- The creation of a national level PPP unit that would undertake information dissemination and guidance functions as discussed above, and provide advisory support to the central PPP program;
- A project development fund to reduce the transactions costs to state and local governments of preparing and bidding out PPPs; and
- A fund to partly cover the cost of state and local government commitments under PPP contracts.

The primary responsibility for developing state and municipal level PPPs lies at those levels of government. The actions outlined above can encourage the development of capacities and PPP programs at subnational levels, but should not substitute for needed actions by the governments contracting for these PPPs.Perhaps most importantly, the scale and quality of the national PPP program provides a model for state and local governments. This includes not just the transactions themselves, but also commitments to disclosure of agreements and transparency and also the regular ex-post review of PPPs to assess whether the hoped-for benefits had been realized in practice.

It could also provide transactions expertise to a limited set of projects by buying-in expertise from the private sector on long-term consulting contracts. However, a broader transactions role across a range of central agencies and ministries and in particular developing sub national PPPs will require more human resources. Were these activities to be pursued on a larger scale then this might better be done through a separate authority or company than a unit within an existing ministry or agency. Regardless of whether or not the steps outlined are undertaken, the center should work through existing approaches to improve the monitoring of the fiscal costs of PPPs entered into by central agencies and state governments.

18.12 Summary

The main feature of PPPs is that the private sector invests in infrastructure and provides related services to the government. It specifies the services the private sector has to deliver and to what standards. Payment depends on private partner meeting these standards. However, PPPs are increasingly being used in social infrastructure such as hospitals and schools.

18.13 Key Words

- **Public Private Partnership** – it means an arrangement between a government/statutory entity/ govt. owned entity on one side and a private sector entity on the other side.
- **Build-own-operate-** it is a model normally not supported from of public private partnership in view of the finite resources of the govt.
- **EPC-** Engineering Procurement construction.

18.14 Self Assessment Test

1 Define the PPP. Explain the process of Public Private Partnership.

2 Describe the issues of PPP.

3 Describe the Govt. policy towards PPP.

4 Discuss the Role of PPP in development of country specially in infra-structure sector.

5. What do you understand by Public private partnership? Explain it with the help of examples.

6. What is the government policy towards PPP.

7. Discuss the steps isses of PPP.

8. Explain the steps involved in PPP.