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Programme: Bachelor of Commerce

Course: Indian Economy

Course Code: BCPG102

Semester-I

SYLLABUS

OBJECTIVE AND EXPECTED OUTCOME OF THE COURSE:

The objective of this paper is to acquaint the students with the ability to understand the features and issues of Indian Economy.

UNIT I

Structure of Indian Economy: Features & evaluation of capitalism and socialism. Nature of Indian Economy, occupational distribution of labour force; Poverty and Income distribution in India, Problems of unemployment and Rising prices. Parallel economy in India. **Human Resources:** Demographic features of Indian population, size and growth of population and economic development. Problem of over population, Population policy in India.

UNIT II

Economic Planning: Importance of planning for Economic development. Salient features of India's five years plans priorities-target achievements, failure, factors affecting successful implementations of plans. **Industries:** Growth and problems of major industries-Iron and Steel, Cotton Textiles, Cement, Sugar and Petroleum. Industrial policy. Cottage and small scale industries; Public sector in India. Disinvestment and Divestment of public sector undertakings in India. Current Industrial Policy.

UNIT III

Basic Issues in Agriculture: Role, nature and cropping pattern; Trends in agricultural production and productivity; Factors determining productivity; Agricultural finance and Agricultural price policy. Rural indebtedness. Techniques and Methods of irrigation in India. Role of NABARD in rural development in India. **Indian Public Finance:** Indian Finance System. Taxation structure, mobilization of resources for development, Taxation and fiscal policy.

UNIT IV

External Sector: India's foreign trade- features, composition and direction; India's balance of payments problem; Indian trade policy; foreign capital, foreign aid, multinational corporations (MNCs); FERA and FEMA. **Forex Market:** Methods of measuring exchange rate. Determinants of exchange rate. Currency depreciation and devaluation. Nature of Indian forex market.

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CHAPTER 1
STRUCTURE OF INDIAN ECONOMY

1.1 Objectives

After reading this lesson, you should be able:

1. To summarise the basic concept of capitalism and socialism.
2. To bring out the essence of nature of Indian economy.
3. To analyse the occupational distribution of labour force in India.
4. To assess the poverty and income distribution in India.

1.2 Introduction

An economic system consists of the institutions and the method by which resources are allocated and products and services are distributed. Economic systems differ primarily in who owns the factors of production, how the allocation of resources is directed and the method used to direct economic activity. The primary distinction between the different systems is the degree to which the government participates in the economy. The two major economic systems in modern societies are capitalism and socialism. In practice, no one society is purely capitalist or socialist, so it is helpful to think of capitalism and socialism as lying on opposite ends of a continuum. For example, the United States is a capitalist nation, but the government still regulates many industries to varying degrees. The industries usually would prefer less regulation, while their critics usually prefer more regulation. The degree of such regulation was the point of controversy after the failure of banks and other financial institutions in 2008 and 2009 and after the BP oil spill in 2010.

1.3 Capitalism : Its Features And Evaluation

A capitalist economy is an economic system in which the production and distribution of commodities take place through the mechanism of free markets. Hence it is also called as market economy or free trade economy. Each individual be it a producer, consumer or resource owner has considerable economic freedom. An individual has the freedom to buy and sell any number of goods and services and to choose any occupation. Thus a market economy has no central coordinator guiding its operation. But self-organization emerges amidst the functioning of market forces namely supply, demand and price.

1.4 The salient features of capitalism

- **Right to Private Property**: Individuals have the right to buy and own property. There is no limit and they can own any amount of property. They also have legal rights to use their property in any way they like.

- **Profit-Motive:** Profit is the only motive for the functioning of capitalism. Production decisions involving high risks are taken by individual only to earn large profits. Hence, profit-motive is the basic force that drives the capitalist economy.

- **Freedom of Choice:** The question 'what to produce?' will be determined by the producers. They have the freedom to decide. The factors of production can also be employed anywhere freely to get due prices for their services. Similarly consumers have the freedom to buy anything they want.

- **Market Forces:** Market forces like demand, supply and price are the signals to direct the system. Most of the economic activities are centered on price mechanism. Production, consumption and distribution questions are expected to be solved by market forces

- **Minimal role of Government:** As most of the basic economic problems are expected to be solved by market forces, the government has minimal role in the economy. Their role will be limited to some important functions. They include regulation of market, defence, foreign policy, currency, etc.

1.5 Merits of Capitalist Economy

- **Increase in productivity**: In a capitalist economy every farmer, trader or industrialist can hold property and use it in any way he likes. He increases the productivity to meet his own self-interest. This in turn leads to increase in income, saving and investment.

- **Maximizes the Welfare:** It is claimed that there is efficiency in production and resource use without any plan. The self-interest of individual also promotes society's welfare.

- **Flexible System:** The shortages and surpluses in the economy are generally adjusted by the forces of demand and supply. Thus it operates automatically through the price mechanism.

- **Non-interference of the State:** The State has a minimum role to play. There is no conflict between the individual interest and the society. The economic institutions function automatically preventing the interference of the government.

- **Low cost and qualitative products:** The consumers and producers have full freedom and therefore it leads to production of quality products at low costs and prices.

- **Technological improvement:** The element of competition under capitalism drives the producers to innovate something new to boost the sales and thereby bring about progress.

1.6 Disadvantages of Capitalist Economy

- **Inequalities:** Capitalism creates extreme inequalities in income and wealth. The producers, landlords, traders reap huge profits and accumulate wealth. Thus the rich become richer and the poor poorer. The poor with limited means are unable to compete with the rich. Thus capitalism widens the gap between the rich and the poor creating inequality.

- **Leads to Monopoly:** Inequality leads to monopoly. Mega corporate units replace smaller units of production. Firms combine to form cartels, trusts and in this process bring about reduction in number of firms engaged in production. They ultimately emerge as multinational corporations (MNCs) or transnational corporations (TNCs). They often hike prices against the welfare of consumer.

- **Depression:** There is over-production of goods due to heavy competition. The rich exploit the poor. The poor are not able to take advantage of the production and hence are exploited. At another level, over-production leads to glut in the market and hence depression. This leads to economic instabilities.

- **Mechanisation and Automation:** Capitalism encourages mechanization and automation. This will result in unemployment particularly in labour surplus economies.

- **Welfare ignored:** Under capitalism, private enterprises produce luxury goods which give higher profits and ignore the basic goods required which give less profit. Thus the welfare of public is ignored.

- **Exploitation of Labour:** Stringent labour laws are enacted for the exclusive profit-motive of capitalists. Fire and hire policy will become the order of the day. Such laws also help to exploit the labour by keeping their wage rate at its lowest minimum.

- **Basic social needs are ignored:**–There are many basic social sectors like literacy, public health, poverty, drinking water, social welfare, and social security. As the profit margin in these sectors is low, capitalists will not invest. Hence most of these vital human issues will be ignored in a capitalist system.

1.7 Socialism: Its Features and Evaluation

According to H. D. Dickinson, "Socialism is an economic organisation of society in which the material means of production are owned by the whole community and operated by organs representative of and responsible to the community according to a general economic plan, all members of the community being entitled to benefit from the results of such socialized planned production on the basis of equal rights."

A socialist economy is an economic organisation in which the means of production are owned and regulated by the state. The production and distribution of goods and factors of production are done by the state under the direction of the planning commission. The decisions as to how much to produce, which methods of production to employ and for whom to produce, are taken by the planning authority. That is why a socialist economy is also called a planned economy. Such economies are China, Cuba, Vietnam, and North Korea. They possess the following common features.

1.7.1 Features of Socialism:

The main features of this system are detailed below.

(1) Public Ownership:

A socialist economy is characterised by public ownership of the means of production and distribution. There is collective ownership whereby all mines, farms, factories, financial institutions, distributing agencies (internal and external trade, shops, stores, etc.), means of transport and communications, etc. are owned, controlled, and regulated by government departments and state corporations. A small private sector also exists in the

form of small business units which are carried on in the villages by local artisans for local consumption.

(2) Central Planning:

A socialist economy is centrally planned which functions under the direction of a central planning authority. It lays down the various objectives and targets to be achieved during the plan period. Central economic planning means "the making of major economic decisions—what and how much is to be produced, how, when and where it is to be produced, and to whom it is to be allocated—by the conscious decision of a determinate authority, on the basis of a comprehensive survey of the economic system as a whole."

And the central planning authority organises and utilises the economic resources by deliberate direction and control of the economy for the purpose of achieving definite objectives and targets laid down in the plan during a specified period of time.

(3) Definite Objectives:

A socialist economy operates within definite socio-economic objectives. These objectives "may concern aggregate demand, full employment, satisfaction of communal demand, allocation of factors of production, distribution of the national income, the amount of capital accumulation, economic development…and so forth." For achieving the various objectives laid down in the plan, priorities and bold targets are fixed covering all aspects of the economy.

(4) Freedom of Consumption:

Under socialism, consumers' sovereignty implies that production in state- owned industries is generally governed by the preferences of consumers, and the available commodities are distributed to the consumers at fixed prices through the state-run department stores. Consumers' sovereignty under socialism is confined to the choice of socially useful commodities.

(5) Equality of Income Distribution:

In a socialist economy, there is great equality of income distribution as compared with a free market economy. The elimination of private ownership in the means of production, private capital accumulation, and profit motive under socialism prevent the amassing of large wealth in the hands of a few rich persons. The unearned incomes in the form of rent, interest and profit go to the state which utilises them in providing free education,

public health facilities, and social security to the masses. "As far as wages and salaries are concerned, most modern socialists do not aim at complete and rigid equality. It is now generally understood that the maintenance offered choice of occupation implies wage differentials."

(6) Planning and the Pricing Process:

The pricing process under socialism does not operate freely but works under the control and regulation of the central planning authority. There are administered prices which are fixed by the central planning authority. There are also the market prices at which consumer goods are sold. There are also the accountings prices on the basis of which the managers decide about the production of consumer goods and investment goods, and also about the choice of production methods.

1.7.1.1 Merits of Socialism:

- Prof. Schumpeter has advanced four arguments in favour of socialism: one. greater economic efficiency; two, welfare due to less inequality; three, absence of monopolistic practices; and four, absence of business fluctuations. We discuss these merits of socialism one by one.

(1) Greater Economic Efficiency:

Economic efficiency under socialism is greater than under capitalism. The means of production are controlled and regulated by the central planning authority towards chosen ends. The central planning authority makes an exhaustive survey of resources and utilises them in the most efficient manner.

Increased productivity is secured by avoiding the wastes of competition and by undertaking expensive research and production processes in a coordinated manner. Economic efficiency is also achieved by utilising resources in producing socially useful goods and services which satisfy the basic wants of the people, like cheap food, cloth, and housing.

(2) Greater Welfare due to Less Inequality of Income:

In a socialist economy there is less inequality of income as compared with a capitalist economy because of the absence of private ownership of the means of production, private capital accumulation, and private profit. All citizens work for the welfare of the state and each is paid his remuneration according to his ability, education and training. All rents,

interests and profits from various sources go to the state which spends them for public welfare in providing free education, cheap and congenial housing, free public health amenities, and social security to the people.

(3) Absence of Monopolistic Practices:

Another advantage of socialism is that it is free from monopolistic practices to be found in a capitalist society. Since under socialism all means of production are owned by the state, both competition and monopoly are eliminated. The exploitation by the monopolistic is absent. Instead of private monopoly, there is the state monopoly of the productive system but this is operated for the welfare of the people. In the state-owned factories, socially useful commodities are produced which are of high quality and are also reasonably priced.

(4) Absence of Business Fluctuations:

A socialist economy is free from business fluctuations. There is economic stability because production and consumption of goods and services are regulated by the central planning authority in accordance with the objectives, targets and priorities of the plan. Thus there is neither overproduction nor unemployment.

1.7.1.2 Demerits of Socialism:

A socialist economy has also certain disadvantages:

1. Loss of Consumers' Sovereignty:

There is loss of consumers' sovereignty in a socialist economy. Consumers do not have the freedom to buy whatever commodities they want. They can consume only those commodities which are available in department stores. Often the quantities which they can buy are fixed by the state.

2. No Freedom of Occupation:

There is also no freedom of occupation in such a society. Every person is provided job by the state. But he cannot leave or change it. Even the place of work is allotted by the state. All occupational movements are sanctioned by the state.

3. Malallocation of Resources:

Under socialism, there is arbitrary allocation of resources. The central planning authority often commits mistakes in resource allocation because the entire work is done on trial and error basis.

4. Bureaucratic:A socialist economy is said to be a bureaucratic economy. It is operated like a machine. So it does not provide the necessary initiative to the people to work hard. People work due to the fear of higher authorities and not for any personal gain or self-interest.

There is no doubt that a socialist economy is better than a capitalist economy because of its overwhelming merits. But it is disliked for the loss of political, economic and personal freedoms.

1.8 The Nature of Indian Economy

THE World Bank in its World Development Report (2002) classified the various countries on the basis of per capita Gross National Product. Developing countries are classified into:

- ***Low Income Countries:*** These economies have a very low level of per capita income. All economies having a per capita GNP of $ 1035 or less(in 2012) are considered as low income countries.
- ***Middle Income Countries:*** These economies are further sub-divided into lower middle income economies having , $1,036 - $4,085 (in 2012) and upper middle income economies having a per capita GNP between $4,086 - $12,615(in 2012)
- ***High Income Countries:*** These are countries having a per capita GNP of ,$12,616 or more.

Classification on the basis of Development

Developing or under-developed Economies: Low and middle income countries are usually regarded as Developing or under-developed countries;

Developed Economies: High income countries are considered as developed economies. But this may not always be true. Countries like Kuwait, Iran, UAE etc. fall in high-income countries but are considered as developing countries.

Transition Economies: These are former centralized/ socialist economies, which are moving to market economies such as Russia, China, eastern European nations, and India. These transition economies are very big in size in every respect. As they are the largest markets in terms of Purchasing Power Parity(PPP), they are the cheapest manufacturing and services hub, and have substantial and, in few cases, the largest natural resources. From the angles of both demand and supply, they are very rich and will be the playground for all global organizations in the coming era.

According to data given in the World Development Report 2002, in 2000, Low Income Countries accounted for 40.6 per cent of the world population but contributed only 10.9 per cent to total World GNP. The Middle Income Countries constituted 44.4 per cent of world population but accounted for 34.2 per cent of World GNP. These two groups, popularly described as developing economies or underdeveloped economies, comprise about 85 per cent of the world population but account for only 45 per cent of world GNP. Most countries of Asia, Africa, Latin America and some countries of Europe are included in them.

The declared social objective of the Indian development strategy since Independence has been growth with equitable distribution. This was sought to be achieved within the democratic political framework. The problem was of reconciling growth with equity in a democratic framework. This necessitated the adoption of mixed economy as an institutional form to reconcile the objectives of growth with equitable distribution in a democratic framework.

The second five year stated categorically, "The task before an underdeveloped country is not merely to get better results within the existing framework of economic and social institutions but to mould and refashion these so that they contribute effectively to the realisation of wider and deeper social values".

These values or basic objectives have been summed up in the phrase "socialist pattern of society" (Second Plan). Essentially, this means that the basic criterion for determining the lines of advance must not be private profit but social gain, and that the pattern of development and the structure of socio-economic relations should be so planned that they result not only in appreciable increases in national income and employment but also in greater equality in incomes and wealth.

Major decisions regarding production, distribution, consumption and investment - and in fact all significant socio-economic relationships - must be made by agencies informed by social purpose. The benefits of economic development must accrue more and more to the relatively less privileged classes of society, and there should be a progressive reduction of the concentration of incomes, wealth and economic power.

For creating the appropriate conditions, the State has to take on heavy responsibilities as the principal agency speaking for and acting on behalf of the community as a whole. The public sector has to expand rapidly.

It has not only to initiate developments which the private sector is either unwilling or unable to undertake; it has to play the dominant role in shaping the entire pattern of investments in the economy, whether it makes the investments directly or whether these are made by the private sector. The private sector has to play its part within the framework of the comprehensive plan accepted by the community.

Public ownership, partial or complete, and public control or participation in management are specially required in those fields in which technological considerations tend towards a concentration of economic power and of wealth. In several fields, private enterprise can make little headway without assistance and support from Government.

1.8.1.1 Indian Economy-Underdeveloped:

On the eve of independence, Indian economy was underdeveloped economy. As an underdeveloped economy, Indian economy had the following features:

(i) Low Per Capita Income:

Underdeveloped economies have low per capita income. India has no exception to it. In 1947-48, per capita income was Rs. 230. People were poor. They were not getting fair square meals a day. They had no shelter and clothing. Most of the people were unemployed.

(ii) Poor Infrastructure:

On the eve of independence infrastructural development which comprised of communication and transport and electricity etc. was very poor. In 1948, power generation capacity was nearly 2100 MW; length of railway lines was 53,596 Kms.

(iii) Dependence on Imports:

The country had to heavily depend on imports. Armed forces of the country also depended on foreign imports. Moreover, several consumer goods like sewing machines, medicines, oil, bicycles etc. were imported from abroad.

(iv) Illiteracy:

Illiteracy was both cause and effect of poverty. Due to illiteracy, people were unable to use new techniques in agriculture and industry. They were unable to organize trade and commerce on modern lines. In 1948, rate of illiteracy was 18 per cent. Thus 82 per cent of the population was illiterate.

(v) Agricultural economy:

Indian economy was predominantly agricultural. In 1948, about 70 per cent population was engaged in agriculture. Moreover, agriculture constituted 50 per cent of national income. But agriculture itself was backward. Regarding productivity, it was 110 kg/hectare for rice in 1947 as against 748 kg in Japan.

(vi) Low Development of Industries:

There was very little development of industries. Large industries used to produce consumer goods. Basic and key industries were very less in number. In 1947, cement production was 26 lakh tonnes, of sugar 10 lakh tonnes and that of cloth just 421 crore meter.

1.8.1.2 . *Stagnant Economy:*

During the British period, Indian economy remained almost stagnant. There was very slow growth of economy. This was clear from the fact that for almost a century, the average annual growth rate of per capita income in India was not more than 0.5 per cent.

The high growth rate of population tended to make it difficult to maintain even the proposed growth rate. In fact poverty was widespread and about 40 per cent people were living below poverty line. The causes of stagnation and backwardness are laissez faire, commercialization of agriculture, neglect of irrigation, destruction of cottage and handicraft and economic drainage and discriminatory tariff policy.

1.8.1.3 . *Semi-Feudal Economy:*

During the British rule, Indian economy had a mixed mode of production. Feudalism was more prominent than other modes of production.

A substantial developed capitalistic sector had emerged. Handicraftsmen had lost their independent status and were engaged in a simple commodity production. Bonded labour force was prevalent in agriculture. Primitive social organizations existed in areas inhabited by the tribals.

1.8.1.4 . *Depreciated Economy:*

On the eve of Independence Indian economy was depreciated. In every economy, extensive use of factors of production, inevitably leads to their wear and tear. If no arrangements are made to replace the depreciated factors then the stock of gross capital declines.

This results into the fall in production capacity. Such an economy is called depreciated economy. After World War II Indian economy also turned into depreciated economy.

During World War II India had supplied large quantity of goods to Britishers. India was paid for it in terms of sterling. But due to lack of real capital, its production capacity declined.

1.8.1.5 . *Pre-dominance of Agriculture:*

Agriculture is the main sector of Indian economy, which is in total contrast to the economic structure of a developed economy. More than 70 per cent of the total population is engaged in agricultural activities while the picture is absolutely different in advanced countries.

According to Dr. Cloustone, "India has depressed classes, the tool has depressed industries and unfortunately, agriculture is one of them" Therefore, the essence of Indian economy is an agrarian economy.

1.8.1.6 . *Underutilized Natural Resources:*

It has been rightly stated that India is a rich country inhabited by poor people. It means that the country possesses abundant stock of natural resources but the problem is that these resources are not fully utilized for the production of material goods and services. The result is poverty of the people. The vicious circle of poverty moves for year to year together.

1.8.1.7 . *Heavy Population Pressure:*

Population is a major factor influencing the nature of a country's economy. Over-population creates complex economic problems.

The income per capita is low, the efficiency of labour is not satisfactory and there is an acute housing shortage. Unemployment and low standard of living dominate the scene. In India, the rate of growth of population was about 1.25per annum during 1941-51.

1.8.1.8 . *Capital Deficiency:*

Deficiency of capital is another basic characteristic of Indian economy. In case of physical capital, its total stock is not adequate for equipping well to the entire labour force and full utilization of natural resources.

Similarly, human capital is far from satisfaction. The major reasons of low level of capital formation in India were (i) low inducement to invest and (ii) low propensity and capacity to save.

1.8.1.9 . Famines:

In the pre-British period famines had been occurring. These famines showed an unbridled increase in the 18th and 19th centuries. Between 1765-1858 the country experienced 12 famines and 4 scarcities. Similarly, between 1860-1908, 20 famines spread their wings.

In 1943 Bengal famine shook the foundation of the country. William Digby estimated that during 1854-1901, 28.8 million persons died due to famines. In the famine of 1899-1900 2.5 million persons died of starvation.

1.8.1.10 . Industrial Backwardness:

On the eve of independence Indian economy was backward from industrial point of view there was deficiency of basic and heavy industries. Among heavy industries, there was Tata Iron and Steel industry.

The production of machines in the country was negligible. Statistics reveal that in 1947 total production of iron & steel was 9 lakh tonnes.

1.8.1.11 . Low Levels of Living:

India has been, and even today is one among the poorest countries of the world. Barma few rich, the common masses forced to lead a miserable life. Almost half of country's population is below the poverty line.

Quantity of goods available per head of population is meager and the quality is invariably indifferent. Nutritional content of consumption is grossly inadequate and hunger, starvation and disease are fairly widespread.

1.8.1.12 . Lack of Social Overhead Capital:

Social Overhead Capital comprises of such industries which help in the growth of other industries. Social overhead capital or infrastructure as it is now called, includes such industries like railways and other means of transport, electricity and other sources of energy, communication, banking etc.

Unfortunately not much attention was paid to this during the British rule and consequently the development of industries in India remained slow and tardy.

1.8.1.13 . Widespread Unemployment:

Unemployment in India is a direct outcome of rapidly increasing population. More people need more jobs but the underdeveloped economy of India cannot accommodate them. This naturally leads to widespread unemployment. Thus unemployment becomes an all round problem in the country.

1.8.1.14 . Income Disparities:

The gap between wealth and poverty is exceedingly wide in India. A handful of rich persons get a relatively large share of the total income while the large mass of poor population gets a relatively small portion of it.

Inequalities of income distribution are to be observed both in the rural and urban sectors of the economy. Inequalities of income are to be seen in the form of unequal distribution of land in the agricultural sector and concentration of economic power in non-agricultural sector.

1.8.1.15 . Absence of Enterprise and Initiative:

In India, enterprise and initiative are inhibited by the social system which denies opportunities for creative faculties. The force of custom, the rigidity of status, absence of intellectual curiosity and distrust of new ideas, combine to create an atmosphere inimical to enterprise, experimentation and innovation. Whatever little entrepreneurship exists tends to become monopolistic and quasi-monopolistic. In a growing economy which gets increasingly diversified there is scope for both the public and the private sectors to expand simultaneously, but it is inevitable, if development is to proceed at the pace envisaged and to contribute effectively to the attainment of the larger social ends in view, that the public sector must grow not only absolutely but also relatively to the private sector.

1.9 Check Your Progress A

1. Capitalism is a system of economic organization characterized by the________and _____of capital with profit motive.
2. Socialism is an economic system in which the means of production (capital equipment, buildings and land) are_________________.
3. High income countries are considered as__________economies.

1.10 Occupational Distribution of Labour Force in India

Labour force is defined as those able-bodied workers in the age group of 15 to 59.

The proportion of working population to total population is called work participation rate. In Underdeveloped Countries (UDC's) the work participation rate of labour force is low. According to 1981 census, the work participation rate in India was 36.7 percent. In 1991, it increases to 37.7 per cent . According to 2001 census, the work participation rate increased to 39.2 percent. It means out of our total population of 102.7 crore, about 40 crore people constitute the work force.

Similarly in 1991, out of total population of 84.6 crore, about 32 crore people constituted the labour force. We will observe how many of our labour force were employed in agriculture and how many engaged in industrial and service sector. The following table presents the comparative analysis of occupational pattern since 1901.

OCCUPATIONAL CLASSIFICATION OF WORKERS

Economic Activity	1901	1951	1961	1971	1981	1991	1999*-2000
1. Primary Sector (Agriculture and Allied activities)	71.7	72.1	71.8	72.2	68.8	66.8	56.7
2. Secondary Sector (Mining, manufacturing, construction, gas, electricity and water supply)	12.6	10.7	12.2	11.2	13.5	12.7	17.5
3. Service Sector (Trade, transport, communication, banking, insurance etc.)	15.7	17.2	16.0	16.7	17.7	20.5	25.8
	100.0	100.0	100.0	100.0	100.0	100.0	100.0

An in depth analysis of the table indicates that occupational distribution of India's work force shows the backwardness of the Indian economy. From 1901 to 1970, there was no change in the occupational pattern especially in primary sector agriculture and allied activities. In 1901, 71.7 per cent of the labour force was engaged in primary sector.

In 1971, almost the same proportion (72.2 per cent) of the labour force was in agriculture only in 1981 there has been small decrease in the proportion of work force engaged in agriculture. In 1991, 66.8 per cent of the labour force was employed in agriculture. A recent estimate shows that 56.7 percent of our labour forces are employed in agriculture. This slow decrease in the proportion of work force employed in agriculture in the reference of increasing population growth shows large disguised unemployment in Indian agriculture.

Another feature of the occupational structure in India is the constant stagnancy in the ratio of labour force employed in secondary and tertiary sector. 27.9 percent of the labour force was employed in secondary and tertiary sector till 1971. In 1951, 10.7 percent was engaged in industrial sector which slightly increased to 12.7 percent in 1991. NSS estimate shows that in 1999-2000, 17.5 per cent was engaged in secondary sector. In second plan huge investment was made to industrialise economy. This had put a small effect on the occupation structure of the country.

While analysing the rate of labour employment in tertiary sector, it is found that 17.2 percent was engaged in this sector in 1951. During the period of 1st six plans the situation remained unchanged. In 1981, 17.7 per cent was employed in tertiary sector. Only in 1991, this ratio has gone up to 20.5 percent and in 1999-2000, it increased to 25.8 percent.

After the satisfaction of basic needs like food, clothing and shelter which directly come from agriculture and industry, people demand various kinds of services like health education, travel, transport, banking and insurance etc. With the development of a large middle class in India, the share of service sector to GDP and ratio of work force engaged in tertiary sector are supposed to increase.

Concluding we can say that there is no visible shift in the labour force from the primary to the secondary and tertiary sectors in our country during twentieth century. If we accept this hypothesis that economic development of a country is associated by a shift of the working population from the primary to the secondary and then to the tertiary sector, then it indicates the economic progress is not favourable in India.

1.11 Problem of Poverty :

The different definitions and different underlying small sample surveys used to determine poverty in India, have resulted in widely different estimates of poverty from 1950s to 2010s. In 2012, the Indian government stated 21.9 per cent of its population is below its official poverty limit. The World Bank, in 2011 based on 2005's PPPs International Comparison Program, estimated 23.6 per cent of Indian population, or about 276 million people, lived below $1.25 per day on purchasing power parity. According to United Nation's Millennium Development Goal (MGD) programme 270 millions or 21.9 per cent people out of 1.2 billion of Indians lived below poverty line of $1.25 in 2011-2012.

Poverty in India is a historical reality. From late 19th century through early 20th century, under British colonial rule, poverty in India intensified, peaking in 1920s. Famines and diseases killed millions each time. After India gained its independence in 1947, mass deaths from famines were prevented, but poverty increased, peaking post-independence in 1960s. Rapid economic growth since 1991, has led to sharp reductions in extreme poverty in India. However, those above poverty line live a fragile economic life. Lack of basic essentials of life such as safe drinking water, sanitation, housing, health infrastructure as well as malnutrition impact the lives of hundreds of millions.

The World Bank reviewed and proposed revisions in May 2014, to its poverty calculation methodology and purchasing power parity basis for measuring poverty worldwide, including India. According to this revised methodology, the world had 872.3 million people below the new poverty line, of which 179.6 million people lived in India. In other words, India with 17.5 per cent of total world's population, had 20.6 per cent share of world's poorest in India

Poverty is socio-economic phenomena in which a section is unable to fulfill even its basic necessities of life. The poverty in India is a problem with some grave dimension; it is on the one hand, quantitatively a very big problem as the number of the poor. Indeed a massive aspect is that it is a problem of very low productivity of the poor, these peoples resources are poor in terms of assets, skills, credit, availability ,etc. this makes their earning to be dismally small.

1.11.1 Meaning of poverty :

In pure economic terms, **income poverty** is when a family's income fails to meet a federally established threshold that differs across countries. Typically it is measured with respect to families and not the individual, and is adjusted for the number of persons in a family. Economists often seek to identify the families whose economic position (defined as **command over resources**) falls below some minimally acceptance level. Similarly, the international standard of **extreme poverty** is set to the possession of less than 1$ a day.

Frequently, poverty is defined in either relative or absolute terms. **Absolute poverty** measures poverty in relation to the amount of money necessary to meet basic needs such as food, clothing, and shelter. The concept of absolute poverty is not concerned with broader **quality of life** issues or with the overall level of inequality in society. The concept therefore fails to recognise that individuals have important social and cultural needs. This, and similar criticisms, led to the

development of the concept of **relative poverty**. Relative poverty defines poverty in relation to the economic status of other members of the society: people are poor if they fall below prevailing standards of living in a given societal context. An important criticism of both concepts is that they are largely concerned with income and consumption.

1.11.2 Poverty in India :

V.M. Dandekar estimated that in 1983-84 at total of 286 million (44.4) persons were living below the poverty line.

Planning commission Expert Group (1993) estimated that rural poverty ratio has declined from 56.4 per cent in1973 to 39.1 per cent in 1987-88 as against it there is a relatively smaller decline in urban poverty ratio which has come down from 42.9 per cent in1973-74 to 40.1 per cent in 1987-88.

The overall poverty ratio has, therefore declined from 54.9 per cent in 1973-74 to 39.3 per cent in 1987-88. Recently, scholars have not agreed on the new parameters of poverty.

Saxena Committee report, using data over 1972 to 2000, separated calorific intake apart from nominal income in its economic analysis of poverty in India, and then stated that 50 per cent of Indians lived below the poverty line. The Planning Commission of India, in contrast, determined that the poverty rate was 39 per cent .

The National Council of Applied Economic Research estimated that 48 per cent of the Indian households earn more than Rs.90,000 (US$1,358.70) annually (or more than US$ 3 PPP per person). According to NCAER, in 2009, of the 222 million households in India, the absolutely poor households (annual incomes below Rs .45000 (US$680) accounted for only 15.6 per cent of them or about 35 million (about 200 million Indians). Another 80 million households are in income levels of Rs.45000 (US$680) to Rs 90000 (US$1,400) per year. These numbers are similar to World Bank estimates of the "below-the-poverty-line" households that may total about 100 million (or about 456 million individuals).

1.11.3 Causes of poverty :

1. Paradox of poverty with growth :

The Indian economy is beset with a paradox or contradiction because on one hand increase in growth of economy, on the other hand these growth benefits did not reach to large masses of the people.

2. Rapid growth of population :

The incidence of poverty is to an extent also caused by the population growth which is large among the poor at all-India rate.

3. Destroyed industries :

During the British period flourishing indigenous small-scale and cottage industries instead of expanding and transforming themselves in to modern industries were destroyed.

4. Unemployment :

In India considerable degree of unemployment and under-employment is found among rural labours. It has been established that incidence of unemployment and under-unemployment is the highest among casual labours.

5. Weak bargaining power :

Even during periods of unemployment, due to their week bargaining power, low wages being paid to them so that their extent of poverty has increased.

6. Low assets :

In India assets distribution in rural and urban area is unequal according to RBI data 27 per cent of rural households owing assets worth less than Rs.20, 000 accounted for only 2.4 per cent of total assets.

7) Low education :

The low education attainments of the poor and educational differentials are the main factors for relatively lower levels of income among the poor. Poor parents are not able to help their children to access higher educational level.

8) Inadequacy of anti-poverty programs :

Another supplement to the transfer could be the various special programmes to ameliorate the conditions of the poor. These however, have not as yet made substantial impact on the poverty.

9) Strategy of development :

The emphasis all along since the second plan till recently has been on the building of the capacity for capital goods. This meant to things investment in capital –intensive projects or less employment.

1.11.4 Measures to remove poverty :

1. Rising income and consumption :

To remove poverty it will require such an ordering of priorities in respect of product mix and technology mix that goods of mass consumption /wages goods and the labour intensive

technologies get the highest ranking growth of consumption goods and large employment opportunities for the poor, where by their income and consumption may rise.

2. Rising social consumption :

The solution of the poor which includes raising the provision of social consumption for the poor. An example of the same is the minimum needs programs. This is such items as elementary education, health, housing, water supply etc.

3. General growth : The growth strategy in a manner that helped to some extent in improving the condition of the poor, this involved such a re-structuring of the production and of productmix that provided more work income and mass goods to the poor.

4. Improving social status :

Improving the social status of the poor which also upgrade their productive capabilities, effort at rising literacy ,widening the access to education and health facilities for the weaker section belonging to the scheduled caste and backward classes, enhance the status, the skill and health of the poor.

5. Special programme :

There are certain special programmes for the development of women and children were launched, which empower them in various ways, including in respect of their legal rights like social welfare schemes.

6. Self-employment :

Special programmes involving the use of local resources and manpower can be devised to provide employment on wages and self-employed basis.

7. Increasing education :

To remove poverty it is necessity to provide better education which is pro occupational and increases labour skill and wages.

8. Training programme :

The training programme which helps the poor in earning by providing them assets, inputs, credit marketing facilities for skill formation etc.

9. Government programme :

The government has been implemented various programmes for the eradication of poverty such as IRDP, NREP, RLGEP, dry land developing programme ,public distribution system etc. The

measures which have listed above together mark a well-conceived strategy for eradicating poverty. But, the important thing is that it should have been implemented effectively.

1.12 Check Your Progress B

I) Fill in the blanks

1) Poverty is ———————————phenomenon.

a) socio-economic b)political c) psychological d) ecological

2) Any person who is not able to get a.................... is poor.

a)minimum level of living b)income c) social status d) political base

3) Poor persons bargaining power is …………..

a)big b) special c) small d) weak

4) Swarn Jayanti Gram Swarozgar Yojna has been implemented in .... area.

a)big b) special areas c) urban d) rural

1.13 Problems of rising economic inequality in India :

India is developing country and there are many problems, among all the basic problem is the economic inequality. Economic inequality is also known as the gap between rich and poor. Income inequality is nothing but wealth disparity or wealth and income difference. The term typically refered to an inequality among individuals and group within a society but can also refered to an inequality among the countries.

Indian economy is beset with gross economic inequalities, there are inequalities in income with a very few concerning a very large chunk of total income and a very large numbers getting a very small proportion.

1.13.1 Meaning of economic inequality :

Economic inequality varies between societies, historical periods, economic structures and system between individual’s abilities to create wealth.

“economic inequality is nothing but the unequal distribution of economic assets, income between individuals”. It is said that “economic inequality is the gap between rich and poor”.

1.13.2 Economic inequality in India :

In India in 1997, 20 per cent of individuals at the lowest bottom rung of the income ladder receive only 8.1 per cent of the national income. At the other hand 20 per cent individuals at the highest rung of the income-ladder receives 46.1 per cent of national income. The disparity

between the various states during the reform period indicate Punjab, Haryana, and Maharashtra at the top and Bihar and Orissa at the bottom.

During the reform period, urban inequality is higher than rural inequality in India and a gradual rise in urban inequality in 1993-94. The rural inequality was 28.50 per cent and urban inequality was 34.50 per cent in 1993-94 whereas in the 1999-2000 rural inequality was 26.33 per cent and urban inequality was 34.25 per cent .

The seminal work of Thomas Piketty, "Capital in the 21st Century", that focussed on inequality in the rich world — its historical magnitudes and the factors influencing it, has reignited the debate on the issue on economic inequality. Piketty's concern regarding potential damage of high inequality is reasonable – this is an issue that India needs to be concerned about, especially in view of the growing economic inequality. India is the world's second largest emerging economy, with 15 per cent of the global labour force, and an impressive growth record over the last two decades. However, rapid growth has not transformed the labour market and employment conditions in the country. Employment grew merely by 0.5 per cent per annum from 2004-05 to 2011-12 - the period that saw the highest growth of GDP by 8.5 per cent per annum. At the same time, 92 per cent of workers are still engaged in informal employment. Close to 276 million workers live below a poverty line of $2 per day, and their bargaining positions have declined despite economy growth. Further, both rural–urban disparities as well as inequality within urban areas in per capita expenditure are growing Recent data also indicate a growing concentration of per capita incomes at the top during the post-reform period. As the distribution of incomes and expenditures has become more unequal, poor people have not gained sufficiently from rapid economic growth. The report by World Economic Forum and Oxfam for India reiterates the growing divide. In 1994, the top 10 per cent of India's population and the bottom 40 per cent controlled the same portion of India's wealth – around 25 per cent . By 2010, India's top 10 per cent controlled nearly 30 per cent of India's assets, and the share of the lower 40 per cent declined to 21 per cent . In addition, widely varying returns to India's very unequally distributed human capital are undoubtedly putting upward pressure on inequality. Poor human development attainments linked to poverty contribute to an inequitable growth process and lost economic opportunities for India's poor. No doubt, India has made progress in addressing the structural drivers of inequalities through a range of rights-based policies as well as legal and programme initiatives. However, in order to address root causes of economic inequality, an inclusive

economic growth model ought to promote equitable access to resources and services, and at the same time, create decent jobs and livelihoods for all women and men.

It is clear that during reform period economic inequality has increased; especially gradual rise in urban inequality.

1.13.3 Causes of economic inequality :

There are many reasons for economic inequality in India they are as follows:-

1) Wealth distribution :

In India a few own a large chunk of income earning assets some others who do not own or own a part of the assets they operate, organize, finances, through banks, co-operatives etc; these inequality enable the few to gets incomes in the from of rent, interest and profit. As these assets accumulate and pass on from generation to generation, the earning capacity of these continuously increases.

2) Income distribution :

Income distribution is not just in India. As far as the rural area is concerned the ownership pattern of the land is highly unequal. The marginal households which accounts for as many as 72 per cent of the rural households own very little about 17 per cent of the land. On the other hand large holding who are about 1 per cent of the rural households but they have their ownership as much as 14 per cent of the area. The position of urban areas is not much different.

3) Inadequate employment generation :

In India, for long the increase in employment opportunities remained less than the rise in the labour force. The situation at present days is very bad. Since large, many remain unemployed or under-employed, their earnings continue to be little or nil for most of their live. The result is that these people remain at the lowest rung of the income scale. And the number of such people increases with the rapid growth in population. Thus, workless peoples are income less. All this explains the fact of large inequalities of income in India.

4) Differential regional growth :

Of the large many at the bottom rung of incomes a very great proportion lives in poor regions and most of the few at the top live in the high income state/ regions, this is the geographically fact of income inequalities for the country as a whole.

5) Growth factor :

As development proceeds the earning of different groups rise differently. The incomes of the upper income and middle income groups rise more rapidly than those of the poor. Thus, growth itself is one reason of economic inequality.

6) Rising rural population :

One such factor is the rapidly rising rural population, which keeps the earning depressed in the village. As against this, those who enter the modern sector get larger share of the rising income. Further, those with skills get still larger incomes as the demand for the skilled labour rises much faster than that of the unskilled labour.

7) Capital-formation :

The capital-intensive type of growth leads to concentration of income in few hands who supply capital.

8) Urbanization :

Modern industries are generally located in urban areas; they give rise to the demands of urban population for things such as transport, housing, drainage water supply, electricity, health care etc. This is also accentuates income inequalities in India. Urbanites are well placed as compared to the rural people in taking advantages of these income earning opportunities. The poor do not get much in fact they may even be worse off.

9) Wages and salaries :

Highly skilled workers earn more than unskilled. This fact causes for increased economic inequality.

10) Taxation :

Regressive tax system increased the leavl of economic inequality because this system is burden on the poor.

1.13.4 Measures to remove economic inequality :

1) Income transfer :

A policy to reduce inequalities through income transfer from the rich to the poor will result in an increase in the social welfare. This is because the welfare-loss of the rich will be far less than the welfare-gain of the poor. This will thus be a net gain for the society.

2) Growth with social justice :

Government has undertaken various measures to curb the evil of inequalities. These measures have encompassed personal distribution's like urban-rural inequalities and state-regional disparities.

3) Structure of taxation :

The structure of taxation which has some progressive features, consist in higher tax rates at higher incomes and large taxes on luxury items etc.

4) Concentration of wealth :

There are measures that aim at the concentration of wealth in a few hands. In the rural areas it has taken the form of ceiling on land which an individual can hold.

5) Existence of public sectors :

The public ownership of some industries and financial institutions with considerable investments has helped in restricting the field of ownership by few in these fields.

6) Transfer to resources :

There are various schemes pertaining to the transfer of resources/assets incomes to the poor were undertaken.

7) Special programs of employment :

There are special programmes of employment designed for specific and week groups, the examples are Swarna Jaynti Gram Swarozgar Yojna, special programmes for tribal people, hilly people, and providing employment to poor workers, artisans etc. and raised their income.

8) Extending public utility services :

There is the general policy of extending public utility services, with an emphasis on meeting the needs of low income groups, e.g health, education, drinking water etc.

9) Control of population :

The policy of reducing the fast growing population among the poor is also helpful in as far as it raises the income status of the poor and thereby improves the income distribution.

10) Appropriate income policy :

The government needs to follow an appropriate income policy which keeps the ratio between the highest income and the lowest income at a socially acceptable figure.

Above the measures are helpful to remove of economic inequality. It is necessity that these measures implemented strongly and we should aim at achieving socio-economic equality.

1.14 Check your progress C

Fill in the blanks

1) Economic inequality is gap between the ……………

a) rich and poor b) good and bad c) white and black d) young and old

2) Economic inequality is related to.......................inequality.

a)income b) bad c) white d) old

3) During the reform period urban inequality is higher than ....inequality.

a) rural b) urban c) backward d) advanced

1.15 Summary :

In this chapter we have studied the structure of Indian economy, the evaluation and causes of capitalism and socialism, occupational distribution of labour force, the problems of poverty, the causes and measures of it, problems of rising economic inequality. Poverty is social phenomenon, which is affected social and economically field of our country. Post reform economic inequalities have increased and it is more in the urban areas than rural areas. During the British period small-scale industries are destroyed.

1.16 Glossary

Economic System*:* the economic system of a country reflects the economic composition, economic thinking and the economic liberalization

Capitalism**:** Capitalism is a system of economic organization characterized by the private ownership and use of capital with profit motive. The most important feature of capitalism is the existence of private property.

Socialism*:* Socialism is an economic system in which the means of production (capital equipment, buildings and land) are owned by the state. The main aim of socialism is to run the economy for social benefit rather than private profit. It emphasizes on work according to one's ability, and equal opportunities for all regardless of caste, class and inherited privileges.

Developing or under-developed Economies: Low and middle income countries are usually regarded as Developing or under-developed countries;

Developed Economies: High income countries are considered as developed economies. But this may not always be true. Countries like Kuwait, Iran, UAE etc. fall in high-income countries but are considered as developing countries.

Transition Economies: These are former centralized/ socialist economies, which are moving to market economies such as Russia, China, eastern European nations, and India.

Poverty: In pure economic terms, **income poverty** is when a family's income fails to meet a federally established threshold that differs across countries. Typically it is measured with respect to families and not the individual, and is adjusted for the number of persons in a family. Economists often seek to identify the families whose economic position (defined as **command over resources**) falls below some minimally acceptance level. Similarly, the international standard of **extreme poverty** is set to the possession of less than 1$ a day.

Absolute Poverty: Absolute poverty measures poverty in relation to the amount of money necessary to meet basic needs such as food, clothing, and shelter. The concept of absolute poverty is not concerned with broader **quality of life** issues or with the overall level of inequality in society.

Relative Poverty: Relative poverty defines poverty in relation to the economic status of other members of the society: people are poor if they fall below prevailing standards of living in a given societal context.

Economic Inequality: Economic inequality is also known as the gap between rich and poor. Income inequality is nothing but wealth disparity or wealth and income difference. The term typically referred to an inequality among individuals and group within a society but can also referred to an inequality among the countries

1.17 Answers to Check Your Progress/SAQ's A

i. private ownership, use
ii. owned by the state
iii. developed

1.18 Answers to Check Your Progress/SAQ's B

i. Socio-economic
ii. income
iii. Weak
iv. Rural

1.19 Answers to Check Your Progress/SAQ's C

i. Rich and poor

ii. Income

iii. rural

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1.21 Terminal and Model Questions

1. What is Socialism? What are the basic features of Socialism?
2. What is Capitalism? Evaluate it as an economic system.
3. Discuss in detail the nature of Indian economy.
4. What do you understand by the term ‘poverty’? What are its main causes?
5. What are the implications of inequalities in income distribution on an economy’s growth?
6. How is an economy classified on the basis of income and on the basis of development?

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CHAPTER 2

PROBLEMS OF UNEMPLOYMENT

2.1 OBJECTIVES

After reading this lesson, you should be able:

1. To summarise the problem of unemployment .
2. To bring out the essence of the causes of unemployment.
3. To analyse the measures of unemployment
4. To assess the impact of rising prices in India.
5. To understand the implications of Parallel economy in India.

2.2 INTRODUCTION

2.2.1 Unemployment

Unemployment means a person willing to work but unable to find a qualified job. Our country is facing many problems but one of the serious problem is of unemployment. Many graduates, doctors, engineers, scientist are unemployed or working underemployed. Due to unemployment we are wasting our country's human resource.

The unemployed rate in between age group 15-29 years has increased since 2009-2010. According to the Global Employment Trends 2014 the unemployment rate has raised to 3.8 per cent , last year it was 3.7 per cent . The International Labour Organisation (ILO) has said in the recent report that India has shown rise in the unemployment in the last two years. Unemployment Rate in India decreased to 4.90 percent in 2013 from 5.20 percent in 2012. Unemployment Rate in India averaged 7.32 percent from 1983 until 2013, reaching an all time high of 9.40 percent in 2009 and a record low of 4.90 percent in 2013. Unemployment Rate in India is reported by the Ministry of Labour and Employment, India.

If the problem of unemployment is solved it will help in development of the country. With Population of 1.20 billion in our country the unemployment rate is increasing day by day. The problem of unemployment is rising but still many industries are facing the problem of skilled candidate for their company. There is a boom of software companies, Outsourcing companies in India, but still facing the problem of unemployment.In order to explain the concept unemployment it is better to distinguish between the concepts like labour force and work force. The labour force

refers to the number of persons who are employed plus the number who are willing to be employed. In India the labour force excludes children below the age 15 and old people above the age 60 and mentally or physically handicapped. The work force includes those who are actually employed in economic activity. If we deduct work force from labour force we get the number of unemployment.

The unemployment rate means the number of persons unemployed per 1000 persons in the labour force.

The labour force participation rate and work force participation rate can be expressed in percentages and as given below.

Labour Force Participation Rate = Labour Force / Size of the population

Work Force Participation Rate = Work force /Size of the population

2.2.2 Types of Unemployment

Normally when we talk of employed people we mean those who have work throughout the year. But this may not possible for all. In agriculture, work is seasonal even though agricultural activities are performed throughout the year. During the peak agricultural seasons (when the crop is ready for harvesting) more people are required for work. Similarly in the sowing, weeding and transplantation period more labour is required. Employment therefore increases at this time. In fact we will find that there is hardly any unemployment in rural areas during these peak agricultural seasons. However, once these seasons are over the agricultural workers, especially those who do not own land or whose land is not sufficient to meet their basic requirement (these are landless labourers and marginal farmers respectively), remain unemployed. This type of unemployment is known as seasonal unemployment.

In every economy there is unemployment but the nature and magnitude differ according to the economic progress. Following are the important types of unemployment.

Voluntary Unemployment

People who are unwilling to work at prevailing wage rate and people who get a continuous flow of income from their property or any other sources and need not to work, such people are voluntarily unemployed.

Involuntary Unemployment

Keynes analysed this type of unemployment. It is a situation when people are ready to work at the prevailing wage rate but could not find job.

Natural rate of Unemployment

This is postulated by the Post-Keynesians. According to them in every economy there exists a particular percentage of unemployment.

Structural unemployment

This type of unemployment is not a temporary phenomenon. It is chronic and is the result of backwardness and low rate of economic development. The structural changes of an economy are the main reason for this type of unemployment.

Frictional Unemployment

Unemployment attributable to the time required to match production activities with qualified resources. Frictional unemployment essentially occurs because resources, especially labor, are in the process of moving from one production activity to another. Employers are seeking workers and workers are seeking employment, the two sides just haven't matched up. Hence unemployment of the frictional variety increases. This mismatch is largely the result of limited information, which is often compounded by geographic separation between producer and resource.

Cyclical Unemployment

Cyclical unemployment is based on a greater availability of workers than there are jobs for workers. It is usually directly tied to the state of the economy. Lower demand for products due to lack of consumer confidence , disinterest, or reduction in consumer spending results in the workforce cutting back on production. Since production is reduced, companies that retail such products may also cut back on workforce, creating yet more cyclical unemployment.

Disguised Unemployment

There are also instances where we find too many people working when so many are not required. In agriculture we may find that all members of the family work. It is possible that 3-4 people can do a given work in the farm, but we find that the whole family of say 10 people doing the job. This may be because the excess people are not able to find employment elsewhere, so rather than remain unemployed they prefer to do the work along with others. This is known as disguised unemployment. This occurs when more than the necessary numbers of people are employed for the specified work. Disguised unemployment is found in agriculture because of the lack of employment opportunities elsewhere. Similarly disguised unemployment can be found in industry and offices as well.

Under Employment

This exists when people are not fully employment ie; when people are partially employed. In other words it is a situation in which a person does not get the type of work he is capable of doing.

Open Unemployment

Mrs. Joan Robinson calls this type of unemployment as 'Marxian Unemployment'. Open unemployment is a situation where a large labour force does not get work opportunities that may yield regular income to them. It is just opposite to disguised unemployment. It exists when people are ready to work but are not working due to non-availability of work.

Technological Unemployment

When the introduction of a new technology causes displacement of workers it is called technological unemployment.

Rural and Urban Unemployment in India

The unemployment rate at all India level stood at 3.8 per cent while in rural and urban areas it was 3.4 per cent and 5 per cent respectively. Unemployment rate is more in urban areas than in rural areas as in urban areas educated unemployed are more in numbers and also in urban areas it requires some vocational training or technical skill to do a job as compared to rural areas. Urban unemployment is that unemployment which exit in urban areas. It is not only painful at personal level but also at social level.

Despite this problem the government has not given attention to it. Urban unemployment can be classified into two forms.

Industrial unemployment: The exact size of the industrial unemployment is not known because the necessary data for its estimation are not available.

Educated unemployment: It constitutes large part of urban unemployment in India. Rural unemployment is the main problem of Indian government and it requires huge capitalization of capital. Disguised unemployment, seasonal unemployment etc are some of the example of rural unemployment. The educated are not the only ones who face the problem of unemployment in the urban areas. There are large numbers of people in the rural areas who do not have a high level of education and who are unemployed.

2.2.3 Measurement of Unemployment in India

The National Sample Survey Organization (NSSO), which provides estimates of the rates of unemployment in India on the basis of its quinquennial surveys, uses three different concepts.

They are Usual Status Unemployment, Current Weekly Status unemployment and Current Daily Status unemployment.

I. Usual Status Unemployment (US)

Here the reference period is 365 days. The usual status gives an idea about long- term employment (or chronic and open employment) during the reference year. A person is considered unemployed on Usual Status basis, if he/she was not working, but was willing to work for the major part of the reference year (more than 183 days) but did not get work for even 183 days. Dividing the usual status unemployment by the size of the labour force, we get unemployment rate by usual status. This measure is more appropriate to those in search of regular employment (educated and skilled persons) who may not accept casual work.

II. Current Weekly Status Unemployment (CWS)

Here the reference period is one week .A person is considered unemployed by Current Weekly Status, if he/she had not worked even for one hour during the week, but was seeking or was available for work. The estimates are made in terms of the average number of persons unemployed per week. The Current Weekly Status approach gives an idea about temporary unemployment (or chronic plus temporary unemployment) during the reference week.

Current Weekly Status is used by the agencies like Inter National Organisations (ILO) to estimate employment and unemployment rates based on weekly reference period for international comparison. Dividing the weekly status unemployment by the size of the labour force, we get unemployment rate by weekly status.

III. Current Daily Status Unemployment (CDS)

Here the reference period is each of the 7 days, preceding the date of survey in each of these days. It records the activity status of a person for each day of the 7 days preceding the survey i.e. persons who did not find work on a day or some days during the survey week. The Current daily status approach gives a composite or comprehensive measure of unemployment, i.e., it is a measure of chronic and temporary unemployment as well as under employment. Dividing the current daily status unemployment by the size of the labour force, we get unemployment rate by usual status. The current daily status gives the most faithful picture of unemployment situation.

2.2.4 Magnitude of Unemployment in India

A comparison between different estimates of unemployment in 2009-10 indicates that the CDS estimate of unemployment is the highest (Table 2.1). The higher unemployment rates according to the CDS approach compared to the weekly status and usual status approaches indicate a high degree of intermittent unemployment. Interestingly, urban unemployment was higher under both the usual principal and subsidiary status (UPSS) and current weekly status (CWS) but rural unemployment was higher under the CDS approach. This possibly indicates higher intermittent or seasonal unemployment in rural than urban areas, something that employment generation schemes like the MGNREGA need to pay attention to. However, overall unemployment rates were lower in 2009-10 under each approach vis-a-vis 2004-05.

Table 2.1 All-India NSS 66th Round Rural and Urban Unemployment Rates:

	Estimates			
S.No.	**Rural(2009-10)**	**Urban(2009-10)**	**Total(2009-10)**	**Total(2004-05)**
1. UPSS	1.6	3.4	2.0	2.3
2. CWS	3.3	4.2	3.6	4.4
3. CDS	6.8	5.8	6.6	8.2

Source: NSSO

Labour force participation rates (LFPR) under all three approaches declined in 2009-10 compared to 2004-05 (Table 2.2). However, the decline in female LFPRs was larger under each measure in comparison with male LFPRs which either declined marginally (UPSS), remained constant (CWS), or increased marginally (CDS).

Table 1.16 All-India Employment and Unemployment Indicators (per 1000)

Indicators	NSS 66th Round (2009-10)			**NSS 61th Round (2004-05)**		
UPSS	Male	Female	Total Person	Male	Female	Total Person
LFPR	557	233	400	559	294	430
Work Participation Rate	546	228	392	547	287	420
Unemployment Rate	20	23	20	22	26	23
CWS	Male	Female	Total Person	Male	Female	Total Person
LFPR	550	207	384	550	257	407
Work Participation Rate	532	198	370	527	244	389
Unemployment Rate	33	43	36	42	50	44
CDS	Male	Female	Total Person	Male	Female	Total Person
LFPR	540	179	365	538	215	381
Work Participation Rate	507	164	341	496	195	350
Unemployment Rate	61	82	66	78	92	82

Source: Key Indicators of Employment and Unemployment in India, 2009-10, NSSO.

2.2.5 Causes of Unemployment in India

Following are the important causes of unemployment in India

1. There are employment opportunities in India, but the rising population problem creates the unemployment. If the population grows in the same rate the next generation will face more problems of unemployment. If there is vacancy for 1 position 100 or 1000 apply for the position and only one gets the job and others remain unemployed.
2. Inflation
3. Indians don't take jobs which are below their grades. Many find it difficult to work at the below qualification level job.
4. Low wages or salary below the market rate.
5. Many big industries look for the skilled candidate only, for their company.
6. Recession
7. Many Employers give preference to the experienced candidates only and not the fresher.
8. Not enough or new jobs: As per the experience & analysis from 'Get Sarkai Naukri', number of new government jobs is decreasing every year. Government is not able to create enough jobs keeping in mind the Indian population.
9. Slow business expansion
10. Advanced Technology: Earlier for a task hundreds or thousand people were required to do a work but now due to the advanced technology only one person can do many people's work. With the advanced technology companies are hiring few persons to operate the machine. Give a command on computer and the work is done this has cut off the employment of many.
11. Corruption: In Government sector and in some private sector people get the job by giving the bribe. Even though the candidate is not that qualified but if he gives the bribe he gets the job. So to get a government job give a bribe.The qualified candidate remains unemployed as no money to give the bribe.

2.2.6 Problems caused due to unemployment:

- Unemployment and poverty go side by side. The problem of unemployment gives rise to the problem of poverty.
- Young people after a long time of unemployment find the wrong way to earn money.
- To get rid from the unemployment stress, they accept alcohol or drugs.

- Unemployed youths accepts suicide as the last option of their life
- Lower economic growth
- Increase rate in Crimes. As the employed youth don't have anything to do they start doing robbery, murder etc.
- Health issues i.e., it affects mentally as well as physically

2.2.7 Solutions to the Problem of Unemployment in India

1. The very first solution for the unemployment is to control the rising population of our country. Government should motivate people to have small families. Indian government has started initiatives to control the population but still the population is rising.
2. The quality of Indian education should be improved. The current education system is not upto the level. Government should keep a strict watch on the education system and try to implement new ways to generate skilled labour force. Government should select a committee to look after the schools and universities. The syllabus taught is of no use to the industries so the education should be as per the current requirements of the industries. Before completing the education a practical knowledge should be given.
3. Also today's youth should join the institute or select the course where proper training is given and the course is as per the current industries requirements. Take the course as per your interest and which will bright your future.
4. Government should encourage and develop the agriculture based industries in rural areas so that the rural candidates don't migrate to the urban areas. More employment should be generated in rural areas for the seasonal unemployment people.
5. Rapid Industrialization should be created.
6. Development of the rural areas will stop the migration of the rural people to the urban cities and this will not put more pressure on the urban city jobs.
7. Government should allow more foreign companies to open their unit in India, so that more employment opportunities will be available.

2.3 CHECK YOUR PROGRESS A

i. The reference period for Usual Status Unemployment (US) is________________days.

ii. The reference period for Current Daily Status Unemployment (CDS) is________________, preceding the date of survey in each of these days.

iii. ________________________ ,________________etc are some of the example of rural unemployment.

2.4 PROBLEM OF RISING PRICES IN INDIA

India is faced today with one of the most critical economic situations. At no other time did Indians witness the horrible phenomenon of spiraling prices as they do today, prices are soaring like rackets and each day one finds a rise in prices of more or less all essential commodities. Inflationary pressures are doing plenty of mischief and the people of middle class families are finding it a Himalayan task to make both ends meet.

In a developing economy, prices usually display an upward trend. But if prices keep rising persistently, they cause great hardship to the people. They spare neither the rich nor the poor, neither the producers nor the consumer. They make economic activities uncertain and unstable, causing great unrest in the minds of the people.

Prices are expressed in terms of money. When the rupee or any other currency buys much less than what it used to, and more is to be paid for practically every item, then the problem of rising prices comes into being. In economic terminology it is known as 'Inflation'. Where the balance between money supply on the one hand and goods and services on the other is disturbed, a critical problem arises. If money supply increases more than goods and services, available prices will rise. The fixed-income groups like salaried people, wage-earners and pensioners are the most helpless victims of inflation. As prices rise, their real income gets eroded. The additional dearness allowance which the government sanctions from time to time proves of no use to them, because their purchasing power actually goes down. Inflation induces businessmen to invest their money in non-productive assets like gold and land whose real worth is not affected by rising-prices. High prices also adversely affect the exports of the country and distort the balance of foreign trade.

In a developing economy a certain rise in prices in inevitable for at least three major reasons. First, the programmes of economic development generate larger employment and money incomes and this increases the demand for basic consumer goods and services. The new incomes are not proportionately reflected in saving because a majority of the beneficiaries have to spend most of the additional money they get on satisfying unfulfilled needs. Secondly, the same programmes of economic development as generate the new money incomes push-up the demand for certain goods wanted also by the consumer, such as agricultural products, fuel, housing materials and the like. A third reason, of which the first two may be looked upon as special cases, is the large increase in currency in emulation and the operation of the law of supply and demand. Unless the production

of basic consumer goods keeps pace with the increase in currency that is rendered inevitable by large scale, long term planning, prices are bound to rise even of the production of consumer goods is maintained at the old level.

2.4.1 Causes of Rising Prices in India:

Numerous factors can be cited to explain price rise in India:

First, our economic planning has suffered from serious drawback, right from the beginning. During the various Five-Year Plans, while the public expenditure persistently increased, the production targets were never realized.

Secondly, this forced the Government to resort to deficit financing. The resulting imbalance inevitably led to inflation.

The third major factor responsible for price rise is that due to great emphasis laid on heavy industries in our Five-Year-Plans, agriculture and consumer goods industries, which produce the items required by the people, have received insufficient attention. Consequently, agricultural production has not kept pace with consumption.

Fourthly, in an underdeveloped economy like ours, the first increases in income always tend to be expended on food articles. In other words, the level of consumption tends to increase with increases in income. The cumulative effect is a growing pressure on prices.

Fifthly, there is a tremendous increase in population. About ten million new mouths are to be fed every year.

Sixthly, there are psychological factors that push up the prices. Continually rising prices give rise to rising expectations, with the result that farmers and stockiest tend to hoard more and more stocks, anticipating further increase in prices.

Seventhly, there has been very heavy taxation on the public—both direct and indirect. In an underdeveloped country like ours, this adds to the inflationary pressure for number of reasons. Heavy taxes on industries are ultimately passed on to the consumers, thus increasing their cost of living. Heavy taxation also discourages greater production. Defective tax-structure has encouraged tax-evasion and accumulation of black money and smuggling.

Eighthly, majority of Indians have no community consciousness. There is no organized consumer resistance to price rise. The Ninth factor is the faulty distribution and marketing system. Last, but not the least, was the international factor, increase of oil prices in the international market.

2.4.2 Measures to Solve the Problem of Rising Prices:

In order to solve this difficult problem, some drastic steps must be taken:

First, the entire strategy of planning should be changed. There should be equal attention on heavy industries and agriculture and consumer goods.

Secondly, the mounting governmental administrative expenditure should be drastically curtailed as it is mostly wasteful and non-development expenditure.

Thirdly, tax burdens on the public should be reduced.

And finally, no hoarder, profiteer or black marketeer should be left with impunity. Unless they are crushed with a heavy hand, the common man is bound to suffer.

2.5 PARALLEL ECONOMY IN INDIA

Parallel economy means functioning of an unsanctioned sector in the economy whose objectives run parallel and in contradiction with the objectives of official or sanctioned or legitimate sector in the same economy (Rajaram, 2006, 577). This is variously referred to as 'unaccounted economy', 'illegal economy', 'subterranean economy', or 'unsanctioned economy'. According to the D.K.Rangnekar (as cited by Datta & Sundharam, 2004, 376), "If the 'Parallel economy' poses a serious threat to stability and growth of the official economy, surely it stems from the fact that the magnitude of 'black-money' is large and rigged deals are growing in volume and complexity at an alarming rate.

D.R.Pendse (as cited by Lekhi, 2003, 191) argued that there are two possible sources of black money. Firstly, it may originate from illegitimate source of income arising out of illegal gratification such as payment of 'Selami or Pagri' or income from smuggling, bribery etc. Secondly, it may originate from legitimate and legal sources of income but concealed from tax authorities out of tax evasion. Parallel Economy means an illegal economic operation or otherwise known as black money. It represents a segment which is not legitimate.It practises those activities which are contrary to the principles of economic policy pursued in an economy. It is well-known that there is a large quantity of money, income and wealth which has been and is being made owned which is unaccounted in our tax system and therefore, has not suffered tax. This form of money is known as black money.

2.5.1 Magnitude Of Black Economy:

A number of studies have been made to estimate the quantitative dimensions of the problem in the economy. The studies identifies the different sources of black income as follows:

(a) Income-tax evasion

(b) Corporation tax evasion

(c) Excise duty evasion

(d) Customs duty evasion

(e) Black income from exports

(f) Evasion of state taxes.

(g) Bribes, illegal commissions.

(h) Goods supply to black market

(i) Unaccounted stock-market profit

(j) Interest earned from unorganised credit markets.

The study has provided a gross estimate of black income generated through each of these sources. It is estimated to have gone up from Rs. 50,977 crores in 1980-81 to Rs. 10, 50,000 crores in 2006-07. Raja Chelliah has estimated that black money is generated at the rate of 20 percent of the country's GDP.

2.5.2 Indian Experience Regarding Parallel Economy:

Various attempts have been made to assess the black money in India from time to time. Major few of them are as presented here:

I. Kaldor's Estimate: Although the Taxation Enquiry Commission had examined the structure of Indian Taxation, a review by Prof. Nicholas Kaldor was desired by the Government in late 1955 "in view of the larger dimensions assumed by the problems of resources for the plan since the commission reported (Important Events 1946-61)." Prof. N. Kaldor in his report on Indian Tax Reform estimated the non-national income (i) wages and salaries (ii) income of self-employed and (iii) profit, interest and rent. After making the rough adjustmements, according to Wanchoo Committee, "the estimated ncome income on which tax has been (black income) would probably be Rs.700 crores and Rs. 1000 crores for the years 1961-62 and 1965-66 respectively. Projecting this estimate further to 1968-69 on the basis of percentage increase in national income from 1961-62 to 1968-69, the income on which tax was evaded for 1968-69, the income on which tax

was evaded for 1968-69 can be estimated at a figure of Rs. 1800 crores" (Datt and Sundharam, 2004, 378-379).

II. Wanchoo Committee's Estimate: Shri K.N.Wanchoo, retired Chief Justice of the Supreme Court of India, as chairman explained what the term black money meant in its final report submitted in December, 1971. This committee estimated non-salary income for 1961-62 of amounting Rs. 2686 crores and non-salary income actually assessed to tax as Rs. 1875 crores, thus, tax escaped for Rs. 811 crores. Therefore, in 1961-62, black money was of amounting Rs. 700 crores which rose to Rs. 1000 crores in 1965-66 and further Rs. 1400 crores in 1969-70. Very lately it was accounted to be 4.4 percent of GNP (Dhar, 2003,719).

III. Rangnekar's Estimate: D.K. Rangnakar as a member of the Wanchoo Committee submitted his report in 1982 (India Today, 2005). According to Rangnekar, tax evaded income for 1961-62 was the order of Rs. 1,150 crores, as compared to the DTEC estimate of Rs. 850 crores. For 1965-66, it was Rs. 2,300 crores, as against Rs. 1,216 crores estimated by DTEC. The projections of black money for 1968-69 and 1969-70 were Rs. 2,833 crores and Rs. 3,080 crores respectively (Datt and Sundharam, 2004, 378).

IV. Chopra's Estimate: A Committee under O.P. Chopra was formed in 1982 for measuring black money in India (India Today, 2005). O.P.Chopra prepared a series of estimates of black income where it increased from Rs. 916 crores (6.1 percent of GDP) in 1961-62 to Rs.8098 crores (10.5 percent of GDP) in 1976-77 (Dhar, 2003). The study showed that a buoyant economy offers more opportunities for unaccounted income. During periods of recession, it may be difficult for producers to exact unaccounted money. Chopra also corroborates the hypothesis that tax evasion is more likely the higher the rate of tax. His findings also support the hypothesis that increase in prices leads to an increase in unaccounted income. Further, he found that funds are diverted to agriculture to convert unaccounted (black) income into legal (white) income (Datt and Sundharam, 2004, 379).

V. Gupta's Estimate: Government of India formed a committee under Poonam Gupta and Sanjeev Gupta in 1981 for calculating black money in India. They used Feige's method of transaction income ratio to estimate black money in a country. They used average of three years

viz. 1949-50, 1950-51 and 1951-52 as the bench mark for estimating black money for the year of 1967-68 to 1978-79. They estimated that it was 19.8% of GDP at market price. The black money increased for Rs. 3034 crores in 1967-68 to Rs. 46867 crores in 1978-79. The main findings of studies on black money were: (a) A buoyant economy offers more opportunities for unaccounted income; (b) The ratio of unaccounted income to assessable non-salary income has gone up after 1973-74; (c) Increase in prices leads to an increase in black money; (d) Funds are diverted to agriculture to convert black money into white money; and (e) One per cent increase in overall taxes leads to more than 3 percent increase in the black economy relation to the official economy (Lekhi, 2003, 192). The National Institute of Public Finance and Policy estimated that in 1985 amount of black money in India was nearly Rs. 1,00,000 crore, which is approximately 20 percent of the national income. In 1996, the estimated black money was believed to be more than Rs. 4, 00,000 crore (The Hindustan Times, January 20, 1997). Most of India's black money - estimated to be about US$1 trillion (Dh3.67tn) - is believed to be parked in bank accounts in Switzerland. According to the Swiss Bankers Association, Swiss law and tax agreements prohibit third countries from general searches for possible tax evaders, or "name-fishing" .The Indian government hopes that situation will change after its tax treaty with the country is revised (Chopra, 2010) .

2.5.3 Causes of Generating Black Money

There are many reasons for the creation of back money in India. Some of them are as follows:

i. Controls and licensing system: Black money is increasing in India for the reasons of controls, permits, quotas and licenses.

ii. Higher Rates of Taxes: Higher rates of taxes has resulted a growing tendency of tax evasion among the tax payers. Tax evasion is common in income tax, corporate tax, corporation tax, union excise duties, custom duties, sales tax , etc.

iii. Ineffective enforcement of tax laws: In India, the enforcement of tax laws in respect of income tax, sales tax, excise duty, stamp duty etc. is quite weak. This has led to enormous unrestrained evasion of taxes and piling up of black money.

iv. Funding of political parties: There is an upward tendency of supporting of political parties with the help of black money. Big trade houses are donating an enormous amount of black money

to the political parties, especially the ruling party with the sole objective to tame the political leadership for deriving undue profit by manipulating policy decisions (Lekhi, 2003, 193).

v. Second World War after influence: During the time of Second World War, a lot of the Indian industry found circumstances favourable for black marketing. Supply industrial goods from the traditional supplies of the West were cutoff, which resulted severe shortages in many essential fields. This formed the sentiment of making of marketing money out of shortages and not out of extension of the business activities.

vi. Inflation: The addition in prices of commodities like petrol, etc. in international market, boost in prices of commodities due to high increase in duties and taxes imposed by the government, the conspicuous utilization created by people with unaccountable money, diverting resources from manufacture to speculation- all these is the root of inflation which in turn creates black money.

vii. Agricultural Income: The reluctance to bring agricultural earnings in the realm of income tax has also contributed to creation of black money. Big industrial houses, over the past few decades have entered the agriculture sector in a big way by acquiring big farms. The black money accrued from other sources is sought to be transformed into white by viewing it on the agricultural returns account.

viii. Privatization: Privatization has opened up a new area to the private sector as well as to ministers and bureaucrats for making black money. It is expected that many scams come to light for making black money through privatization.

ix. Transactions in Urban Real Estates: Real estate transaction is a significant source of generating black money in India.

x. Other Factors: Generation of black income in a country like India also results from other different activities like smuggling, property deals, bribery, kickbacks, commissions, concealment of income by professionals, artists etc. In this way an enormous amounts of black income incessantly results in enhancement of the area and activities of parallel economy (Lekhi, 2003, 194).

2.5.4 Impact of Black Income on the Indian Economy

Generation of black income and thereby establishment of parallel economy has been creating the following serious impacts on the social and economic system of the country.

• Black income has been causing underestimation of GDP in India as an enormous volume of income is diverted to this unaccounted sector resulting in growing continuation of parallel economy of the country.

• The direct effect of black income is the loss of revenue to the state exchequer as a tax evasion.

• Black money has resulted in the diversion of resources for the purchase of real estate and luxury housing.

• Black money has resulted in transfer of funds from India to foreign countries through clandestine channels (Dhar, 2003, 721).

• The availability of black incomes with businessmen and capitalists and the consequent inequalities of income place a large amount of funds at their disposal.

• A part of the black incomes is held in cash and as a result there is an abundance of liquidity which becomes available through the addition of savings held in the form of cash, bullion, gold, silver, etc.

• Money evaded by illegitimate way is spent in undesirable and vulgar manner. Virtues like hardwork and honesty are underestimated. Thus the existence of parallel economy has totally distorted and disrupted the planning of the economy of the country.

2.5.5 Government Initiatives to Curb Parallel Economy:

The government has taken a number of steps to curb black money. Searches, seizures, surveys, and scrutiny of income tax returns are being done by the Income Tax Department. Amendments have also been made to the Finance Act 2004 to intensify efforts to curb black money. These include prosecution for falsification of books of accounts and taxing of gifts worth more than Rs. 25, 000 to unrelated persons. There have been two amendments of the Voluntary Disclosure of Income Scheme (VDIS) under which black incomes and assets could be declared, the tax paid at current rates and amnesty availed from penalty and prosecution. For the smooth functioning of the economy, the following measures are suggested to combat the menace of the parallel economy:

i. Demonetization: In 1946, demonetization was resorted to but the Direct Taxes Enquiry Committee in its interim report observed, “Demonetization was not successful then, because only a very small proportion of total notes in circulation were demonetized in 1946 and its worth was Rs.1,235.93 crores.” On January 16, 1978 demonetization of high denomination notes was introduced. The high demonetization rates as on that day amounted to Rs. 146 crores. Notes

tendered to Reserve Bank of India amounted to Rs. 125 crores as per data available till August 1981 (Lekhi, 2003, 195).

ii. Voluntary Disclosure Schemes: The Government has floated various voluntary disclosure schemes to determine the black money. In 1951, a voluntary disclosure scheme with relaxation in panel provision was introduced. It resulted in total disclosures amounting to Rs. 71 crores and tax collection of Rs. 11 crores only. Up to 1968 a total concealed income of the order of Rs. 519 crores was declared on which Rs. 131 crores were paid as tax; this further highlights the failure of the Government to unearth black incomes. The wealth disclosed under the scheme will attract income tax, but not wealth tax. Under the scheme, previously undisclosed income reported by the declarant, will be subject to tax at the rate of 30% for individuals and 35% in other cases. Further, the Finance Minister has announced that the declarant will not be liable to pay interest or penalties and will be granted immunity from prosecution under the Income tax Act 1961, Wealth tax Act, 1957, Foreign Exchange Regulation Act, 1973 and Companies Act, 1956. This scheme will remain in force till December 31, 1997 (Highlights of Union Budgets, 1997). Finance Minister Mr. P. Chidambaram while presenting 1997-98 budgets announced a Voluntary Disclosure Scheme (VDS). Voluntary Disclosure Scheme which was extensively advertised yielded tax revenue of Rs.10, 500 crores- an unprecedented revenue gain from any VDS scheme launched since the independence.

iii. Special Bearer Bond Scheme: Bearer bonds were most likely first used in the United States during the post-Civil War era to fund Reconstruction (1865– 1885). Bearer bonds that are owned by whoever is holding them, rather than having registered owners like most other securities. Like most other bonds, they have a stated maturity date and interest rate, but coupons representing interest payments are generally physically attached to the security and must be submitted to the company for payment (Bernfeld, 2010). Special Bearer Bonds Scheme (1981) was intended for canalizing unaccounted money for productive purposes. The Special Bearer Bonds, 1981 of the face value of Rs. 10,000 each were issued at par with a maturity period of 10 years.

iv. Measures to Check Tax Evasion: Dealing with tax evasion has always been one of the most difficult challenges for governments all round the world. Tax evasion is done by individuals belonging to different strata of the society in different ways. As per the surveys and reports, there are many people who provide false income details to the tax authorities to reduce the amount of

liability. The income tax evasion penalties can help the government recover maximum amounts in the form of tax and utilize the money for the benefit of the common public. Tax evasion is one of the basic causes to generate the black income. Therefore, various measures were undertaken to plug the loopholes in tax evasion. Most of these measures were based on the recommendations of various committees and commissions *viz* Taxation Enquiry Commission (1953), Administrative Reforms Commission (1969), Direct Tax Enquiry Committee (1971) etc. Most of these recommendations were an upgrading in tax laws (Charlie, 2010).

v. Economic Liberalization: Introduction of economic liberalization has detached the regime of controls and regulations and thereby the extent of black economy would be reduced regularly (Lekhi, 2003, 196).

vi. The Prevention of Money-Laundering Act, 2004 : It came into effect on 1 July 2005. Section 3 of the Act makes the offense of money-laundering cover those persons or entities who directly or indirectly attempt to indulge or knowingly assist or knowingly are party or are actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property, such person or entity shall be guilty of offense of money-laundering. Section 4 of the Act prescribes punishment for money laundering with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine which may extend to five lakh rupees and for the offences mentioned [elsewhere] the punishment shall be up to ten years (Money Laundering, 2010). Money laundering networks have and continue to provide avenues to siphon money between individuals, groups, and nations across national borders and across the world for legitimate and illegitimate purposes (Lambert, 1996).

vii. Other Measures: The Government has also introduced some measures to contain the growth of black income in the country which includes Deposit in the National Housing Bank in 1991, NRI foreign exchange remittance, issuing National Development Bonds in US dollars, controlling the election expenses incurred by the candidates, conducting searches, seizures, raids and other steps to plug loopholes in the tax administration etc.

In July 1991, the Union Finance Minister projected a new scheme- National Housing Bank Scheme to persuade black money back into the legitimate operations of the national economy. The scheme offered possessors of unaccounted for money an opportunity to deposit any quantity of money (with a maximum limit of Rs. 10000) with NHB without disclosing the basis of funds. Some scholars have maintained that all these measures have touched only the tip of the iceberg.

All of schemes have hardly fetched Rs. 5000 crore over a period of fifty years. The main drawback in these schemes is that they touch the problem of black money already created but they do not go into the root cause of generation of black money. Unless this problem is tackled, the menace of black money will continue to increase.

India has tried to combat tax evasion by requiring an identification number for all major financial deals. The permanent account number (PAN) is a compulsory 10-character number issued to taxpayers by the tax department. But many transactions, especially those related to property, are conducted in cash and are unlikely to be reported. In the fiscal year 2007-2008, the country's high-value transactions amounted to more than 55.7 trillion rupees, according to India's Annual Information Return filed with the government. But nearly one third of the 3.3 million transactions were conducted without a PAN. In many other transactions, PAN numbers were fake (Chopra, 2010).

As per the *Global Financial Integrity* report titled 'Illicit Financial Flows from Developing Countries: 2003-2012,' around $439 billion of black money left the Indian shores, between 2003 and 2012. What is interesting is that in 2003 the total amount of black money leaving India had stood at $10.1 billion. By 2012, this had jumped more than nine times to around $94.8 billion. In comparison, the money leaving China during the same period grew by less than four times during this period.

Given this, one really can't blame the government for being overly worried about the black money leaving the country. Also, black money that remains in the country has some benefits. Cambridge University economist Ha-Joon Chang explains this in his book *Bad Samaritans — The Guilty Secrets of Rich Nations and the Threat to Global Prosperity*, in the context of a minister taking a bribe (which is also black money, given that the minister is not going to declare the bribe as an income). As he writes: "A bribe is a transfer of wealth from one person to another. It does not necessarily have negative effects on economic efficiency and growth." If the minister taking the bribe decides to spend/invest that money in the country, it has a positive impact on economic growth, as the spending creates economic demand and the investment creates jobs. At least in theory, the idea seems to make sense. In comparison, the black money leaving the country is a total waste. As Chang writes: "A critical issue is whether the dirty money stays in the country. If the bribe is deposited in a Swiss bank, it cannot contribute to creating further income and jobs through investment — which is one way odious money can partially 'redeem' itself."Once we take

this factor into account Modi government's crackdown on black money leaving the shores of the country starts to make immense sense. But the question is how good are the chances of recovering the money that has already left the shores?

There is a great belief in India that all the black money is lying with banks in Switzerland. But this belief is incorrect. As Chang writes: “Switzerland is not a country living off black money deposited in its secretive banks. It is, in fact, literally the most industrialised country in the world.”

Data released by the Swiss National Bank, the central bank of Switzerland, suggests that Indian money in Swiss banks was at around Rs 14,000 crore in 2013. In 2006, the total amount had stood at Rs 41,000 crore. The reason for this fall is simple. Over the last few years as black money and Switzerland have come into focus, it would be stupid for individuals or companies sending black money out of India, to keep sending it to Switzerland. There are around 70 tax havens all over the world. And so this money could be anywhere. Getting all this money back would involve a lot of international diplomacy and cooperation. Also, the question is why tax havens would return this money. The economies of many tax havens run because of this black money and no one undoes a business model that is working.An estimate made by the International Monetary Fund suggests that around $18 trillion of wealth lies in international tax havens other than Switzerland and beyond the reach of any tax authorities. Some of this money must have definitely originated in India. Long story short — it would be next to impossible to get back any of this black money.

Now let's get back to domestic black money. As per Chang, this money, if invested properly, can create jobs as well as economic growth. In the Indian case a lot of this money gets invested into gold and real estate. Money going into gold does not create any jobs. And money that goes into real estate has driven up home prices in particular, all over the country, to extremely high levels. Most middle class Indians cannot afford to buy a home now. Given this, it makes tremendous sense for the government to crack down on domestic black money, instead of making noises about recovering black money that has already left the shores of this country. Further, the focus should be on ensuring that the number of people paying income tax goes up in the years to come. In short, the black money menace first needs to be tackled domestically.

2.6 CHECK YOUR PROGRESS B

i. High prices adversely affect the____________of the country and distort the __________________.

ii. In a developing economy, prices usually display an________________trend.

2.7 SUMMARY

As a result of massive unemployment there is poverty and increase in social evils like robbery, crime etc. The social consequences of the educated unemployed are quite serious. We will find that people with superior qualifications are doing jobs which could be done by less qualified people. This results in under-utilisation of one's capacity. We can find graduate engineers doing jobs which could be performed by diploma holders. Similarly there may be clerks and typists with postgraduate qualifications where perhaps matriculates could do the work. This is because people with lesser qualifications (matriculates) are unable to find jobs so they go for higher education with the hope that they will be in a better position to qualify for the same jobs.

Many thieves, pickpockets, smugglers, drug traffickers etc. take up these activities because they are unable to find gainful employment. The frustrations of unemployed youth can also lead to terrorism. The highly educated unemployed have anger against society for their state of affairs. They feel that if this system cannot meet their aspirations for getting proper jobs it should be destroyed. This leads them to take to organised violence against the state. Terrorism in Assam and in many other parts of the country is largely a result of the large number of educated unemployed youth in these states, among other factors.

Our government is quite conscious of the magnitude and implications of the problem of rising prices. It has already initiated a number of steps to check inflationary tendencies. What we now need is a strict enforcement of these steps. Apart from accelerating growth and imposing curbs on money supply, we need an effective distribution system. We also need the support of the social workers and other public minded citizens to keep a watch on the unethical practices of shopkeepers. But nothing can mitigate the situation unless the growth of our population is checked.

Parallel economy is a new threat for the Indian economy. In India parallel economy is expanding very rapidly. Government of India introduced commissions under Kaldor, Wanchoo, Rangnekar, Chopra, and Gupta for estimating black economy. There are many factors like Controls and Licensing System, Higher Rates of Taxes, Ineffective Enforcement of Tax Laws, Inflation, Funding of political parties etc. that influence its growth. In India amount of black money are

increasing continuously which badly impacts the economic growth of the nation. Such money is a new challenge for Indian economy. Indian economy is badly affected by black money as it is underestimating GDP, increasing inequality of income, increasing illegal activities etc. Over the past 50 years, the government has at various times announced several schemes offering opportunities to bring black money overboard but the result are not so effective. Some of these schemes are: introducing the scheme of Special Bearer Bonds, demonetizing high denomination currency notes, stringent raids and scheme of voluntary disclosures. These instruments are expected to reduce the volume of the black economy.

2.8 GLOSSARY

Voluntary Unemployment: People who are unwilling to work at prevailing wage rate and people who get a continuous flow of income from their property or any other sources and need not to work, such people are voluntarily unemployed.

Involuntary Unemployment: Keynes analysed this type of unemployment. It is a situation when people are ready to work at the prevailing wage rate but could not find job.

Natural rate of Unemployment: This is postulated by the Post-Keynesians. According to them in every economy there exists a particular percentage of unemployment.

Structural unemployment : This type of unemployment is not a temporary phenomenon. It is chronic and is the result of backwardness and low rate of economic development. The structural changes of an economy are the main reason for this type of unemployment.

Frictional Unemployment: Unemployment attributable to the time required to match production activities with qualified resources. Frictional unemployment essentially occurs because resources, especially labor, are in the process of moving from one production activity to another. Employers are seeking workers and workers are seeking employment, the two sides just haven't matched up. Hence unemployment of the frictional variety increases. This mismatch is largely the result of limited information, which is often compounded by geographic separation between producer and resource.

Disguised Unemployment: Disguised unemployment occurs when more than the necessary numbers of people are employed for the specified work. Disguised unemployment is found in agriculture because of the lack of employment opportunities elsewhere. Similarly disguised unemployment can be found in industry and offices as well.

Under Employment: This exists when people are not fully employment ie; when people are partially employed. In other words it is a situation in which a person does not get the type of work he is capable of doing.

Open Unemployment: Mrs. Joan Robinson calls this type of unemployment as 'Marxian Unemployment'. It exists when people are ready to work but are not working due to non-availability of work.

Technological Unemployment: When the introduction of a new technology causes displacement of workers it is called technological unemployment.

Industrial unemployment: The exact size of the industrial unemployment is not known because the necessary data for its estimation are not available.

Educated unemployment: It constitutes large part of urban unemployment in India. Rural unemployment is the main problem of Indian government and it requires huge capitalization of capital.

2.9 ANSWERS TO CHECK YOUR PROGRESS/SAQ'S A

i. 365

ii. each of the 7 days

iii. Disguised unemployment, seasonal unemployment

2.10 ANSWERS TO CHECK YOUR PROGRESS/SAQ'S B

i. Exports, Balance of Foreign Trade

ii. upward

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2.12 TERMINAL AND MODEL QUESTIONS

1. What do you understand by unemployment?
2. What are the different types of unemployment in India?
3. What are the main causes of unemployment in India?
4. What are the major consequences of unemployment in India?
5. Elucidate the causes and consequences of rising prices in India.
6. What are the consequences of black money or parallel economy for developing economies like India? What steps can be taken to reduce the impact of parallel economy in India?

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CHAPTER 3
HUMAN RESOURCES

3.1 OBJECTIVES

After reading this lesson, you should be able:

- To summarise the basic concept of human resources.
- To associate the Malthusian Theory of Population and the Theory of Demographic Transition with the Indian population scenario.
- To bring out the characteristic features of India's demography and their linkage with economic development.
- To summarise the Population policy in India.

3.2 INTRODUCTION

The centrality of human resource (people) to the life, survival and growth of an organisation, both large and small, public or private, cannot be under estimated. People are the life-blood of any enterprises; even with the and dynamics of the management of people in organisations, the many functions in managing people and the shifting nature of the responsibility and authority for managing people in the ever growing and complex organisations. The quality of human resources has a strong influence on the ability of societies, enterprises and governments to properly identify and analyse problems, to realistically and imaginatively envisage the future and to craft plans for achieving goals and objectives. The ingredients of high quality human resources are expert knowledge and skills, capacity for knowledge acquisition, analytical capacity, ability to communicate and creative adaptive responsibilities. All of these are necessary in the evolving socio-economic development situation of all countries-under developed, developed and developing. As opined by Adam Smith the prosperity of a country is determined by the skill, efficiency and attitude of the labour used by that country. Many countries have been able to develop themselves due to the will, capacity and skill of their human resources. As for example, the countries like Japan, Singapore, Germany, and Hong Kong have been able to achieve economic miracle by mobilising their human resource.

There is a close relationship between population and economic development in the economy. It is a demographic hazard in some economies; while in various others it is acting as the demographic dividend. The study of human resources is vital from the point of view of economic welfare. It is a well-established fact that human beings are not only instruments of production but also are ends in themselves. It became rather imperative to know in quantitative terms the number of people living in a country at a particular point of time, the rate of growth of the population, composition as well as distribution of population. The above mentioned parameters are analyzed

in a systematic manner under the ambit of demography. The term is of Greek origin and is composed of the two words, *demos*(people) and *graphein*(describe), associated with population including- changes in population size; patterns of births, deaths, and migration; and the structure and composition of the population such as the relative proportions of women, men and different age groups. In the ensuing paragraphs we shall enquire into the major causes and consequences of population structures and change via the analysis of population growth theories.

3.3 THEORIES OF POPULATION GROWTH

3.3.1 Malthusian Theory of Population

In 1798 Malthus published an Essay on the Principle of Population. By analyzing the then prevailing situation in different countries Malthus initiated a debate about the connection between population and food resources that continues to this day. His premise was that:

(1) food was necessary for the continuation of life, and

(2) procreation was also necessary for the continuation of life.

Necessity of food for human survival is to continue, similarly the passions between the sexes are to continue, and both are natural necessities of life. But the two necessary factors of human life grow at different rate. Whereas population size increases geometrically (2, 4, 8, 16, 32, 64), the food supply increases arithmetically (1, 2, 3, 4, 5, 6). Population size, therefore, always pushes against the limits of food supply needed to support the population. There is a limit to increase the food supply by bringing more land under cultivation but there is limit to that. With the existing rate of growth, the population was expected to double every 25 years. For such a high growth rate of population, human beings should adopt such measures to check the growth of population. In his opinion the population checks were:

a)Preventive checks, and

b)Positive checks.

Among the *preventive checks*, Malthus recommended

a) to follow celibacy
b) to marry late,
c) abstinence from entering into sexual unions resulting in procreation.

If human beings don't adopt the "preventive checks", "positive checks" come into operation in the form of famine, epidemics, war, and other natural calamities, and a lot of population is wiped out. For the remaining population food supply may be sufficient, though it may be a temporary relief.

3.3.1.1 Criticism of Malthusian Theory:

The Malthusian theory of population has been a subject of keen controversy. The theory has been criticized on various aspects some few of which are explained below:

i. It is pointed out that Malthus's pessimistic conclusions have not been borne out by the history of Western European countries. Gloomy forecast made by Malthus about the economic conditions of future generations of mankind has been falsified in the Western world. Population has not increased as rapidly as predicted b Malthus; on the other hand, production has increased tremendously because of the rapid advances in technology. As a result, living standards of the people have risen instead of falling as was predicted by Malthus.

ii. Malthus asserted that food production would not keep pace with population growth owing to the operation of the law of diminishing returns in agriculture. But by making rapid advances in technology and accumulating capital in larger quantity, advanced countries have been able to postpone the stage of diminishing returns. By making use of fertilizers, pesticide better seeds, tractors and other agricultural machinery, they have been able to increase their production greatly. In fact, in most of the advanced countries the rate of increase of food production has been much greater than the rate of population growth. Even in India now, thanks to the Green Revolution, the increase in food production is greater than the increase in population. Thus, inventions and improvements in the methods of production have belied the gloomy forecast of Malthus by holding the law of diminishing returns in check almost indefinitely.

iii. Malthus compared the population growth with the increase in food production alone. Malthus held that because land was available in limited quantity, food production could not rise faster than population. But he should have considered all types of production in considering the question of optimum size of population. England did feel the shortage of land and food. If England had been forced to support her population entirely from her own soil, there can be little doubt that England would have experienced a series of famines by which her growth of population would have been checked. But England did not experience such a disaster. It is because England industrialized itself by developing her natural resources other than land like coal and iron, and accumulating man-made capital equipment like factories, tools, machinery, mines, ships and railways, this enabled her to produce plenty of industrial and manufacturing goods which she then exported in exchange for food-stuffs from foreign countries. There is no food problem in Great Britain. Therefore, Malthus made a mistake in taking agricultural land and food

production alone into account when discussing the population question. As already said, he should have rather considered all types of production.

iv. Malthus held that the increase in the means of subsistence or food supplies would cause population to grow rapidly so that ultimately means of subsistence or food supply would be in level with population, and everyone would get only bare minimum subsistence. In other words, according to Malthus, living standards of the people cannot rise in the long run above the level of minimum subsistence. But, as already pointed out, living standards of the people in the Western world have risen greatly and stand much above the minimum subsistence level. There is no evidence of birth-rate rising with the increases in the standard of living. Instead, there is evidence that birth-rates fall as the economy grows. In Western countries, attitude towards children changed as they developed economically. Parents began to feel that it was their duty to do as much as they could for each child. Therefore, they preferred not to have more children than they could attend to properly. People now began to care more for maintaining a higher standard of living rather than for bearing more children. The wide use of contraceptives in the Western world brought down the birth rates. This change in the attitude towards children and the wide use of contraceptives in the Western world has falsified Malthusian doctrine.

v. Malthus gave no proof of his assertion that population increased exactly in geometric progression and food production increased exactly in arithmetic progression. It has been rightly pointed out that population and food supply do not change in accordance with these mathematical series. Growth of population and food supply cannot be expected to show the precision or accuracy of such series.

India at present is in that unenviable position which Malthus feared. We have the highest birth-rate and the highest death-rate in the world. Grinding poverty, ever-recurring epidemics, famine and communal quarrels are the order of the day. We are deficient in food supply.

3.3.2 The Theory of Demographic Transition

The theory of demographic transition (or of population stages or of population cycle) has many versions. It has been propounded by W.S. Thomson and F.W. Notestein. They explain the theory in three stages. But the two famous versions are C.P. Blacker's Five Stages of Population Growth which have been explained here, and Karl Sax's Four Stages of Population Growth, namely, High Stationary, Early Explosive Increase, Late Explosive Increase, and Low Stationary. He does not explain Blacker's Declining Stage, while his four stages almost resemble Blacker's other stages.

The theory of demographic transition explains the effects of changes in birth rate and death rate on the growth rate of population. According to E.G. Dolan, "Demographic transition refers to a

population cycle that begins with a fall in the death rate, continues with a phase of rapid population growth and concludes with a decline in the birth rate."

The theory of demographic transition is based on the actual population trends of advanced countries of the world. This theory states that every country passes through different stages of population development.

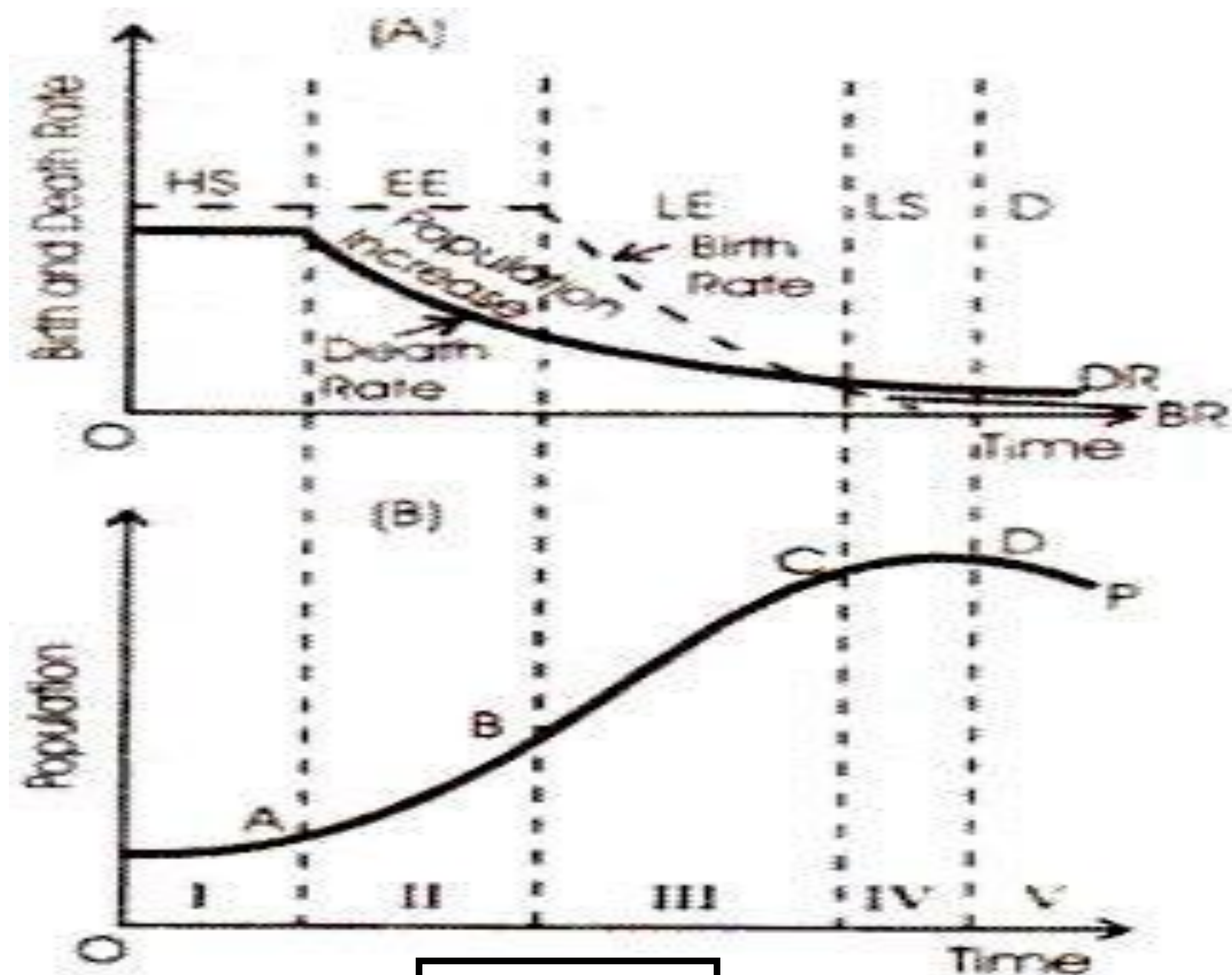

Figure 1.1

According to C.P. Blacker, they are: (i) the high stationary phase marked by high fertility and mortality rates; (ii) the early expanding phase marked by high fertility and high but declining mortality; (iii) the late expanding phase with declining fertility but with mortality declining more rapidly; (iv) the low stationary phase with low fertility balanced by equally low mortality; and (v) the declining phase with low mortality, lower fertility and an excess of deaths over births.

These stages are explained in the Fig. 1.1 (A) & (B). In the figure, the time for different stages is taken on the horizontal axis and annual birth and death rates on the vertical axis. The curves BR

and DR relate to birth rate and death rate respectively. P is the population curve in the lower portion of the figure.

3.3.2.1 First Stage:

In this stage, the country is backward and is characterised by high birth and death rates with the result that the growth rate of population is low. People mostly live in rural areas and their main occupation is agriculture which is in a state of backwardness. There are a few simple, light and small consumer goods industries.

The tertiary sector consisting of transport, commerce, banking and insurance is underdeveloped. All these factors are responsible for low incomes and poverty of the masses. Large family is regarded as a necessity to argument the low family income. Children are an asset to the society and parents. The existence of the joint family system provides employment to all children in keeping with their ages. More children in a family are also regarded as an insurance against old age by the parents. People being illiterate, ignorant, superstitious and fatalists are averse to any method of birth control. Children are regarded as God-given and pre-ordained.

All these economic and social factors are responsible for a high birth rate in the country. Along with high birth rate, the death rate is also high due to non-nutritional food with low caloric value, lack of medical facilities and the lack of any sense of cleanliness. People live in dirty and unhealthy surroundings in ill-ventilated small houses. As a result, they are disease ridden and the absence of proper medical care results in large deaths. The mortality rate is the highest among the children and the next among § women of child-bearing age. Thus the birth and death rates remain o approximately equal over time so that a g static equilibrium with zero population growth prevails. According to Blacker, this stage continued in Western Europe approximately upto 1840 and in India and China till 1900. This is illustrated in Fig. 1.1 (A) by the time period HS—"High Stationary" stage and by the horizontal portion of the P (population) curve in the lower portion of the figure.

3.3.2.2 Second Stage:

In the second stage, the economy enters the phase of economic growth. Agricultural and industrial productivity increases, and means of transport develop. There is greater mobility of labour. Education expands. Incomes increase. People get more and better quality food products, medical and health facilities are expanded.

Modern drugs are used by the people. All these factors bring down the death rate. But the birth rate is almost stable. People do not have any inclination to reduce the birth of children because with economic growth, employment opportunities increase and children are able to add more to the family income. With improvements in the standard of living and the dietary habits of the people, the life expectancy also increases. People do not make any effort to control the size of family because of the presence of religious dogmas and social taboos towards family planning. Of all the factors in economic growth, it is difficult to break with the past social institutions, customs and beliefs. As a result of these factors, the birth rate remains at the previous high level. With the decline in the death rate and no change in the birth rate, population increases at a rapid rate. This leads to Population Explosion.

This is an "Early Expanding" (EE) stage in population development when the population growth curve is rising from A to B as shown in Fig. 1.1 (B), with the decline in death rate and no change in birth rate, as shown in the upper portion of the figure. According to Blacker, 40 per cent of the world population was in this stage upto 1930. Many countries of Africa are still in this stage.

3.3.2.3 Third Stage:

In this stage, birth rate starts declining accompanied by death rates declining rapidly. With better medical facilities, the survival rate of children increases. People are not willing to support large families. The country is burdened with the growing population.

People adopt the use of contraceptives so as to limit families. Birth rates decline initially in urban areas, according to Notestein. With death rates declining rapidly, the population grows at a diminishing rate. This is the "Late Expanding" stage as shown by LE in Fig.1.1 (A) and BC in Fig.1.1 (B). According to Blacker, 20 per cent of the world population was in this stage in 1930.

3.3.2.4 Fourth Stage:

In this stage, the fertility rate declines and tends to equal the death rate so that the growth rate of population is stationary. As growth gains momentum and people's level of income increases, their standard of living rises. The leading growth sectors expand and lead to an expansion in output in other sectors through technical transformations.

Education expands and permeates the entire society. People discard old customs, dogmas and beliefs, develop individualistic spirit and break with the joint family. Men and women prefer to marry late. People readily adopt family planning devices. They prefer to go in for a baby car rather than a baby.

Moreover, increased specialisation following rising income levels and consequent social and economic mobility make it costly and inconvenient to rear a large number of children. All this tends to reduce the birth rate further which along with an already low death rate brings a decline in the growth rate of population.

The advanced countries of the world are passing through this "Lower Stationary" stage of population growth, as shown by LS in Fig. 1.1(A) and CD in Fig. (B). Population growth is curtailed and there is zero population growth.

3.3.2.5 Fifth Stage:

In this stage, death rates exceed birth rates and population growth declines. This is shown as D in Fig.1.1 (A) and the portion DP in Fig.1.1 (B). A continuing decline in birth rates when it is not possible to lower death rates further in the advanced countries leads to a 'declining' stage of population. The existence of this stage in any developed country is a matter of speculation, according to Blacker. However, France appears to approach this stage.

3.3.2.6 Criticism of the Theory of Demographic Transition:

Despite its usefulness as a theory describing demographic transition in western countries, it has been criticised on the following grounds:

i. Sequences of Stages not uniform:

Critics point out that the sequences of the demographic stages have not been uniform. For instance, in some East and South European countries, and in Spain in particular, the fertility rates declined even when mortality rates were high. But in America, the growth rate of population was higher than in the second and third stage of demographic transition.

ii. Birth Rate not declined initially in Urban Areas:

Note-stein's assertion that the birth rate declined initially among urban population in Europe has not been supported by empirical evidence. Countries like Sweden and France with predominantly rural populations experienced decline in birth rates to the same extent as countries like Great Britain with predominantly urban population.

iii. Explanations of Birth Rate decline vary:

The theory fails to give the fundamental explanations of decline in birth rates in western countries. In fact, the causes of decline in birth rate are so diverse that they differ from country to country.

The theory of demographic transition is the most acceptable theory of population growth. It does not lay emphasis on food supply like the Malthusian theory, nor does it develop a pessimistic outlook towards population growth. It is also superior to the optimum theory which lays an exclusive emphasis on the increase in per capita income for the growth of population and neglects other factors which influence it.

The biological theories are also one-sided because they study the problem of population growth simply from the biological angle. Thus the demographic transition theory is superior to all the theories of population because it is based on the actual population growth trends of the developed countries of Europe. Almost all the European countries have passed through the first three stages of this theory and are now in the fourth stage.

Thus the theory of demographic transition is a generalisation and not a theory. Not only this, the theory is equally applicable to the developing countries of the world. Very backward countries in some of the African states are still in the first stage whereas other developing countries are either in the second or in the third stage. India has entered the third stage where the death rate is declining faster than the birth rate due to better medical facilities and family welfare measures of the government. But the birth rate is declining very slowly with the result that the country is experiencing population explosion

3.4 COMMON CONCEPTS AND INDICATORS

Most demographic concepts are expressed as rates or ratios – they involve two numbers. One of these numbers is the particular statistic that has been calculated for a specific geographical-administrative unit; the other number provides a standard for comparison. For example, the *birth rate* is the total number of live births in a particular area (an entire country, a state, a district or other territorial unit) during a specified period (usually a year) divided by the total population of that area in thousands. In other words, the birth rate is the number of live births per 1000 population. The *death rate* is a similar statistic, expressed as the number of deaths in a given area during a given time per 1000 population.

These statistics depend on the reporting of births and deaths by the families in which they occur. In fact, in most countries including India, people are required by law to report births and deaths to the appropriate authorities – the local police station or primary health centre in the case of villages, and the relevant municipal office in the case of towns and cities.

The *rate of natural increase* or the growth rate of population refers to the difference between the birth rate and the death rate. When this difference is zero (or, in practice, very small) then we say that the population has 'stabilised', or has reached the 'replacement level', which is the rate of growth required for new generations to replace the older ones that are dying out. Sometimes, societies can experience a negative growth rate – that is, their fertility levels are below the replacement rate. This is true of many countries and regions in the world today, such as Japan, Russia, Italy and Eastern Europe. On the other hand, some societies experience very high growth rates, particularly when they are going through the demographic transition described earlier.

The *fertility rate* refers to the number of live births per 1000 women in the child-bearing age group, usually taken to be 15 to 49 years. But like the other rates discussed on the previous page (the birth and death rates) this is a 'crude' rate – it is a rough average for an entire population and does not take account of the differences across age-groups. Differences across age groups can sometimes be very significant in affecting the meaning of indicators. That is why demographers also calculate age-specific rates.

The *total fertility rate* refers to the total number of live births that a hypothetical woman would have if she lived through the reproductive age group and had the average number of babies in each segment of this age group as determined by the age-specific fertility rates for that area. Another way of expressing this is that the total fertility rate is the 'the average number of births to a cohort of women up to the end of the reproductive age period (estimated on the basis of the age-specific rates observed during a given period)' (Visaria and Visaria 2003).

The *infant mortality* rate is the number of deaths of babies before the age of one year per 1000 live births. Likewise, the *maternal mortality* rate is the number of women who die in childbirth per 1000 live births. High rates of infant and maternal mortality are an unambiguous indicator of backwardness and poverty; development is accompanied by sharp falls in these rates as medical facilities and levels of education, awareness and prosperity increase. One concept which is somewhat complicated is that of *life expectancy.* This refers to the estimated number of years that an average person is expected to survive. It is calculated on the basis of data on age-specific death rates in a given area over a period of time.

The *sex ratio* refers to the number of females per 1000 males in a given area at a specified time period. Historically, all over the world it has been found that there are slightly more females than males in most countries. This is despite the fact that slightly more male babies are born than

female ones; nature seems to produce roughly 943 to 952 female babies for every 1000 males. If despite this fact the sex ratio is somewhat in favour of females, this seems to be due to two reasons. First, girl babies appear to have an advantage over boy babies in terms of resistance to disease in infancy. At the other end of the life cycle, women have tended to outlive men in most societies, so that there are older women than men. The combination of these two factors leads to a sex ratio of roughly 1050 females per 1000 males in most contexts. However, it has been found that the sex ratio has been declining in some countries like China, South Korea and specially India. This phenomenon has been linked to prevailing social norms that tend to value males much more than females, which leads to 'son preference' and the relative neglect of girl babies.

The *age structure of the population* refers to the proportion of persons in different age groups relative to the total population. The age structure changes in response to changes in levels of development and the average life expectancy. Initially, poor medical facilities, prevalence of disease and other factors make for a relatively short life span. Moreover, high infant and maternal mortality rates also have an impact on the age structure. With development, quality of life improves and with it the life expectancy also improves. This changes the age structure: relatively smaller proportions of the population are found in the younger age groups and larger proportions in the older age groups. This is also referred to as the ageing of the population.

The *dependency ratio* is a measure comparing the portion of a population which is composed of dependents (i.e., elderly people who are too old to work, and children who are too young to work) with the portion that is in the working age group, generally defined as 15 to 64 years. The dependency ratio is equal to the population below 15 or above 64, divided by population in the 15-64 age group; the ratio is usually expressed as a percentage. A rising dependency ratio is a cause for worry in countries that are facing an ageing population, since it becomes difficult for a relatively smaller proportion of working-age people to carry the burden of providing for a relatively larger proportion of dependents. On the other hand, a falling dependency ratio can be a source of economic growth and prosperity due to the larger proportion of workers relative to non-workers. This is sometimes referred to as the 'demographic dividend', or benefit flowing from the changing age structure. However, this benefit is temporary because the larger pool of working age people will eventually turn into non-working old people.

3.5CHECK YOUR PROGRESS A

1.State whether the following statements are True or False:

a.The age structure changes in response to changes in levels of development and the

average life expectancy.

b.The rate of natural increase or the growth rate of population refers to the ratio of the birth rate and the death rate.

c.The birth rate is the number of live births per 1000 population.

d.In the opinion of Malthus, the population checks were either Preventive checks or Positive checks.

e.The theory of demographic transition states that not every country passes through different stages of population development.

3.6 SIZE AND GROWTH OF INDIA'S POPULATION

India is the second most populous country in the world after China, with a total population of 121 crores (or 1.21 billion) according to the Census of India 2011 (Provisional). The ensuing paragraphs throw light on the size, age profile etc. of the population of Indian sub-continent over a period of time.

3.6.1 Size of the Indian Population

As can be seen from Table 1, the growth rate of India's population has not always been very high. Between 1901–1951 the average annual growth rate did not exceed 1.33 per cent, a modest rate of growth. In fact between 1911 and 1921 there was a negative rate of growth of – 0.03 per cent. This was because of the influenza epidemic during 1918–19 which killed about 12.5 million persons or 5 per cent of the total population of the country (Visaria and Visaria 2003: 191). The growth rate of population substantially increased after independence from British rule going up to 2.2 per cent during 1961-1981. Since then although the annual growth rate has decreased it remains one of the highest in the developing world.

TABLE 1.1: The population of India and its growth during the 20th century

Year	Population	Decadal Growth of		Average annual growth rate(%)
		Population	(%)	
1901	23,83,96,327			
1911	25,20,93,390	1,36,97,063	5.75	0.56
1921	25,13,21,213	-7,72,177	-0.31	-0.03
1931	27,89,77,238	2,76,56,025	11.00	1.04
1941	31,86,60,580	3,96,83,342	14.22	1.33
1951	36,10,88,090	4,24,27,510	13.31	1.25
1961	43,92,34,771	7,81,46,681	21.64	1.96
1971	54,81,59,652	10,89,24,881	24.80	2.22
1981	68,33,29,097	13,51,69,445	24.66	2.20
1991	84,64,21,039	16,30,91,942	23.87	2.14
2001	1,02,87,37,436	18,23,16,397	21.54	1.95
2011	1,21,01,93,422	18,14,55,986	17.64	1.62

Source: Registrar General of India(2011).

Figure 1.1:Population of India (in millions)

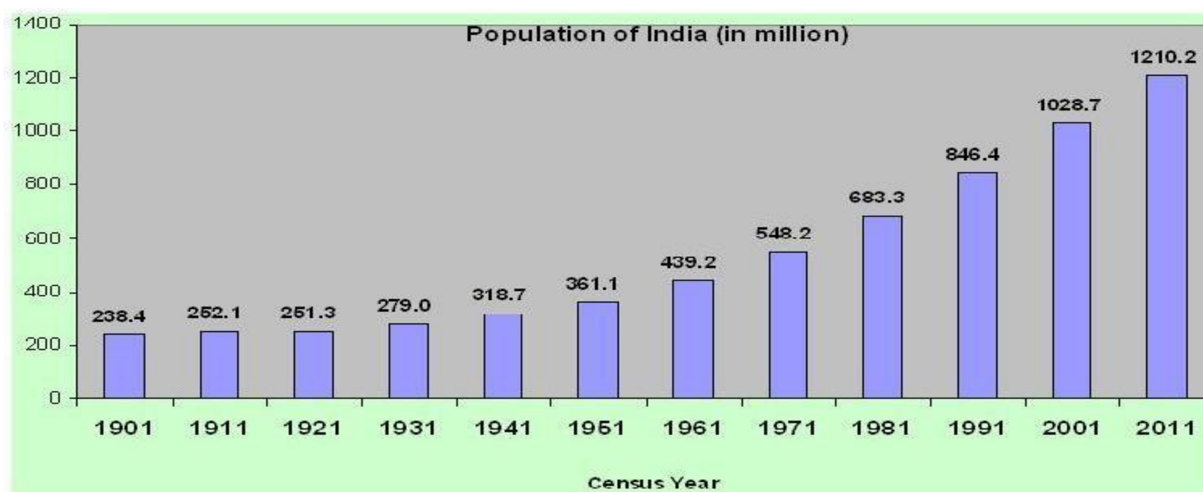

Table 1.2: Population Growth, Crude Birth and Death Rates : 1901-2011

Year	Population (in million)	Percentage Decadal variation	Average annual exponential growth rate (percent)	Crude Birth Rate	Crude Death Rate
1	2	3	4	5	6
1901	238.4	-	-	45.8	44.4
1911	252.1	5.75	(+) 0.56	49.2	42.6
1921	251.3	-0.31	(-) 0.03	48.1	47.2
1931	279.0	11.00	(+) 1.04	46.4	36.3
1941	318.7	14.22	(+) 1.33	45.2	31.2
1951	361.1	13.31	(+) 1.25	39.9	27.4
1961	439.2	21.64	(+) 1.96	41.7	22.8
1971	548.2	24.80	(+) 2.2	41.2	19.0
1981	683.3	24.66	(+) 2.22	37.2	15.0
1991	846.4	23.87	(+) 2.14	32.5	11.4
2001	1028.7	21.54	(+) 1.97	24.8	8.9
2011	1210.2	17.64	(+) 1.64		

Source:- Census of India

Improvements in medical cures for these diseases, programmes for mass vaccination, and efforts to improve sanitation helped to control epidemics. However, diseases like malaria, tuberculosis, diarrhoea and dysentery continue to kill people even today, although the numbers are nowhere as high as they used to be in the epidemics of the past. Surat witnessed a small epidemic of plague in September 1994, while dengue and chikungunya epidemics have been reported in various parts of the country in 2006. Famines were also a major and recurring source of increased mortality. Famines were caused by high levels of continuing poverty and malnutrition in an agro-climatic environment that was very vulnerable to variations in rainfall.

Lack of adequate means of transportation and communication as well as inadequate efforts on the part of the state were some of the factors responsible for famines. However, as scholars like Amartya Sen and others have shown, famines were not necessarily due to fall in foodgrains

production; they were also caused by a 'failure of entitlements', or the inability of people to buy or otherwise obtain food. Substantial improvements in the productivity of Indian agriculture (specially through the expansion of irrigation); improved means of communication; and more vigorous relief and preventive measures by the state have all helped to drastically reduce deaths from famine. Nevertheless, starvation deaths are still reported from some backward regions of the country. The National Rural Employment Guarantee Act is the latest state initiative to tackle the problem of hunger and starvation in rural areas.

Unlike the death rate, the birth rate has not registered a sharp fall. This is because the birth rate is a socio-cultural phenomenon that is relatively slow to change. By and large, increased levels of prosperity exert a strong downward pull on the birth rate.

3.6.1.1 Population Growth as a Factor of Economic Development

The process of economic development involves the utilization of physical resources of a nation by the labour force of a country so that the productive potential of the country is realised. In this effort of development there is no doubt that the labour force of a country makes a positive contribution, but is equally true that rapidly growing population retards the process of development. The impact of rising population acting as a drag on economic resources is felt in a variety of ways. It would be of interest to examine the problem in this setting.

i. *Population and growth of national per capita income:* During 1980-81 and 200-01, the annual average growth rate of net national product (NNP) was 5.4 per cent and that of per capita NNP was 3.4 per cent. It has been observed in the Census 2011 that there has been decline in the growth of population in 2001- 2011, consequently increasing the per capita income.

ii. *Population and Food Supply:* Ever since Malthus wrote his *celebrated Essay on Population* , attention was focussed on the problem of population versus food supply. There is no doubt that per capita cultivated area is gradually on the decline in India. Between 1921 and 2011 the per capita cultivated area has declined by nearly 71 per cent. To compensate this fall in cultivated land-man ratio, it is imperative that efforts be made to raise productivity.

iii. *Population and unemployment:* Rising population is accompanied by a rise in the labour force of the community. It has been indicated in earlier paragraphs that the rate of unemployment has increased in absolute and relative terms during the last 55 years of planning. Obviously, a significant proportion of the national resources will have to be

used to expand opportunities to absorb the increasing labour force and the backlog of unemployed left over due to the continuous pressure of a rapidly growing population.

iv. *Population and the Burden of Education, Medical Care and Housing:* rising population increases the number of children and hence demands higher expenditure on education. There is no doubt that expenditure can be viewed as social investment in human beings that ultimately enhances the productivity of the labour force, but it may be emphasised that the time lag in this respect is quite long and hence the direct effect in raising output per unit of investment is very low. Same kind of situation prevails regarding medical care and housing facilities to be provided to the growing chunk of population.

v. *Increase in Population and Capital formation:* it is quite necessary that national income should grow at the same rate at which population is growing so that the existing level of real per capita income is maintained. To achieve this, capital investment is necessary. In order to bring about an increase of national income at the rate of 1.5 per cent, capital accumulation of the order of 6.2 per cent is necessary.

3.6.2 Age Structure of the Indian Population

India has a very young population – that is, the majority of Indians tend to be young, and the average age is also less than that for most other countries. Table 1.3 shows that the share of the under 15 age group in the total population has come down from its highest level of 42 per cent in 1971 to 35 per cent in 2001. The share of the 15-60 age group has increased slightly from 53 per cent to 59 per cent, while the share of the 60+ age group is very small but it has begun to increase (from 5 per cent to 7 per cent) over the same period. But the age composition of the Indian

Table 1.3: Age Composition of the Population of India, 1961-2026

Year	Age – groups			Total
	0-14 years	15-59 Years	60+ Years	
1961	41	53	6	100
1971	42	53	5	100
1981	40	54	6	100
1991	38	56	7	100
2001	34	59	7	100
2011	29	63	8	100
2026	23	64	12	100

Age Group columns show percentage shares; rows may not add up to 100 because of rounding

Source: Based on data from the Technical Group on Population Projections (1996 and 2006) of the National Commission on Population. Webpage for 1996 Report: http://populationcommission.nic.in/facts1.htm

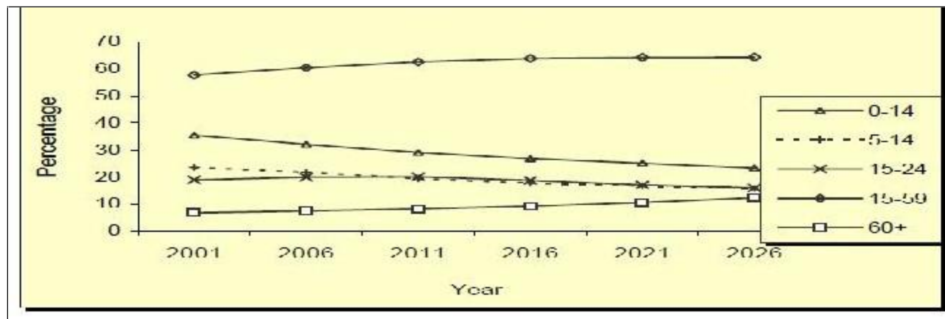

Figure 1.1: Percentage of Population by broad age-groups India 2001 - 2026

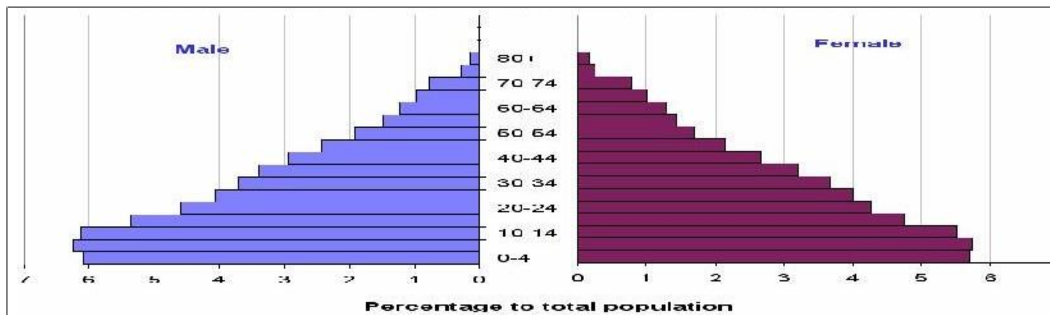

Chart 1.2 Age-group wise Population Pyramid 2001

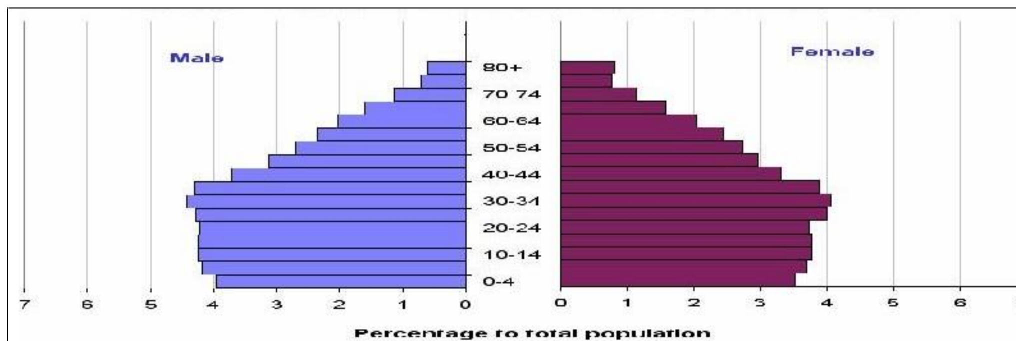

Chart 1.2 Age-group wise Population Pyramid 2011

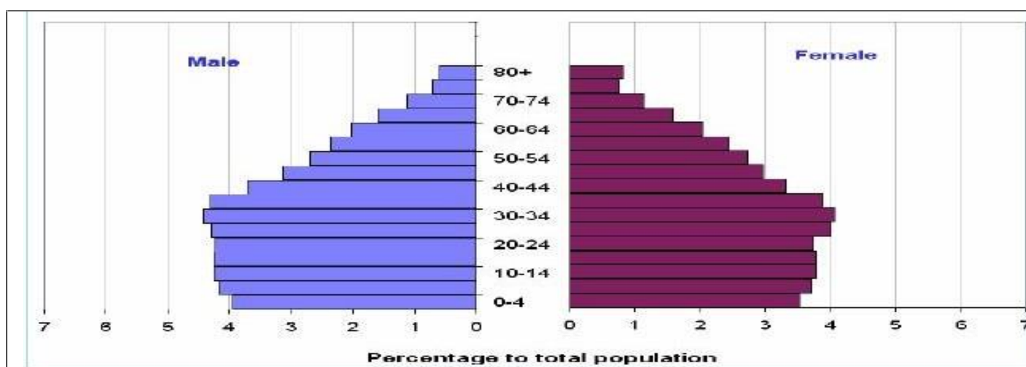

Chart 1.2 Projected Age-group wise Population Pyramid 2026

Source: Based on data from relevant volumes of the Census of India (1961, 1981 & 2001) and the Report of the Technical Group on Population Projections (2006) of the National Commission on Population.

population is expected to change significantly in the next two decades. Most of this change will be at the two ends of the age spectrum – as Table 1.3 shows, the 0 -14 age group will reduce its share by about 11 per cent (from 34 per cent in 2001 to 23 per cent in 2026) while the 60 plus age group will increase its share by about 5 per cent (from 7 per cent in 2001 to about 12 per cent in 2026.)

These pyramids show you the effect of a gradual fall in the birth rate and rise in the life expectancy. As more and more people begin to live to an older age, the top of the pyramid grows wider. As relatively fewer new births take place, the bottom of the pyramid grows narrower. But the birth rate is slow to fall, so the bottom doesn't change much till late 80s. The middle of the pyramid grows wider and wider as its share of the total population increases. This creates a 'bulge' in the middle age groups that is clearly visible in the pyramid for 2026. This is referred to as the 'demographic dividend' which will be discussed later in this chapter.

The bias towards younger age groups in the age structure is believed to be an advantage for India. Like the East Asian economies in the past decade and like Ireland today, India is supposed to be benefitting from a 'demographic dividend'. This dividend arises from the fact that the current generation of working-age people is a relatively large one, and it has only a relatively small preceding generation of old people to support. But there is nothing automatic about this advantage – it needs to be consciously exploited through appropriate policies.

The demographic advantage or 'dividend' to be derived from the age structure of the population is due to the fact that India is (and will remain for some time) one of the youngest countries in the world. A third of India's population was below 15 years of age in 2000. In 2020, the average Indian will be only 29 years old, compared with an average age of 37 in China and the United States, 45 in Western Europe, and 48 in Japan. This implies a large and growing labour force, which can deliver unexpected benefits in terms of growth and prosperity.

The recent survey on employment and unemployment in India, conducted by the National Sample Survey Office (NSSO), has attracted considerable media attention. This was mainly due to the wide fluctuations in overall employment growth as shown by these surveys. Overall employment in the country rose markedly by 59.4 million between 1999-2000 and 2004-05. But during the next five years, 2004-05 to 2009-10, net employment generated fell sharply to only 4.7 million, leading to the suggestion that this was a period of "jobless growth". Employment growth recovered subsequently, with 10 million new jobs registered between the surveys held in 2009-10

and 2011-12. However, an exclusive focus on the growth of overall employment – which is the sum of employment in agriculture and the non-agricultural sectors – can be misleading for a developing country like India. With economic development, employment in agriculture is expected to decline, both in relative terms as well as in absolute numbers. However, agricultural employment in India increased by 17.4 million between 1999-2000 and 2004-05, and some studies have attributed this increase to rural distress, that is, people were driven to find work to supplement household incomes during a difficult period (Table 1.4). On the other hand, between 2004-05 and 2009-10, agricultural employment declined absolutely by 20.4 million, leading also to the deceleration in overall employment growth. This decline in agricultural employment was, at least partly, a reversal from the "distress employment" created during the previous five-year period (Thomas 2012). Agricultural employment declined further by 12.9 million between 2009-10 and 2011-12 (Table 1.4).

Table 1.4: Net Increase in the Number of Workers in India, 1983 to 2011-12 (numbers in million)

Period	Net Increase			Net Annual Increase	
	All Workers	Agricultural Workers	Non-Agricultural workers	All Workers	Non-Agricultural workers
1983 to 1993-94	71.1	32.4	38.7	6.8	3.7
1993-94 to 2004-05	83.4	18.2	65.2	7.9	5.9
2004-05 to 2011-12	14.7	-33.3	48.0	1.4	6.9
1993-94 to 1999-2000	24.0	0.8	23.2	4.0	3.9
1999-2000 to 2004-05	59.4	17.4	41.9	11.9	8.4
2004-05 to 2009-10	4.7	-20.4	25.1	0.9	5.0
2009-10 to 2011-12	10.0	-12.9	22.9	5.0	11.5

Source: Estimates based on the Survey on Employment and Unemployment, NSSO, 38th, 50th, 55th, 61st, 66th and 68th rounds
Refers to the usual principal and usual subsidiary status (UPSS) workers. Size of the workforce (in any year) is obtained by multiplying workforce participation rate (WPR) from the NSSO reports with the population figures from the Census of India. There are some differences between the estimates of workers reported in this article and those in Thomas (2012). This is because the population figures for 2004-05 and 2009-10 used in Thomas (2012) were projections based on the Census of India data until 2001. In this article, these population figures have been revised using data from the Census of India 2011.

The creation of non-agricultural employment in India was at the rate of 8.4 million a year between 1999-2000 and 2004-05, which slowed down to five million a year between 2004-05 and 2009-10, but rose again to 11.5 million a year between 2009-10 and 2011-12. Notably, the rate of generation of non-agricultural employment in the country improved from 5.9 million a year between 1993-94 and 2004-05 to 6.9 million a year between 2004-05 and 2011-12 (Table 1.4). Therefore the suggestion, based on trends in overall employment, that India's employment growth decelerated after the mid-2000s is without basis. However, a more pertinent question is whether the pace and nature of employment generation in India is adequate given the challenges on the labour supply front.

The ‘demographic dividend’ results from an increase in the proportion of workers relative to non-workers in the population. In terms of age, the working population is roughly that between 15 and 64 years of age. This working age group must support itself as well as those outside this age group (i.e., children and elderly people) who are unable to work and are therefore dependents. Changes in the age structure due to the demographic transition lower the ‘dependency ratio’, or the ratio of non-working age to working-age population, thus creating the potential for generating growth.

But this potential can be converted into actual growth only if the rise in the working age group is accompanied by increasing levels of education and employment. If the new entrants to the labour force are not educated then their productivity remains low. If they remain unemployed, then they are unable to earn at all and become dependents rather than earners. Thus, changing age structure by itself cannot guarantee any benefits unless it is properly utilised through planned development. The real problem is in defining the dependency ratio as the ratio of the non-working age to working-age population, rather than the ratio of non-workers to workers. The difference between the two is determined by the extent of unemployment and underemployment, which keep a part of the labour force out of productive work. This difference explains why some countries are able to exploit the demographic advantage while others are not. India is indeed facing a window of opportunity created by the demographic dividend. The effect of demographic trends on the dependency ratio defined in terms of age groups is quite visible. The total dependency ratio fell from 79 in 1970 to 64 in 2005. But the process is likely to extend well into this century with the age-based dependency ratio projected to fall to 48 in 2025 because of continued fall in the proportion of children and then rise to 50 by 2050 because of an increase in the proportion of the aged.

3.6.3 The Declining Sex-Ratio in India

The sex ratio is an important indicator of gender balance in the population. As mentioned in the section on concepts earlier, historically, the sex ratio has been slightly in favour of females, that is, the number of females per 1000 males has generally been somewhat higher than 1000. However, India has had a declining sex-ratio for more than a century, as is clear from Table 1.5

Table 1.5:India’s Population, decadal variation in Population, Annual Exponential Growth Rate, CBR, CDR and Sex Ratio(1901-2011)

Year	Population (in million)	Percentage Decadal variation	Average annual exponential growth rate (percent)	Crude Birth Rate	Crude Death Rate	Sex Ratio (females per 1000 males)
1	2	3	4	5	6	7
1901	238.4	-	-	45.8	44.4	972
1911	252.1	5.75	(+) 0.56	49.2	42.6	964
1921	251.3	- 0.31	(+) 0.03	48.1	47.2	955
1931	279.0	11.00	(+) 1.04	46.4	36.3	950
1941	318.7	14.22	(+) 1.33	45.2	31.2	945
1951	361.1	13.31	(+) 1.25	39.9	27.4	946
1961	439.2	21.51	(+) 1.95	41.7	22.8	941
1971	548.2	24.80	(+) 2.2	41.2	19.0	930
1981	683.3	24.66	(+) 2.22	37.2	15.0	934
1991	846.4	23.87	(+) 2.14	32.5	11.4	927
2001	1028.7	21.54	(+)1.97	24.8	8.9	933
2011	1210.2	17.64	(+) 1.64			940

Source: Census of India

Table 1.6 Sex ratio of India(all age groups), Child sex ratio(0-6 years) and their variations over previous decade.

Year	Sex-ratio (all age groups)	Variation over previous decade	Child Sex ratio (0 – 6 years)	Variation over previous decade
1901	972	-	-	-
1911	964	-8	-	-
1921	955	-9	-	-
1931	950	-5	-	-
1941	945	-5	-	-
1951	946	+1	-	-
1961	941	-5	976	-
1971	930	-11	964	-12
1981	934	+4	962	-2
1991	927	-7	945	-17
2001	933	+6	927	-18
2011	940	+7	914	-13

Source: Census of India (Provisional)

Note: The sex ratio is defined as the number of females per thousand males. Data on age specific sex ratios is not available before 1961.

From 972 females per 1000 males at the turn of the twentieth century, the sex ratio has declined to 933 at the turn of the twenty-first century. The trends of the last four decades have been

particularly worrying – from 941 in 1961 the sex ratio had fallen to an all time low of 927 in 1991 before posting a modest increase in 2001. According to the provisional data of Census of India 2011 sex ratio has been increased and now it is 940 females per 1000 males.

But what has really alarmed demographers, policy makers, social activists and concerned citizens is the drastic fall in the child sex ratio. Age specific sex ratios began to be computed in 1961. As is shown in Table 1.6, the sex ratio for the 0 – 6 years age group (known as the juvenile or child sex ratio) has generally been substantially higher than the overall sex ratio for all age groups, but it has been falling very sharply. In fact the decade 1991-2001 represents an anomaly in that the overall sex ratio has posted its highest ever increase of 6 points from the all time low of 927 to 933, but the child sex ratio has dropped from 945 to 927, a plunge of 18 points taking it below the overall sex ratio for the first time. In 2011 Census (provisional) the child sex ratio again decreased by 13 points and now it is 914. The problem, however, is employment. Data from the National Sample Survey studies of 1999-2000 and from the 2001 Census of India reveal a sharp fall in the rate of employment generation (creation of new jobs) across both rural and urban areas. This is true for the young as well. The rate of growth of employment in the 15-30 age group, which stood at around 2.4 per cent a year between 1987 and 1994 for both rural and urban men, fell to 0.7 for rural men and 0.3 per cent for urban men during 1994 to 2004. This suggests that the advantage offered by a young labour force is not being exploited.

Strategies exist to exploit the demographic window of opportunity that India has today. But India's recent experience suggests that market forces by themselves do not ensure that such strategies would be implemented. Unless a way forward is found, we may miss out on the potential benefits that the country's changing age structure temporarily offers. *[Source: Adapted from an article by C.P. Chandrashekhar in* Frontline *Volume 23 - Issue 01, January 14-27, 2006]*

Demographers and sociologists have offered several reasons for the decline in the sex ratio in India. The main health factor that affects women differently from men is childbearing. It is relevant to ask if the fall in the sex ratio may be partly due to the increased risk of death in childbirth that only women face. However, maternal mortality is supposed to decline with development, as levels of nutrition, general education and awareness as well as the availability of medical and communication facilities improves. Indeed, maternal mortality rates have been coming down in India even though they remain high by international standards. So it is difficult to see how maternal mortality could have been responsible for the *worsening* of the sex ratio over time. Combined with the fact that the decline in the child sex ratios has been much steeper than

the overall figure, social scientists believe that the cause has to be sought in the differential treatment of girl babies.

Several factors may be held responsible for the decline in the child sex ratio including severe neglect of girl babies in infancy, leading to higher death rates; sex specific abortions that prevent girl babies from being born; and female infanticide (or the killing of girl babies due to religious or cultural beliefs). Each of these reasons point to a serious social problem, and there is some evidence that all of these have been at work in India. Practices of female infanticide have been known to exist in many regions, while increasing importance is being attached to modern medical techniques by which the sex of the baby can be determined in the very early stages of pregnancy. The availability of the sonogram (an x-ray like diagnostic device based on ultra-sound technology), originally developed to identify genetic or other disorders in the foetus, may be used to identify and selectively abort female foetuses.

It is also possible (though this issue is still being researched) that as economically prosperous families decide to have fewer children – often only one or two now – they may also wish to choose the sex of their child. This becomes possible with the availability of ultra-sound technology, although the government has passed strict laws banning this practice and imposing heavy fines and imprisonment as punishment. Known as the Pre-Natal Diagnostic Techniques (Regulation and Prevention of Misuse) Act, this law has been in force since 1996, and has been further strengthened in 2003. However, in the long run the solution to problems like the bias against girl children depends more on how social attitudes evolve, even though laws and rules can also help.

3.6.4 Literacy

Literacy as a prerequisite to education is an instrument of empowerment. The more literate the population the greater the consciousness of career options, as well as participation in the knowledge economy. Further, literacy can lead to health awareness and fuller participation in the cultural and economic well being of the community. Literacy levels have improved considerably after independence, and almost two-thirds of our population is now literate. But improvements in the literacy rate have to struggle to keep up with the rate of growth of the Indian population, which is still quite high. Enormous effort is needed to ensure the literacy of the new generations – which are only just beginning to be smaller in numbers than in the past (remember the discussion on age structure and the population pyramids earlier in this chapter).

Literacy varies considerably across gender, across regions, and across social groups. As can be seen from Table 4, the literacy rate for women is 16.7 per cent less than the literacy rate for men (Census of India 2011-Provisional). However, female literacy has been rising faster than male literacy, partly because it started from relatively low levels. Female literacy rose by about 11.2 per cent between 2001 and 2011 compared to the rise in male liercy of 6.2 per cent in the same period (Provisional). Literacy increased approximately 9 per cent in total. Male literacy rose about 6 per cent whereas female literacy rose about 10 per cent . Again female literacy has been rising faster than male literacy. Literacy rates also vary by social group – historically disadvantaged communities like the Scheduled Castes and Scheduled Tribes have lower rates of literacy, and rates of female literacy within these groups are even lower. Regional variations are still very wide, with states like Kerala approaching universal literacy, while states like Bihar are lagging far behind. The inequalities in the literacy rate are especially important because they tend to reproduce inequality across generations. Illiterate parents are at a severe disadvantage in ensuring that their children are well educated, thus perpetuating existing inequalities.

TABLE 1.7: Literacy Rate in India-Percentage of population 7 years of age and above

Year	Persons	Males	Females	Male-Female gap in literacy rate
1951	18.3	27.2	8.9	18.3
1961	28.3	40.4	15.4	25.1
1971	34.5	46.0	22.0	24.0
1981	43.6	56.4	29.8	26.6
1991	52.2	64.1	39.3	24.8
2001	65.4	75.9	54.2	21.7
2011*	74.0	82.1	65.4	16.7

*Source: Bose (2001:22) *Census of India 2011 (Provisional).*

3.6.5 Rural-Urban Differences

The vast majority of the population of India has always lived in the rural areas, and that continues to be true. According to Census of India 2011 (Provisional) still more people are living in rural areas but the population of urban areas has increased. Now 68.8 per cent population lives in rural areas while 31.2 per cent people live in urban areas. However, as Table 5 shows, the urban population has been increasing its share steadily, from about 11 per cent at the beginning of the twentieth century to about 28 per cent at the beginning of the twenty-first century, an increase of about two-and-a-half times. It is not a question of numbers alone; processes of modern development ensure that the economic and social significance of the agrarian-rural way of life

declines relative to the significance of the industrial-urban way of life. This has been broadly true all over the world, and it is true in India as well.

Table 1.8: Rural and Urban Population of India

Year	Population(Millions)		Percentage of Total Population	
	Rural	Urban	Rural	Urban
1901	213	26	89.2	10.8
1911	226	26	89.7	10.3
1921	223	28	88.8	11.2
1931	246	33	88.0	12.0
1941	275	44	86.1	13.9
1951	299	62	82.7	17.3
1961	360	79	82.0	18.0
1971	439	109	80.1	19.9
1981	524	159	76.7	23.3
1991	629	218	74.3	25.7
2001	743	286	72.2	27.8
2011*	833	377	68.8	31.2

*Source :India 2006. A Reference Annual; * Census of India 2011(Provisional)*

Agriculture used to be by far the largest contributor to the country's total economic production, but today it only contributes about one-fourth of the gross domestic product. While the majority of our people live in the rural areas and make their living out of agriculture, the relative economic value of what they produce has fallen drastically. Moreover, more and more people who live in villages may no longer work in agriculture or even in the village. Rural people are increasingly engaged in non-farm rural occupations like transport services, business enterprises or craft manufacturing. If they are close enough, then they may travel daily to the nearest urban centre to work while continuing to live in the village. Mass media and communication channels are now bringing images of urban life styles and patterns of consumption into the rural areas. Consequently, urban norms and standards are becoming well known even in the remote villages, creating new desires and aspirations for consumption. Mass transit and mass communication are bridging the gap between the rural and urban areas. Even in the past, the rural areas were never really beyond the reach of market forces and today they are being more closely integrated into the consumer market. Considered from an urban point of view, the rapid growth in urbanisation shows that the town or city has been acting as a magnet for the rural population. Those who cannot find work (or sufficient work) in the rural areas go to the city in search of work. This flow of rural-to-urban migration has also been accelerated by the continuous decline of common property resources like ponds, forests and grazing lands. These common resources enabled poor people to survive in the villages although they owned little or no land. Now, these resources have

been turned into private property, or they are exhausted. (Ponds may run dry or no longer provide enough fish; forests may have been cut down and have vanished…). If people no longer have access to these resources, but on the other hand have to buy many things in the market that they used to get free (like fuel, fodder or supplementary food items), then their hardship increases. This hardship is worsened by the fact that opportunities for earning cash income are limited in the villages.

Sometimes the city may also be preferred for social reasons, specially the relative anonymity it offers. The fact that urban life involves interaction with strangers can be an advantage for different reasons. For the socially oppressed groups like the Scheduled Castes and Scheduled Tribes, this may offer some partial protection from the daily humiliation they may suffer in the village where everyone knows their caste identity. The anonymity of the city also allows the poorer sections of the socially dominant rural groups to engage in low status work that they would not be able to do in the village. All these reasons make the city an attractive destination for the villagers. The swelling cities bear testimony to this flow of population. This is evident from the rapid rate of urbanisation in the post-Independence period. While urbanisation has been occurring at a rapid pace, it is the biggest cities – the metropolitans – that have been growing the fastest. These metros attract migrants from the rural areas as well as from small towns. There are now 5,161 towns and cities in India, where 286 million people live. What is striking, however, is that more than two-thirds of the urban population lives in 27 big cities with million-plus populations. Clearly the larger cities in India are growing at such a rapid rate that the urban infrastructure can hardly keep pace. With the mass media's primary focus on these cities, the public face of India is becoming more and more urban rather than rural. Yet in terms of the political power dynamics in the country, the rural areas remain a decisive force.

3.7 POPULATION POLICY IN INDIA

It will be clear from the discussion in this chapter that population dynamics is an important matter and that it crucially affects the developmental prospects of a nation as well as the health and well being of its people. This is particularly true of developing countries that have to face special challenges in this regard. It is hardly surprising therefore that India has had an official population policy for more than a half century. In fact, India was perhaps the first country to explicitly announce such a policy in 1952.

The population policy took the concrete form of the National Family Planning Programme. The broad objectives of this programme have remained the same – to try to influence the rate and pattern of population growth in socially desirable directions. In the early days, the most important objective was to slow down the rate of population growth through the promotion of various birth control methods, improve public health standards, and increase public awareness about population and health issues. Over the past half-century or so, India has many significant achievements to her credit in the field of population.

The Family Planning Programme suffered a setback during the years of the National Emergency (1975-76). Normal parliamentary and legal procedures were suspended during this time and special laws and ordinances issued directly by the government (without being passed by Parliament) were in force. During this time the government tried to intensify the effort to bring down the growth rate of population by introducing a coercive programme of mass sterilisation. Here sterilisation refers to medical procedures like vasectomy (for men) and tubectomy (for women) which prevent conception and childbirth. Vast numbers of mostly poor and powerless people were forcibly sterilised and there was massive pressure on lower level government officials (like school teachers or office workers) to bring people for sterilisation in the camps that were organised for this purpose. There was widespread popular opposition to this programme, and the new government elected after the Emergency abandoned it. The National Family Planning Programme was renamed as the National Family Welfare Programme after the Emergency, and coercive methods were no longer used. The programme now has a broad-based set of socio-demographic objectives. A new set of guidelines were formulated as part of the National Population Policy of the year 2000. The National Population Policy(2000) with a view to encourage two-child norm and aim at stabilizing the population by 2046 A.D. The main features of the policy are summarised below in the form of the policy targets set for the year 2010.

National Socio-Demographic Goals for 2010

- **i.** Address the unmet needs for basic reproductive and child health services, supplies and infrastructure.
- **ii.** Make school education up to age 14 free and compulsory, and reduce drop outs at primary and secondary school levels to below 20 per cent for both boys and girls.
- **iii.** Reduce infant mortality rate to below 30 per 1000 live births.
- **iv.** Reduce maternal mortality ratio to below 100 per 100,000 live births.
- **v.** Achieve universal immunisation of children against all vaccine preventable diseases.

vi. Promote delayed marriage for girls, not earlier than age 18 and preferably after 20 years of age.
vii. Achieve 80 percent institutional deliveries and 100 per cent deliveries by trained persons.
viii. Achieve universal access to information/counselling, and services for fertility regulation and contraception with a wide basket of choices.
ix. Achieve 100 per cent registration of births, deaths, marriage and pregnancy.
x. Contain the spread of Acquired Immuno Deficiency Syndrome (AIDS), and promote greater integration between the management of reproductive tract infections (RTI) and sexually transmitted infections (STI) and the National AIDS Control Organisation.
xi. Prevent and control communicable diseases.
xii. Integrate Indian Systems of Medicine (ISM) in the provision of reproductive and child health services, and in reaching out to households.
xiii. Promote vigorously the small family norm to achieve replacement levels of TFR.
xiv. Bring about convergence in implementation of related social sector programmes so that family welfare becomes a people centred programme.

The Action Plan drawn for the next 10 crucial years included the following:

a. Self-help groups at village panchayat levels comprising mostly of housewives will interact with health care workers and gram panchayats.
b. Elementary education to be made free and compulsory.
c. Registration of marriage, pregnancy to be made compulsory along with births and deaths.

The history of India's National Family Welfare Programme teaches us that while the state can do a lot to try and create the conditions for demographic change, most demographic variables (specially those related to human fertility) are ultimately matters of economic, social and cultural change.

India's Demographic Achievement

Half a century after formulating the national family welfare programme, India has:

i. reduced crude birth rate from 40.8 (1951) to 24.1 (2004, SRS);
ii. reduced the infant mortality rate from 146 per 1000 live births (1951) to 58 per 1000 live births (2004, SRS);
iii. quadrupled the couple protection rate from 10.4 percent (1971) to 44 percent (1999);
iv. reduced crude death rate from 25 (1951) to 7.5 (2004, SRS);
v. added 25 years to life expectancy from 37 years to 62 years;
vi. achieved nearly universal awareness of the need for and methods of family planning, and
vii. halved the total fertility rate from 6.0 (1951) to 3.0 (2004, SRS).

Source: National Commission on Population.

3.8 SUMMARY

As per the Census 2011, India's population which is nearly 121 crores now is composed of 51.5 per cent of males and 48.5 per cent of females. As compared to the past times, the Census 2011's results show that there has been much less growth in population during 2001 to 2011, than before, and there has been a sharp decline in decadal growth of population. Another noteworthy issue is that in this growth of population, fewer men were added in the population than women. Certain qualitative improvements have also been observed in the results of Census 2011 like the improved sex ratio, increase in literacy rate, better female literacy rate, narrowing down of regional disparities. On the other hand, a major cause of concern highlighted by Census 2011 is that there are 50 lakh less children in the 0-6 years in 2011 than 2001. This is the obvious outcome of decline in growth rate of population in the last decade as compared to the previous decade. The major problem with this decline is that the sex ratio in the 0- 6 years has declined from 927 girls per 1000 boys to 914. Most of the other demographic parameters were quite encouraging in the Census 2011. About the female population who are considered disadvantaged in terms of health and education, Census 2011 shows a silver lining. Finally it can be concluded hereby that the actual realization of demographic dividend will depend on improving health care levels as well as increasing human resource development, especially education.

3.9 GLOSSARY

Demography: The term demography is of Greek origin and is composed of the two words, *demos*(people) and *graphein*(describe), associated with population including- changes in population size; patterns of births, deaths, and migration; and the structure and composition of the population such as the relative proportions of women, men and different age groups.

Birth Rate: The *birth rate* is the total number of live births in a particular area (an entire country, a state, a district or other territorial unit) during a specified period (usually a year) divided by the total population of that area in thousands. In other words, the birth rate is the number of live births per 1000 population.

Death Rate: The *death rate* is a statistic, expressed as the number of deaths in a given area during a given time per 1000 population.

Rate of Natural Increase of Population: The *rate of natural increase* or the growth rate of population refers to the difference between the birth rate and the death rate.

Fertility Rate: The *fertility rate* refers to the number of live births per 1000 women in the child - bearing age group, usually taken to be 15 to 49 years.

Total Fertility Rate: The *total fertility rate* refers to the total number of live births that a hypothetical woman would have if she lived through the reproductive age group and had the

average number of babies in each segment of this age group as determined by the age-specific fertility rates for that area.

Infant Mortality Rate: The *infant mortality* rate is the number of deaths of babies before the age of one year per 1000 live births.

Maternal Mortality Rate: The *maternal mortality* rate is the number of women who die in childbirth per 1000 live births.

Life Expectancy: This refers to the estimated number of years that an average person is expected to survive. It is calculated on the basis of data on age-specific death rates in a given area over a period of time.

Sex Ratio: The *sex ratio* refers to the number of females per 1000 males in a given area at a specified time period.

Age Structure of the Population :The *age structure of the population* refers to the proportion of persons in different age groups relative to the total population. The age structure changes in response to changes in levels of development and the average life expectancy.

The Dependency Ratio: The *Dependency ratio* is a measure comparing the portion of a population which is composed of dependents (i.e., elderly people who are too old to work, and children who are too young to work) with the portion that is in the working age group, generally defined as 15 to 64 years. The dependency ratio is equal to the population below 15 or above 64, divided by population in the 15-64 age group; the ratio is usually expressed as a percentage.

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3.11 ANSWERS TO CHECK YOUR PROGRESS

i. True

ii. False

iii. True

iv. False

v. False

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3.13 TERMINAL AND MODEL QUESTIONS

1. Explain the basic argument of the theory of demographic transition. Why is the transition period associated with a 'population explosion'?
2. Why did Malthus believe that catastrophic events like famines and epidemics that cause mass deaths were inevitable?
3. What is meant by 'birth rate' and 'death rate'? Explain why the birth rate is relatively slow to fall while the death rate declines much faster.
4. Critically analyse the theories of Demographic Transition.
5. What is meant by the 'age structure' of the population? Why is it relevant for economic development and growth?
6. What is meant by the 'sex ratio'? What are some of the implications of a declining sex ratio? Do you feel that parents still prefer to have sons rather than daughters? What, in your opinion, could be some of the reasons for this preference?
7. Explain the significance of Population Policy for a developing economy like India. Briefly analyse the Population Policy of India.

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CHAPTER 4

ECONOMIC PLANNING 1

4.1 Objectives

After reading this chapter you will be able to:

i. Understand the meaning of Planning
ii. Understand the Need of Planning
iii. Understand the types of Planning.
iv. Evaluate the importance of Planning.

4.2 Introduction

Economic development has been closely linked with planning. Planning has become a craze in modern times, especially in under-developed and developing countries. The idea of planning acquired a tremendous support after the end of World War II when advanced but disrupted economies had to be rehabilitated and the underdeveloped economies were fired with the ambition of rapid economic development.

The idea of planning was not kindly taken up in some countries by some people. It was perhaps due to the fact that planning came to be most actively associated with socialist economies. Hatred of socialism was most actively transferred to planning too. But such unreasoned opposition to planning has now almost vanished. Even in capitalist countries, where the economy is governed and directed by market incentives, planning are being practiced more or less in one or the other sector of the economy. About 20% of the American economy may be considered as planned because to this extent current resources are controlled and disposed of by the State.

Although the distinction between planned and the unplanned economy is there, yet planning has been universally accepted and the planned sector is expanding almost everywhere. For the under developed countries, desirous of accelerating development, planning is sine qua non of progress. As Robbins says, "Planning is the grand panacea of our age" It is no longer a forbidden fruit.

The concept of economic planning attracted the attention of most of developing countries since it's first experiment made by then soviet union in 1928. Since then it was adopted by number of countries in various forms. For having enough understanding of the concept, it is felt essential to study its basic doctrine.

4.3 Meaning of Planning:

The term "planning" is now so much in common use that it seems to be unnecessary to define it or to explain its meaning. In fact, it is not possible to give it any precise or universally acceptable definition. There is no unanimity among political thinkers and economists about the concept of planning. As Raymond Burrows remarks, "Planning as a modern panacea is as perplexing to a pedant as it is popular to a protagonist".

It is rather difficult to give a concise definition of economic planning with a fair degree of precision and acceptability to one and all. Hence different economists have defined economic planning in a variety of ways by keeping in mind the goals to be achieved and the techniques for achieving them. Apart from stating that planning is a method, a technique or a means to an end, the end being the realization of clearly set targets, we discuss the number of definitions which in their totality convey the full meaning and content of economic planning.

National Planning Commission of India- "Planning under a democratic system may be defined as the technical co-ordination, by disinterested experts, of consumption, production , investment, trade and income distribution, in accordance with social objectives set by bodies representative of the nation. Such planning is not only to be considered from the point of view of economics and the raising of the standard of living but mist include cultural and spiritual and the human side of life".

"Economic Planning is the making of major economic decisions what and how much is to be produced, how, when and where it is to be produced, and to whom it is to be allocated by the comprehensive survey of the economic system as whole". This is by far the most comprehensive definition as it describes the anatomy of planning. The planning is done by central authority like state possessing the powers for implementation. It is to be preceded by a comprehensive survey of economic conditions which will point out the defects and deficiencies of the prevailing economic system. After this survey, definite goals are fixed. The manner and timing, quantitative aspects of achieving these goals are then outlined; finally, the benefits accruing from such action are to be shared for the maximum satisfaction of the largest number of people through deliberate decision, control and direction.

To sum up, planning comprises the following essential features:

1. Predetermined and well defied objectives or goals.

2. For economic planning deliberate control and direction of the economy by a central authority, e.g., the state.
3. Optimum utilization of natural resources and capital which may be scarce and labour that may be abundant.
4. The objectives are to be achieved within a given interval of time – 5 years, 7 years, etc.
5.The performance of the economic functions of increasing production, maximizing employment and controlling population growth so that production outstrips population growth.

4.4 Need For Planning in Underdeveloped Countries:

Planning is beneficial for both the developed and underdeveloped countries for the developed countries to maintain or accelerate growth already achieved and for underdeveloped countries to overcome poverty and to raise the standard of living. Unless the underdeveloped countries wake up and follow the planning, they will be left far behind in the race of economic well-being. The following arguments reveals an urgent need of planning in underdeveloped and developing countries :

1. Remove the poverty and inequalities :

The economic vicious circle of poverty arising due to low income, low savings and high propensity to consume, and further lower investment and low capital formation, low productivity, low income and poverty must be broken and it can be done only by planning. Planning is like a shot in the arm which enables a sick person to overcome his sickness. Planning alone can create more jobs and remove the wide spread unemployment and disguised unemployment which is a common feature of underdeveloped countries. It is the sovereign remedy for raising national and per capita income, for reducing inequities in income and wealth, for increasing employment opportunities and for achieving as all round rapid economic development. It is commonly said that the pendulum has swung too wide in favor of planning that is cannot swing back against planning.

2. Development of Agriculture and Industrial Sector :

Planning alone can transform an agricultural and primary producing economy into a more balanced economy with heavy, medium and light industries. Agriculture and industry stimulate production in each other by creating demand for their products. Development of agriculture is also essential to supply the raw material to the industrial sector. Economic planning held in designing the plans of agricultural and industrial sectors of developing economies.

3. Development of Infrastructure :

Planning alone can help an underdeveloped economy to build up its infrastructure – irrigation and power, transport and communication and schools and hospitals. The establishment of these social economic overheads is essential for an all-round harmonious and integrated development. The private enterprise is guided by profit motive and is not interested in these items of social gain.

4.To increase the rate of Economic Development :

One of the principle objective of the planning in underdeveloped countries is to increase the rate of economic development. In the words *D.R.Gadgil* "Planning for economic development implies external direction or regulation of economic activity by the planning authority which in most cases identify with the government of state." It means planning increases the rate of capital formation by raising the levels of income, saving and investment. It is only a central planning authority which can control banking and other credit institutions when these are under private enterprise they have a tendency to crowd in urban areas. The vast rural areas are completely neglected and thrown to the wolves, the indigenous money-lender. A planned economy can revolutionize the economy by providing financial institutions and by mobilizing savings and investments in the rural areas. Planning alone can remove the imbalance in foreign trade which is generally unfavourable to the underdeveloped countries that are the exporters of primary produce and imports of produced goods.

5. To improve and Strengthen Market Mechanism :

The rationale for planning arises in such countries to improve and strengthen the market mechanism. The market mechanism works imperfectly in underdeveloped countries because of the ignorance and unfamiliarity with it. A large part of the economy comprises the non-monetized sector. The product, factor, money and capital markets are not organized properly. The market mechanism is required to be perfected in underdeveloped countries through planning.

6. Balanced Development of the Economy :

In the absence of sufficient enterprise and initiative, the planning authority is the only institution for planning balanced development in the economy. For rapid economic development, underdeveloped countries require the development of the agricultural and industrial sectors, the establishment of social and economic overheads, the expansion of the domestic and foreign trade

sectors in a harmonious way. All this requires simultaneous investment in different sectors which is only possible underdevelopment planning .

7. Development of Money and Capital Markets :

The expansion of the domestic and foreign trade requires not only the development of the agricultural and industrial sectors along with social and economic overheads but also the existence of financial institutions. Money and Capital market are underdeveloped countries are primary stage. This factor acts as an obstacle to the growth of industries and trade. The planning authority which can control and regulate the domestic and foreign trade in the best interests of the economy.

4.5 Types of Planning :

There are various types of Economic Planning. There are so many types of plans as there are patterns of economic systems. There are some plans which are functional, structural, Indicative, Democratic and Decentralized planning, Physical planning, Regional and National Planning. The following are the main types of economic planning.

4.5.1 Democratic Planning :

Individual Freedom is soul of democracy but central control is important in planning. Therefore democracy and planning were different concepts, yet for the nation's economic development plan is implemented with co-operation of peoples. That we say that democratic planning is one of important types of economic planning in democratic system of Government. In democratic planning representatives of people control the economy. Economic planning is being implemented by representatives. Government of a country like India has democratic form of constitution with a Parliament elected by the people. The decisions regarding planning are finally taken by the people through Parliament. The technical bodies like the Planning Commission prepare the draft outline of the Plan which is widely circulated amongst peoples, economist, social worker, political leaders and consider their advice regarding plan. Each state considers these plans and prepares its own master plan and all these things are processed and placed before Parliament. Only when the Parliament approves and votes funds under various heads, planning is implemented. Thus the party in power can modify, alter and improve the plan. The Government takes the opposition into confidence for preparing the plans which would meet with whole-hearted support and co-operation of people. Prof. Hike, Mr. Lipmann and other Experts said that, planning didn't control under democracy. Their opinion was Democracy and Planning were

mutual unrelated concepts, but democratic government and democratic administration were important part of democratic planning and people's role important in democratic planning.

4.5.2 Decentralized Planning :

In Decentralized planning, the central authority only fixes the overall targets of production and investment, but considerable freedom is given to various bodies like State Government. On the different levels like state level and district level they fix their own production targets within national framework. There is freedom to fix the prices and wages. Such types of planning prevail in Great Britain and France. In Decentralized planning, the planning authority may endeavour to influence economic activities indirectly through incentives. Country like India having conflicting interests and great differences in economic resources and backwardness of the people, a regional decentralization planning may became inevitable. This type of planning is done for each region or authority for implementation is delegated to regional authorities like state level, district level and they carry out the work within the framework of national planning. Decentralize planning is conceived as a more efficient and more productive in attaining desired result.

4.5.3 Planning by Inducement

In this kind of Planning, there is no compulsion. The government uses persuasion to implement certain schemes of projects and tries to influence investment decisions by offering incentives to the entrepreneurs through fiscal and monetary policies. There is freedom for private enterprises to produce and to consume with suitable controls. This kind of planning may exist in a democratic set-up of a capitalist economy. Planning by inducement is also called flexible planning because, there is a lot of freedom for the economy to undertake developmental programmes. Although there might be fixed objectives in the public sector, targets are suggested for the majority of industries in the private sector. The government may encourage private investment through subsidies and may offer tax concessions. The private sector may contribute substantially to capital formation. Even in this type of planning the government can step in, when the market mechanism is being manipulated to the detriment of the economy. The government can introduce price control and rationing whenever considered desirable. Planning by inducement requires less sacrifice of individual liberty. The private sector coexists with the public sector and has a sense of participation in economics development of the country. However, it may take longer time to achieve the same results as achieved by planning by direction.

4.5.3.1 Defects of the Inducement Planning :

Naturally planning by inducement has certain deficiencies as compared with planning by direction.

1. The private sector, which is more motivated by profit, may not always carry out the programmes efficiently as there is no compulsion to do so.
2. The incentives and subsidies offered by government may not be adequate One cannot be sure that the carrot alone will do the trick of making the stubborn donkey to work without the stick.
3. There is no way of controlling consumption, and productive activities being carried out by private sector.

4.5.4 Regional and National Planning:

A national plan is a plan for the country as a whole, whereas a regional plan comprehends a particular region. In a vast country like India with a diversity of climate and physical resources, regional planning, concerned primarily with the economic development of a region, becomes inevitable. "Every country", says Zewing, "whose area is large needs a high degree of regional decentralization". For each region a separate authority is set up for formulating and implementing the regional plan. It is really decentralised panning as national planning represents centralised planning. Even a regional plan must form an integral part of the national plan and must be carried out within the framework of the overall plan and be in conformity with its priorities and objectives. As J.R.Ballerby says, " A regional plan must conform to the larger plan". The regional plan of course takes into consideration regional potentialities and requirements and ensures balanced regional development of the country. As

Dr.Balkrishna observes, "Though national planning may achieve the wider territorial balance in respect of economic progress is not well within its reach. Besides, the unit cost of production will not be at its minimum unless there is a correct regionalization of industries. Therefore, economic planning ought to provide for inter-provincial justice and unless this assured, the distributive aspect of planning cannot be made to function". It should be born in mind that, regional planning is not to be designed to secure regional independence of self-sufficiency of directed to achieve rival claims and local ambitions which cannot be justified on economic grounds. The object on the other hand, is to secure maximum efficiency in the utilization of the community's resources and to diminish regional inequalities. They are really intended to remedy the regional inequalities which may result from an overall plan.

4.5.5 Functional Planning and Structural Planning

Planning may be attempted within the existing socioeconomic framework or it may seek to change the economic structure radically. The former is known as functional planning and the latter structural planning. Functional planning attempts to modify or improve the existing structure or repair or rehabilitate it, if it is damaged of disrupted, e.g. Indian economy after the partition. Functional planning assumes that planning is possible even in a capitalistic economy whereas advocates of structural planning think that planning and capitalism are incompatible. Quite respectable opinions have taken sides on this question. For instance Dr. Ludwig Von Mises is of the view that "planning and capitalism are utterly incompatible" On the other hand, Professor Landauer holds the opinion that planning and capitalism could be reconciled. We are inclined to agree with the latter view and hold that even capitalist countries can have measure of planning and benefit from its progress or eliminate serious imbalances in the economy. Structural planning is therefore revolutionary, whereas functional planning is evolutionary. Planning in India so far is functional. Even though the avowed object of Indian planning is to establish a socialistic pattern of society but no drastic or revolutionary steps have been taken to change radically the existing economic order. In the U.S.S.R. and China, on the other hand, planning has been structural because the very structural changes have been made in those economies. Ultimately in India, too, planning may turn out to be structural as the Planning Commission observe, "The problem, therefore, is not one of merely rechanneling economic activity within existing socio-economic framework; rechanneling economic activity within existing socio-economic frame work; that framework has itself to be remodeled" The fact is that a country desirous of accelerating economic development may begin with functional planning and end with structural planning, Country may start with structural planning and having established a new economic order may have to be content later merely with functional planning, e.g. in Russia and China Functional and structural planning may go on side by side in an economy at the same time. When an economy is undergoing rapid economic development some major economic changes (e.g. change in the Indian land system, abolition of Zamindari and other land reforms) are inevitable along with minor shake up (i.e. Functional Planning) here and there. There will be structural changes in some spheres and only minor adjustments elsewhere in the economy.

4.5.6 Financial Planning :

The planning is also classified as Functional planning and physical planning. In financial planning the allocation of resources and measurement of resources is made in terms of money. Physical planning implies the allocation of resources in terms of men, material and machinery, which we generally call the natural and human resources. In the first, finance is the key to economic planning. If sufficient finances are not available, the physical targets of any plan may be difficult to achieve. The outlay is fixed in terms of money and the estimates are made regarding the growth of the national income arising out of this outlay in financial planning. The finances are raised through taxation, savings and borrowings. In financial planning, a number of balances are worked out. First, efforts are made to establish equilibrium between the incomes of people-wages of workers, incomes of peasants and others and the amount of consumer goods which will be available to the population. In the private sector equilibrium has to be established between the parts of incomes of the population which will be used for private investment and the amount of investment goods made available to private investors. Similarly, in the public sector, a balance must be established between funds made available for investment purposes and the amount of investment goods which will be produced of imported. In addition to these three balances, balance should be established between foreign payments and receipts. Thus financial planning consists in securing balance between demand and supply. The fixing of targets of increase in national income and of increase in savings and investment rate and thus estimating the growth of income are the major problems in financial planning.

4.5.6.1 Limitations of Financial Planning

Financial Planning has many limitations, they are as below :

1. Financial resources are not unlimited. Very heavy taxation may adversely affect the propensity to save.

2. There is a vast non-monetized sector in underdeveloped economies as the people live on subsistence level and much of the produce is not brought to the market in such economies. The monetized sector is small. On account of the imbalance between these two sectors, shortages in supply are likely to result in an inflationary rise in prices thus upsetting physical targets.

3. If the shortages in supplies are made up through imports, the problem of balance of payments will become serious.

4. As Prof. Dobb says " The problem of industrialization in backward countries is essentially not financial but a problem of economic organization" and availability of physical resources.

4.5.7 Physical Planning :

In physical planning, on the other hand, an attempt is made to measure development effort in terms of factor allocations and product yields, so as to maximize income and employment. Here, we have to maintain physical balances between investments and outputs. Investment co-efficient are calculated. These co-efficient indicate the amount as well as the composition of investment in terms of various kinds of goods needed for obtaining a desired increase of output of a kinds of goods needed for obtaining a desire increase of output of a product. For example, we may be interested in knowing how much iron, how much coal, how much electric power are needed in order to produce an additional tone of steel. Obviously the output of one industry or branch of economy becomes the input for producing the output of another industry or branch of economy. Thus in physical planning, an overall assessment is made of the available real resources such as raw materials and manpower and how they are to be mobilized for avoiding bottlenecks. In short, physical planning concerns itself with physical targets with regard to agricultural and industrial production and transportation services. On the other hand financial planning deal with fixing of financial targets of incomes and investments.

4.5.7.1 Limitations of Physical Planning:

Financial planning has its own limitations, so also physical planning suffers from certain drawbacks. The limitations of physical planning may be summarised as below.

(1) To estimate the available physical resources, accurate statistical data must be available. Underdeveloped countries do not have an efficient statistical data collection mechanism.

(2) Unexpected shortages of power supply and unexpected failures of harvests may upset the physical balances between different segments of the economy Unless there are large reserves stocks, the underdeveloped countries lack in these reserve stocks.

(3) When shortages in physical tartest occur, prices rise and control and rationing are introduced. These cause much hardship to the people.

4.6 Importance of Planning in Economic Development:

Keeping in view the various definitions we can say that aim of all the plans is to utilize the available resources more effectively achieving the well defined objectives during given period of

time. The importance of planning in the process of economic development can clearly be judge from the following issues:

i. **Increase in Capital Formation**

Without increasing the rate of capital formation, we can not increase the rate of development. In the less developed countries rate of saving is very low and due to this rate of investment is low. Through effective planning we can increase the rate of savings in the country.

ii. **Elimination of Poverty**

Through planning we can increase the rate of economic development in the country. National income and per capita income will rise and poverty will remove.

iii. **Increase in the Rate of Economic Development**

One of the most important objectives of Economic Planning is to increase the rate of economic development. Capital formation should be carried out. Infrastructure facilities should be extended and social overhead such as education, technical training and health facilities should be increased. Planning in Pakistan should be done keeping in mind that country is populous and there are too many people looking for jobs, hence labor intensive projects should be given priority, which will absorb labor force and employment opportunities will increase. Increase in employment will increase national income and per capital income. Standard of living of people will raise and rate of domestic savings will increase.

iv. **Diversification of Economy**

All sectors of economy should be given proper importance. No sector of economy should be neglected. Pakistan is an agrarian country, the development of industry of Pakistan depends upon agriculture, therefore more emphasis should be given to agriculture. Since population is too much and it is further increasing at a fast rate, therefore production of food grains should be increased.

v. **Price Stability**

Increase in price level hits the poor and fixed income people very much, whereas decrease in price reduces profit margins of the businessmen, which causes reduction in investment. One economic planning is to maintain the price stability. Through planning

equal distribution of national wealth be made. The society should not be divided between *"Haves and Have-nots"*

vi. **Higher Standard of Living**

Economic Planning should ensure that good education; technical training and better medical facilities are available to all the people of the country. Every one should be provided a reasonable accommodation. Thus policy should standard of living of the masses.

vii. **Improving Balance of Payments**

All out efforts should be done under planning that balance of payments continues to improve. Export oriented and import substitutions industries should be given importance. Luxurious goods should be banned and small and agro-based industries should be given concessions and facilities. Imports should be reduced and export increased, in order to improve foreign exchange earnings. Dependence on foreign aid and grants should be curtailed.

viii. **Increase in National Income**

The objective of planning is to utilize the resources of the country in such a manner that it should increase the size of national income. In the developing countries planning is very useful for increasing the production of the country.

ix. **Superior Decisions**

The decision of planning authority are more superior as compared to the individuals. Planning authority keeps in view the interest of the whole nation. It prepares the plan keeping in view the economic condition of the country.

x. **Achievement of Full Employment**

In the less developed countries and in the advanced countries the objectives of planning is to achieve the full employment. The main objectives of the planning to create jobs for the people of the country.

xi. **Equal Distribution of Wealth**

In the capitalistic countries the gap between rich and poor is increasing. It creates social evils. Through planning we can reduce the inequalities in income.

xii. **Elimination of Regional Disparity**

Through planning the regional economic disparities can be removed. In the plan special fund can be allocated for the development of backward areas. It is the one of main objective of planning that there will be reduction in the regional disparity.

xiii. Improvement in the Balance of Payment

The balance of payment of developing countries remains deficit. It adversely affects the rate of economic growth. Through planning government can reduce the imports and can increase the exports.

xiv. Balanced Economy

If one sector of the economy is developed the country will not achieve maximum rate of development. Through planning resources of the country can be allocated in such a manner that it provides balance to the economy.

xv. Control of Economic Crises

Due to economic crises, economy faces many problems. Through planning depression can be controlled and production can be increased.

xvi. Solution of Over Population

When the size of population is greater than the size of natural resources it can be adjusted through effective planning.

xvii. Self Sufficiency in Food

Each country wants to become self sufficient in food. So this objective is also achieved through planning. In the each development the target was proposed for the agriculture sector.

xviii. Industrial Development

Today without industrialization no any country can improve its economic condition. For the establishment of new industries, planning is very effective.

xix. Increase in welfare Program

The provision of social services is main aim of the planning. For example some developing countries plan various facilities like housing, schooling, transport and water provided to the people.

4.7 Summary :

The study of planning and different types of planning help in focusing its strength and weakness in implementing it. The developing and developed countries have wider options in selecting the

particular types of economic planning on the ground of their resources, types of Government and socio economic phenomena in the country.

1.4 Glossary

Economic Planning: Economic Planning is the making of major economic decisions what and how much is to be produced, how, when and where it is to be produced, and to whom it is to be allocated by the comprehensive survey of the economic system as whole.

Decentralized Planning: In Decentralized planning, the central authority only fixes the overall targets of production and investment, but considerable freedom is given to various bodies like State Government.

Planning by Inducement: In this kind of Planning, there is no compulsion. The government uses persuasion to implement certain schemes of projects and tries to influence investment decisions by offering incentives to the entrepreneurs through fiscal and monetary policies. There is freedom for private enterprises to produce and to consume with suitable controls.

1.5. Check your progress. A)

Choose the correct alternative and fill in the blanks

1. ———————— is the first country in the world implemented Planning for economic development.

a) Russia b) England c) America d) India

2. —————— is beneficial for both the developed and underdeveloped countries

a) Capital b) Planning c) Market mechanism d) Saving

3. Principle objectives of the planning in underdeveloped countries —————the rate of economic development.

a) fixed b) increase c) decrease d) maintain

4. In mixed economy —————— is developed the economic plan.

a) private sector b) public sector c) central planning commission d)State

5) In India the planning started during the year——————-

a) 1951 b) 1947 c) 1991 d) 1961

1.6 Answers of check your progress

1. Russia 2. Planning 3. Increase 4. Center Planning Commission 5. 1951

4.8 Terminal and Model Questions

1. Explain the Meaning and Need of Planning in economic development
2. Describe the types of planning and its limitations.
3. What is the significance of planning in economic development?

4.9 References for Further Reading :

1. I.C.Dhingra,A.K.Garg,(1983) Economic Development and Planning, S. Chand & Sons, New Delhi
2. Kavimandan (1983), Economic Development and Planning.(Marathi)
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CHAPTER 5

ECONOMIC PLANNING - 2

4.1 Objectives

After reading this chapter you will be able to:

i. To understanding major objectives of planning in India.

ii. To take review of major, achievements and failures of planning in India.

iii. To study in brief financing pattern of Ninth and Tenth Five Year Plan in India.

iv. Understand the overall nature of Eleventh Five Year Plan in India.

4.2 Introduction

For having systematic economic development, India has accepted the way of economic planning since 1951. By realising the various adverse impacts of non-planned economic development process, India has emphasised the way of planning economic development for developing it's under developed economy. Economic planning has helped in achieving some important objectives of socio-economic development in India. An overall evaluation of economic planning in India is explained for assessing the major objectives determined at the beginning of economic planning. Further the brief review of ninth, tenth and eleventh five year plan has been taken into account. Government of India adopted planning technique from 1951. From 1950-51 to 2011-12 Government of India implemented totally eleven five year plans and five one year plans which are shown in following table –

Table No. 5.1 : Plans and plan period

Plans	Period
1st Five Year Plan	1951-56
2nd Five Year Plan	1956-61
3rd Five Year Plan	1961-66
Annual Plan For 3 Years	1966-67 To 1968-69
4th Five Year Plan	1969-74
5th Five Year Plan	1974-79
6th Five Year Plan	1980-85
7th Five Year Plan	1985-90
Annual Plan For Two Years	1990-91 To 1991-92

8th Five Year Plan	1992-97
9th Five Year Plan	1997-2002
10th Five Year Plan	2002-2007
11th Five Year Plan	2007-2012
12th Five Year Plan	2012-2017

Under planning period Government of India spelt out some long term objectives up to seventh plan the main objectives were –

4.2.1 Guiding Principles of Indian Planning :

1) Economic Growth : The First objective of Indian planning is to achieve economic growth approximately 5 per cent per annum increase in the net national product. Economic growth has always remained in focus as the main objectives. There are number of problems which are faces by the Indian Economy. It has often been assured that the gain of economic growth would percolate downwards and thus property, inequalities would be decline and poverty problem would automatically be solved. The growth of employment was also taken for granted.

High priority to economic growth in Indian plans looks justified from beginning. The economy of the country had received severe jolt under the British rule on account of massive drain of wealth from India. In this period while the European countries developed, India suffered under-development. So, once this country got Independence, the major choice of decision makers was for economic growth. It was shown in a following table.

Table No.5.2 Growth Rates of Five Year Plans

Plans	Growth rate Objectives / target
I	2.1
II	4.5
III	5.6
IV	5.7
V	4.4
VI	5.2
VII	5.0
VIII	5.6
IX	6.5
X	8.00
XI	9.00

2) Self-reliance : Self reliance means independent from other. But in case of country like India self-reliance is elimination of dependence on foreign aid and capital also. But India was dependent on foreign countries at least in their respects.

First, despite the fact that Indian economy was agricultural basis, the output of food grains was not adequate and the country was imported foodgrains from the U.S.A. and some other countries. Second is on account of virtual non-existence of basic industries, transport facilities, machine tools, engineering industries, electricity plants, other capital goods had to be acquired from developed countries.

Third and last is saving rate being low, foreign aid had to be obtained in order to step up the investment rate in the country. In planning period our import was increased but export doesn't increased sufficiently. So Balance of payment disequilibrium was increased, it was affecting the countries dignity and economic position. So our planners considered about this objectives. It is now seen that in the field of self reliance, India succeed in almost self-sufficient in food and in case of production of iron and steel, machine tools heavy engineering industries our country has made considerable advancement towards self-realiance.

3) Removal of unemployment : Generally unemployment means people able and willing to work in a prevailing wage rate but not get adequate work. Number of underdeveloped countries facing the problem of unemployment. India is facing the problem of unemployment. So our planner given more attention to the removal of unemployment in the country. In each and every plan in India the main objective was removal of poverty. For the purpose of this objectives, Government of India adopted different programmes for increase employment opportunities i.e. S.F.D.A., M.F.A.L., E.G.S. IRDP, Swarnjaynti Gram Rojgar Yojana, Jawahar and Nehru Yojana, Priminister employment assurance scheme etc.

4) Reduction of Income Inequalities : Another objectives of Indian planning is a reduction of income inequalities in the country. However in case of priority it always got a very low place. According to experts, Indian plans have never made any serious attempt to redistribute income and wealth. From fourth plan Government of India given a priority to this objectives. In its opinion, fiscal measures at best can reduce disposable income at the top and thus their importance for eliminating income inequalities is limited. For this purpose number of programmes started for poor people for improving their economic conditions. From rapid growing big business houses like Tata, Birla, Dalmiya, Jain, Chougule etc, it is obvious that

income inequalities have been increasing in urban areas as well. Anti monopoly measures can reduce inequalities in income and wealth, but from this point of view, Government passed the act like M.R.T.P. and adopted progressive tax system policy etc.

5) Elimination of Poverty : Poverty problem is also main problem of under developed countries. India is facing the problem like poverty. Poverty means people doesn't fulfils their minimum needs i.e. food clothing, shelter, safe drinking water, education, health etc. Poverty can be two types one is absolute poverty and second is relative poverty. In our country both types are prevailing. So our planners and government has given a priority for elimination of poverty in some plans. From first to Eleventh five year plan, Government has given more attention to the cottage and small scale industries, agricultural development, social security programmes, welfare programmes for labour farmers etc. under fifth five year plan. 'Garibi Hatao' programmes has been introduced under these programmes numbers of sub programmes were started.

6) Modernization : After Independence, Indian economy required structural and institutional changes to cope with the modern world. So our planners adopted modernization is an important objective of planning up to sixth plan this objective was never on the agenda of any plan. But in the Sixth, Seventh, eight and eleventh five year plans modernization is main objective modernization we mean to improve existing industrial, agricultural, transport, communication system in the country. Modernization also in case of Banking sector, public sector also. In case of modernization our country like India made considerable progress in all means and all sectors in the economy.

4.2.1 Evaluation of Indian Planning :

Government of India adopted planning process from 1950. Till date, Eleventh Five Year plans were completed. But some critics criticized on India planning as follows:

1) Conflicting and Inconsistent objectives.
2) Over Dominance of welfare consideration etc.
3) Few priority for unemployment problem.
4) Neglect of Agriculture Sector.
5) Too Ambitions and unrealistic objectives.

Indian planning is now completed sixty years. So it is very essential to have a evaluation or to see achievement and failures of the plans. Actually planning is a process, under which some objectives are fixed and targets also fixed and government authority or Planning Commission

implemented all the planning process. Financial support is also essential. Russian Government adopted planning techniques firstly in 1928 and made spectacular achievements within twenty years. After five plans Government of Russia stopped the planning. So experience of planning in India is to be evaluated in following way.

4.2.2 Achievements of planning in India :

1) Increase in national and per capita Income : One of the main objectives of Indian planning is to increase national and per capita income. In planning era India's national and per capita income increased considerably. Following table shows growth of both the income up to 2001-2002.

Table No.5.3 National Income and per capita Income of India(at 1993-94 and 2003-04 prices)

Year	National Income	Per Capita Income (Rs. In crores)
1950-51	1,32,367	3,687
1960-61	1,92,235	4,429
1970-71	2,70,597	5,002
1980-81	3,63,417	5,352
1990-91	6,14,206	7,321
2003-04	12,66.005	11,799
At 2004-05 Prices		
2004-05	26,23,995	24,095
2008-09	36,72,192	31,821
2009-10	39,29,853	33,588

Source:*Government of India, Economic Survey, various issues, RBI Handbook of Statistics on Indian Economy,2009-10.*

Table No. 5.4 Average Annual Growth Rates of National Income and per National Income

Year	National Income	Per Capital Income
1950-51 to 1980-81	3.4	1.2
1980-81 to 1996-97	5.5	3.3
1996-97 to 2003-04	6.2	3.6
2004-05 to 2009-10	8.4	6.9

Source:*Government of India, Economic Survey, various issues,RBI Handbook of Statistics on Indian Economy,2009-10.*

Table No.5.3 & 5.4 show that:

1). Decade wise statistical information between 1950- 51 to 2001-2002. Here net National Income and per capita Income increased considerably. It is shown that, average annual growth rate and per capita income. India's NNP growth rate is greater than PCI, the reason of low growth rate of PCI is increasing the population of the country.

2) Increased Agricultural Production : Since 1950-51 to till the date Government of India spent more and more amount on agricultural sector. So Green Revolution, milk production, Eggs production was increased. So India became Self-sufficient in food production since 1990. Our food grains like Rice, wheat, Sugar cane, Milk, Oil seeds production increased rapidly. Since 1950-51 to 2001-02 per capita availability of food grains, milk, sugar etc. are increased and the problem of hunger of Indian people is to be solved to some extent.

3) Increased Industrial Production During five year plans, the Government had invested heavily on industrial sector especially major and prime industries like Iron and steel, Power, transport, communication, chemical industries, metallurgical industries etc. As a result, there has been considerable progress in such industries as steel, aluminium, engineering goods, chemicals, fertilizers, petroleum products etc. So increasing industrial production became helpful to employment activities in the economy and total production, consumption and welfare of the country. Progress of Industrial production is shown in following table.

Table No. 4.3 Progress of Industrial Production(Selected industries)

	Industries	**1950-51**	**1970-71**	**2001-02**	**2009-10**
1	**Coal (m. tones)**	32	76	353	566
2	**Iron ore (m. tones)**	3	32	76	218.6
3	**Fertilizers (m tones)**	0.02	1	15	16.7
4	**Aluminium (Thousand tonnes)**	4	169	552	745.5
5	**Petroleum (M. tonnes)**	0.3	7	32	33.7
6	**Electricity (billion kwh.)**	5	56	579	768

Source:*Government of India, Economic Survey,2005-06,2010-11.*

4) Infrastructural Development : Another achievement of planning in India is an Infrastructural development in the country. The expansion of roads and road transport helpful for the development of market. Irrigation, power etc. development leads to agriculture and industrial sectors in the economy. The infrastructure has opened the possibilities of modernization of semi-urban and rural areas. In ninth plan period Vajapaee Government has given more priority to

'Chatushakon Prakalp' for infrastructure development such as road development. So development of transport to be inexperienced.

5) Development of International Trade : Since 1950, in planning era Indians international trade had increased. The size and composition of our imports and exports also increased. Before planning period India imported food grains, manufacturing goods etc and exported raw materials, tea, coffee, cashew etc. In half century of planning India's dependency on foreign countries for the import of food-grains and capital goods has declined. This has led to the policy of import substitution. In short, Indians foreign trade had increased and in the same time composition of exports has changed in favour of manufactures mineral ores and engineering goods.

6) Development of Science and Technology : After Independence especially under planning period India's development of science and technology also upper level. Our management technique, physics, chemistry, space science became advanced. Now India has been providing experts services in science and technology to the countries like middle East and African countries. This is matter of proud for the country.

7) Increase in standard of living : Another achievement of Indian planning is increased standard of living of the people in the country. Before planning period per capita availabilities of essential goods such as Sugar, Milk, food grains, clothes, edible oil etc, is to be small quantity but it has to be increased in planning period shown in following table.

Table No. 5.5 Net Per capita Availability of some essential Consumer Goods in India

	Goods and commodity	1950-1951	1970-71	2002-2003	2009-10
1	Sugar (Kgs)	4	7.4	16	18.6
2	Cereals and Pulses (kgs)	144	167	180	162
3	Edible oil (kgs)	3.3	4.5	7.2	14.3
4	Cloth (C.meters)	14.4	16	32	43.1

Source:*Government of India, Economic Survey, 2005-06,2010-11.*

8). Development of Education : One of the great achievement of Indian planning said by the thinker is Educational Development since 1950. During planning period primary, secondary, higher secondary educational facilities had increased subsequently. India ranks third country in the world in the terms of educational system. The total number of students enrolled in colleges and universities increased from 3.6 lacks to 43 lacks between 1951 to 1997

4.2.3 Failures of Indian planning :

For out of a size decades near about five decade congress Government had ruling in center. The Government have been proclaiming measures to achieve growth with justice, abolition of poverty or Garibi hatao, removal of exploitation and inequality of incomes etc. But it is not slogans. Indian planning has achieved significant success in various area's, but planning also failed in some area e.g. shown in following ways.

1) Failure in Elimination of Poverty : The basic objective of planning is the provision of national minimum level of living. From first plans to eleventh plan Government of India adopted number of programmes for poverty elimination. But poverty has not eliminate completely. Till date 27 per cent of people living below the poverty line.

2) Failures to Solve Unemployment Problem : Generally, poverty and unemployment are the co-related problems. The widespread unemployment is another important failure of our planning. According to planning commission, the backlog of unemployed Persons were 5.3 milion at the end of first plan and 7.5 million at the end of the Eight plan. Taking unemployment and under employment together, at the beginning of the Tenth plan i.e. 2001-02, 9.2 percent of the labour force or 35 millions person were unemployed.

3) Failures to Reduce Inequalities : During planning period, the redistribution of income in favour of poor people is unequal nature. In the year 1991 also 50 per cent of share of national Income owned by only 10 per cent of the people and 40 per cent of income owned by 70 per cent of the people, In planning period Government adopted policy like Abolition of Jamindari system. Redistribution of land etc. But distribution of income and wealth is to be an uneven. This is important failure of planning.

4) Failure to check black money : During planning period, various controls has been made for speculation. But shortage, black-marketing, speculation don't control to the Government. The fiscal measures adopted by the Government failed to check black money. This is also another failure of planned economy.

5) Failure of reduce concentration of Economic Power : One of the objectives of our planning is to reduce concentration of economic power. But in actual practice big business hours like Tata, Birla, Jain, Ambani, Chougule families are became very rich and richer. This is also important failures of Indian Planning.

6) Inefficiency : During planning period, number of programmes for employment generation and rural development etc. are to be started. But in actual practice number of programmes are working inefficient manner. So planning achievement is limited. This is also another failure of Indian planning. In above discussion we can conclude that, India's planning policies and strategy were sound but there was crisis of implementation due to the existence of a gap between the theory and practice of socialist planning.

4.3 Financing Pattern Of Five Year Plans

Introduction : Success of any plan depends on two things, one is the targets laid down in the plan and second is the financing resources available for this purpose. In short, when targets specified in the plan are higher, larger resources will be needed to achieve them. Absence of adequate financial resources, Government can not complete his plans and to secure targets and achievement. For development of plans, resources may be raised from various sources which may broadly be classified in the domestic sources budgetary surpluses, contribution of public enterprises, market borrowings, small savings deserves particular mentions. At the same time external assistance is obtained from International financial institutions and developed countries. Sometimes deficit financing may be used for completion of plan.

4.3.1 Sources of Financing of Five-year plan :

Broadly speaking there are three sources of the public sector plans. These are follows –

i) Internal source

a) current revenue balance

b) Public borrowings

c) Small savings.

d) Surplus of public enterprises

ii) Deficit financing

iii) Foreign Aid

4.4 Tenth Five Year Plan(2002 to 2007)

The tenth five year plan officially started on 1st April, 2002 and covered the period 2006-07. This is first plan in twenty first century. The tenth plan kept the objective of achieving 8 per cent growth per annum over the plan period. Besides it sme objectives determined in the Tenth five year plan were as below.

4.4.1 Objectives of Tenth Five Year Plan (2002 to 2007)

1) Reduction in poverty ratio by 5 per cent points 2007 and by 15 per cent points by 2012.

2) Providing gainful and high quality employment.

3) All children in school by 2003;

4) Reduction in gender gaps in literacy and wage rates by at least 50 per cent by 2007.

5) Reduction in population growth rate 16.2 per cent between 2001 to 2011.

6) Increase in literacy rate to 75 per cent during planning period.

7) To decrease the infant mortality rate 45 per thousand to 28 per thousand between the year 2007 to 2012.

8) Reduction of maternal mortality ratio 2 per thousand to 1 per thousand between the year 2007 to 2012.

9) Increased forest covered area in India 25 per cent to 33 per cent in planning period.

10) Providing drinking water in all villages in the country.

11) Cleaning the major polluted river.

4.4.2 Financing the Eleventh plan

Table No. 5.6: **Financing of the Tenth Plan (Rs. In crores)**

		Centre		States		Total	
		Amount	%	Amount	%	Amount	%
1	**Balance from current Revenue**	-6385	-0.7	26578	4.0	20193	1.3
2	**Borrowing in Market**	685185	74.4	261482	39.0	946667	59.4
3	**Net Inflow from Abroad**	27200	2.9	___	___	27200	1.7
4	**Gross Budgetary support(1+2+3)**	706000	76.6	288060	43.0	994060	62.4
5	**Central Assistance to States &UTs**	-300265	32.6	+300265	44.7	—	—
6	**Net Budgetary support(4-5)**	405735	44.0	588325	87.7	994060	62.4
7	**Resources of Public Enterprises(a+b)**	515556	56.0	82684	12.3	598240	37.6
a.	**Internal resources**	4090000	44.4	-7760	-1.2	401240	25.2
b.	**Extra-budgetary resources**	106556	11.6	90444	13.5	197000	12.4
8	**Resources for Public Sector Plan(6+7)**	921291 (57.9)	100.0	671009 (42.1)	100.0	1592300 (100.0)	100.0

Source: *Planning Commisssio,Tenth Five Year Plan(2002-07,Vol.1,p.87)*

With the help of the table we conclude that:

1) For the tenth five year plan 62.4 per cent of amount or funds came from balance from current revenue, borrowing in the market and foreign aid. It means that majority of funds collected from fiscal measures only.

2) Under Tenth Five Year Plan 37.6 per cent of resources or funds collected from revenue of public enterprises.

3) Under Tenth five-year plan 57.9 per cent of resources given by central Govt.

4) For continuation of Tenth plan 42.1 per cent of resources given by different state Government

4.4.1 Sectoral Allocation of Resources :

Table No. 5.7: Sector wise Investment (Rs. In crores)

Particulars	Investment Share		% increase
	Amount	per cent	
Agri & Allied Activities	58,933	3.9	58.3
Rural Development	1,21,928	8	37.1
Special programmes	20,879	1.3	286.1
Irrigation and flood control	1,03,315	6.8	48.0
Sub-Total (1+2+3+4)	**3,05,055**	**20**	**51.4**
Power	4,03,927	26.5	84.2
Mining Industries	58,939	3.9	31.9
Transport	2,25,977	14.8	57.8
Communication	98,968	6.5	6.6
Science, Technology and Environment	30,424	2	94.2
Public Services	38,630	2.5	181.3
Social Services	3,47,391	22.8	78.6
General Services	16,328	5	4.4
Total Allocation	**15,25,638**	**100**	**62.1**

Source:*Planning Commisssio,Tenth Five Year Plan(2002-07,Vol.1,p.87)*

With the help of above table we conclude that:

1) Out of total plan resources 20 per cent amount is allocated to the Agriculture and allied sector only, which is lesser than Ninth Five Year Plan.

2) In case of Energy and power considerable amount is spent or allocated in this plan which is higher than ninth five year plan.

3) Under Tenth five-year plan resources allocated to the transport is 14.8 per cent of total plan allocations.

5) In tenth five year plan amount allocated to the social services has been higher than ninth five year plan i.e. 22.8 per cent.

4.5 Eleventh Five Year plan (2007 to 2012)

The National Development council approved eleventh plan draft in December 2006. The vision of new plan i.e. Eleventh plan was 'Faster and more inclusive growth'. Because the last four years of the tenth plan recorded a rate of growth of as high as 8.6 per cent per annum making India one of the fastest growing economies of the world. However, according to the plan, a major weakness in the economy is that the growth is not perceived as being sufficiently inclusive for many groups especially, SCs, STs and minorities. Gender inequality also remains a pervasive problem and some of the structural changes taking place have an adverse effect on women. The lack of inclusiveness is borne out by date on several dimention of performance.

B Objectives of Eleventh plan : The plan envisages a high growth of GDP of the order of 9 per cent for the country as whole. This implies that per capita GDP would grow at about 7.5 per cent per year to double in 10 years. However the plan document hastens to add that the target is not just faster growth but also inclusive growth which ensures broad based improvement in the quality of the people, especially the poor SCs, STs, OBCs and the minorities etc. Besides the broad objectives, 'Faster and inclusive growth', it has set 27 monitorable targets, classified in to Six categories and are given below.

4.5.1 Targets set to Achieve the objectives :

1) Income and poverty

i) To achieve average GDP growth rate 9 per cent per year.

ii) To achieve agricultural GDP growth rate of 4 per cent per year

iii) Increase employment opportunities upto 58 millions in five years.

iv) 5 per cent reduction of educated employment in the country during planning period.

v) To increase approximately 20 per cent wage rates of unskilled workers.

vi) Reduction in poverty by 10 per cent.

2) Education :

i) Reducing the drop out rate of children at the elementary level from 52.2 per cent to 20 per cent

ii) To ensure quality education and developing minimum standard in elementary school.

iii) Increasing literacy rate up to 85 per cent by 2011-12.

iv) Reducing gender gap in literacy to 10 per cent points by 2011-12.

v) Increasing the enrollment ratio in higher education from 10 per cent to 15 per cent.

3) Health

i) To reduce Infact mortality rate upto 28 and maternal mortality rate to 1 per 1000 by 2011-12.

ii) To reduce total fertility rate to 2.1 per cent by 2011-12 iii) Providing clean drinking water facilities to all by 2009. iv) Reducing the malnutrition among children of age group i.e. 0-3.

v) To Reduce Anaemia problems of women and girls 50 per cent.

4) Women and Children :

i) Increase sex ratio for age group 0-6 to be raised to 935 by 2011-12.

ii) Ensuring that at least 33 per cent of beneficiaries of all Government Schemes are women and girl children.

iii) Ensuring that all children enjoy a safe childhood and are not forced to work.

5) Infrastructure:

i) To ensure electricity connection to all villages and BPL households by 2009.

ii) Connecting all habitation with population 1000 and above (500 and above for hilly areas) by 2009.

iii) To connect every village by telephone and broad band facility to all villages up to 2012.

iv) To provide homestead site to all by 2012 and set up the pace of house construction for rural poor so far as to cover all the poor by 2016-17.

6) Environment :

i) Forest and tree cover to be increased by 5 per cent

ii) To attains WTO standards of air quality in all major cities by 2011-12.

iii) To treat all urban waste water by 2011-12 to clean river waters.

iv) To increase energy efficiency by 20 per cent points.

4.5.2 Financing the Eleventh plan :

The Table No. 5.8 Eleventh plan projections of Resourcesng.

		Centre		States		Total	
		Amount	%	Amount	%	Amount	%
1	Balance from current Revenue	653989	30.3	385050	25.9	1039039	28.5
2	Borrowing in Market	767722	35.6	649423	43.6	1417145	38.9
3	Net Inflow from Abroad	__	__	__	__	__	__
4	Gross Budgetary support(1+2+3)	1421711	65.9	1034473	69.5	2456184	67.4
5	Central Assistance to States &UTs	-324851	-15.1	+324851	21.8	__	__
6	Net Budgetary support(4-5)	1096860	50.8	1359324	91.3	2456184	67.4
7	Resources of Public Enterprises	1059710	49.2	128824	8.7	1188534	32.6
8	Resources for Public Sector Plan(6+7)	2156571	100.0	1488147	3644718	1488147	100.0

Source: *Compiled and computed from Eleventh Five Year Plan(2007-2012),Vol.1*

4.5.3 Sectoral Allocation of Resources :

The size of eleventh five year plan as compared to Tenth five year plan is an increased by 125 per cent i.e. Rs. 16,18,460 crores in Tenth plan and Rs. 36,44,718 crores in Eleventh plan. However, sectoral allocation of resources are shown in following table.

Table No. 5.9 Particulars Amount in crores Share in Crores total (per cent)

	11th Plan Projections (2007-12)	
Agri. & Allied activities	1,36,381	3.7
Rural Development	3,01,069	8.3
Special Area Programmes	26,329	0.7
Irrigation & Flood control	20,10,326	5.8
Total Agriculture(1 to 4)	6,74,105	18.5
Energy	8,54,123	23.4
Industry & Minerals	1,53,600	4.2
Transport	5,72,413	15.7
Communication	95,380	2.6
Science, Technology and environment	87,933	2.4
General Economic services	62,523	1.7
Social Services	11,02,327	30.9
General Services	42,283	1.2
Total	36,44,718	100

Source: *Compiled and computed from Planning Commission(2007),Eleventh Five Year Plan(2007-2012),Vol.1*

4.5.4 Evaluation of Eleventh Five Year Plan :

In the year June 2007 the U.S. economy came under recession as a result of subprime lending crises. The financial stress soon extended to other countries as well and on September 14, 2008 with collapse of the US investment Bank Lehman Brothers U.S. economy entered in to recession.

The collapse of major financial institutions in Europe: As a result, there was a full blown global financial crisis. The effect on Indian economy was not significant in the beginning. But from October 2008, adverse effects of American recession on Indian stock market, export and number of sectors were experienced to some extents. So results of Eleventh five-year plan were against Indian economy. Most of the sectors of the economy witnessed a market slow down in the year 2008-09. This would be clear from the following facts.

1) Growth rate of economy in the year 2007-08 was 9.7 per cent. It was gone down up to 6.7 per cent in the year 2008-09.

2) Rate of growth in agriculture was 4.7 in the year 2007-08. It was also reduced up to 1.6 per cent in the year 2008-09.

3) Manufacturing industries growth also experienced slow down ward from 10.3 per cent to 3.2 per cent

4) Rate of growth of electricity, gas decreased up to 3.9 per cent from 8.5 per cent in 2007-08.

5) Under Eleventh plan period rate of growth of the construction sector decreased 5.9 per cent which was10.6 per cent in the year 2006-07.

6) In this planning period growth rate of Six core industries for example oil, petroleum, coal, electricity, cement and finished steel also go down.

7) India's growth of export also decreased up to 3.6 per cent as against 29 per cent in the year 2007-08.

8) Indias current account deficit widened to 2.4 per cent of GDP in 2008-09 from 1.3 per cent of GDP in 2007-08.

9) The portfolio flows to India which were as high as $ 27,433 million in 2007-08 turned negative and stood at - $ 14,030 million during 2008-09.

10) The average annual exchange rate of the rupee was Rs. 45.99 in terms of dollar in the year 2007-08. It was also decreased by 12 per cent in the year 2008-09

11) Another failures of eleventh five year plan was money and credit markets were also affected.

12) The most adversely affected were the IT sectors that are closely linked up to the global economy like the IT sector with the number of qualified engineers being forced to sit out. Many employees had to bear wage cuts while many were obliged to go on 'forced leave'

4.6 Summary :

After discussion regarding economic planning in India we can say that planning technique had been used by Russia in 1928 for economic development. Afterwards it was followed by number of countries in the Europe. In India planning process is started before independence. But systematic planning for economic development adopted by the Government In the year 1950 upto 2011-12, India has completed Eleven Five Year Plans. In this topic some major objectives of planning have discussed firstly. Secondly evaluation of planning is made. Thirdly Ninth and Tenth five year plans financing pattern was explained and lastly Eleventh five year plan is also explained.

4.7 Glossary :

Planning Commission : The machinery established for making draft five year along with finalised and implementing five year plans.

National Development council : The body of reviewing the draft plan and making some suggestion and sanctioning in five year plans.

One year plan : Some times five year planning is not possible at that time plan is make for one year only. It is called as one year plan.

New Economic Policy : The policy of Liberalisation, Globalization and privatization adopted by the Government of India in the year 1991.

Bharat Nirman Yojana : The Government of India adopted the policy of rural electrification and the policy of free of charge electric connection to the weaker sections e.g. S.C., S.T., B.P.L. families, tribal people family etc.

4.8 Check your progress A

Choose the correct alternatives given below –

1) Planning technique is used firstly in …Country. a) India b) America c) Russia.

2) Indian planning commission was established in 1950 under the chairmanship of …………….

a) Dr. Rajendra Prasad b) Pandit Neharu c) M. K. Gandhi

3) In first five year plan first priority was given to .... sector.

a) Industry b) Energy c) agricultural

4) In India five year planning was firstly brake down in the year …………….

a) 1966-69 b) 1978-80 c) 1990-02

5) Tenth five year period in India was …………….

a) 2000 to 2005 b) 2002 to 2007 c) 2007 to 2012.

4.9 Check your progress B

Write whether following the statements are true or a false.

1) Before 1950, planning process was started in India.

2) Under Second five year plan in India priority was given to agriculture sector.

3) The objectives like 'Garibi Hatao' was especially designed in fifth five year plan.

4) The Sixth Five year plan was started before New economic policy in India.

5) 'Bharat Nirman Yojana' has been especially launched in tenth five year plan.

4.10 Answers to Check your progress A

1) Russia 2) Pandit Neharu 3) Agriculture 4) 1966-1969 5) 2002-2007

4.11 Answers to Check your progress B

1) True 2) False 3) True 4) False 5) False

4.12 Self-study questions.

1) Discuss in detail the major objectives of Indian Economic planning.

2) Discuss the achievements of economic planning in India.

3) Explain critically the achievements of economic planning in India.

4) Discuss the targets set in Eleventh Five year plan in India.

4.13 References for Further Reading

1) A. N. Agarwal : Indian Economic Problems : Development and Planning, Wishva Prakashan, New Delhi (2003)

2) Datta, Sundaram : Indian Economy; S. Chand and Company, New Delhi (2011)

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CHAPTER 6

INDUSTRIES

6.1 INTRODUCTION

We distinguish the industries in terms of capital investment as large, small and tiny sectors. Industrial units with investment higher than specified for small scale industries are large-scale industries. Large-scale industries can further be classified as traditional and modern. Industries may be described as 'Traditional' in the sense that they have a fairly long history and were well established when the First Five Year plan was launched. They include most prominently the cotton and jute textiles, sugar, iron and steel, paper and cement industries; with a recent addition of Petro chemicals as well. Let us now discuss the present status of some of these major large scale industries in India.

6.2 IRON AND STEEL INDUSTRY

The iron and steel industry is the basic industry of the country. Indeed, steel is the backbone of all development, industrial as well as agricultural. Steel is the basic material in the development of machine building, consumer goods industries, transport and communications, irrigation and scientific agriculture. The real beginning of modern iron and steel production started with the establishment of Tata Iron and Steel works in 1907 (TISCO). In 1919 the Indian Iron and Steel company and in 1923 Mysore State Iron Works were started. The first unit in the public sector, now known as the Visvesvaraya Iron and Steel Works Ltd. started functioning at Bhadravati in 1923.

Progress after Independence:

On the eve of Independence in 1947 total capacity of iron and steel industry was of the order of 1.3 million tones-1 million tonnes from Tata Iron and Steel Co.(TISCO) and 0.3 million tones from Indian Iron and Steel Co.(IISCO). The iron and steel industry has been accorded the highest priority under the five year plans. During the Second plan three steel plants were set up in the public sector at Bhilai (M.P), Durgapur (West Bengal) and Rourkela (Orissa). The Third plan placed emphasis on expansion of these three plants and the setting up of new steel plant at Bokaro. The Fourth plan aimed at setting up new steel plants at Salem in Tamil Nadu, Vijaya Nagar in Karnataka and Vishakapatanam in A.P. The Bokaro steel plant was commissioned in

1978. There are at present six integrated steel plants in the country – five in the public sector and one TISCO in the private sector. The public sector steel plants are owned by the Steel Authority of India Ltd.(SAIL) which was set up in 1974. At present there are 177 mini steel plants in the country. As a result of the investment in new plants and expansion of the old ones, the production of finished steel has increased from 55.15 million tonnes in 2006-07 to 59.33 million tonnes in 2009-10. India ranked as the fourth largest producer of crude steel in the world during January- November 2011.

Table 6.1: Production in Steel Industry (million tones)

YEAR	FINISHED STEEL
1950-51	1.0
1980-81	6.8
1990-91	9.6
2000-01	30.3
2007-08	56.1
2008-09	57.2
2009-10	60.6
2010-11	66.0

Source:*Economic Survey,2011-12. RBI Handbook of Statistics on the Indian Economy(2009-10)*

Production and Consumption

The steel industry is regarded as the barometer of the overall industrial growth. The production of finished steel in India rose from 1.04 million tonnes in 1950-51 to 59.33 million tonnes in 2009-10. India has now emerged as the third largest producer of steel in the world. The consumption of finished steel in 2009-10 was 57.7 M.T. Total export of finished steel in 2009-10 was 2.5M.T.

Table 6.2: Production, Consumption, Export and Import of Finished Steel and Pig Iron

(*in million tonnes*)

		2002-03	**2006-07**	**2009-10**
Finished Steel including alloy steel	**Production**	37.17	52.33	60.9
	Consumption	30.68	46.78	57.7
	Import	1.66	4.93	7.3
	Export	4.52	5.24	2.5
Crade Steel	**Production**	34.71	50.82	64.9

Source:*Annual Report 2010-11, Ministry of Steel, Government of India.*

Policy regarding Iron and Steel Industry

Government of India has recently announced important changes in policy on Iron and Steel Industry. Price and distribution controls on iron and steel were removed from January 1992. This led to rise in prices of various items of steel. The imports of all items of steel are now freely allowed. Along with the deregulation of Iron and Steel, import duty on various items of steel was also reduced. This has had a moderating influence on market prices of steel.

Under the New Industrial Policy of 1991, Government of India exempted the steel sector, which includes mini steel plants; from licensing subject to locational stipulation. The government envisages considerable additions to capacity in the steel sector specially from the sponge Iron segment.

The government has also removed barriers pertaining to private sector which is likely to boost private sector investment in steel. There was a sudden spurt in investment during the first half of the Ninth Plan. However, due to recession during the 1990s, the investment already made as well as committed has not produced the much desired result.

Problems of the Iron and Steel Industry

i. *Inefficiency of public sector units:*

   The inefficiency of PSUs is one of the major problems of the Iron and Steel Industry. These units have been losing continuously and heavily particularly because of heavy investment on social overheads, poor labour relations, poor and inefficient top management, under utilization of capacity, etc. In recent years , however there has been clear improvement in the working of the public sector.

ii. *The Problem of Administered Prices:*

   The government has been following, for many years, a system of administered prices, and controlled distribution of steel among consumers. In the face of very heavy demand for various items of steel, price control and distribution of steel led to heavy black marketing and acute shortage of steel. Only the private distributors stood to gain; the main producers were denied the advantage of higher prices paid by the consumers and the government lost heavily through the distributors' black market income being outside the tax net. The administered price regime has been dismantled and the industry is now free to fix prices.

iii. *Lack of technical and trained personnel:*

In India, we do not have adequate technical staff and trained workers. Therefore, we have to take the services of foreign technicians on high remuneration.

iv. *Shortage of Metallurgical coal:*

For melting iron, good quality coal is required. India does not possess sufficient good quality coal. This adversely affects the production of finished steel.

v. *Shortage of Finance:*

One of the important problems facing the industry is shortage of finance. This industry requires heavy capital investment which is difficult to secure.

vi. *Under-utilisation of Capacity:*

The iron and steel industry has been working below full capacity. It was 70 per cent in the public sector concerns whereas it was 97 percent in private concerns. This resulted in high cost of production and losses, mainly due to inadequate supply of coal and power & transport bottlenecks, lack of proper maintenance, poor management, specially frequent changes in top management of public sector Steel plant, and excessive labour problems. The steel industry suffered, in recent past, due to lack of demand by engineering industries like railway wagons. However, from the mid of Ninth Plan, capacity utilization has improved considerably.

vii. *Sickness of Mini Steel Plants:*

The main problem faced by the mini steel plants is their sickness. The problems faced by these units include short supply of inputs like scrap, inadequate power supply, constraint of working capital and poor management.

viii. *Labour unrest :*

There were periods of strained labour relations at many plants. Production suffered as a result.

ix. *Rapidly increasing demand:*

Demand for steel is increasing very fast under the impact of Five Year Plans. This requires that the output of the industry should be increased rapidly to cope with the ever increasing demand.

x. *Product-mix and waste-materials:*

There is need to reorient the product-mix of the industry and to use the waste materials namely slag.

xi. *Distortions of Planning:*

Excessive control and lakh of proper co-ordination also resulted in the poor performance of the iron and steel industry.

6.3 THE COTTON AND SYNTHETIC TEXTILE INDUSTRY

The organised cotton industry is one of the oldest industries in India. Ther are about 1100 mills in the country (900 spinning mills and 200 composite mills) with 28 million spindles and 2 lakh looms. It has become one of the major large scale industries in India.

The first cotton mill was established in 1818 at Fort Gloster near Calcutta. The real growth of the industry started with the setting up of the Bombay Spinning and Weaving Mills in 1854 with Parsi capital. The Swadeshi movement and the First World War helped in the expansion of the industry. In the early period of this century the industry faced stiff competition from Japan. After 1930, however, the situation improved as a result of bilateral trade agreements with Japan. With the grant of protection in 1927 the industry began to make rapid progress. During the Second World War competition from Japan ceased and the industry increased its production to cater to war demands. In 1947 protection to the industry was withdrawn. The partition of the country was a serious blow to the industry. India retained most of the factories whereas 40 per cent of the area under cotton cultivation went to Pakistan. This adversely affected the supply of raw cotton.

Till 1920 the development of cotton textile industry was concentrated in and around Mumbai. With the establishment of cotton textile mills in north India, Tamil Nadu, Karnataka, and Madhya Pradesh, there took place decentralization of this industry. Even now sixty percent of the spindles and looms are concentrated in Mumbai and Ahmedabad. The industry has three mutually exclusive and disparate sectors, namely, *the mills, the handlooms and the power looms*. The mills manufacturing cloth come under the organized sector while the other two are generally included in the decentralized sector.

Till 1960, a major proportion of cloth output in India was produced in the mill sector (72.5 per cent in 1960). Since the mid 1960's the major share (95 per cent) of cloth output comes from the decentralized sector. Of the two sub sectors -handlooms and power looms – in the decentralized sector, it is the power looms sub sector that has grown at a faster pace. For instance in 1998-99,

the share of power looms in total fabric production was as large as 74.7 percent while handlooms contributed 18.8 percent.

Table 6.3: Percentage Share of Production of Fabrics in India

YEAR	Percentage share of Mill Sector	Percentage share of Decentralised Sector
1950-51	79	21
1970-71	53	47
1990-91	11	89
2000-01	4	96
2008-09	3	97
2009-10	3	97
2010-11	3	97

Cotton textile industry provides employment to about 35 million workers and accounts for 14 percent of total industrial production in the country. This industry accounts for 16.33 percent of the total value of exports and 4percent to the GDP in this country. Textiles and cloths worth US Dollar 26.82 billion were exported during 2010-11.

With the aim of developing the three sectors of the industry, viz. mills, power looms and hand looms in an integrated manner, the government announced a new textile policy in 1985. The main objective of this policy was to enable the industry to increase production of cloth of good quality at reasonable prices for the vast population of the country as well as for exports. A textile modernization fund of Rs. 750 crore was created in 1986 to meet the modernization requirements of the textile industry. A textile workers rehabilitation fund has been set up to provide interim relief to workers rendered unemployed as a consequence of permanent closure of the textile mills.

The Government of India has agreed to phase out Multi Fibre Agreement within 10 years. The MFA is now to be dismantled in four stages. Thus immense opportunities await the Indian textile exports in years to come.

The Cotton Technology Mission has been launched to improve cotton yield in the country. The mission is a major initiative of the Govt. to help the industry face global competition once the MFA under the August of the WTO ends.

It is the world's second largest producer of textiles and garments. The Indian textiles industry accounts for about 24 per cent of the world's spindle capacity and eight per cent of global rotor capacity. The potential size of the Indian textiles and apparel industry is expected to reach

US$ 223 billion by 2021. The textiles industry has made a major contribution to the national economy in terms of direct and indirect employment generation and net foreign exchange earnings. The sector contributes about 14 per cent to industrial production, 4 per cent to the gross domestic product (GDP), and 27 per cent to the country's foreign exchange inflows. It provides direct employment to over 45 million people. The textiles sector is the second largest provider of employment after agriculture. Thus, the growth and all round development of this industry has a direct bearing on the improvement of India's economy.

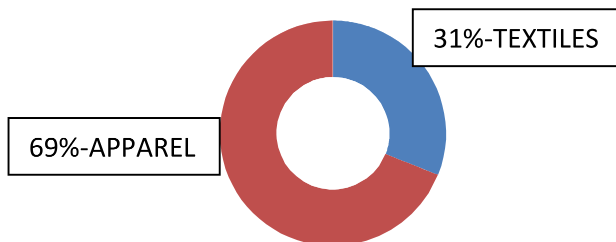

Figure 6.1:India's Textile Market Share($ billion)

India has overtaken Italy, Germany and Bangladesh to emerge as the world's second largest textile exporter. India's share in Global Textiles increased by 17.5 per cent in 2013 compared to 2012. Textiles exports from India will touch US$ 300 billion by the year 2024-25. In 2012, apparel had a share of 69 per cent of the overall market; textiles contributed the remaining 31 per cent.

Various Categories of Indian Textile Industry:

Indian textile industry can be divided into several segments, some of which can be listed as below:

Cotton – Second largest cotton and cellulosic fibres producing country in the world.

Silk – India is the second largest producer of silk and contributes about 18 per cent to the total world raw silk production.

Wool –India has 3rd largest sheep population in the world, having 6.15 crores sheep, producing 45 million kg of raw wool, and accounting for 3.1 per cent of total world wool production. India ranks 6th amongst clean wool producer countries and 9th amongst greasy wool producers.

Man-Made Fibres- the fourth largest in synthetic fibres/yarns globally.

Jute – India is the largest producer and second largest exporter of the jute goods.

Market Size

The Indian textiles industry, currently estimated at around US $108 billion, is expected to reach

US $ 141 billion by 2021. The industry is the second largest employer after agriculture, providing direct employment to over 45 million and 60 million people indirectly. The Indian Textile Industry contributes approximately 5 per cent to GDP, and 14 per cent to overall Index of Industrial Production (IIP). The Indian textile industry has the potential to grow five-fold over the next ten years to touch US$ 500 billion mark on the back of growing demand for polyester fabric. The US$ 500 billion market figure consists of domestic sales of US$ 315 billion and exports of US$

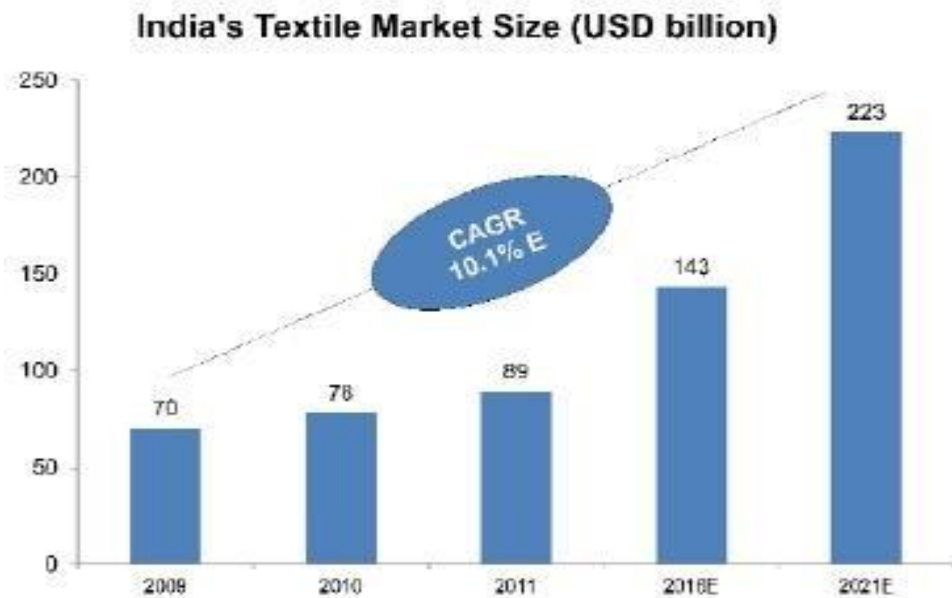

Figure 6.2: India's Textile Market Size (US $s billion)

185 billion. The current industry size comprises domestic market of US$ 68 billion and exports of US$ 40 billion.

Apparel exports from India have registered a growth of 17.6 per cent in the period April – September 2014 over the same period in the previous financial year.

Global vs Domestic Scenario

The global trade of textile and garments was approximately $781 billion in 2013. This is almost 4.6 per cent of the trade of all commodities, which is estimated at approximately $17 trillion. From 2008 to 2013, the global textile and garment trade has grown at a CAGR of 4 per cent.

The current global garment market is estimated at approximately $1.15 trillion which form nearly 1.8 per cent of the world GDP. Almost 75 per cent of this market is concentrated in Europe, USA, China and Japan. An analysis of per capita spend on garment in various countries shows a

significant difference between numbers in developed and developing economies. Within the major markets, India has the lowest per capita spend on garment ($37) which is only 3 per cent of the highest one viz. Australia ($1,131).

The top five textile and garment exporting nations are China, India, Italy, Germany and Turkey. China is the single largest exporter with 39 per cent share while India stood at a distant second place with 5 per cent share.

The top five textile and garment importing nations are US, China, Germany, Japan and United Kingdom. USA is the largest importer with a share of 17 per cent of the total global trade. The Indian textile and garment industry has an important presence in the country's economy through its contribution to industrial output, employment generation, and the export earnings. It contributes almost 5 per cent to the $ 1.8 trillion Indian economy whereas its share in Indian exports stands at a significant 13 per cent. India is the second largest exporter of textile and garment goods with a global trade share of approximately 5 per cent.

The Indian domestic consumption of textile and garment is valued at US$ 63 billion in 2013. Within this, garment retail has the highest share of 73 per cent contributing $46 billion, technical textile contributes $13 billion with a share of 21 per cent and home textiles contribute $4 billion with a 6 per cent share.

In 2013, India became second largest exporter of textile & garment in the world surpassing Italy and Germany. India exported textile and garment goods worth $40 billion, with a share of about 5 per cent of global textile and garment trade. In terms of value, Indian textile and garment exports is dominated by garment category which has a majority share of 40 per cent followed by yarn, fabrics, fibre, made-ups and other textiles including carpets, nonwovens, etc.

POLICIES AND GOVERNEMNT INCENTIVES

Government Initiatives

The Indian government has come up with a number of export promotion policies for the textiles sector.

- It has allowed 100 per cent FDI in the Indian textiles sector under the automatic route.
- Sector Policy
- Technology Upgradation Fund Scheme has infused investment of more than INR 2500 Billion in the industry. Support has been provided for modernisation and upgradation by providing credit at reduced rates and capital subsidies.

- Scheme for Integrated Textile Parks provides world class infrastructure to new textile units. To date, 57 Textile Parks have been sanctioned with an investment of INR 60 Billion. By 2017, 25 more Textile Parks are to be sanctioned.
- Integrated Processing Development Scheme for sanctioning processing parks has been initiated. INR 5 Billion has been earmarked for this scheme.
- Integrated Skill Development Scheme has provided training to 1.5 Million people to cover all sub-sectors of textiles such as Textile and Apparel, Handicrafts, Handlooms, Jute and Sericulture.

Key Provisions of Budget 2014-15:

- Allocation of INR 500 Million towards the setting up of a trade facilitation centre and a crafts museum to develop and promote handloom products and carry forward the rich tradition of the handlooms of Varanasi.
- Allocation of INR 2000 Million towards the proposed setting up of mega textile clusters at Bareilly, Lucknow, Surat, Kutch, Bhagalpur and Mysore and one in Tamil Nadu.
- Allocation of INR 300 Million towards the setting up of Hastkala Academy for the preservation, revival and documentation of the handloom/handicraft sector in PPP mode in Delhi.
- Allocation of INR 500 Million towards the setting up of Pashmina Promotion Programme (P-3) and a programme for the development of other crafts of Jammu & Kashmir.
- The duty-free entitlement for import of trimmings and embellishments used by the readymade textile garment sector for manufacture of garments for exports is being increased from 3 per cent to 5 per cent.
- Non-fusible embroidery motifs or prints are being included in the list of items eligible to be imported duty-free for manufacture of garments for exports.
- The list of specified goods required by handicraft manufacturer-exporters is being expanded by including wire rolls so as to provide customs duty exemption on import by handicrafts manufacturer-exporters.
- Fusible embroidery motifs or prints, anti-theft devices, pin bullets for packing, plastic tag bullets, metal tabs, bows, ring and slider hand rings are being included in the list of items eligible to be imported duty-free for manufacture of handloom made ups or cotton made ups or manmade made ups for export.

- Specified goods imported for use in the manufacture of textile garments for export are fully exempt from Basic Customs Duty (BCD) and Countervailing Duty (CVD) subject to conditions that the manufacturer produces an entitlement certificate from the Apparel Export Promotion Council or from the Indian Silk Export Promotion Council. Basic Customs Duty (BCD) on raw materials for manufacture of spandex yarn viz. polytetramethylene ether glycol and diphenylmethane 4,4 di-isocyanate is being reduced from 5 per cent to NIL. Any of the following two deductions can be availed:
    - Investment allowance (additional depreciation) at the rate of 15 per cent to manufacturing companies that invest more than INR 1 Billion in plant and machinery acquired and installed between 01.04.2013 and 31.03.2015, provided the aggregate amount of investment in new plant and machinery during the said period exceeds INR 1 Billion.
    - In order to provide a fillip to companies engaged in manufacturing, the said benefit of additional deduction of 15 per cent of the cost of new plant and machinery, exceeding INR 250 Million, acquired and installed during any previous year, until 31.03.2017.

Tax Incentives:

R&D Incentives: Industry/private-sponsored research programmes:

A weighted tax deduction is given under Section 35 (2AA) of the Income Tax Act.

A weighted deduction of 200 per cent is granted to assesses for any sums paid to a national laboratory, university or institute of technology, or specified persons with a specific direction that the said sum would be used for scientific research within a program approved by the prescribed authority.

Companies Engaged in Manufacture Having an In-House R&D Centre:

A weighted tax deduction of 200 per cent under Section 35 (2AB) of the Income Tax Act for both capital and revenue expenditure incurred on scientific research and development.

State Incentives:

Apart from the above, each state in India offers additional incentives for industrial projects. Some of the states also have separate policies for the textiles sector.

Incentives are in areas like subsidized land cost, relaxation in stamp duty exemption on sale/lease of land, power tariff incentives, concessional rates of interest on loans, investment subsidies/tax

incentives, backward areas subsidies and special incentive packages for mega projects

Export incentives:

Export Promotion Capital Goods Scheme (PCGS)

Duty Remission Scheme

Focus Product Scheme, Special Focus Product Scheme, Focus Market Scheme.

Area-Based Incentives: Incentives for units in SEZ/NIMZ as specified in respective acts or the setting up of projects in special areas such as the North-east, Jammu & Kashmir, Himachal Pradesh & Uttarakhand.

Major Players (Indian & Foreign) in Textile Industry

Chiripal Group

Chiripal Group laid foundations of ultra-modern 100 per cent cotton & blended bottom wear fabrics and the most modern & versatile denim manufacturing project called Nandan Denim Limited (NDL). NDL is one of the largest integrated Ahmedabad-based textile player engaged in the business of spinning and denim weaving. The company operates from various offices in India and across the world. It is in-housed with one of the most sophisticated weaving plants and other facilities to manufacture superior quality grey cotton fabrics, khakis and denims. The company is listed on the BSE and NSE stock exchanges

The Victoria Mills Ltd

The Victoria Mills Ltd was established in 1913. The Company started with a small capital of Rs 400,000 (US$ 6,296.55) and had issued bonus shares from time to time and the present paid up capital is Rs 9,856,000 (US$ 155,147.06) and Reserves Rs 185,602,146 (US$ 12.37 million). Original mill was situated at Gamdevi, Mumbai and later shifted to Pandurang Budhkar Marg, Lower Parel, Mumbai. It was a composite textile mill producing fabrics for local as well as the international market.

Digjam

As the leading textile company of India, manufacturing suiting fabrics, Digjam has kept re-inventing itself keeping pace with the changing trends. DIGJAM has a high-end fabric brand presence in the domestic market, reputed for its finish and quality. The company manufactures over 3,000 design-shade combinations each year in Light Wool, Polyester Wool and Woolen fabrics for the DIGJAM brand alone. DIGJAM products and their ranges are available at its exclusive showrooms and over 4,000 other retail outlets across the country.

The Ruby Mills Ltd

Incorporated in the year, 1917 as a Composite Textile Mill mainly manufacturing cottons. The management of the unit was taken over by the late Mr C N Shah in 1946 and thereafter the mill has been regularly progressing and manufacturing a wide range of products. The Ruby Mills Ltd, has two plants located at Dadar, Central Bombay and Dhamni on Bombay-Pune Highway. Since 1996, The Ruby Mills Ltd, is manufacturing micro dot fusible interlining & basic interlining, in technical collaboration with Gygli Textil AG, Switzerland. The Company has been in operation since 1921 with an Annual Income of Rs 680 million (US$ 10.95 million).

Bombay Dyeing

Bombay Dyeing was established in 1879 as a small operation of Indian spun cotton yarn dip dyed by hand. The company specialises in stylish linens, towels, home furnishings, leisure clothing, kids wear and a whole range of other products which are available in over 350 exclusive Bombay Dyeing Retail or 2,000 multi-brand stores. Bombay Dyeing also has a polyester division which is engaged in manufacture of 100 per cent virgin Polyester Staple Fibre and Textile grade PET Chips. It uses NGSSS technology from Invista Polyester Technologies and Chemtex International Inc, USA.

Arvind Mills

Started in 1931 by three brothers, with a share capital of Rs 2,525,000 (US$ 41,957*), Arvind Mills was set up with the aim of manufacturing high-end superfine fabrics in India. Arvind has carved a niche with brand names like Arrow, Flying Machine, USPA, New Port, Mega Mart, and The Arvind Store. It has diversified into other major segments such as fabrics, garments, advanced materials, chemicals and dyes, retail, engineering, real estate, sustainable agriculture, and telecom.

Welspun India Ltd

Welspun India Ltd is a fully integrated home textile manufacturer and one of the top three globally. With a network across 32 countries, the company offers the entire range of home textile products to consumers from almost every corner of the world. It also owns leading brands such as Christy and Hygrocotton, among others. The company has modern manufacturing facilities at Anjar and Vapi in Gujarat, India, where it produces the entire range of home textiles for bed and bath category.

Alok Industries Ltd

Alok Industries Ltd vertically integrated textile company, provides end-to-end solutions through five core divisions – Cotton Yarn, Apparel Fabric, Home Textiles, Garments, and Polyester Yarn. Alok's large customer base comprises domestic and overseas retailers, garment exporters in India and converter countries who are vendors to major international labels. They include some of the world's largest retailers and India's largest manufacturers of apparel and home textiles.

Raymond Ltd

Raymond Ltd With a capacity of 38 million meters in wool and wool-blended fabrics, Raymond commands over 60 per cent market share in worsted suiting in India and ranks amongst the first threefully integrated manufacturers of worsted suiting in the world. It exports products to over 55 countries including USA, Canada, Europe, Japan and the Middle East. It is the first to introduce Polyester-Wool and Polyester-Wool-Viscose in the India.

Foreign Investor in Indian Textile Industry

Rieter (Switzerland)

Trutzschler (Germany)

Soktas (Turkey)

Zambiati (Italy)

Bilsar (Turkey)

Monti (Italy)

CMT (Mauritius)

E-land (S. Korea)

Nissinbo (Japan)

Marubeni (Japan)

Skaps (USA)

Ahlstorm (USA)

Terram (UK)

Strata Geosystems (USA)

Marks & Spencer (UK)

Zara (Spain)

Mango (Spain)

Promod (France)

Benetton (Italy)

Esprit (USA)

Levi's (USA)

Forever 21 (USA)

Challenges faced by the Indian Textile Industry

In spite of immense factors fuelling the growth of the Indian textile industry, there are certain challenges faced by the country in terms of scarcity of trained manpower, escalating energy costs, high transportation costs, obsolete labor laws, low level of technology, and lack of economies of scale.

Future Prospects

The Indian textiles industry is set for strong growth, buoyed by both strong domestic consumption as well as export demand. The industry is expected to reach US$ 220 billion by 2020.

With consumerism and disposable income on the rise, the retail sector has experienced a rapid growth in the past decade with several international players like Marks & Spencer, Guess and Next having entered the Indian market. The organised apparel segment is expected to grow at a compound annual growth rate (CAGR) of more than 13 per cent over a 10-year period.

Growth Drivers

- Rising per capita income, favourable demographics and a shift in preference for branded products is expected to boost demand
- Favourable trade policies and superior quality will drive textile exports
- Increase in domestic demand is set to boost cloth production
- Pointed and favourable policies instituted by the government will give the industry a fillip.
- With consumerism and disposable income on the rise, the retail sector has experienced rapid growth in the past decade, with many global players entering the Indian market
- The centers of excellence focused on testing and evaluation as well as resource centres and training facilities have been set up
- As per the plan for 2012-17, the Integrated Skill Development Scheme aims to train over 2,675,000 people up to 2017, covering all sub-sectors of the textile sector – textiles and apparel, handicrafts, handlooms, jute and sericulture.

- Changing lifestyles and increasing demand for quality products are set to fuel the need for apparel

Investment Opportunities

- Entire value chain of synthetics
- Value added and specialty fabrics
- Fabric processing set-ups for all kind of natural and synthetic textiles
- Technical textiles
- Garments
- Retail brands

Problems Of Textiles Industry:

i. *Modernisation and rationalization :*

There are four aspects of the problem.

a) *Modernization requires funds*: Textile mills lack internal surpluses to meet their modernization needs. But banks are unwilling to provide necessary funds. The attitude of various financial institutions has been lukewarm.

b) *Lack of modernization:*This raises the cost of production. The cost of production is further increased by hike in wages in the organized sector and the cost of raw materials. Higher costs lead to higher prices. This adversely affects their competitive position and hence their share in the export market.

c) *Non-availability of modern sophisticated machinery*: The Non-availability of modern sophisticated machinery within the country is a major problem. Moreover, textile industry has not attracted enough foreign investments.

d) *The decreasing share of the organized sector* and increasing share of the decentralized sector on account of a deliberate policy adopted by the Govt, the modernization of one sector alone will not do either.

ii. *Lack of raw-materials:*

Among the raw materials, cotton is the most important. Given the fact that the productivity of crop Is very low in India, its cost of production, and hence price is relatively higher. Moreover, the quality of Indian cotton is deplorably low. The prices of other raw materials like dyes, chemicals and starch have also been increasing sharply. All these have raised the prices of yarn and cloth. Thus, rising prices of raw materials,

particularly cotton, are bound to have great impact on the economics of textile production. In addition to raw cotton, non-availability of power and coal and railway wagons make things more complicated.

iii. *Low demand for cotton cloth :*

a) Cotton cloth is pitted against synthetic cloth. Synthetic cloth has been attracting more demand both from the urban and the rural consumer. Further massive power loom sector has been flooding the market with its cheap products. All this adversely affected cotton cloth industry.

b) Low demand for cotton cloth has also been a consequence of low availability of the purchasing power with the weaker sections of the society. Lack of demand is also due to changing pattern of consumption. There is a trend of an increase in consumption of mixed fabrics.

c) The capacity utilization of cotton textile industry is very low.

iv. *Sickness :*

Because of two problems i.e out dated plant and machinery and labour disputes, a number of cotton mills are facing recession and are turning sick, which often leads to widespread unemployment Govt. of India established the National Textile Corporation in 1968 with the objective of reviving the sick textile mills.

Suggestions :

We may make the following suggestions.

- Proper attention should be paid to quality. Steps should be taken to ensure full utilization of spindles and looms.
- Timely financial assistance on easy terms should be provided to such of the sick mills as are capable of generating repayment capacity out of such assistance.
- It is essential that measures are taken to ensure a steady consumption of indigenous cotton and create buffer stock operations for cotton.
- A reasonable floor price of cotton should be assured to the grower, so that he is encouraged to grow more cotton.
- The uneconomic subsidy system has to be discontinued.

New Textile Policy,2000 :

A new textile policy was announced on Nov.2, 2000. The aims of the new policy are:

1. To increase apparel and textile exports to $ 50 billion from the present level of $ 11 billion.

2. To encourage the private sector in setting up specialized financial arrangements to fund the diverse need of the industry.

3. To encourage the private sector to set up integrated complex and units.

The principal provisions of the new policy are as follows:

i. Free flow of capital allowed in the sector.

ii. Duty structure would be reviewed.

iii. A venture capital fund should be set up to encourage entrepreneurship among technocrats.

iv. There should not be any mandatory export obligation on FDI.

v. The highly export oriented garment sector has been taken off SSI reserve list.

6.4 THE SUGAR INDUSTRY

Sugar industry is one of the major industries of India. It ranks second among the agro-based industries. It provides employment in mills and in the production of sugar cane. Its contribution to the revenues of both the Central and the State Governments in the form of various taxes is quite high. It provides direct employment to about 3.25 lakh workers. The industry contributes an estimated Rs.1600 crore annually to the Central and State exchequers.

History:

Sugar industry had its origin in India in 1903. But the industry developed on modern lines only after 1920. Since 1920, the development of the industry was phenomenal when the industry was given tariff protection against foreign competition. The industry has been described as the "Child of Protection". Within five years of the grant of protection, the number of factories increased from 31 in 1931-32 to 137 in 1936-37. In fact by 1939-40 India attained self sufficiency in sugar production. After the Second World War, the prices of sugar started rising and the Govt. had to adopt the system of price control and rationing. In 1952, production reached its peak level and controls were given up.

Progress under the Plans:

Production of sugar increased by leaps and bounds during the planning period. The number of sugar mills rose from 138 in 1950-51 to 582 in 2006-07, out of which 189 are in the private sector,306 in the co-operative sector and 62 in the public sector. The production of sugar increased from 1.1million tonnes in 1950-51 to 24.3 million tonnes in 2010-11.

Table 6.4: Production of Sugar in India

(in million tonnes)

YEAR	PRODUCTION
1950-51	1.1
1970-71	3.7
1990-91	11.8
2000-01	18.5
2007-08	26.3
2008-09	14.7
2009-10	18.8
2010-11	24.3

At present there are 245 sugar factories in the private sector, 62 in the public sector and remaining 317 factories in co-operative sector working in the Country, India is the second largest producer of sugar with a share of over 15 per cent of world sugar production.

Problems of the Sugar Industry

Sugar industry has been suffering from the following problems.

i. *Shift in Locational Pattern:*

   The sugar industry was initially located in Uttar Pradesh which together accounted for about 60 per cent of sugar production in 1960. Analyical studies about production costs revealed that irrational nature of the regional pattern of production. Since the sucrose content of sugarcane begins to deteriorate soon after the stalks have been cut, it is essential that mills must be located in close proximity to the sources of raw material. Consequently attempts were made to locate the new units in the cane producing states. i.e., from U.P. and Bihar to Maharashtra, Andhra Pradesh, Karnataka and Tamil Nadu.

ii. *Shortage in the Supply of Sugar Cane:*

   The sugar industry suffers from an inadequate and irregular supply of sugar cane. Cane output fluctuates with general weather conditions and the diversion of the land under cane to other crops.

iii. *Problem of Uneconomic Units:*

   Most of the sugar mills of the country were of uneconomic size, and they cannot be expected to produce sugar on a very large scale. As a result of this, production cost of these mills was quite high.

iv. *Low Yield of Cane per acre:*

The yield of sugar cane per hectare in India is very low. It is much less than that of Cuba. Java,and Hawai Islands. Further, quality of sugar cane produced in India is not quite satisfactory.

v. *Use of by Products:*

The by products of the industry such as baggasse, molasses, etc. are not put to economic use. The economic utilization of by-products can help in reducing cost of production.

vi. *Problem of Modernisation:*

vii. Most of the sugar mills of our country possess out-dated machines. The machines are to be replaced by a new one to increase the productivity and to reduce the cost of production.

viii. *Burden of Excessive Taxation:*

The industry has to face the burden of excessive taxation.

ix. *Short duration of the Crushing season:*

Another problem is short duration of the crushing season in India. The average duration of the crushing season is about 4 to 5 months in India as against 8 to 10 months in Cuba and Jawa.

x. *The Sugar economy is highly controlled:*

This industry requires compulsory licensing under the existing policy. There is a statutory minimum price (SMP) for sugar cane fixed by the centre and state advised price over and above the SMP. Though there is no price control on free sale sugar, its market supplies are regulated by fixing quarterly release quotas to maintain stability.

xi. *Governments' Changing policy :*

The frequently changing government policy with short term objectives in view , injected an element of serious uncertainty in the development of the industry .

Policy Measures as regards Sugar Industry:

The Government of India set up the B.B.Mahajan Committee which submitted its report in April 1998 and made the following recommendations:

i. Complete decontrol of sugar in order to provide level playing field to the domestic industry *vis-à-vis* imported sugar;

ii. Discontinuation of sugar through Public Distribution System (PDS) so as to prevent PDS sugar entering the open market;

iii. Setting up of a board for determining the Statutory Minimum Price (SMP) for sugarcane in the month of September every year;
iv. Prescribed a minimum distance of 15 kms. between existing sugar mill and a new sugar mill.
v. Continuance of import of sugar under the Open General Licence (OGL) in order to protect the consumers against any unusual rise in prices.
vi. Abolition of existing incentives for a new factory.

The Government of India is carefully considering the above recommendations. In the meantime, the Government has announced its decision:

i. To remove the sugar industry from compulsory licensing under the provisions of Industries(Development and Regulation) Act 1956; and
ii. To maintain a minimum distance of 15 kms. between an existing sugar mill and a new mill in order to avoid unhealthy competition among sugar factories to procure sugarcane.

Sugar Development Fund

The sugar Development Fund was set up in 1982 under the Sugar Cess act and is funded by transfer of proceeds of sugar cess imposed at the rate of Rs. 14 per quintal on sugar produced by all sugar factories. The Fund is utilised for advancing loans at concessional rate of interestfor the rehabilitation and modernisation of sugar industry and for development of sugarcane I the sugar factory area. This Fund makes grants for undertaking research projects for the development of sugar industry. The Fund is also used to defray expenditure for the purpose of building up and maintenance of buffer stocks of sugar with a view to stabilising its price.

6.5 THE CEMENT INDUSTRY

Cement is one of the key industries in India. It is a capital intensive industry. The first cement manufacturing unit was started in 1904 in India. But the systematic manufacturing of cement was started in 1914 by the India Cement Company Ltd. (Gujarat). At the beginning of economic planning, there were 21 factories in India with an annual capacity of 3.28 million tonnes. The government had complete control over the production, distribution and price of cement and this had dampened the growth of the cement industry. Later a policy of partial decontrol was announced in 1982 and this policy was continued till 1989. The cement industry was delicensed in 1991. The industry responded favourably to the government initiatives and the production capacity also increased. Total production increased from a mere 2.7 million tonnes in 1950-51 to

51.7 million tonnes in 1991-92 and finally to 190 million tonnes in 2009-10. At present (2011) there are 166 large cement plants in the country with an installed capacity of 282.09 million tonnes per annum. Besides, there are about 350 mini-steel plants with an estimated installed capacity of 11.10 million tones per annum. Now, India is the second largest producer of cement in the world after China. This industry provides employment to about 2 lakh people. The production during 2010-11 rose to 223.6MT. During 2007-08, cement export was 3.65 million tones and it increased to 4.62 MT in 2010-11.

Table 6.5: Performance of the Cement industry

YEAR	INSTALLED CAPACITY (MILLION TONNES)	PRODUCTION (MILLION TONNES)	PRODUCTION AS A PERCENTAGE OF CAPACITY (MILLION TONNES)
1950-51	3.3	2.7	82
1970-71	17.3	14.3	83
1990-91	64.0	48.8	76
2003-04	151.7	117.0	77
2007-08	184.2	167.6	91
2008-09	230.27	181.4	79
2009-10	NA	200.7	NA
2010-11	NA	209.7	NA

Source:*RBI, Report on Currency and Finance, 1997-98, Economic Survey 2010-11, Handbook of Statistics on Indian Economy, 2011-12*

The major Indian cement companies are Associated Cement Company (ACC), Grasim Industries, Ambuja Cements, J.K. Cements and Madras cement. The Indian government has ranked different states in India in terms of current production. Rajasthan ranks first, (16.18 per cent) followed by Andhra Pradesh (15.5 per cent), Madhya Pradesh (11.02 per cent) Tamil Nadu (10.47 per cent) and Gujarat (8.38 per cent)

Problems

The cement industry in India has been suffering from the following problems:

i. *Inadequate Production:*

   The main factors responsible for shortfall in production are:

   a. Drastic power cuts ranging from 20 to 75 per cent in various cement producing states;
   b. Shortage of coal;
   c. Inadequate availability of wagons; and

d. Limited availability of furnace oil resulting in partial or complete closure of many units. This explains why capacity utilisation which was as high as 93 per cent at one time came down to 67 per cent in 1980-81; in recent years it has been 76 per cent.

ii. *Cost Escalation and Rigid Prices:*

As in the case of many other industries, there was a rise in the cost of production of cement; and ironically it was due to government policies- like price and freight on coal, power and wages covered by wage awards.

iii. *Partial Control and Dual Pricing:*

Another problem of the cement industry related to the system of price control. The ostensible benefits envisaged from the price control system in the cement industry were:

a. Fair price to producer;
b. Availability of cement to consumers at fair price throughout the country(and the government was the single biggest consumer of cement in the country);
c. Self-sufficiency in the shortest possible time;
d. Reduction of regional imbalances; and
e. Review of freight pooling system (with particular reference to cost to the consumer and burden on transport system).

In practice, price control system resulted in unnecessary loss of about Rs.15 per tonne.

iv. *Unrealistic Distribution Policies:*

The government introduced a permit system of distribution which never worked properly. After a lot of delay, the Government of India announced a scheme of partial decontrol with effect from February 1982 and introduced dual pricing in cement- levy cement for Government and small house builders(at Rs.33 per bag) and free open market cement for general consumers at (Rs.65 per bag). According to the scheme levy quota was fixed at 66.6 pr cent of the cement produced by a factory in the case of existing units and 50 per cent in the case of new and sick units; and the balance 33.4 per cent of production could be sold in the open market. Since the country has reached has reached self-sufficiency in cement, all price and distribution controls were withdrawn from March 1989. However, price per bag of cement which was in the range of Rs. 80-85 during 1990-91 has shot up to Rs. 135- 153 in 1997-98 and further to Rs.250-300 per bag in 2013-14.

In recent years, the Government of India has given both direct and indirect encouragement to the cement industry. The indirect benefits have been in the form of demand push by giving priority to infrastructure and housing sectors. Besides, imports of cement are made unviable by the government and there is no fear of dumping the foreign cement in India.

6.6 THE PETROCHEMICAL INDUSTRY

Petro-chemicals industry is one of the fastest growing industries of India. This industry has revolutionised the industrial scene by providing the products which are substituting the traditional raw materials like wood, glass and metals. Its products meet various needs of the people at the low cost. Petro-chemicals are derived from petroleum or natural gas. We use a variety of products from morning till evening made from petrochemicals Toothbrushes, toothpaste, combs, hairpins, soap cases, plastic mugs, garments, ball point pens, detergents, electric switches, lipstick, insecticides, bags, bed covers, and foam are some of the goods made from petro-chemicals. Indian Petro-Chemical Corporation has set up a huge petro-chemical complex near Vadodara producing a wide range of products. Besides Vadodara, Gandhar, and Hazira in Gujarat and Nagathone in Maharashtra are other important centres of petro-chemical industry. India is self sufficient in the production of petrochemicals. Crude oil has no value unless it is refined, while refining crude oil, thousands of products like kerosene, diesel, lubricants and raw material for petro-chemical industry are derived. India has at present 18 refineries. These refineries are at Digboi, Bongaigaon, Nunamati (All are in Assam), Mumbai (two) (Maharashtra), Visakhapatnam (Andhra Pradesh), Barauni (Bihar), Koyali (Gujarat), Mathura (U.P.), Panipat (Haryana), Koch(Kerala), Mangalore (Karnataka) and Chennai (Tamil Nadu). The only private oil refineries belonging to Reliance Industries Ltd. is located at Jamnagar (Gujarat). The discovery of crude oil and natural gas in the offshore region in the western coast of India has provided a new dimension to the possibility of petrochemicals expansion from the Sixth Plan onwards.

Chemical industry is one of the oldest industry in India and contributes to 3 per cent of the Indian GDP, 13-4 per cent of exports and 8-9 per cent of total imports. The Petrochemical industry, which entered in the Indian industrial scene in 1970s, registered a rapid growth in the 1980s and 190s. Today, petrochemical products permeate the entire spectrum of daily use items and cover almost every sphere of lie like clothing, housing, construction, furniture, Automobiles etc. The Indian basic petrochemicals market (including end products market which includes polymers,

synthetic fibers, elastomers and surfactants) the total petrochemical market has grown at CAGR of 1 per cent from USD 19.3 billion FY1 to USD 24 billion FY13.Oil and Gas are considered to be feedstock in petrochemical process that manufacture such products a plastics, detergents, solvents, elastomers and fibers such as nylon ad polyesters. The oil and gas sector is one of the six core industries in India that plays a pivotal roe influencing decisions across important spheres of the economy.

Current Scenario:

Foreign investment is one of the major reasons behind the growth of oil and gas sector. The petroleum and natural gas sector attracted foreign direct investment worth $6519.53 million between April 20 and January 2015. Currently oil producing companies and refineries are not doing as well as oil marketing companies.

Figure 1 depicts the trend of imports and exports of major chemicals and petrochemicals in India during 2009-2010 to 2013-2014 along with the trade balance across these years.

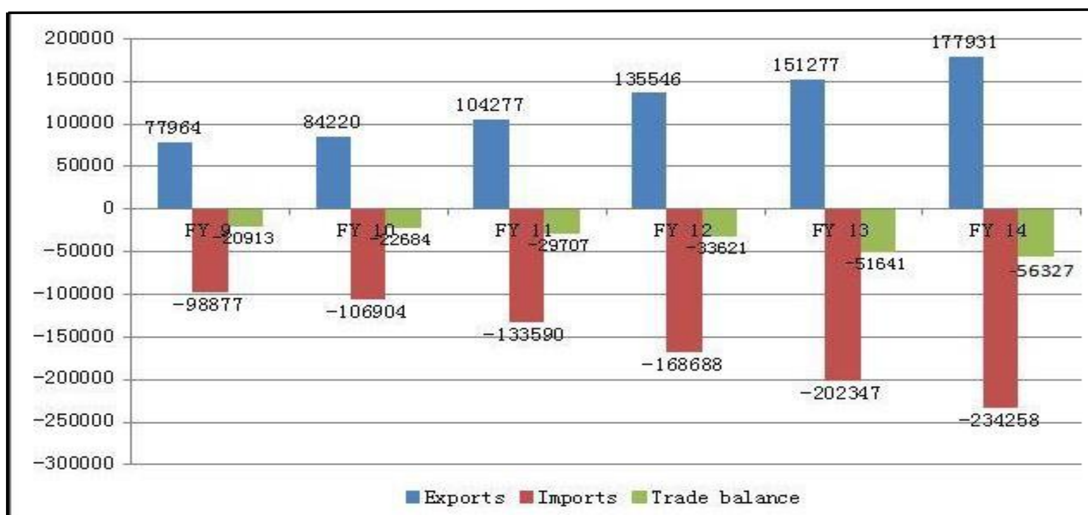

Figure 6.1: Trends in Export and Import of Major Chemicals and Petro Chemicals (in Rs.crores)

The import of major chemical and petrochemical products contributed 8.6 per cent of total imports in 2013-14, compared to 7.6 per cent in 2012-13 whereas exports of major chemical and petrochemical products contributed 9.4 per cent of total exports in 2013-4, compared to 9.3 per cent in 2011-13.

The major policy initiative of developing Petroleum, Chemicals and Petrochemical Investment Regions (PCIRs) as petrochemical hub in South Asia was formulated in 2007 which aimed attracting massive investments in these industries totaling around $10 billion (£6 billion).

However due to lack of any focused approach by the government, nor a continuation in leadership less than 10 per centof the proposed investments in PCIRs have been realized. The lone PCIR located at Dahej, Gujarat, accounts for a major chunk of investment.

So far, PCIRs have been approved at five locations in the states of Gujarat, Andhra Pradesh, Tamil Nadu, Orissa and Karnataka. Meanwhile, PCIRs are being planned in Madhya Pradesh and other regions. Currently only 2.7 per cent of refinery output is being used for petrochemical industries. Cracker units are being built a refineries and downstream facilities through PCIRs to address the challenges presented by lack of stock.

Future Trend:

By 2015-2016, India's demand for gas is to touch 124 MTPA against a domestic supply of 3 MTPA and higher imports of 47.2 MTPA, leaving a shortage of 4 MTPA as per projections by Petroleum and Natural Gas Ministry of India. India is predicted to account for 12.4 per cent of Asia Pacific regional oil demand by 2015.

The Indian petrochemical and chemical market is estimated to be around $14 billion – the third largest in Asia. The chemical industry is likely to touch $190 billion by the financial year 2017–18 on account of an estimated increase in demand for chemicals from various sectors. The ministry aims to increase the output from refineries for petrochemical industry to 7 per cent, thereby increasing the market from $150 billion to close to $40 billion. This will generate 3.7 million jobs. It will also revolutionize and metamorphose the entire industry and it will be a reality in the next five years. The chemical and petrochemical industry can be a game changer for Indian economy. Till now though India has been primarily refining crude oil for energy requirements, now the emphasis will be on deriving more value from sources by cracking materials for downstream industries. In future the refineries will not be for fuel purpose only but will also aim at increasing feedstock for downstream industries by 3 times.

Policy Announcements:

According to Union Budget 2015-2016, Provision of subsidy for sensitive petroleum products has been set a Rs. 301 billion for 2015-6 (BE) which could be adequate for full FY16 and carry-over of Q4 FY15 if crude oil prices remain at current levels. Government has proposed to reduce basic custom duty on certain inputs, raw materials, intermediates and components of chemical and petro chemical industry.

A draft national chemical policy has been firmed up with extensive consultations with stakeholders and is under finalization. The new chemical policy aims to increase share of chemical sector in India's GDP through initiatives like sting up of chemical clusters, building Enabling infrastructure, facilitating fast rack project clearances, expanding manufacturing capacities and skill development. The policy will also bring the entire chemical industry under one administrative roof. Currently, the refinery part of petrochemicals with the Ministry of Petroleum and Natural Gas; agrochemicals with the Agriculture Ministry and different aspects of chemicals are fragmented. The new policy whose main thrust will hinge on the Make in India initiative will help establish links between the fragmented chemical industry units and allow the industry to become self reliant, successful exporter and a strong industry in the next 5 years.

The ministry is reviewing the PCIR policy of 207 in order to fast rack its implementation and attract investments.

The new Government is giving thrust on some of the key ease of doing business parameters like sting up a fully functional single-window system for all clearances, reforming labour laws and easing the land acquisition rules which would give necessary push to 'Make in India'.

Challenges faced by Petrochemical Industry:

India's high inflation rate and rising prices, weakening business and consumer sentiment and the complicated access to lending pose a great threat to the chemical and petrochemical sector. Raw materials are difficult to procure and expensive due to the lack of adequate facilities at ports and railways. Many manufacturing plants need to be upgraded and made more environmental friendly.

Lack of business confidence, policy paralysis, poor infrastructure, and a difficult business environment are some of the reasons for no major petrochemicals[foreign direct investment(FDI)] in India. In order to attract multinationals to invest in India, major structural and policy changes are required. India's chemical sector spends 1-2% of its turnover on R&D, compared to 5-10% in developed countries. The sector's high resource dependence is a major threat to its stability. Inputs roughly account for 80 per cent of final outputs, which makes profit margins highly dependent on input prices. Other challenges include low capacity utilization and a shortage of skilled wokforce.

6.7 CHECK YOUR PROGRESS/SAQ'S

1. Large-scale industries can further be classified as________________and______________.

2. The textile industry has three mutually exclusive and disparate sectors, namely,_____________, _______________and________________.

3. The Government of India set up the B.B.Mahajan Committee for recommendations on the _________________________industry

6.8 ANSWERS TO CHECK YOUR PROGRESS/SAQ'S

1. Traditional, modern

2. the mills, the handlooms and the power looms.

3. Sugar

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6.10 TERMINAL AND MODEL QUESTIONS

1. What is the significance of Iron and Steel Industry in India? Discuss the present position and problems of this industry.
2. Discuss the present position of petroleum industry in India.
3. What are the policy initiatives undertaken by the government for taking care of the Sugar industry and the Textiles Industrty.

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Chapter 7

Industrial Policy

7.1 OBJECTIVES

7.2 INTRODUCTION

In pursuit of the above objectives, Government have decided to take a series of initiatives in respect of the policies relating to the following areas, each of which will be discussed in detail in the latter part of this chapter :

i. Industrial Licensing.
ii. Foreign Investment
iii. Foreign Technology Agreements.
iv. Public Sector Policy
v. MRTP Act.

A package for the Small and Tiny Sectors of industry is being announced separately which is discussed in detail in ensuing paragraphs:

7.3 POLICY FOR COTTAGE AND SMALL SCALE INDUSTRIES:

There has been a significant growth of small scale industry since independence. A differential investment limit has been adopted since 9th October 2001 for 41 reserved items where the investment limit upto Rs. five crore is prescribed for qualifying as a small scale unit. The investment limit for tiny units is Rs. 25 lakhs. 749 items are reserved for manufacture in the small scale sector. All undertakings other than the small scale industrial undertakings engaged in the manufacture of items reserved for manufacture in the small scale sector are required to obtain an industrial license and undertake an export obligation of 50 per cent of the annual production. This condition of licensing is, however, not applicable to those undertakings operating under 100 per cent Export Oriented Undertakings Scheme, the Export Processing Zone (EPZ) or the Special Economic Zone Schemes (SEZs).

In order to highlight the small scale industries' significance in the various policies , a brief of some of the Government Policies for development and promotion of Small-Scale Industries in India is given in the ensuing paragraphs. With this background in view, in what follows is a

review of India's Industrial Policies for the development and promotion of small-scale enterprises in the country.

7.3.1 Industrial Policy Resolution (IPR) 1948:

The IPR, 1948 for the first time, accepted the importance of small-scale industries in the overall industrial development of the country. It was well realized that small-scale industries are particularly suited for the utilization of local resources and for creation of employment opportunities.

However, they have to face acute problems of raw materials, capital, skilled labour, marketing, etc. since a long period of time. Therefore, emphasis was laid in the IPR, 1948 that these problems of small-scale enterprises should be solved by the Central Government with the cooperation of the State Governments. In nutshell, the main thrust of IPR 1948, as far as small-scale enterprises were concerned, was 'protection.'

7.3.2 Industrial Policy Resolution (IPR) 1956:

The main contribution of the IPR 1948 was that it set in the nature and pattern of industrial development in the country. The post-IPR 1948 period was marked by significant developments taken place in the country. For example, planning has proceeded on an organised manner and the First Five Year Plan 1951-56 had been completed. Industries (Development and Regulation) Act, 1951 was also introduced to regulate and control industries in the country.

The parliament had also accepted 'the socialist pattern of society' as the basic aim of social and economic policy during this period. It was this background that the declaration of a new industrial policy resolution seemed essential. This came in the form of IPR 1956.

The IPR 1956 provided that along with continuing policy support to the small sector, it also aimed at to ensure that decentralised sector acquires sufficient vitality to self-supporting and its development is integrated with that of large- scale industry in the country. To mention, some 128 items were reserved for exclusive production in the small-scale sector.

Besides, the Small-Scale Industries Board (SSIB) constituted a working group in 1959 to examine and formulate a development plan for small-scale industries during the, Third Five Year Plan, 1961-66. In the Third Five Year Plan period, specific developmental projects like 'Rural Industries Projects' and 'Industrial Estates Projects' were started to strengthen the small-scale sector in the country. Thus, to the earlier emphasis of 'protection' was added 'development.' The

IPR 1956 for small-scale industries aimed at "Protection plus Development." In a way, the IPR 1956 initiated the modem SSI in India.

7.3.3 Industrial Policy Resolution (IPR) 1977:

During the two decades after the IPR 1956, the economy witnessed lopsided industrial development skewed in favour of large and medium sector, on the one hand, and increase in unemployment, on the other. This situation led to a renewed emphasis on industrial policy. This gave emergence to IPR 1977.

The Policy Statement categorically mentioned:

"The emphasis on industrial policy so far has been mainly on large industries, neglecting cottage industries completely, relegating small industries to a minor role. The main thrust of the new industrial policy will be on effective promotion of cottage and small-scale industries widely dispersed in rural areas and small towns. It is the policy of the Government that whatever can be produced by small and cottage industries must only be so produced."

The IPR 1977 accordingly classified small sector into three broad categories:

1. Cottage and Household Industries which provide self-employment on a large scale.

2. Tiny sector incorporating investment in industrial units in plant and machinery up to Rs. 1 lakh and situated in towns with a population of less than 50,000 according to 1971 Census.

3. Small-scale industries comprising of industrial units with an investment of upto Rs.10 lakhs and in case of ancillary units with an investment up to Rs. 15 lakhs.

The measures suggested for the promotion of small-scale and cottage industries included:

(i) Reservation of 504 items for exclusive production in small-scale sector.

(ii) Proposal to set up in each district an agency called 'District Industry Centre' (DIC) to serve as a focal point of development for small-scale and cottage industries. The scheme of DIC was introduced in May 1978. The main objective of setting up DICs was to promote under a single roof all the services and support required by small and village entrepreneurs.

What follows from above is that to the earlier thrust of protection (IPR 1948) and development (IPR 1956), the IPR 1977 added 'promotion'. As per this resolution, the small sector was, thus, to be protected, developed, and promoted.'

7.3.4 Industrial Policy Resolution (IPR) 1980:

The Government of India adopted a new Industrial Policy Resolution (IPR) on July 23, 1980. The main objective of IPR 1980 was defined as facilitating an increase in industrial production through optimum utilization of installed capacity and expansion of industries.

As to the small sector, the resolution envisaged:

Increase in investment ceilings from Rs. 1 lakh to Rs. 2 lakhs in case of tiny units, from Rs. 10 lakhs to Rs. 20 lakhs in case of small-scale units and from Rs. 15 lakhs to Rs. 25 lakhs in case of ancillaries.

Introduction of the concept of nucleus plants to replace the earlier scheme of the District Industry Centres in each industrially backward district to promote the maximum small-scale industries there.

Promotion of village and rural industries to generate economic viability in the villages well compatible with the environment.

Thus, the IPR 1980 reimphasised the spirit of the IPR 1956. The small-scale sector still remained the best sector for generating wage and self-employment based opportunities in the country.

7.3.5 Industrial Policy Resolution (IPR) 1990:

The IPR 1990 was announced during June 1990. As to the small-scale sector, the resolution continued to give increasing importance to small-scale enterprises to serve the objective of employment generation. The important elements included in the resolution to boost the development of small-scale sector were as follows:

The investment ceiling in plant and machinery for small-scale industries (fixed in 1985) was raised from Rs. 35 lakhs to Rs. 60 lakhs and correspondingly, for ancillary units from Rs. 45 lakhs to Rs. 75 lakhs.

Investment ceiling for tiny units had been increased from Rs.2 lakhs to Rs.5 lakhs provided the unit is located in an area having a population of 50,000 as per 1981 Census.

As many as 836 items were reserved for exclusive manufacture in small- scale sector.

A new scheme of Central Investment Subsidy exclusively for small-scale sector in rural and backward areas capable of generating more employment at lower cost of capital had been mooted and implemented.

With a view, to improve the competitiveness of the products manufactured in the small-scale sector; programmes of technology up gradation will be implemented under the umbrella of an apex Technology Development Centre in Small Industries Development Organisation (SIDO).

To ensure both adequate and timely flow of credit facilities for the small- scale industries, a new apex bank known as 'Small Industries Development Bank of India (SIDBI)' was established in 1990.

Greater emphasis on training of women and youth under Entrepreneurship Development Programme (EDP) and to establish a special cell in SIDO for this purpose.

Implementation of delicencing of all new units with investment of Rs. 25 crores in fixed assets in non-backward areas and Rs. 75 crores in centrally notified backward areas. Similarly, delicensing shall be implemented in the case of 100 per cent Export Oriented Units (EOU) set up in Export Processing Zones (EPZ) up to an investment ceiling of Rs. 75 lakhs.

7.4 INDUSTRIAL LICENSING POLICY

Industrial Licensing is governed by the Industries (Development & Regulation) Act, 1951. The Industrial Policy Resolution of 1956 identified the following three categories of industries: those that would be reserved for development in public sector, those that would be permitted for development through private enterprise with or without State participation, and those in which investment initiatives would ordinarily emanate from private entrepreneurs. Over the years, keeping in view the changing industrial scene in the country, the policy has undergone modifications. Industrial licensing policy and procedures have also been liberalised from time to time. A full realisation of the industrial potential of the country calls for a continuation of this process of change.

In order to achieve the objectives of the strategy for the industrial sector for the 1990s and beyond it is necessary to make a number of changes in the system of industrial approvals. Major policy initiatives and procedural reforms are called for in order to actively encourage and assist Indian entrepreneurs to exploit and meet the emerging domestic and global opportunities and

challenges. The bedrock of any such package of measures must be to let the entrepreneurs make investment decisions on the basis of their own commercial judgement. The attainment of technological dynamism and international competitiveness requires that enterprises must be enabled to swiftly respond to fast changing external conditions that have become characteristic of today's industrial world. Government policy and procedures must be geared to assisting entrepreneurs in their efforts. This can be done only if the role played by the government were to be changed from that of only exercising control to one of providing help and guidance by making essential procedures fully transparent and by eliminating delays.

The winds of change have been with us for some time. The industrial licensing system has been gradually moving away from the concept of capacity licensing. The system of reservations for public sector undertakings has been evolving towards an ethos of greater flexibility and private sector enterprise has been gradually allowed to enter into many of these areas on a case by case basis. Further impetus must be provided to these changes which alone can push this country towards the attainment of its entrepreneurial and industrial potential. This calls for bold and imaginative decisions designed to remove restraints on capacity creation, while at the same, ensuring that over-riding national interests are not jeopardised.

In the above context, industrial licensing will henceforth be abolished for all industries, except those specified, irrespective of levels of investment. These specified industries (Annex-II), will continue to be subject to compulsory licensing for reasons related to security and strategic concerns, social reasons, problems related to safety and over-riding environmental issues, manufacture of products of hazardous nature and articles of elitist consumption. The exemption from licensing will be particularly helpful to the many dynamic small and medium entrepreneurs who have been unnecessarily hampered by the licensing system. As a whole the Indian economy will benefit by becoming more competitive, more efficient and modern and will take its rightful place in the world of industrial progress.

7.5 FOREIGN INVESTMENT

While freeing Indian industry from official controls, opportunities for promoting foreign investments in India should also be fully exploited. In view of the significant development of India's industrial economy in the last 40 years, the general resilience, size and level of sophistication achieved, and the significant changes that have also taken place in the world industrial economy, the relationship between domestic and foreign industry needs to be much more dynamic than it has been in the past in terms of both technology and investment. Foreign

investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. This is particularly necessary in the changing global scenario of industrial and economic cooperation marked by mobility of capital. The government will therefore welcome foreign investment which is in the interest of the country's industrial development.

In order to invite foreign investment in high priority industries, requiring large investments and advanced technology, it has been decided to provide approval for direct foreign investment upto 51 per cent foreign equity in such industries. There shall be no bottlenecks of any kind in this process. This group of industries has generally been known as the "Appendix I Industries" and are areas in which FERA companies have already been allowed to invest on a discretionary basis. This change will go a long way in making Indian policy on foreign investment transparent. Such a framework will make it attractive for companies abroad to invest in India.

Promotion of exports of Indian products calls for a systematic exploration of world markets possible only through intensive and highly professional marketing activities. To the extent that expertise of this nature is not well developed so far in India, Government will encourage foreign trading companies to assist us in our export activities. Attraction of substantial investment and access to high technology, often closely held, and to world markets, involves interaction with some of the world's largest international manufacturing and marketing firms. The Government will appoint a special board to negotiate with such firms so that we can engage in purposive negotiation with such large firms, and provide the avenues for large investments in the development of industries and technology in the national interest.

7.6 FOREIGN TECHNOLOGY AGREEMENT

There is a great need for promoting an industrial environment where the acquisition of technological capability receives priority. In the fast changing world of technology the relationship between the suppliers and users of technology must be a continuous one. Such a relationship becomes difficult to achieve when the approval process includes unnecessary governmental interference on a case to case basis involving endemic delays and fostering uncertainty. The Indian entrepreneur has now come of age so that he no longer needs such bureaucratic clearances of his commercial technology relationships with foreign technology suppliers. Indian industry can scarcely be competitive with the rest of the world if it is to operate within such a regulatory environment.

With a view to injecting the desired level of technological dynamism in Indian industry, Government will provide automatic approval for technology agreement related to high priority industries within specified parameters. Similar facilities will be available for other industries as well if such agreements do not require the expenditure of free exchange. Indian companies will be free to negotiate the terms of technology transfer with their foreign counterparts according to their own commercial judgement. The predictability and independence of action that this measure is providing to Indian industry will induce them to develop indigenous competence for the efficient absorption of foreign technology. Greater competitive pressure will also induce our industry to invest much more in research and development and they have been doing in the past. In order to help this process, the hiring of foreign technicians and foreign testing of indigenously developed technologies, will also not require prior clearance as prescribed so far, individually or as a part of industrial or investment approvals.

7.7 PUBLIC SECTOR POLICY

The public sector has been central to our philosophy of development. In the pursuit of our development objectives, public ownership and control in critical sector of the economy has played an important role in preventing the concentration of economic power, reducing regional disparities and ensuring that planned development serves the common good. The Industrial Policy Resolution of 1956 gave the public sector a strategic role in the economy. Massive investments have been made over the past four decades to build a public sector which has a commanding role in the economy. Today key sectors of the economy are dominated by mature public enterprises that have successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in a number of areas.

After the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems are observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate attention to R&D and human resource development. In addition, public enterprises have shown a very low rate of return on the capital invested. This has inhibited their ability to re-generate themselves in terms of new investments as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government. The original concept of the public sector has also undergone considerable dilution. The most striking example is the take-over of sick units from the private sector. This

category of public sector units accounts for almost one third of the total losses of central public enterprises. Another category of public enterprises, which does not fit into the original idea of the public sector being at the commanding heights of the economy, is the plethora of public enterprises which are in the consumer goods and services sectors.

It is time therefore that the Government adopt a new approach to public enterprises. There must be a greater commitment to the support of public enterprises which are essential for the operation of the industrial economy. Measures must be taken to make these enterprises more growth oriented and technically dynamic. Units which may be faltering at present but are potentially viable must be restructured and given a new lease of life. The priority areas for growth of public enterprises in the future will be the following:

- Essential infrastructure goods and services.
- Exploration and exploitation of oil and mineral resources.
- Technology development and building of manufacturing capabilities in areas which are crucial in the long term development of the economy and where private sector investment is inadequate.
- Manufacture of products where strategic considerations predominate such as defence equipment.

At the same time the public sector will not be barred from entering areas not specifically reserved for it.

In view of these considerations, Government will review the existing portfolio of public investments with greater realism. This review will be in respect of industries based on low technology, small scale and non-strategic areas, inefficient and unproductive areas, areas with low or nil social considerations or public purpose, and areas where the private sector has developed sufficient expertise and resources.

Government will strengthen those public enterprises which fall in the reserved areas of operation or are in high priority areas or are generating good or reasonable profits. Such enterprises will be provided a much greater degree of management autonomy through the system of memoranda of understanding. Competition will also be induced in these areas by inviting private sector participation. In the case of selected enterprises, part of Government holdings in the equity share capital of these enterprises will be disinvested in order to provide further market discipline to the performance of public enterprises. There are a large number of chronically sick public

enterprises incurring heavy losses, operating in a competitive market and serve little or no public purpose. These need to be attended to. The country must be proud of the public sector that it owns and it must operate in the public interest.

7.7.1 Problems of Public sector undertakings

The most important criticism levied against public sector undertakings has been that in relation to the capital employed, the level of profits has been too low. Even the government has crticised the public sector undertakings on this count. Of the various factors responsible for low profits in the public sector undertakings, the following are particularly important :-

i. Price policy of public sector undertakings.
ii. Under – utilization of capacity
iii. Problem related to planning and construction of projects.
iv. Problems of labour, personnel and management
v. Lack of autonomy

The government in order to put an end to these problems, decided to disinvest its stake in the PSUs. The companies traditionally established as pillars of growth have now become a burden on the economy. Except few mighty oil and petroleum companies, almost all other PSUs are incurring losses. The national gross domestic product and gross national savings are also adversely affected by low returns from PSUs. About 10 to 15 per cent of the total gross domestic savings are reduced on account of low savings from PSUs.

7.8 MONOPOLIES AND RESTRICTIVE TRADE PRACTICES ACT (MRTP ACT)

The principal objectives sought to be achieved through the MRTP Act are as follows:

i. Prevention of concentration of economic power to the common detriment, control of monopolies, and
ii. Prohibition of monopolistic and restrictive and unfair trade practices.

The MRTP Act became effective in June 1970. With the emphasis placed on productivity in the Sixth Plan, major amendments to the MRTP Act were carried out in 1982 and 1984 in order to remove impediments to industrial growth and expansion. This process of change was given a new momentum in 1985 by an increase of threshold limit of assets.

With the growing complexity of industrial structure and the need for achieving economies of scale for ensuring high productivity and competitive advantage in the international market, the

interference of the Government through the MRTP Act in investment decisions of large companies has become deleterious in its effects on Indian industrial growth. The pre-entry scrutiny of investment decisions by so called MRTP companies will no longer be required. Instead, emphasis will be on controlling and regulating monopolistic, restrictive and unfair trade practices rather than making it necessary for the monopoly house to obtain prior approval of Central Government for expansion, establishment of new undertakings, merger, amalgamation and takeover and appointment of certain directors. The thrust of policy will be more on controlling unfair or restrictive business practices. The MRTP Act will be restructured by eliminating the legal requirement for prior governmental approval for expansion of present undertakings and establishment of new undertakings. The provisions relating to merger, amalgamation, and takeover will also be repealed. Similarly, the provisions regarding restrictions on acquisition of and transfer of shares will be appropriately incorporated in the Companies Act.

7.9 DISINVESTMENT OF PUBLIC SECTOR UNDERTAKINGS

Investment and disinvestment are two sides of the same coin. When we deal with the investment management, it automatically encompasses, disinvestment also, as what is investment for one is disinvestment for another, particularly in the secondary market. It investment is an art and science, the more so is the disinvestment process.

Investment refers to conversion of money or cash into securities, debentures, bonds or any other claims on money. At the same time, disinvestment involves the conversion of money claims or securities into money or cash.

Disinvestment is a wider term extending from dilution of the stake of the government to a level where there is no change in the control to dilution that results in the transfer of management. The transfer of ownership may occur when in an enterprise the dilution of government ownership is beyond 51 percent. The disinvestment implies that the government will sell to public or private enterprises / public institutes part of its holding in public sector enterprises.

7.9.1 Reasons for disinvestment

The public sector in India at present is at cross roads. The new economic policy initiated in July – 1991, clearly indicated that the public sector undertakings have shown a very negative rate of return on capital employed. On account of this phenomenon many public sector undertakings have become burden to the government. They are infact turning out to be liabilities to the government rather than being assets. This is a sector which the government clearly wants to get rid of. In this

direction the government has adopted a new approach to reform and improve the public sector undertakings performance i.e 'Disinvestment policy'. This has gained lot of importance especially in latter part of 90s. At present the government seriously perceives the disinvestment policy as an active tool to reduce the burden to financing the public sector undertakings.

7.9.2 Objectives of Disinvestment

The following are the main objectives of disinvestment policy of the government.

i. To reduce the financial burden on government.
ii. To improve public finances.
iii. To introduce, competition and market discipline.
iv. To find growth.
v. To encourage wider share of ownership.
vi. To depoliticise essential services.
vii. The Disinvestment process in India

The following are the three methods adopted by the Government of India for disinvesting the Public sector undertakings. There are three broad methods involved, which are used in valuation of shares.

Net Asset Method: This will indicate the net assets of the enterprise as shown in the books of accounts. It shows the historical value of the assets. It is the cost price less depreciation provided so far on assets. It does not reflect the true position of profitability of the firm as it overlooks the value of intangibles such as goodwill, brands, distribution network and customer relationships which are important to determine the intrinsic value of the enterprise. This model is more suitable in case of liquidation than in case of disinvestment.

Profit Earning Capacity Value Method: The profit earning capacity is generally based on the profits actually earned or anticipated. It values a company on the basis of the underlying assets. This method does not consider or project the future cash flow.

Discounted Cash Flow Method: In this method the future incremental cash flows are forecasted and discounted into present value by applying cost of capital rate. The method indicates the intrinsic value of the firm and this method is considered as superior than other methods as it projects future cash flows and the earning potential of the firm, takes into account intangibles such as brand equity, marketing & distribution network, the level of competition likely to be faced in future, risk factors to which enterprises are exposed as well as value of its core assets. Out of these three methods the Discounted cash flow method is used widely though it is the most difficult.

7.9.3 Recent Trends in Disinvestment Process

The change process in Indian begun in the year 1991-92 and in that year 31 selected PSUs were disinvested totalling an aggregate equity of Rs.3,038 crores. In the decade 1991-92 to 2000-01, the total rose to Rs.20,506 crores as against the target of 54,300 crores. In the year 2000-01 itself the government was able to raise Rs.1,868 crores against the target of Rs.10,000 crores. The target set for disinvestment proceeds was met in only three of the last twelve years. The most recent of such years is 1998-99. In the early 90's, India used to have relatively modest targets of generating around Rs.2000 – Rs.3000 crores through disinvestment. By mid-nineties, the targets were jacked up to an annual revenue of Rs.5,000 crores. By the late nineties, Rs.10,000 crore plus targets became common.

Table – 7.1: Disinvestment proceeds

Year	Target	Actual
1991-92	2,500	3,038
1992-93	2,500	1,913
1993-94	3,500	Nil
1994-95	4,000	4,843
1995-96	7,000	362
1996-97	5,000	380
1997-98	4,800	902
1998-99	5,000	5,371
1999-00	10,000	1,829
2000-01	10,000	1,869
2001-02	12,000	5,632
2002-03	12,000	3,342
2003-04	13,200	-
Source: ET Survey, Mar.2003		

The reasons for such low proceeds from disinvestment against the actual target set are –

i. Unfavorable market conditions.
ii. Offers made by the government were not attractive for private sector investors.
iii. Lot of hue and cry being made on valuation process.
iv. Government has no clear-cut policy on disinvestment.
v. Strong opposition from employee and trade unions.
vi. Lack of transparency in the whole process.
vii. Lack of political will.

7.9.4 Modus Operandi – Method of Disinvestment

Government stakes in 48 companies have been sold in varying degrees by 2002-03. Till 1998-99, the government used to sell minority stakes through domestic or international issue of shares in small trenches every year. Post 1999-00, there has been a greater stress on strategic sale – involving an effective transfer of control and management to private entity. The prominent companies which have witnessed strategic sale include Modern Foods, BALCO, CMC, VSNL, IBP, ITDC Hotels, Maruthi , Pradeep Phosphate and HZL.

Table – 7.2:Methods followed by India for Disinvestment

Year	No. of Companies	Method of disinvestment
'91-92	47	Minority shares sold by auction method in bundles of "very good" "good" and "average" companies
'92-93	35	Bundling of shares abandoned. Shares sold separately for each company by auction method.
'93-94	-	Equity of 7 companies sold by open auction but proceeds received in 1994-95
'94-95	13	Sale through auction method, in which NRIs and other persons legally permitted to buy, hold or sell equity, allowed to participate.
'95-96	5	Equities of 4 companies auctioned.
'96-97	1	GDR (VSNL) in international market
'97-98	1	GDR (MTNL) in international market
'98-99	5	GDR (VSNL) / Domestic offerings with the participation of FIIs (CONCOR, GAIL). Cross purchase by 3 oil sector companies i.e. GAIL, ONGC & IOC.
'99-00	2	GDR (GAIL), Domestic issues (VSNL), restructuring BALCO
'00-01	4	Strategic sale of BALCO, LIMC, takeover – KRL (CRL), CPCL (MRL), BRPL
'01-02	10	Strategic sale of CMC (51%), HTL (74%), VSNL(25%), IBP (33.58%), PPL (74%), and sale by other modes (ITDC & HCI).
'02-03	6	Strategic sale of JESSOP (72%), HTL (26%), MFIL (26%), IPCL (25%) and other modes (HCI, Maruthi).

Source: ET Survey, Mar.2003

Simultaneously, provisions of the MRTP Act had been strengthened in order to enable the MRTP Commission to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices. The newly empowered MRTP Commission was then encouraged to require investigation *suo moto* or on complaints received from individual consumers or classes of consumers. The MRTP Act gave way to the Competition Act in 2002.

7.10 Annexure I

Proposed List of Industries to be Reserved for the Public Sector

1. Arms and ammunition and allied items of defence equipment, Defence aircraft and warships.

2. Atomic Energy.

3. Coal and lignite.

4. Mineral oils.

5. Mining if iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond.

6. Mining of copper, lead, zinc, tin, molybdenum and wolfram.

7. Minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953.

8. Railway transport.

7.11 Annexure II

List of Industries in Respect of which Industrial Licensing will be Compulsory

1. Coal and Lignite.

2. Petroleum (other than crude) and its distillation products.

3. Distillation and brewing of alcoholic drinks.

4. Sugar.

5. Animal fats and oils.

6. Cigars and cigarettes of tobacco and manufactured tobacco substitutes.

7. Asbestos and asbestos-based products.

8. Plywood, decorative veneers, and other wood based products such as particle board, medium density fibre board, block board.

9. Raw hides and skins, leather, chamois leather and patent leather.

10. Tanned or dressed furskins.

11. Motor cars.

12. Paper and Newsprint except bagasse-based units.

13. Electronic aerospace and defence equipment; All types.

14. Industrial explosives, including detonating fuse, safety fuse, gun powder, Nitro-cellulose and matches.

15. Hazardous chemicals.

16. Drugs and Pharmaceuticals (according to Drug Policy).

17. Entertainment electronics (VCRs, colour TVs, C.D. Players, Tape Recorders).

18.White Goods (Domestic Refrigerators, Domestic Dishwashing machines, Programmable Domestic Washing Machines, Microwave ovens, Airconditioners).

Note: The compulsory licensing provisions would not apply in respect of the small-scale units taking up the manufacture of any of the above items reserved for exclusive manufacture in small scale sector.

7.12 Annexure III

List of Industries for Automatic Approval of Foreign Technology Agreements and For 51 per cent Foreign Equity Approvals

1. Metallurgical Industries

    i. Ferro alloys.
    ii. Castings and forgings.
    iii. Non-ferrous metals and their alloys.
    iv. Sponge iron and pelletisation.
    v. Large diameter steel welded pipes of over 300 mm diameter and stainless steel pipes.
    vi. Pig iron.

2. Boilers and Steam Generating Plants

3. Prime Movers (other than electrical generators)

i. Industrial turbines.

ii. Internal combustion engines.

iii. Alternate energy systems like solar wind etc. and equipment therefor.

iv. Gas/hydro/steam turbines upto 60 MW.

4. Electrical Equipment

i. Equipment for transmission and distribution of electricity including power and distribution transformers, power relays, HT-switch gear synchronous condensers.

ii. Electrical motors.

iii. Electrical furnaces, industrial furnaces and induction heating equipment.

iv. X-ray equipment.

v. Electronic equipment, components including subscribers' end telecommunication equipments.

vi. Component wires for manufacture of lead-in wires.

vii. Hydro/steam/gas generators/generating sets upto 60 MW.

viii.Generating sets and pumping sets based on internal combustion engines.

ix. Jelly-filled telecommunication cables.

x. Optic fibre.

xi. Energy efficient lamps and

xii. Midget carbon electrodes.

5. Transportation

i. Mechanised sailing vessels upto 10,000 DWT including fishing trawlers.

ii. Ship ancillaries.

iii. (a) Commercial vehicles, public transport vehicles including automotive commercial three wheeler jeep type vehicles, industrial locomotives.

(b) Automotive two wheelers and three wheelers.

(c) Automotive components/spares and ancillaries.

iv. Shock absorbers for railway equipment and

v. Brake system for railway stock and locomotives.

6. Industrial Machinery

i. Industrial machinery and equipment.

ii. Machine tools and industrial robots and their controls and accessories.

iii. Jigs, fixtures, tools and dies of specilised types and cross land tooling, and
iv. Engineering production aids such as cutting and forming tools, patterns and dies and tools.

8. Agricultural Machinery

i. Tractors.
ii. Self-propelled harvestor Combines.
iii. Rice transplanters.

9. Earth Moving Machinery

i. Earth moving machinery and construction machinery and components thereof.

10. Industrial Instruments

i. Indicating, recording and regulating devices for pressures, temperatures, rate of flow weight levels and the like.

11. Scientific and Electromedical Instruments and Laboratory Equipment.

12. Nitrogenous & Phosphatic Fertilizers falling under

i. Inorganic fertilizers under '18-Fertilizers' in the First Schedule to IDR Act, 1951.

13. Chemicals (other than fertilizers).

i. Heavy organic chemicals including petrochemicals.

ii. Heavy inorganic chemicals.

iii. Organic fine chemicals.

iv. Synthetic resins and plastics.

v. Man made fibres.

vi. Synthetic rubber.

vii. Industrial explosives.

viii. Technical grade insecticides, fungicides, weedicides, and the like.

ix. Synthetic detergents

x. Miscellaneous chemicals (for industrial use only)

a. Catalysts and catalyst supports.

b. Photographic chemicals.

c. Rubber chemicals.

d. Polyols.

e. Iso-cyanates, urethanes, etc.

f. Speciality chemicals for enhanced oil recovery.

g. Heating fluids.

h. Coal tar distillation and product therefrom.

i. Tonnage plants for the manufacture of industrial gases.

j. High altitude breathing oxygen/medical oxygen.

k. Nitrous oxide.

l. Refrigerant gases like liquid nitrogen, carbondioxide etc.in large volumes.

m. Argon and other rare gases.

n. Alkali/acid resisting cement compound

o. Leather chemicals and auxiliaries.

14. Drugs and Pharmaceuticals

According to Drug Policy.

15. i. Paper and pulp including paper products.

ii. Industrial laminates.

16. i. Automobile tyres and tubes.

ii. Rubberised heavy duty industrial beltings of all types.

iii. Rubberised conveyor beltings.

iv. Rubber reinforced and lined fire fighting hose pipes.

v. High pressure braided hoses.

vi. Engineering and industrial plastic products.

17. Plate Glass

    i. Glass shells for television tubes.

    ii. Float glass and plate glass.

    iii. H.T. insulators.

    iv. Glass fibres of all types.

18. Ceramics

    i. Ceramics for industrial uses.

19. Cement Products

    i. Portland cement.

    ii. Gypsum boards, wall boards and the like.

20. High Technology Reproduction and Multiplication Equipment.

21. Carbon and Carbon Products

    i. Graphite electrodes and anodes.

    ii. Impervious graphite blocks and sheets.

22. Pretensioned High Pressure RCC Pipes.

23. Rubber Machinery

24. Printing Machinery.

    i. Web-fed high speed off-set rotary printing machine having output of 30,000 or more impressions per hour.

    ii. Photo composing/ type setting machines.

    iii. Multi-colour sheet-fed off-set printing machines of sizes 18"x25" and above.

    iv. High speed roto-grature printing machines having output of 30,000 or more impressions per hour.

25. Welding Electrodes other than those for Welding Mild Steel

26. Industrial Synthetic Diamonds.

27. i. Photosynthesis improvers.

ii. Genetically modified free living symbiotics nitrogen fixer.

iii. Pheromones.

iv. Bio-insecticides.

28. Extraction and Upgrading of Minor Oils

29. Pre-fabricated Building Material.

30. Soya Products

i. Soya texture proteins.

ii. Soya protein isolates.

iii. Soya protein concentrates.

iv. Other specialised products of soyabean.

v. Winterised and deodourised refined soyabean oil.

31. (a) Certified high yielding hybrid seeds and synthetic seeds and

(b) Certified high yielding plantlets developed through plant tissue culture.

32. All food processing industries other than milk food, malted foods, and flour, but excluding the items reserved for small-scale sector.

33. All items of packaging for food processing industries excluding the items reserved for small scale sector.

34. Hotels and tourism-related industry.

7.13 Summary

Industrialization contributes a lot to economic development. This can help us to improve the required industry. Industrialization on the eve of planning laid some emphasis on correcting the lop sided pattern of Indian industry, low capital intensity, composition of manufacturing output. The main features and objectives of new industrial policy have also been discussed. The chapter also outlines the initiatives taken by the Government of India to promote small scale and cottage

industries, which has the largest potential to employ the huge mass of unemployed, raise national income etc. Since the economic crisis of 1990s, the congress led government initiated the process of disinvestment of the Public Sector Enterprises. It was continued by all the governments since then. The objectives of disinvestment, the modus-operandi for the same and the implications on Indian economy have also been explained.

7.14 Check Your Progress

i. The profit earning capacity is generally based on the_______________________________.
ii. Earning Capacity Value Method values a company on the basis of the________________.
iii. Earning Capacity Value Method method does not consider or project the______________.
iv. The investment ceiling in plant and machinery for small-scale industries (fixed in 1985) was raised from____________________to______________________and correspondingly, for ancillary units from______________to_______________________.

7.15 Glossary

Industrial Policy: The term "industrial policy" refers to government's policy towards industries - their establishment, functioning, growth and management. The policy indicate the respective areas of the large, medium and small scale sector. It also spell out government's policy towards foreign capital, labour, tariff and other related aspect. Naturally, the industrial development of a country is shaped, guided, fostered, regulated and controlled by its industrial policy.

Monopolies and Restrictive Trade Practices Act (MRTP Act):The principal objectives sought to be achieved through the MRTP Act are as follows:

i. Prevention of concentration of economic power to the common detriment, control of monopolies, and

ii. Prohibition of monopolistic and restrictive and unfair trade practices.

The MRTP Act became effective in June 1970.

7.16 Answers to Check Your Progress/SAQ's

i. profits actually earned or anticipated
ii. underlying assets
iii. future cash flow
iv. Rs. 35 lakhs , Rs. 60 lakhs; Rs. 45 lakhs , Rs. 75 lakhs.

7.17 Bibliography/References/Suggested Readings

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7.18 Terminal and Model Questions

1. What are the main initiatives taken in the Industrial Policy Resolution,1991?
2. What are the changes proposed in the policy regarding foreign investment in the New Industrial Policy of 1991?
3. What are the special initiatives of Government of India with respect to small scale and Cottage industries?
4. What is disinvestment? Discuss the process of disinvestment in India and what has been the impact of disinvestment in India?

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CHAPTER 8

BASIC ISSUES IN AGRICULTURE

8.1 INTRODUCTION

Cropping activities go on all the year-round in India, provided water is available for crops. In northern India, there are two distinct seasons, *kharif* (July to October), and *rabi* (October to March). Crops grown between March and June are known as *zaid*. In some parts of the country, there are no such distinct seasons, but there they have their own classification of seasons. The village revenue officials keep plot-wise record of crops grown in each season. These are annually compiled district-wise, state-wise and on all-India basis. From these records one could calculate the relative abundance of a crop or a group of crops in a region. These crops are grown sole or mixed (mixed-cropping), or in a definite sequence (rotational cropping). The land may be occupied by one crop during one season (mono-cropping), or by two crops (double-cropping) which may be grown in a year in sequence. Of late, the trend is even more than two crops (multiple-cropping) in a year. These intensive cropping may be done either in sequence or even there may be relay-cropping-one crop under-sown in a standing crop. With wide-rowed slow growing cropping patterns, companion crops may be grown.

8.2 CROPPING PATTERNS

There are various ways of utilising the land intensively. It is proposed to give a synoptic view of cropping patterns prevalent in the country. Before dealing with the cropping patterns, brief descriptions of the factors that determine the cropping systems of an individual locality or region are briefly presented here. In any locality, the prevalent cropping systems are the cumulative results of past and present decisions by individuals, communities or governments and their agencies. These decisions are usually based on experience, tradition, expected profit, personal preferences and resources, social and political pressures and so on.

It is clear that there are innumerable micro variations in the cropping patterns, which cannot be described in this note, some broad contours of farming emerge. The most important element of farming in India is the production of grains and the dominant food-chain is grain. On this basis, the country may be divided broadly into five agricultural regions.

i. The rice region extending from the eastern part to include a very large part of the northeastern and the south-eastern India, with another strip along the western coast.
ii. The wheat region, occupying most of the northern, western and central India.
iii. The millet-sorghum region, comprising Rajasthan, Madhya Pradesh and the Deccan Plateau in the centre of the Indian Peninsula.

iv. The temperate Himalayan region of Kashmir, Himachal Pradesh and Uttar Pradesh and some adjoining areas. Here potatoes are as important as cereal crops (which are mainly maize and rice), and the tree-fruits form a large part of agricultural production.

v. The plantation crops region of Assam and the hills of southern India where good quality tea is produced. There is an important production of high-quality coffee in the hills of the western peninsular India. Rubber is mostly grown in Kerala and parts of Karnataka and Tamil Nadu. There are some large estates, but most of the growers would come under the category of small holders. Sugarcane, which in many countries is a plantation crop, is almost entirely grown by small holders in India.

There had been substantial investments in major irrigation works in the colonial days. The post-Independence era saw many multi-purpose irrigation works. Lately, interest in the medium and minor irrigation works has increased, especially after the drought of 1966. Thus, at present, an all-India irrigation potential of 59 m ha has been created and is expected to increase up 110 m ha by 2025. Irrigation, especially the minor works, has provided a base for multiple-cropping. The All-India Coordinated Crops-Improvement Projects run cooperatively by the Indian Council of Agricultural Research and the agricultural universities have generated short-season, photo-period-insensitive high-yielding varieties of various crops suitable for a high intensity of cropping. The adaptability of these varieties on the farmer's fields has been demonstrated in the National Demonstration Programme spread all over the country. The various developmental and the educative programmes, especially the High Yielding Varieties Programme, have also resulted in newer cropping patterns involving intensive cropping. The area of rice has increased in Punjab and Haryana. Similarly wheat is now grown in West Bengal and to some extent in the southern states of the country.

All these factors have led to the present cropping patterns, which are getting more and more intensive both in respect of the number of crops grown per year and in respect of the intensity of inputs utilized in the production of these crops.

8.3 THE PRESENT CROPPING PATTERNS

As indicated earlier, we can hardly describe all the cropping patterns within the framework of this paper. Therefore only important ones are highlighted. There are many ways in which a cropping pattern can be discussed. A broad picture of the major cropping patterns in India can be presented by taking the major crops into consideration. To begin with, the south-westerly monsoon crops (kharif), bajra, maize, ragi, groundnut and cotton. Among the post-monsoon crops (rabi), wheat, sorghum (rabi) and gram can also be considered to be the base crops for describing the cropping patterns. With such an approach, the

crop occupying the highest percentage of the sown area of the region is taken as the base crop and all other possible alternative crops which are sown in the region either as substitutes of the base crop in the same season or as the crops which fit in the rotation in the subsequent season, are considered in the pattern. Also these crops have been identified as associating themselves with a particular type of agro-climate, and certain other minor crops with similar requirements are grouped in one category. For example, wheat, barley and oats, are taken as one category. Similarly the minor millets (Paspalum, Setaria and Panicum spp.) are grouped with sorghum or bajra. Certain other crops, such as the plantation crops and other industrial crops are discussed separately. Among the kharif crops, rice, jowar, bajra, maize, groundnut and cotton are the prominent crops to be considered the base crops for describing the kharif cropping patterns.

8.3.1 Kharif Season Cropping Patterns

8.3.1.1. The rice-based cropping patterns:

Rice is grown in the high-rainfall area or in areas where supplemental irrigation is available to ensure good yields. If the crop has to depend solely on rainfall, it requires not less than 30 cm per month of rainfall over the entire growing period. However, only 9 per cent of the area in the country comes under this category, and it lies in the eastern parts. Nearly 45 per cent of the total rice area in India receives 30 cm per month of rainfall during at least two months (July and August) of the south-westerly monsoon and much less during other months. In contrast to these parts, the eastern and southern regions comprising Assam, West Bengal, coastal Orissa, coastal Andhra Pradesh, Karnataka (most part), Tamil Nadu and Kerala receive rainfall of 10 to 20 cm per month in four to eight consecutive months, starting earlier or going over later than the south-westerly monsoon months. With supplemental irrigation, 2 or 3 crops are taken in these areas. However, it has been observed that on an all-India basis, nearly 80 per cent of rice is sown during June-September and the rest during the rest of the season. Area-wise the mono-season belt occupies 53.6 per cent of the area (comprising Assam, West Bengal, coastal Orissa, coastal Andhra Pradesh, parts of Tamil Nadu, Karnataka and Kerala).

On an all-India basis, about 30 rice-based cropping patterns have been identified in different states. In the most humid areas of eastern India comprising Tripura, Manipur and Mizoram, rice is the exclusive crop. In Meghalaya, rice is alternated with cotton, vegetable and food-crops, whereas in Arunachal Pradesh, where rice is not grown exclusively, the alternative crops being maize, small millets and oilseeds. In parts of Assam, West Bengal, Bihar, Orissa and northern coastal districts of Andhra Pradesh, jute forms an important commercial crop alternative to rice. In West Bengal, besides rice and jute, pulses and maize are grown on a limited scale. In Bihar, rice is grown over 49 per cent(5.3 m ha) of its

cropped area(14.2 per cent of all-India area), whereas pulses, wheat, jute, maize, sugarcane and oilseeds are the alternative crops. In Uttar Pradesh rice is grown on 19 per cent (4.6 m ha) of its cropped area and represents about 12.4 per cent of the all-India area under this crop. Rice is concentrated in the eastern districts of Uttar Pradesh where the alternative crops are pulses, groundnut, sugarcane, bajra and jowar in the decreasing order of their importance. Tobacco is grown in some districts.

In Orissa, rice is grown on more than 50 per cent of the area, whereas the alternative crops are: pulses, ragi, oilseeds, maize and small millets. In Madhya Pradesh rice is grown in the Chattisgarh area on 4.3 m ha(11.7 per cent of the all-India rice area), but the crop suffers because of inadequate rainfall and irrigation. The important alternative crops of this area are: small millets, pulses and groundnut. Wheat is also grown on a limited scale.

In the southern states, namely Andhra Pradesh, Tamil Nadu and Kerala rice is grown in more than one season and mostly under irrigation or under sufficient rainfall. Together, these three states have over 6.0 m ha, representing over 17 per cent of the all-India area under rice.

Important alternative plantation crops in Andhra Pradesh are: pulses, groundnut, jowar, maize, sugarcane and tobacco. In Karnataka the crops alternative to rice is: ragi, plantation crops, bajra, cotton, groundnut, jowar and maize. In Kerala plantation crops and tapioca form the main plantation crops alternative to rice. In Maharashtra rice is grown mostly in the Konkan area over 1.3 m ha, along with ragi, pulses, rabi jowar, sugarcane, groundnuts and oilseeds. In other states, namely Gujarat, Jammu and Kashmir, Rajasthan and Himachal Pradesh, rice forms a minor plantation crop and is mostly grown with irrigation. However, in Punjab and Haryana and to some extent in western Uttar Pradesh owing to high water-table during this monsoon season, rice has become a major crops in such areas.

8.3.1.2. The kharif cereals other than rice.

Maize, jowar and bajra form the main kharif cereals, whereas ragi and small millets come next and are grown on a limited area. by and large, maize is a crop grown commonly in high-rainfall areas, or on soils with a better capacity for retaining moisture, but with good drainage. Next comes jowar in the medium rainfall regions whereas bajra has been the main crop in areas with low or less dependable rainfall and on light textured soils. The extent of the area under these crops during the south-westerly monsoon season is maize, 5.6 m ha; jowar (kharif), 11 M.ha, and bajra,12.4 m ha. Even though these crops are spread all over the western, northern and southern India, the regions of these crops patterns are demarcated well to the west of 80° longitude (except that of maize). Ragi as a kharif cereal (2.4 m ha) is mainly concentrated in Karnataka, Tamil Nadu and Andhra Pradesh which account for main than 60 per

cent of the total area under this crop in India. The cropping patterns based on each of these kharif cereals are discussed below:

8.3.1.2.1 The maize-based cropping patterns

The largest area under the kharif maize is in Uttar Pradesh (1.4m ha), followed by Bihar (0.96 m ha), Rajasthan (0.78 m ha), Madhya Pradesh (0.58 m ha) and Punjab (0.52 m ha). In four states namely Gujarat, Jammu and Kashmir, Himachal Pradesh and Andhra Pradesh, the area under maize ranges from 0.24 to 0.28 m ha in each, whereas other states have much less area under it. Taking the rainfall of the maize growing areas under consideration, over 72 per cent of the areas receive 20-30 cm per month of rainfall in at least two months or more during the south westerly monsoon season.

On the all-India basis, about 12 cropping patterns have been identified. They have maize as the base crop. In the maize growing areas of Uttar Pradesh and Bihar, rice in kharif and wheat in rabi are the main alternative crops. In some areas, bajra, groundnut, sugarcane, ragi and pulses are taken as alternative crops. In Rajasthan maize is grown as an extensive crop in some areas, whereas at other places, it is replaced by small millets, pulses, groundnut and wheat (rabi) as alternative crop. in Madhya Pradesh mainly the kharif jowar is replaced by maize, whereas rice and groundnut are also grown to a limited extent. In Punjab maize has groundnut, fodder crops and wheat (rabi) as alternative crops. In other states, e.g. Gujarat, rice, groundnut, cotton and wheat form the alternative crops in the maize-growing areas of Himachal Pradesh, whereas in Andhra Pradesh, rice, kharif jowar, and oilseeds are grown in these areas.

8.3.1.2.2 The kharif jowar-based cropping patterns

The area under the kharif jowar in India is highest in Maharashtra (2.5 m ha), closely followed by Madhya Pradesh (2.3 m ha), whereas in each of the states of Rajasthan, Andhra Pradesh, Karnataka and Gujarat, the area under this crops is between 1.0 and 1.4 m ha. Jowar is mainly grown where rainfall distribution ranges from 10-20 per month at least for 3 to 4 months of the south-westerly monsoon or is still more abundant. On the all-India basis, about 17 major cropping patterns have been identified. In them the base crops is kharif jowar. Most of the alternative crops are also of the type which can be grown under medium rainfall.

In Maharashtra cotton, pulses, groundnut and small millets are sown as alternative crops. In the adjacent states of Madhya Pradesh, besides the above alternative crops, wheat and fodder are sown. In Rajasthan wheat, cotton, bajra and maize are grown in the kharif-jowar tract, whereas in Andhra Pradesh, groundnuts, cotton, oilseeds and pulses form the main alternative crops. Besides cotton and

groundnut, ragi is sown in the kharif-jowar tract of Karnataka, whereas in Gujarat, bajra, cotton and groundnut are the major alternative crop.

8.3.1.2.3 The bajra-based cropping patterns

Bajra is more drought-resistant crop than several other cereal crops and is generally preferred in low-rainfall areas and on light soils. The area under the bajra crop in India is about 12.4 m ha and Rajasthan (4.6 m ha) shares about the 2/3 total area. Maharashtra, Gujarat and Uttar Pradesh together have over 4.6 m ha, constituting an additional 1/3 area under bajra, in India. Over 66 per cent of this crop is grown in areas receiving 10-20 cm per month of rainfall, extending over 1 to 4 months of the south-westerly monsoon.

On the all-India basis, about 20 major cropping patterns have been identified with bajra. However, it may be observed that jowar and bajra are grown mostly under identical environmental conditions and both have a wide spectrum adaptability in respect of rainfall, temperature and rainfall.

Considering the cropping patterns in different states, bajra is grown along with pulses, groundnut, oilseeds and kharif jowar in Rajasthan. Gujarat has a similar cropping pattern in its bajra areas, except that cotton and tobacco are also grown. In Maharashtra besides having some areas solely under bajra, pulses, wheat, rabi jowar, groundnut and cotton are substituted for it. In Uttar Pradesh, maize, rice and wheat form the main alternative crops to this crop.

8.3.1.2.4 The groundnut based cropping patterns.

Groundnut is sown over an area of about 7.2 m ha, mostly in five major groundnut-producing states of Gujarat (24.4 per cent area), Andhra Pradesh (20.2) per cent), Tamil Nadu (13.5 per cent), Maharashtra (12.2 per cent) and Karnataka (12.0 per cent). Five other states viz. Madhya Pradesh, Uttar Pradesh, Punjab, Rajasthan and Orissa together have about 17.3 per cent of the total area under this crop. The rainfall in the groundnut area ranges from 20-30 cm per month in one of the monsoon months and much less in the other months. In some cases the rainfall is even less than 10 cm. per month during the growth of the crop. The irrigated area under groundnut is very small and that too, in a few states only, viz. Punjab(16.4 per cent), Tamil Nadu (13.3 per cent)and Andhra Pradesh (12.5 per cent).

On the all-India level, about 9 cropping patterns have been identified with this crop. In Gujarat besides the sole crop of groundnut in some areas, bajra, is the major alternative crop, whereas the kharif jowar, cotton and pulses are also grown in this tract. In Andhra Pradesh and Tamil Nadu, this crop receives irrigation in some areas and rice forms an alternative crop. Under rain-fed conditions, bajra, kharif jowar, small millets, cotton and pulses are grown as alternative crops. In Maharashtra both the kharif

and rabi jowar and small millets are important alternative crops. In Karnataka also, jowar is the major alternative crop, whereas cotton, tobacco, sugarcane and wheat are also grown in this tract.

8.3.1.2.5 The cotton-based cropping patterns

Cotton is grown over 7.6 m ha in India. Maharashtra shares 36 per cent (2.8 m ha), followed by Gujarat with 21 per cent (1.6 m ha), Karnataka with 13 per cent (1 m ha) and Madhya Pradesh with 9 per cent (0.6 m ha) of the area. Together, these four states account for about 80 per cent of the area under cotton. Other cotton-growing states with smaller areas are Punjab, with 5 per cent (0.4 m ha), Andhra Pradesh and Tamil Nadu each with 4 per cent (0.31 m ha), Haryana and Rajasthan with 3 per cent of each (0.2 m ha each). Most of the cotton areas in the country are under the high to medium rainfall zone. The cotton grown in Madhya Pradesh, Maharashtra, Karnataka, and Andhra Pradesh (4.8 m ha) is rainfed, whereas in Gujarat and Tamil Nadu (1.93 m ha) it receives partial irrigation 16-20 per cent of the area). The area under cotton in Punjab, Haryana, Rajasthan and Uttar Pradesh (0.8 m ha) gets adequate irrigation, ranging from 71 to 97 per cent of the area. These growing conditions, together with the species of cotton grown, determine the duration of the crop which may vary from about 5 to 9 months. On the all-India basis, about 16 broad cropping patterns have been identified. In Maharashtra, Madhya Pradesh, Andhra Pradesh and Karnataka, the cropping patterns in the cotton-growing areas are mostly similar owing to identical rainfall. These patterns include jowar (kharif and rabi), groundnut and small millets. Pulses and wheat are also grown in a limited area. In some pockets, where irrigation is available, rice and sugarcane are also grown. In Gujarat, rice, tobacco and maize are grown, besides the rainfed crops, e.g. jowar and bajra.

8.3.2 The Rabi Season Cropping Patterns

Table 8.1: The extent of Areas under Different Rabi Crops State-wise

Crop	Area	Percent of all India area
Wheat	*19 m ha*	Uttar Pradesh (33), Madhya Pradesh(19), Punjab (13), Rajasthan (8), Bihar (7.5), Haryana (6.5), Maharashtra (5.5
Gram	*8m ha*	Uttar Pradesh (25.2), Madhya Pradesh (21.4), Rajasthan (20.7), Haryana (14.2)
Jowar	*6.5 m ha*	Maharashtra (55.0), Karnataka (25.7), Andhra Pradesh (24.3)

Among the *rabi* crops, wheat, together with barley and oats, *jowar* and gram, are the main base crops in the *rabi* cropping patterns. Generally, wheat and gram are concentrated in the subtropical region in northern India, whereas the *rabi* sorghum is grown mostly in the Deccan. The extent of these areas in different states is as given in Table 8.1 above.

8.3.2.1. The wheat-and-gram-based cropping patterns.

These two crops are grown under identical climate and can often be substituted for each other. The core of the wheat region responsible for 70 per cent of the area and 76 per cent of production comprises Punjab, Haryana, Delhi, Uttar Pradesh, and Madhya Pradesh, flanked by Rajasthan and Gujarat in the western region and Bihar and West Bengal in the eastern region. This area has an extensive irrigation system ranging from 85 per cent area in Punjab to 51 per cent in Bihar.

The rainfall during the south-westerly monsoon is also fairly high with over 20 cm to 30 cm of rainfall in at least two out of the four months of the rainy season. However, winter showers are scattered and form less than 2.5 cm in each month from November to February. On the all-India level, about 19 cropping patterns have been identified with wheat and 7 cropping patterns with gram. In Uttar Pradesh, maize, rice, *jowar (K),* small millets and groundnut form the main crops preceding wheat and gram. Generally, gram is grown on more moisture- retentive soils, but with little irrigation or in areas with less of rainfall. In Madhya Pradesh, wheat is grown with stored moisture, with little irrigation and rainfall during the crop period. The crop suffers heavily for want of adequate moisture with the resultant low yields (57 per cent of the all-India yield). The kharif jowar*,* groundnut, oilseeds, cotton, small millets and fodders form the alternative crops to wheat and gram. In Punjab, 85 per cent of the wheat area is under irrigation and, therefore, has rice, maize, fodders, *bajra* and cotton as the crops preceding wheat. The area under gram in Punjab is very meagre (4.2 per cent of the all-India gram area). In Rajasthan, the kharif jowar fodders and *bajra* precede wheat, whereas gram and other oil seeds form alternative crops in winter.

In Bihar, rice, maize and pulses are the main preceding crops, wheat, in the wheat-growing areas, whereas oilseeds and *bajra* are also grown as alternative crops. In Haryana, wheat and gram are the main alternative crops in winter. Rice, maize*, bajra* and *jowar* form the main preceding crops. In Maharashtra, most of the wheat crop is grown on residual moisture, *bajra* and other small millets or short-duration pulses form the monsoon crop in the wheat areas. Generally, heavy black cotton soils of Maharashtra and the adjacent Madhya Pradesh are left fallow in the kharif season for operational difficulties and wheat is grown after the cessation of rains with stored moisture. In Maharashtra, the *rabi jowar* is a crop alternative to wheat.

8.3.2.2. Rabi jowar-based cropping patterns

On the all-India level, about 13 cropping patterns have been identified with the *rabi jowar.* Maharashtra has the largest number of these cropping patterns, wherein starting with the exclusive rabi *jowar, bajra,*

pulses, oilseeds and tobacco are grown as alternative crops. In Karnataka, small millets, groundnut, *bajra,* pulses and oilseeds form alternative crops to the rabi *jowar.* Cotton and tobacco are also grown in some parts of the *rabi-jowar* area of Karnataka. In Andhra Pradesh, short duration pulses, small millets, paddy and oilseeds form the main alternative crops in the jowar area.

8.3.2.3. Plantation and Other Commercial Crops

Crops under this category include sugarcane, tobacco, potato, jute, tea, coffee, coconut, rubber and other crops, such as spices and condiments. Some of them are seasonal, some annual and some perennial. Generally, the areas occupied by them are very limited as compared with food and other crops.

Nevertheless, they are important commercially. Most of them require specific environmental conditions and from the point of view of cropping patterns, they are concentrated in some particular regions. Besides, certain horticultural crops, such as apple, mango and citrus, are important. The extent of the area and the regions in which they are grown are shown in Table 8.2 .

Table 8.2 : The extent of the area and the regions in which they are grown

Crop	Area	Region (per cent of all-India area)
Sugarcane	2.5 m ha	Uttar Pradesh (51), Haryana (6),Bihar (6), Punjab (6), Maharashtra (8), Andhra Pradesh (5),Tamil Nadu (5), Karnataka (3)
Tobacco	0.427 m ha	Andhra Pradesh (48), Gujarat (19.5), Karnataka (8.7),
		Maharashtra (3.5), Tamil Nadu (3.5)
Potato	0.491	Uttar Pradesh (33.6), Bihar (20.4), West Bengal (13.3), Assam (5.2), Orissa (4.8)
Jute	0.778	West Bengal (60), North eastern Region (18.7), Bihar (17.6), Orissa (6.1), Uttar Pradesh (1.7)
Coconut	1.05 m ha	Kerala (68.3), Karnataka (12.4), Tamil Nadu (9.7), Andhra Pradesh (3.5)
Rubber	0.197 m ha	Kerala (92.8), Tamil Nadu (5.0), Karnataka (1.9)
Cashew	0.264 m ha	Kerala (67.4), Karnataka (12.1), Andhra Pradesh (10.8), Tamil Nadu (9.8), Maharashtra (4.8)
Tea	0.35 m ha	West Bengal, Assam and Tripura (77), Kerala, Tamil Nadu and Karnataka (20)
Coffee	0.138 m ha	Kerala , Tamil Nadu and Karnataka (99)
All fruit-crops	1.8 m ha	Spread all-over India
Onion	0.16 m ha	Maharashtra (18.5), Karnataka (11.7), Andhra Pradesh (12.8), Tamil Nadu (11.2), West Bengal (7.6), Madhya Pradesh (7.2), Orissa (6.8), Punjab (6.2)
Chillies	0.733 m ha	Andhra Pradesh (26.9), Maharashtra (20.4), Karnataka(14.5), Madhya Pradesh (5.5), Tamil Nadu (10.1)
Coriander	0.283 m ha	Andhra Pradesh (36), Rajasthan (23.6), Madhya Pradesh (11.1), Tamil Nadu (10.0)

In several sugarcane-growing areas, mono-cropping is practised, and during the interval between the crops, short duration seasonal crops are grown. In U.P., Bihar, Punjab and Haryana, wheat and maize are the rotation crops. Rice is also grown in some areas. In the southern states, namely Tamil Nadu,

Karnataka and Andhra Pradesh, ragi, rice and pulses are grown along with sugarcane. In Maharashtra, pulses, jowar and cotton are grown.

In the potato-growing region, maize, pulses, wheat are the alternative crops. In the tobacco growing areas, depending on the season and the type of tobacco, jowar, oilseeds and maize are grown in rotation. In the jute-growing areas, rice is the usual alternative crop.

In the case of plantation-crops, intercropping with pulses and fodder crops is common. Spices and condiments are generally grown on fertile soils. Chillies are rotated with jowar, whereas onion, coriander, turmeric and ginger are grown as mixed crops with other seasonal crops.

8.3.2.4. Mixed Cropping

Crops mixtures are widely grown, especially during the kharif season. Pulses and some oilseeds are grown with maize, jowar and bajra. Lowland rice is invariably grown unmixed, but in the case of upland rice, several mixtures are prevalent in eastern Uttar Pradesh, with Chotanagpur Division of Bihar and in the Chhatisgarh Division of Madhya Pradesh. During the rabi season, especially in the unirrigated area of the north, wheat and barley and wheat and gram or wheat + barley + gram are the mixtures of grain crops. Brassica and safflower are grown mixed with gram or even with wheat. Mixed cropping was considered by researchers a primitive practice, but now many researchers regard mixed cropping as the most efficient way of using land. Several new mixtures have recently been suggested. They ensure an efficient utilization of sunshine and land. Breeders are developing plant types in pulses and oilseeds, with good compatibility with row crops.

8.4 DIVERSIFICATION OF CROPPING PATTERNS IN INDIA

The Cropping Patters in India underwent several changes with the advent of modern agricultural technology, especially during the period of the Green Revolution in the late sixties and early seventies. There is a continuous surge for diversified agriculture in terms of crops, primarily on economic considerations. The crop pattern changes, however, are the outcome of the interactive effect of many factors which can be broadly categorized into the following five groups:

i. Resource related factors covering irrigation, rainfall and soil fertility.
ii. Technology related factors covering not only seed, fertilizer, and water technologies but also those related to marketing, storage and processing.
iii. Household related factors covering food and fodder self-sufficiency requirement as well as investment capacity.
iv. Price related factors covering output and input prices as well as trade policies and other economic policies that affect these prices either directly or indirectly.

v. Institutional and infrastructure related factors covering farm size and tenancy arrangements, research, extension and marketing systems and government regulatory policies.

These factors are not water-tight but inter-related. For instance, the adoption of crop technologies is influenced not only by resource related factors but also by institutional and infrastructure factors. Similarly, government policies - both supportive and regulatory in nature - affect both the input and output prices. Likewise, special government programmes also affect area allocation and crop composition. More importantly, both the economic liberalization policies as well as the globalization process are also exerting strong pressures on the area allocation decision of farmers, essentially through their impact on the relative prices of inputs and outputs. Although the factors that influence the area allocation decision of farmers are all important, they obviously differ in terms of the relative importance both across farm groups and resource regions. While factors such as food and fodder self-sufficiency, farm size, and investment constraints are important in influencing the area allocation pattern among smaller farms, larger farmers with an ability to circumvent resources constraints usually go more by economic considerations based on relative crop prices than by other non-economic considerations. Similarly, economic factors play a relatively stronger role in influencing the crop pattern in areas with a better irrigation and infrastructure potential. In such areas, commercialization and market networks co-evolve to make the farmers more dynamic and highly responsive to economic impulses.

8.5 TRENDS IN AGRICULTURAL PRODUCTION AND PRODUCTIVITY

Since the introduction of economic planning in India, agricultural development has been receiving a special emphasis. It was only after 1965, i.e., from the mid-period of the Third Plan, special emphasis was laid on the development of the agricultural sector. Since then, a huge amount of fund was allocated for the development and modernization of this agricultural sector every year. All these initiatives have led to:

(a) A steady increase in areas under cultivation;

(b) A steady rise in agricultural productivity; and

(c) A rising trend in agricultural production.

8.6.1 Growth in Area:

In India the growth in gross area under all crops has increased from 122 million hectares in 1949-50 to 151 million hectares in 1964-65 and then it increased to 168.4 million hectares in 2008- 09. Further, gross area under all food grains has increased from 99 million hectares in 1949-50 to 118 million hectares in 1964-65 and then to 123.2 million hectares in 2008-09. Similarly, the gross area under all

non-food-grains has also increased from 23 million hectares in 1949-50 to 33 million hectares in 1964-65 and then to 45.2 million hectares in 2008-09.

In India, out of the total cultivable area of 186 million hectares, the net sown area is estimated at 143 million hectares. Moreover, the areas under cultivation of all crops have increased by 0.25 per cent during the period 1980-81 to 1995-96 as compared to 0.51 per cent during 1967-68 to 1980-81. Again the area under food-grain cultivation has decline by 0.32 per cent per annum between 1980-81 to 1995-96 as compared to an increase in the area of the tune of 0.38 per cent between 1967-68 and 1980-81.

During the pre-green revolution period, i.e., during 1951-65 additional area including marginal lands, fallow lands, waste lands and forest lands were brought under cultivation. The annual rate of growth in area under crops during the period 1950-65 was quite substantial.

All crops: 1.6 per cent, Food grains: 1.4 per cent and Non-food grains: 2.5 per cent. But in the post-green revolution period, i.e., during 1965-95, area under all crops could not increase significantly and the annual growth rate in area was also quite minimum—

All crops: 0.3 per cent, Food-grains: 1.2 per cent and Non- food-grains: 0.7 per cent.

8.6.2. Agricultural Productivity:

By the term agricultural productivity we mean the varying relationship between the agricultural output and one of the major inputs such as land. The most commonly used term for representing agricultural productivity is the average yield per hectare of land.

After the introduction of modern agricultural technique along-with the adoption of hybrid seeds, extension of irrigation facilities and application of intensive method of cultivation in India, yield per hectare of all crops has recorded a steep rising trend. Table 8.3 shows the trend in agricultural productivity in India, i.e., the average yield per hectare.

Table 8.3: Trend in Yield per Hectare of Principal Crops in India since Independence

Items	*Yield per hectare*			*Annual Growth Rate (%)*	
	1949-50	*1964-65*	*2008-09*	*1949-50 to 1964-65*	*1964-65 to 2008-09*
All foodgrains (quintals)	5.5	7.6	18.98	1.4	2.4
Rice (quintals)	7.1	10.8	21.86	2.1	2.3
Wheat (quintals)	6.6	9.1	28.91	1.3	3.4
Coarse cereals (quintals)	4.3	5.1	11.76	1.3	1.3
Pulses (quintals)	4.0	5.2	6.55	0.2	0.5
All Non-foodgrains	—	—	—	0.9	1.6
Oils seeds (quintals)	5.2	5.6	10.16	0.1	1.6
Cotton (kgs)	95	122	419	2.0	2.4
Sugarcane (tonnes)	34	47	62	1.0	1.2
Potato (quintals)	66	84	180	1.6	3.0
All crops				1.3	1.9

The Table 8.3 reveals that in India the average yield per hectare for all food-grains has recorded an increase from 5.5 quintals in 1949-50 to 7.6 quintals in 1964-65 and then to 18.98 quintals in 2008- 09 showing an annual growth rate of 1.4 per cent during 1950-65 and 2.4 per cent during 1965-2007. Moreover, the average yield per hectare in respect of rice and wheat which were 7.1 quintals and 6.6 quintals respectively in 1949-50 gradually increased to 10.8 quintals and 9.1 quintals in 1964-65 showing an annual growth rate of 2.1 per cent and 1.3 per cent in respect of rice and wheat respectively.

Again during the post-Green Revolution period (1965-2009), the average yield per hectare in respect of rice and wheat has again increased to 21.86 quintals and 28.91 quintals respectively showing a considerable annual growth rate of 3.4 per cent in respect of wheat and 2.3 per cent in respect of rice. But the annual growth rate of coarse cereals increased by only 1.3 per cent and that of pulses of only 0.5 per cent during the period 1967-2009. Moreover, the annual growth rate of yield per hectare of all crops went up to 2.49 per cent during the period 1980-81 to 1993-94 as compared to that of 1.28 per cent during 1967-68 to 1980-81.

Among the non-food-grains, cotton and sugarcane achieved a modest growth rate of 2.0 per cent and 1.0 per cent respectively during 1950-65 and again to the extent of 2.4 per cent and 1.2 per cent respectively during 1967-2009.

Moreover, potato has recorded a considerable increase in annual growth rate from 1.6 per cent during 1950-65 to 3.0 per cent during 1967-2009. Again, taking all crops together, the annual average growth rate of all crops rose from 1.3 per cent during 1950-1965 to 1.9 per cent during 1967-2009. Thus the above data reveal that the green revolution and the application of new bio-chemical technology have become very much effective only in case of wheat and potato but proved ineffective in case of other crops.

Moreover, if we compare the average yield per hectare of various crops in India with foreign countries then we find that India lags far behind the other developed countries of the world. In 1990- 91, the annual average yield of rice per hectare was only 17.5 quintals in India as against 41 quintals in U.S.A., 61.9 quintals in Japan and 54 quintals in China. Again, the annual average yield of wheat per hectare was only 22.7 quintals in India as against 68 quintals in Germany, 61 quintals in France and 30 quintals in China.

8.6.3. Trends in Agricultural Production:

Agricultural production in India can be broadly classified into food crops and commercial crops. In India the major food crops include rice, wheat, pulses, coarse cereals etc. Similarly, the commercial crops or non-food crops include raw cotton, tea, coffee, raw jute, sugarcane, oil seeds etc.

In India, total agricultural production has been increasing with the combined effect of growth in total cultivated areas and increases in the average yield per hectare of the various crops. Table 8.4 reveals the trend in total agricultural production in India since independence.

Table 8.4 : Trends and Growth rate of production of Agricultural crops since 1949-50

Items	*1949-50*	*1964-65*	*2008-09*	*Annual Growth rate (%)*	
				1949-50 to 1964-65	*1967-68 to 2008-2009*
1. All foodgrains (m tonnes)	55	89	233.9	3.2	2.21
Rice (m tonnes)	24	39	99.2	3.5	2.20
Wheat (m tonnes)	6	12	80.6	4.0	5.0
Coarse cereals (m tonnes)	17	25	44.8	2.2	0.6
Pulses (m tonnes)	8	12	14.7	1.4	-0.2
2. All non-foodgrains	—	—	—	3.5	2.6
Oil seeds (m tonnes)	5	9	28.2	3.3	1.9
Sugarcane (m tonnes)	50	122	273.9	4.3	2.5
Cotton (m bales of 170 kg. each)	3	6	23.2	4.6	1.4
Potato (m tonnes)	2	4	28.5	4.3	4.9
3. All Crops				3.1	2.4

The Table 8.4 reveals that total production of food grains had increased from 55 million tonnes in 1949-50 to 89 million tonnes in 1964-65 and then increased to 176 million tonnes in 1990-91. But in 1991-92, total production of food grains came down to 167 million tonnes mainly due to fall in the production of coarse cereals and in 1993-94, the production was around 184 million tonnes.

In 2002- 03, total production of food grains has further decreased to 174.8 million tonnes. As per advance estimates, total production of food grains has again increased to 233.9 million tonnes in 2008-09. Thus in the pre-green revolution period (1950-65) the food grains production had experienced impressive annual growth rate of 3.2 per cent and in the post-green revolution period (1967-2007), the same annual growth rate was to the extent of 2.7 per cent.

The major cereals like rice and wheat recorded a high growth rate, i.e., 3.5 and 4.0 per cent respectively during the first period (1950-65) and again to the extent of 2.2 and 5.0 per cent respectively during the second period (1967-2007). But the growth rate in coarse cereals and pulses remained quite marginal.

Total production of rice and wheat have increased from 24 million tonnes and 6 million tonnes in 1949-50 to 39 million tonnes and 12 million tonnes in 1964-65 and then to 99.2 million tonnes and 80.6 million tonnes respectively in 2008-09. In respect of non-food grains the trends in production in respect of potato and sugarcane were quite impressive and that of cotton and oilseeds were not up to the mark.

The table further shows that the new agricultural strategy could not bring a break-through in agricultural output of the country excepting wheat and potato which recorded about 4.8 per cent and 6.7 per cent annual growth rate respectively during the post-green revolution period. The growth in

output in respect of all other crops remained low and that of coarse cereals and pulses were only marginal where the annual growth rates were only 0.4 and 1.04 per cent respectively.

From the above analysis we can draw the following important observations:

i. In the pre-green revolution period, the growth of output has mainly contributed by the growth or expansion in area but in the post-green revolution period, improvement in agricultural productivity arising from the adoption of modern technique has contributed to growth in output.
ii. In-spite of adopting modern technology, the growth rate in output, excepting wheat could not maintain a steady level.
iii. During the post-green revolution period the growth rate in output was comparatively lower than the first annual growth rate in food grains was maintained at the level of 2.7 per cent in the second period.
iv. The growth rate in output of oil seeds, pulses and coarse food grains declined substantially in the second period as the cultivation of these crops have been shifted to inferior lands.
v. Although agricultural production attained a substantial increase since independence but these production trends have been subjected to continuous fluctuations mainly due to variation of monsoons and other natural factors.

8.6.4. Trends in Agriculture Productivity

Productivity shows the production or output per unit of input. Agricultural productivity is generally studied form two perspectives:

(i) Productivity of Land
(ii) Productivity of Labor

8.5.4.1 Productivity of Land:

1. It is given as output per hectare of land. In the early period of independence the yield per hectare of land was extremely low in case of all crops. The two major food-crops viz. Wheat and rice have shown substantial increase in productivity during early 70's. The productivity in coarse cereals like maize improved largely after 1980-81.This is mainly due to widespread use of high yielding varieties of seeds, development of irrigation facilities and use of fertilizers. In case of other crops like pulses and oilseeds, productivity gains have been negligible. But for other food crops the increase in productivity has been very slow. In the case of non-food crops the significant increase in productivity occurs in cotton. The productivity growth in oilseeds has not been very encouraging (Table 8.5).

Table 8.5: Productivity Trends in Major Crops(Yield: Kg per Hectare)

Crops	1960-61	1970-71	1980-81	1990-91	2000-01	2003-04	2004-05	2005-06	2006-07
Rice	1013	1123	1336	1740	1901	2077	1984	2102	2084
Wheat	851	1307	1630	2281	2708	2713	2602	2619	2617
Coarse cereals	528	665	695	900	1027	1221	1153	1172	1158
Pulses	539	524	473	578	544	635	577	598	594
Total food grains	**710**	**872**	**1023**	**1380**	**1626**	**1727**	**1652**	**1715**	**1707**
Oilseeds	507	579	532	771	810	1064	885	1004	895
Cotton (Lint)@	125	106	152	225	190	307	318	362	392
Jute & Mesta*	1049	1032	1130	1634	1867	2008	2019	2173	2154

@ Production in million bales of 170 kg. each. * Production in million bales of 180 kg. each.

Source: Ministry of Agriculture, Government of India, 2007

8.5.4.2 Productivity of Labor Engaged in Agriculture:

It is given as output per person working in agriculture. The per capita output of Indian cultivator is very poor as compared to cultivators in the developed countries. This can be seen from the fact that 52 per cent of workforce engaged in agriculture contributes only 18.5 percent of national income in 2006-07. Thus remaining 48 percent (engaged in non-agro sector) contributes more than 80 per cent of national income. In developed nations like USA, U.K. the contribution of agriculture accounts for about 5 per cent to 7 per cent of national income with only 5 per cent to 25 per cent of workforce engaged in agriculture. This clearly indicates the low level of productivity of workforce engaged in the agriculture.

International Comparisons of India's Agricultural Productivity:

Despite the substantial improvements in the productivity in case of major crops the productivity trends in India is far below those obtained in many developed nations. Table 8.6 gives the productivity of some crops in India and other countries.

Table 8.6 : International Comparisons of Yield of some Selected Commodities-2003(kg/hectare)

Rice		Wheat	
Country	Yield	Country	Yield
Egypt	9430.89	U.K.	7777.899
U.S.A.	7447.65	France	6234.862
Japan	5849.85	China	3906.534
Myanmar	3705.263	**India**	**2617.094**
Bangladesh	3428.829	Pakistan	2380.716
India	**3000.295**	Bangladesh	1992.288
Pakistan	3054.751	Iran	1984.615
World	**3837.404**	**World**	**2664.966**
Maize		**Groundnut**	
Italy	7744	China	2623.805
France	7137.373	U.S.A	3540.49
Egypt	7710.843	Argentina	2025.641
China	4854.379	Brazil	2082.353
Philippines	1802.012	**India**	**937.5**
Pakistan	1457.143	Uganda	710.9005
India	**2114.286**	Sudan	631.5789
World	**4471.689**	**World**	**1347.466**

Source: Compiled from Economic Survey, 2003.

8.6 MEASURES TO IMPROVE PRODUCTIVITY

Government has initiated various measures to overcome the problem of low agriculture productivity but the following measures are required to strengthen the agriculture development:

(1) Effective Implementation of Land Reforms:

The land reforms in terms of Zamindari abolition, ceiling and redistribution of land tenurial relations, consolidation of small and scattered holdings, minimum wages of landless labor etc needs to be effectively implemented. This will help to provide incentives and motivation to farmers to improve productivity and investment in agriculture sector. It will also have social implication by providing due share in the output. The strong political will and better administrative skills are required to operationalize these reforms at the grass root level.

(2) Greater Usage of Modern Technology:

The components of modern technology in terms of improved seeds, fertilizers and pesticides have to be made available easily to the farmers at fair prices. Farmers are required to be given training about the usage of these components especially fertilizers and chemical pesticides. The services of constant expertise, guidance and counseling about seeds sowing, time of sowing etc needs to be developed. In fact a second green revolution is required to distribute these technological inputs including improved variety of seeds to the cultivators.

(3) Better Credit Facilities:

The timely and sufficient financial assistance is the precondition to improve usage of better technology. Government had launched various schemes and institutions to improve agricultural credit such as establishment of cooperative banks, rural branches of nationalized banks, grameen banks etc. However, there is a lack of coordination under the multi-agency credit system. Further, there is an absence of appropriate motivation and knowledge especially amongst commercial banks to provide agriculture credit in the rural areas. In fact, the rural credit system should be developed as comprehensive financial cum service constancy organization that provides financial and farm-related help to the farmers.

(4) Restructuring Cropping Pattern:

The scientific research has mainly focused upon two major crops viz, wheat and rice. The breakthrough in terms of improved varieties of seeds has to be explored for other crops.

(5) Development of Irrigation Facilities:

The main obstacle in the exploitation and use of modern technology is the water shortage. The inter-linking of river projects needs to be implemented speedily to reduce the ill-effects of

floods and droughts. The greater use of dry and commercial cropping that requires lesser use of water should be encouraged. The surface-irrigation and water-pumping arrangements should be increased.

(6) Development of Research Institutes:

The research labs and agricultural universities have to be established, upgraded and sustained. The problems such as lack of resources, equipments and experts in these institutes need to be addressed immediately. The weakening of link between laboratory research and application on farm has to be minimized

(7) Betterment of Warehousing and Distribution Services:

The warehousing facilities are so under-developed that it renders the stored goods unsuitable for consumption. It is paradoxical that the country suffers from deficient food supplies in many regions and the food grains are rotten in warehouses. The modern warehousing facilities, transportation system and marketing methods needs to be developed to increase the availability of food to the masses. This would provide incentives to marketable surplus among farmers and go a long way to improve productivity. The public- private alliance may be encouraged to increase investment in warehousing services.

(8) Population Control:

The continuous growth in the population especially in the rural areas is the major cause of uneconomic land-holding which limits the usage of modern technology. Thus the family planning and population control remain national priority.

(9) Introduction of Co-Operative Farming and Marketing:

The co-operatives in India are suffering due to strict Government controls and legislations. The co-operative should be given greater operational freedom and allowed to enlarge their activities including banking and marketing of agro products.

8.7 NATIONAL AGRICULTURE POLICY, 2000

The Government on 28th July 2000 made public a National Agriculture Policy aimed at catapulting agricultural growth to over 4 per cent per annum by 2005. This growth is to be achieved through a combination of measures including structural, institutional, agronomics and tax reforms discussed as follows:

- Price protection to farmers in the post- WTO regime when all the quantitative restrictions are removed.

• Private sector participation would be promoted through contract farming and land leasing arrangements to allow accelerated technology transfer, capital inflow, assured markets for crop production, especially of oilseeds, cotton and horticultural crops.

Private sector investment in agriculture would be encouraged, particularly in areas like agricultural research, human resource development, post harvest management and marketing.

• Government would enlarge coverage of futures markets to minimise the wide fluctuations in commodity prices as also for hedging their risks. The policy hoped to achieve sustainable development of agriculture, create gainful employment and raise standards of living.

• The Policy envisages evolving a "National Livestock Breeding Strategy" to meet the requirement of milk, meat, egg and livestock products and to enhance the role of draught animals as a source of energy for farming operations.

• Plant varieties would be protected through a legislation to encourage research and breeding of new varieties. Development of animal husbandry, poultry, dairy and aquaculture would receive top priority.

• The restrictions on the movement of agricultural commodities throughout the country would be progressively dismantled. The structure of taxes on foodgrains and other commercial crops would be reviewed.

• The excise duty on materials such as farm machinery and implements and fertilisers used as inputs in agricultural production, post harvest storage and processing would be reviewed.

• Appropriate measures would be adopted to ensure that agriculturists, by and large, remained outside the regulatory and tax collection system.

• Rural electrification would be given high priority as a prime mover for agricultural development.

• The use of new and renewable sources of energy for irrigation and other agricultural purposes would be encouraged.

• Progressive institutionalization of rural and farm credit would be continued for providing timely and adequate credit to farmers.

• Endeavour would be made to provide a package insurance policy for the farmers, right from sowing of crops to post-harvest operations, including market fluctuations in the prices of agricultural produce. The agriculture policy, 2000 emphasized on the organizational and institutional changes to improve agriculture growth.

8.8 NATIONAL POLICY FOR FARMERS, 2007

Government of India has approved the National Policy for Farmers, 2007 taking into account the recommendations of the National Commission on Farmers and after consulting the State Governments. The National Policy for Farmers, among other things, has provided for a holistic approach to development of the farm sector. The focus will be on the economic well being of the farmers in addition to improved production and productivity. The broad areas of its coverage include:

i. Asset reforms: To ensure that a farmer household in villages either possesses or has access to a productive asset or marketable skill.
ii. Water use efficiency: the stress on awareness and efficiency of water use will be given.
iii. New technologies like biotechnology, information and communication technology (ICT), renewable energy technology, space applications and nano-technology would be encouraged for improving productivity per unit of land and water on a sustainable basis.
iv. National Agricultural Bio-security System would be established to organize a coordinated agricultural biosecurity programme.
v. Seeds and Soil Health: Quality seeds, disease free planting material and soil health enhancement hold the key to raising small farm productivity. Every farmer is to be issued with a soil health passbook containing integrated information on farm soils with corresponding advisories.
vi. Support services for women: Appropriate support services like crèches, child care centres and adequate nutrition needed by women working in fields would be funded.
vii. Credit & Insurance: The financial services would be galvanized for timely, adequate and easy reach to the farmers at reasonable interest rates.
viii. Gyan Chaupals will promote learning of farmers thereby strengthening extension services.
ix. Necessary steps would be taken to put in place an appropriate social security scheme for farmers.
x. Minimum Support Price (MSP) mechanism to be implemented effectively across the country so as to ensure remunerative prices for agricultural produce.
xi. Food Security basket is to be enlarged to include nutritious millets such as bajra, jowar, ragi and millets, mostly grown in dry land farming areas.

8.9 CAUSES FOR LOW AGRICULTURAL PRODUCTIVITY IN INDIA

General Causes:

i. Social Environment:

The social environment of villages is often stated to be an obstacle in agricultural development. It is said that the Indian farmer is illiterate, superstitious, conservative, and unresponsive to new agricultural techniques. On the face of it, this seems to be correct. However, the fact is that given the limitation of present production relations, the unassuming and ignorant looking farmer uses his resources efficiently. On the basis of a study of Senapur Village, W. David Hopper concludes within his limitations that the Indian farmer uses his resources efficiently. G.S. Sahota also concludes that it is inappropriate to regard Indian farmer as superstitious, inefficient and irrational or to say that marginal productivity of labour is zero in agriculture.

ii. Pressure of Population on Land:

The pressure of population on; land is continuously increasing. Whereas the number of people dependent on agriculture was 16.3 crore in 1901, it rose to 44.2 crore in 1981. Though additional land has been brought under cultivation since 1901, yet per capita cultivated land has declined from 0.444 hectare in 1921 to 0.296 hectare in 1961 and further to 0.219 hectare in 1991. Increasing pressure of population on land is partly responsible for the sub-division and fragmentation of holding. Productivity on small uneconomic holdings is low.

Institutional Causes:

i. Land Tenure System:

Perhaps the most important reason of low agricultural productivity has been the zamindari system. Highly exploitative in character, this system drained out the very capacity, willingness and enthusiasm of the cultivators to increase production and productivity. Legislations passed for abolition of intermediaries in the post-Independence period. It did not break the stranglehold of the zamindars on the rural economy. They only changed their garb and became large landowners.

Exploitative practices continued. Regulation of rent, security of tenure, ownership rights for tenants, etc. did ‘not make the position of tenants better. Tenancy of most of the tenants continues to be insecure and they have to pay exorbitant rental fees.

In this land tenure system, it is difficult to increase productivity only through technological means. In fact, land reforms should precede technological changes. If investment in agriculture has to be increased, it is necessary to eliminate the rentier class of zamindars and usurious class of moneylenders.

ii. Lack of Credit and Marketing Facilities:

It is often assumed that the decisions of Indian farmers are not affected or modified in response to price incentives. In other words, the Indian farmer continues to produce the same agricultural even at more attractive prices. However, the facts are different. The studies of Raj Krishna, Hopper and Stem clearly point out that the Indian farmer reacts rationally to his economic environment.

Frequently on account of lack of marketing facilities or non-availability of loan on fair rate of interest, the cultivators are not able to invest the requisite resources in agriculture. This keeps the level of productivity on land low. If the government can revitalise the credit cooperative societies and the regional rural banks to grant more credit to the small farmers, the level of productivity can undoubtedly increase.

iii. Uneconomic Holdings:

According to the National Sample Survey, 52 per cent holdings in 1961 – 62 had a size of less than 2 hectares. In 1990 – 91, 78 per cent of total holdings fell under this category. Most of these holdings are not only extremely small. They are also fragmented into a number of tiny plots so that cultivation of them can be carried out only by labour intensive techniques.

This results in low productivity. Until the excessive labour employed on agriculture is transferred to alterative jobs and the holdings are consolidated (or cooperative farming initiated) modem techniques of agriculture cannot be adopted and the possibility of increasing agricultural productivity will remain limited.

Technical Causes:

i. Outmoded Agricultural Techniques:

Most of the Indian farmers continue to use outmoded agricultural techniques. Wooden ploughs and bullocks are still used by a majority of farmers. Use of fertilisers and new high-yielding varieties of seeds is also extremely limited. In summary, Indian agriculture is traditional. Therefore, productivity is low.

ii. Inadequate Irrigation Facilities:

Gross cropped area in India in 1993-34 was 186.4 million hectares of which 68.4 million hectare had irrigation facilities. Thus, 36.7 per cent of gross cropped area had irrigation facilities in 1993-94. This shows that even now about 63 per cent of the gross cropped area continues to depend on rains. Rainfall is often insufficient, uncertain and irregular.

Accordingly, productivity is bound to be low in all those areas, which lack irrigation facilities, and are totally dependent on rains. Even in areas having irrigation facilities, potential is not wholly utilised

because of defective management. The costs of irrigation are also increasing continuously and small farmer is, therefore, unable to make use of available irrigation facilities.

Weakness in Policy Perspectives:

Owing to a number of economic and political compulsions, the Indian strategy for agricultural growth remained preoccupied with the goal of achieving quick increases in food-grains production by concentrating the resources and efforts on the relatively better-endowed areas and strata of cultivators. A consequence of the approach has been the less-than- optimum allocation of the critically scarce inputs like water and fertilisers across crops and a group of farmers.

8.10 CHECK YOUR PROGRESS

Which one of the following is announced by the government in support of a crop?
(a) Maximum support price
(b) Minimum support price
(c) Moderate support price
(d) Influential support price
________________it is the type of cropping pattern wherein the crops are grown in a definite sequence.
e) By the term_________ _______we mean the varying relationship between the agricultural output and one of the major inputs such as land.

8.11 SUMMARY

What is most notable is the change in the relative importance of these factors over time. From a very generalized perspective, Indian agriculture is increasingly getting influenced more and more by economic factors. This need not be surprising because irrigation expansion, infrastructure development, penetration of rural markets, development and spread of short duration and drought resistant crop technologies have all contributed to minimizing the role of non-economic factors in crop choice of even small farmers. What is more, the reform initiatives undertaken in the context of the ongoing agricultural liberalization and globalization policies are also going to further strengthen the role of price related economic incentives in determining crop composition both at the micro and macro levels. Obviously, such a changing economic environment will also ensure that government price and trade policies will become still more powerful instruments for directing area allocation decisions of farmers, aligning thereby the crop pattern changes in line with the changing demand-supply conditions. In a condition where agricultural growth results more from productivity improvement than from area expansion, the increasing role that price related economic incentives play in crop choice can also pave the way for the next stage of agricultural evolution where growth originates more and more from value-added production. The major change in cropping pattern that have been observed in India is a substantial area

shift from cereals to non-cereals. Although cereals gained a marginal increase in area, share in the first decade of the Green Revolution, their area and share declined gradually thereafter.

Between 1966/67 and 1996/97, 3.35 percent of the gross cultivated area (GCA) – representing approximately about 5.7 million hectares (m/ha) - has shifted from cereal crops to non-cereal crops. Since the area share of pulses taken as a group also declined by 1.57 percent during the same period, the area share of food grains as a group declined by 4.92 percent during 1966- 97. In area terms, the shift from food grains to non-food grains involves an approximate area of about 8.36 m/ha. While cereals and pulses have lost area, the major gainers of this area shift are the non-food grain crops especially oilseeds. The area share of oilseeds as a group that has gone up by 4.08 percent accounts for about 83 percent of the 8.36 m/ha involved in the area shift between 1966/67 and 1996/97. As we consider the share of individual crops within cereals, although the share of cereals as a group has declined, the area share of rice has increased continuously over all the four periods. Wheat, although having a declining area share until 1986/87, also gained in its share when the entire period is considered. Thus, the area loss of cereals can be attributed entirely to the declining area share of coarse cereals, especially sorghum, pearl millet, barely and small millets. It can be noted that even within coarse cereals, the area share of maize shows a marginal improvement over the years. Within oilseeds, the crops showing steady improvement in their area share are: rapeseed and mustard, soybean and sunflower. Among these three oilseeds gaining in area share, rapeseed and mustard are substantially grown as intercrops with wheat. On the other hand, the area shares of other oilseeds including groundnut (that has a dominant area share within oilseeds) but excluding coconut, which is more a plantation crop than field crop, have either fluctuated or declined. The area share of groundnut, though improved during the last period, has declined as compared to its share in the pre-Green Revolution period.

But, the declining area share of crops - especially those with only a marginal change in their area share - need not necessarily imply a decline in the actual area under these crops. Since the Gross Cropped Area (GCA) is constantly increasing over time, partly through an expansion of net sown areas as in the initial stages of the Green Revolution and partly through increasing intensity of cropping mainly by irrigation expansion, the declining area share can coincide with an increase in absolute increase in the area under crops. This can be seen from tables above showing actual area under various crops and their groups. Although the increase in the area share of other commercial crops is not as dramatic as that of oilseeds, it is still notable because of its implications for the direction of Indian agriculture. But, among these other commercial crops that cover fibres, spices, fruits and vegetables, and other field crops such as

tobacco and sugar cane and plantation crops, only spices, fruits and vegetables show a steady improvement in their area shares, whereas others show mostly a declining trend. This is particularly true for fibres and other field crops that have over four fifths of the total area under the broad group of other commercial crops. However, sugar cane, included in the category of other field crops, shows an increase in its area share. This is also true for cotton included in the fibre category. While all spice crops show a gradual increase in their area share, only three of the six crops included in the fruits and vegetables category show a gain in their area share over the years. These crops are banana, potato and onion.

8.12 GLOSSARY

Rotational Cropping: it is the type of cropping pattern wherein the crops are grown in a definite sequence.

Agricultural Productivity: By the term agricultural productivity we mean the varying relationship between the agricultural output and one of the major inputs such as land. The most commonly used term for representing agricultural productivity is the average yield per hectare of land.

8.13 ANSWERS TO CHECK YOUR PROGRESS/SAQ'S

Minmum Support Price.

Rotational Cropping

Agricultural Productivity

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8.15 TERMINAL AND MODEL QUESTIONS

1. What is the cropping pattern prevalent in India? Discuss in detail about the Rabi cropping pattern.
2. Write a brief note on the trends in agricultural production in India.
3. What do you understand by the term agricultural productivity? Which are the factors determining agricultural productivity ?What are the causes of low agricultural productivity in India?

CHAPTER 9
AGRICULTURAL FINANCE AND AGRICULTURAL PRICE POLICY

9.1 OBJECTIVES

After reading this chapter, you will be able to:

i. Explain the concept of agricultural credit in India and its importance;
ii. Discuss the significance of Agricultural Pricing Policy;
iii. Evaluate the micro finance scenario in India;
iv. Evaluate the working of Commission for Agricultural Costs and Prices (CACP) ,
v. Explain the concept of Minimum Support Prices, and
vi. Understand the role of Agricultural Marketing in determining Prices.

9.2 FINANCING AGRICULTURE IN INDIA

Finance in agriculture is as important as other inputs being used in agricultural production. Technical inputs can be purchased and used by farmer only if he has money (funds). But his own money is always inadequate and he needs outside finance or credit. Professional money lenders were the only source of credit to agriculture till 1935. They used to charge unduly high rates of interest and follow serious practices while giving loans and recovering them. As a result, farmers were heavily burdened with debts and many of them perpetuated debts. With the passing of Reserve Bank of India Act 1934, District Central Co-op. Banks Act and Land Development Banks Act, agricultural credit received impetus and there were improvements in agricultural credit. A powerful alternative agency came into being. Large-scale credit became available with reasonable rates of interest at easy terms, both in terms of granting loans and recovery of them. Although the co-operative banks started financing agriculture with their establishments in 1930's real impetus was received only after Independence when suitable legislation were passed and policies were formulated. Thereafter, bank credit to agriculture made phenomenal progress by opening branches in rural areas and attracting deposits.

Till 14 major commercial banks were nationalized in 1969, co-operative banks were the main institutional agencies providing finance to agriculture. After nationalization, it was made mandatory for these banks to provide finance to agriculture as a priority sector. These banks undertook special programs of branch expansion and created a network of banking services throughout the country and started financing agriculture on large scale. Thus agriculture credit acquired multi-agency dimension. Development and adoption of new technologies and availability of finance go hand in hand. In bringing "Green Revolution", "White Revolution" and

"Yellow Revolution" finance has played a crucial role. Now the agriculture credit, through multi agency approach has come to stay.

The procedures and amount of loans for various purposes have been standardized. Among the various purposes "Crop loans" (Short-term loan) has the major share. In addition, farmers get loans for purchase of electric motor with pump, tractor and other machinery, digging wells or boring wells, installation of pipe lines, drip irrigation, planting fruit orchards, purchase of dairy animals and feeds/fodder for them, poultry, sheep/goat keeping and for many other allied enterprises.

9.3 AGRICULTURAL CREDIT SYSTEM IN INDIA

Farmers get external financial assistance from two sources namely,

i) non-institutional or unorganized agencies, and

ii) institutional or organized agencies.

It is a fact that agriculture has been financed by non-institutional agencies for a long time and institutional agencies were started functioning only during the early part of this century.

9.3.1 Non-Institutional Sources of Finance in India

Non-institutional sources include money lenders, land lords, traders, commission agents, friends and relatives.

9.3.1.1 i) Money Lenders

There are two types of money lenders in rural areas.

a) agricultural money lenders and

b) professional money lender.

Agricultural money lender's main occupation is farming and money lending is secondary one. Professional money lender's main profession is money lending. Although the reliance on money lender by rural poor declined over the years, the credit disbursed by money lenders still forms a major portion of the total credit obtained by the farmers.

Agricultural money lender's main occupation is farming and money lending is secondary one while the Professional money lender's main profession is money lending. Although the reliance on agricultural and professional money lenders by rural poor declined over the years, i.e., from 80 per cent of their total credit requirement in 1951 to 30 per cent in 2002, the credit disbursed by money lenders still forms a major portion of the total credit obtained by the farmers.

9.3.1.1.1 Advantages

i. Unrestricted supply of credit for any purpose..

ii. Easy access by farmers as money lenders maintain close relationship with rural families.

iii. Method of business adopted are simple and flexible.

iv. Timely availability of credit without much formalities.

v. Knowledge on local conditions and experience of money lender facilitate his business.

vi. Money lenders do not insist upon any particular type of security for the grant of loans.

9.3.1.1.2 Unfair Practices of Money Lenders

Money lenders deceive the farmers through many ways such as:

i. They manipulate bonds and promissory notes obtained from debtors and enter large sum than actually lent.

ii. They give no receipt for repayments and often they deny such repayments.

iii. They charge very high rate of interest

iv. They give loans for both productive and unproductive purposes which results in indebtedness.

Table 8.1:Proportion of Borrowing* by Farmers from Organized and Unorganized Lending Agencies (percentages)

Lending Agencies	1951	1961	1971	1981	1991	2002
I Organized Agencies						
1.Government	3.3	6.7	7.1	4.0	6.1	2.3
2. Co-operatives	3.1	11.4	22.0	29.0	21.6	27.3
3.Commercial Banks	0.9	0.3	2.4	28.0	33.7	24.5
4. Insurance, Provident Fund and Other Institutions	-	-	0.2	-	2.6	3.0
Sub-Total	**7.3**	**18.4**	**31.7**	**61.0**	**64.0**	**57.1**
II Unorganized Agencies						
1. Land Lords	1.5	0.9	8.1	4.0	4.0	1.0
2. Agricultural Money lenders	24.9	48.1	23.0	9.0	7.0	10.0
3. Professional Money lenders	44.8	13.8	13.1	8.0	10.5	19.6
4. Traders and Commission Agents	5.5	7.1	8.4	3.0	2.2	2.6
5. Friends and Relatives	14.2	5.2	13.1	9.0	5.5	7.1
6. Others	1.8	6.5	2.6	6.0	6.8	2.6
Sub-Total	**92.7**	**81.6**	**68.3**	**39.0**	**36.0**	**42.9**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

**: includes financial corporation/institution, financial company and other institutional agencies.*
Note: Percentage share of different credit agencies to the outstanding cash dues of the households as on 30th June
-- denotes not available
Source: All India Rural Credit Survey (1954); All India Debt and Investment Survey, Various Issues.

9.4 RECENT REPORTS ON 'INFORMAL CREDIT RELATED ISSUES'

In the absence of survey data beyond AIDIS 2002 (published in December 2005), data has been heavily drawn upon three recent Reports (RBI, 2006; GOI, 2010; RBI, 2011) that were also based on the sample surveys and extended the AIDIS data. The Report of the Task Force on 'Credit Related Issues of Farmers' (Chairman: Shri U. C. Sarangi), submitted to the Ministry of Agriculture, Government of India, looked into the issue of a large number of farmers who had taken loans from private moneylenders, but not covered under the 'Agricultural Debt Waiver and Debt Relief Scheme' of 2008. The Task Force Report has observed that "*…more disquieting feature of the trend was the increase in the share of moneylenders in the total debt of cultivators. There was an inverse relationship between land-size and the share of debt from informal sources. Moreover, a considerable proportion of the debt from informal sources was incurred at a fairly high rate of interest*". About 36 per cent of the debt of farmers from informal sources had interest ranging from 20 to 25 per cent. Another 38 per cent of loans had been borrowed at an even higher rate of 30 per cent and above, indicating the excessive interest burden of such debt on small and marginal farmers. The continued dependence of small and marginal farmers on informal sources of credit such as private moneylenders was attributed to constraint in the rural banking network and services arising out of financial sector reforms. Rigid procedures and systems of formal sources preventing easy access by small and marginal farmers, vied with the easy and more flexible methods of lending adopted by informal sources. The Task Force members came across situations where farmers were borrowing at the rate of five to ten per cent per month.

The identification of farmers indebted to private moneylenders is difficult. Such loans in most cases have no formal records and identifying and authenticating the debt from moneylenders may lead to problems of moral hazard (GOI, 2010). According to the Report, credit needs of small and marginal farmers are not only growing but are getting diversified due to increasing commercialization and modernization of agriculture. Simultaneously, for a variety of other needs, farmers incur considerable expenditure, resulting in increased borrowings. Adequacy, timeliness, affordability and convenience are factors that influence farmers, and for that matter, all borrowers, in their choice of creditors. Given that a single source may not to be able to satisfy all their credit needs, many farmers approach both formal and informal sources. Invariably, those who cannot afford any collateral are forced to borrow from informal sources. The Task Force

reviewed the debt swap schemes of banks and revealed that these schemes had limited success as farmers were reluctant to disclose the name of the money-lenders, apprehensive in disclosing debt and some had even repaid the existing debt out of their Kisan Credit Card limits. Even though the Task Force came across some good debt swap schemes, bankers reported difficulty in taking these to scale and also reported that there was little guarantee that farmers would not ever again borrow from moneylenders.

Based on a review of the existing laws on money lending in the country, the 'Technical Group to Review Legislation on Money Lending' (RBI, 2006) has observed: "*…in spite of there being a legislation, a large number of moneylenders continue to operate without license, and even the registered moneylenders charge interest rates much higher than permitted by the legislation, apart from not complying with other provisions of the legislation. Signs of effective enforcement are absent*". The Report recommended legislative reforms to streamline the activities of moneylenders through suitable mechanism of incentives and disincentives. In this regard, Jeromi (2007) attempted to analyse the working of moneylenders in Kerala based on a sample survey, and mentioned that the existing legal provisions and regulatory and supervisory mechanisms are inadequate to protect the interests of both depositors and creditors in rural Kerala.

The growing commercialisation of Indian agriculture has encouraged the rise of trader-moneylender, as the formal sector finance is inadequate to meet the growing credit requirements of agriculture. The Task Force (GOI, 2010) noted that the moneylender today comes in many forms – as an outright lender, as a supplier of inputs/consumer goods, as a for-profit non-banking finance companies (NBFCs) including the for-profit MFIs, as a buyer of produce, and as an owner of the land on which the farmer is dependent. The sheer numbers of moneylenders, easy access to them, and their intricate relationships with the borrowers coupled with limited access to formal institutions made it difficult for borrowers to complain against them.

9.5 MICRO FINANCE SCENARIO

Microfinance sector in India has progressed remarkably since 1990s and this sector has been acting as an important ally in expanding *financial inclusion* in rural areas (NABARD, 2012). Reserve Bank provides guidelines to banks for mainstreaming micro-credit providers, *inter alia*, stipulated that micro-credit extended by banks to individual borrowers directly or through any intermediary would be reckoned as part of their priority sector lending. However, no particular

model was prescribed for micro-finance and banks have been extended freedom to formulate their own models or choose any conduit/intermediary for extending micro-credit. Though, there are different models for microfinance provision, the self-help-group (SHG)-Bank Linkage Programme has emerged as the major microfinance program in the country. It is being implemented by commercial banks, regional rural banks (RRBs) and cooperative banks. The gathering momentum in the microfinance sector has brought into focus the issue of regulating the sector.

The Malegam Committee Report (RBI, 2011) was constituted to study issues and concerns in the MFI sector in the wake of Andhra Pradesh micro finance crisis in 2010.

The Committee, *inter alia*, recommended

(i) creation of a separate category of NBFC-MFIs;

(ii) a margin cap and an interest rate cap on individual loans;

(iii) transparency in interest charges;

(iv) lending by not more than two MFIs to individual borrowers;

(v) creation of one or more credit information bureaus;

(vi) establishment of a proper system of grievance redressal procedure by MFIs;

(vii) creation of one or more “social capital funds”; and

(viii) continuation of categorisation of bank loans to MFIs, complying with the regulation laid down for NBFC-MFIs, under the priority sector.

The recommendations of the Committee were discussed with all stakeholders, including the Government of India, select State Governments, major NBFCs working as MFIs, industry associations of MFIs working in the country, other smaller MFIs, and major banks. The Reserve Bank has accepted the broad framework of regulations recommended by the Committee Report.

The The Micro Finance Institutions (Development and Regulation) Bill, 2012 envisages that the Reserve Bank would be the overall regulator of the MFI sector, regardless of legal structure. The Reserve Bank has provided the views on the Bill to the Government of India. The aims of the

Bill are to regulate the sector in the customers' interest and to avoid a multitude of microfinance legislation in different states. The proper balancing of the resources at the Reserve Bank to supervise these additional sets of institutions besides the existing regulated institutions could be an important issue. Requiring all MFIs to register is a critical and necessary step towards effective regulation. The proposal for appointment of an Ombudsman will boost the banking industry's own efforts to handle grievances better. Compulsory registration of the MFIs would bring the erstwhile money-lenders into the fold of organised financial services in the hinterland who had been acting as MFIs hitherto.

9.6 AGRICULTURE PRODUCE PRICING POLICY

Agricultural Price Policy plays an important role in achieving growth and equity in the Indian economy in general, and the agriculture sector in particular. The major underlying objective of the Government's Price Policy is to protect both producers and consumers. Achieving food security at both the national and household levels is one of the major challenges in India today. Currently, the Food Security System and Price Policy basically consist of three instruments: Procurement Prices/Minimum Support Prices (MSPs), Buffer Stocks and the Public Distribution System (PDS). Agricultural Price Policy is one of the important instruments in achieving food security by improving production, employment and incomes of the farmers. There is a need to provide remunerative prices for farmers in order to maintain food security and increase the incomes of farmers.

9.6.1 Evolution of Agriculture Pricing Policies

In India, the agriculture price policies and allied instruments were evolved in the pre-Independence era. The procurement and distribution of major food grains were started and statutory maximum prices were fixed, but were not strictly enforced. In the post-Independence era, the objective of achieving food security was linked with environment sustainability. The objective of the Government's price policy for agri-produce is to set remunerative prices with a view to encourage higher investment and production. Though the Government decided to purchase food grains at fixed prices, if market prices fell precipitously, but till 1954 there was no sharp decline in food prices.

The demand for food grains particularly rice and wheat, was on the increase from year to year as a result of growing population and rising incomes. Thus a trend had developed towards increased

level of consumption as well as substitution of coarse grains like maize, jawar, etc. by wheat and rice. Consequently shortages even of a marginal nature used to persist and there was a steady upward trend in price levels to bring demand and supply into balance.

9.7 COMMISSION FOR AGRICULTURAL COSTS AND PRICES (CACP)

Till 1964, procurement was confined to surplus States. It was extended to deficit States as well during the drought years and thereafter. In a situation of shortage or scarcity, unregulated purchase and movement of food grains by private trade led to indiscriminate and speculative rise in prices by movement of surpluses of the producing regions to areas of high purchasing power. To deal with that situation, the Government took a number of decisions. On 1 August, 1964, the Government appointed a Committee under the Chairmanship of Shri L.K. Jha, Secretary to the then Prime Minister on the determination of the prices of rice and wheat for the 1964-65 season.

Later on, the Committee was also asked to suggest prices of coarse food grains for the 1964-65 season. The Committee submitted its report related to prices on 24 September, 1964 and in respect of the agency to advise on price policy and price structure on 24 December, 1964. Based on the recommendations of the Committee, the Agricultural Prices Commission (APC) was set up on 1 January 1965 with the basic objective of assuring fair prices for farm produce and to advise the Government on price policy of major agricultural commodities. The thrust of the policy in 1965 was to meet the overall needs of the economy and with due regard to the interest of the producer and the consumer. At that point of time, the highest priority was to maximize production since the country was passing through a critical shortage of food grains. Perhaps the most significant aspect of the Price Support Mechanism had been the insulation of farmers against a decline in prices. When an overall balance between demand and supply was in sight in 1980, the APC's terms of reference, apart from other issues, also included for taking into account the changes in the Terms of Trade between agricultural and non-agricultural sectors. The Commission was renamed in 1985 as the Commission for Agricultural Costs and Prices (CACP).

The first and foremost mandate of CACP was to recommend Minimum Support Prices (MSP) with a view to make Indian agriculture a Remunerative Sector so that farmers would be incentivized to adopt modern technologies and better farming practices, raising productivity and overall production broadly in line with the emerging demand pattern.

Assurance of a remunerative and stable price environment is considered very important for increasing agricultural production and productivity since the market place for agricultural produce tends to be inherently unstable, which often inflict undue losses on the growers, even when they adopt the best available technology package and produce efficiently. Towards this end, Minimum Support Prices (MSP) for major agricultural products are fixed by the Government, each year, after taking into account the recommendations of the Commission for Agricultural Costs and Prices (CACP).

While formulating these recommendations, the Commission analyses a wide spectrum of data, covering the costs of cultivation/production, trends and spread of input use, production and productivity of the crop concerned, market prices, both domestic and global inter-crop price parity, emerging supply-demand situation, procurement and distribution, terms of trade between agriculture and non-agriculture sectors, and so on. Since the price policy involves certain considerations of long-run consequences, the Commission also looks at the yield-raising research being conducted by institutions like Indian Council for Agricultural Research (ICAR). The basic data are generally collected from the Directorate of Economics and Statistics, State Governments, Central Ministries and the nodal agencies concerned with the implementation of agricultural price policy. Besides, the Commission undertakes field visits for close interaction with farmers in different parts of the country and also have wider consultation with senior officers, researchers and managers of relevant organizations.

9.7.1 Terms of Reference

The terms of reference of the Commission for Agricultural Costs and Prices, were framed as under:-

i. To advise on the price policy of paddy, rice, wheat, jowar, bajra, maize, ragi, barley, gram, tur, moong, urad, sugarcane, groundnut, soyabean, sunflower seed, rapeseed and mustard, cotton, jute, tobacco and such other commodities as the Government may indicate from time to time with a view to evolving a balanced and integrated price structure in the perspective of the overall needs of the economy and with due regard to the interests of the producer and the consumer.
ii. To take into account the changes in terms of trade between agricultural and non agricultural sectors.

iii. To examine, where necessary, the prevailing methods and cost of marketing of agricultural commodities in different regions, suggest measures to reduce costs of marketing and recommend fair price margins for different stages of marketing.

iv. To keep under review the developing price situation and to make appropriate recommendations, as and when necessary, within the framework of the overall price policy.

v. To undertake studies in respect of different crops as may be prescribed by the Government from time to time.

vi. To advise on any problems relating to agricultural prices and production that may be referred to it by the Government from time to time.

From time to time, the terms of reference of the Commission have been modified and expanded to keep in line with the changes in agricultural scenario of the country. From the year 1994-95 onwards, Niger-seed and Sesamum were included under the Minimum Support Price (MSP) Scheme of CACP, in addition to the edible oilseeds already covered by the Commission. Similarly, during 2001-2002, the Government enhanced the terms of reference of the Commission by including one additional commodity, namely, lentil (masur). The number of crops covered by the MSP scheme have thus increased to 254.

9.8 MINIMUM SUPPORT PRICE

In each season the Government used to announce the Minimum Support Prices (MSPs). for major agricultural commodities and organizes purchase operations, wherever required, through public, cooperative, and other designated agencies to ensure that prices do not fall below that level. It decides on the support prices for various agricultural commodities taking into account the recommendations of the Commission for Agricultural Costs and Prices (CACP), the views of State Governments and Central Ministries as well as such other relevant factors as are considered important for fixation of support prices.

The MSP is announced well ahead of the sowing season so that farmers can take informed decisions on cropping.

9.8.1 Determination Of Minimum Support Prices

In formulating the recommendations in respect of the level of Minimum Support Prices and other non-price measures, the Commission takes into account, apart from a comprehensive view of the

entire structure of the economy of a particular commodity or group of commodities, the following factors:

i) Cost of production

ii) Changes in input prices

iii) Input-output price parity

iv) Trends in market prices

v) Demand and supply

vi) Inter-crop price parity

vii) Effect on industrial cost structure

viii) Effect on cost of living

ix) Effect on general price level

x) International price situation

xi) Parity between prices paid and prices received by the farmers.

xii) Effect on issue prices and implications for subsidy

The estimates of Cost of Cultivation/Cost of Production, an important input for forming the recommendation of MSP, are made available to the Commission through the Comprehensive Scheme for Studying the Cost of Cultivation of Principal Crops, operated by the Directorate of Economics and Statistics, Department of Agriculture and Cooperation, Ministry of Agriculture, Government of India. These estimates take into account real factors of production and include all actual expenses in cash and kind incurred by the farmer in production, rent paid for leased in land, imputed value of family labour, interest value of owned capital assets (excluding land), rental value of owned land (net of land revenue), depreciation on farm implements and buildings and other miscellaneous expenses.

9.8.2 Impact Of Hike In Minimum Support Price on the Whole Sale Price Index

Minimum Support Price declared before every cropping season is based on cost of cultivation calculated by CACP. The MSP gets revised upward every year however the magnitude of increase can vary and sometimes varies substantially.

Table 8.2:Annual Average Percentage Increase in MSP and WPI (II) (2006-2012)

Commodity	MSP	WPI
Rice	12.53	8.35
Wheat	11.62	8.66

There was a substantial increase in the MSP of wheat by 15.38 per cent and 33 per cent in 2006-07 and 2007-08 respectively, while the Whole Sale Price Index for wheat was increased only by 19.05 per cent and 7.2 per cent respectively.

The MSP of wheat was increased by more than 97 per cent between 2005-06 (Rs.650) and 2011-12 (Rs. 1,285) while the Whole Sale Price Index was increased by approximately 60 per cent. As regard Rice, the MSP was increased from Rs.570 in 2005-06 to Rs.1,080 in 2011-12 with an increase of 89.47 per cent while the Whole Sale Price Index for rice for the same period was increased by 63.81 per cent. It is evident from the Table (I) above that increase in MSPs

Table:8.3 Minimum Support Price and Whole Sale Price Index (I)

	Wheat						Rice					
Year	**MSP***	**Annual % change in MSP**	**Change % with base year 2005-06**	**WPI^**	**Annual % change in WPI**	**Change % with base year 2005-06**	**MSP**	**Annual % change in MSP**	**Change % with base year 2005-06**	**WPI**	**Annual % change in WPI**	**Change % with base year 2005-06**
2005-06	650	-	-	105	-	-	570	-	-	105	-	-
2006-07	750	15.38	15.38	125	19.05	19.05	580	1.75	1.75	110	4.76	4.76
2007-08	1000	33.33	53.85	134	7.2	27.62	645	11.21	13.16	122	10.91	16.19
2008-09	1080	8	66.15	148	10.45	40.95	850	31.78	49.12	141	15.57	34.29
2009-10	1100	1.85	69.23	166	12.11	58.10	950	11.76	66.67	158	12.06	50.48
2010-11	1170	6.36	80	171	3.01	62.86	1000	5.26	75.44	167	5.70	59.05
2011-12	1285	9.83	97.69	168	-1.75	60	1080	8	89.47	172	2.99	63.81

**Source: www.rbi.org.in*

^ Source: India. Planning Commission, Economic Survey 2012-13, Annexure A 67-68

generally coincides with rise in their respective Whole Sale Price Indexes. But contrary to this a decline of 1.75 per cent was seen in Whole Sale Price Index of wheat between 2010-11 and 2011-12 whereas the MSP was increased by 9.83 per cent.

There are different views on the co-relation between the Minimum Support Price and inflation of food articles. According to Monetary Policy Statement 2012-13 of Reserve Bank of India, price pressure from the Minimum Support Price continues to remain a major risk to inflation as the increase in the MSP tends to translate in to increase in the market price for most commodities.

According to Ms. Somya Kanti Ghose, Senior Fellow in International Council for Research on International Economic Relations (ICRIER) apart from direct impact of Minimum Support Prices increase on the Whole Sale Price Index, there is also an indirect impact. Increase in MSP acts as a floor to Whole Sale Price Inflation and thereby feeding into an expectation of an all – pervasive increase in food prices.

The Department of Agriculture & Cooperation implements the Market Intervention Scheme (MIS) for procurement of horticultural commodities which are perishable in nature and are not covered under the Price Support Scheme. The objective of intervention is to protect the growers of these commodities from making distress sale in the event of a bumper crop during the peak arrival period when the prices tend to fall below economic levels and cost of production. The condition is that there should be either at least a 10 percent increase in production or a 10 percent decrease in the ruling market prices over the previous normal year. The Market Intervention Scheme (MIS) is implemented at the request of a State/UT Government which is ready to bear 50 percent of the loss (25 percent in case of North-Eastern States), if any, incurred on its implementation. The extent of total amount of loss to be shared on a 50:50 basis, between the Central Government and the State Government is restricted to 25 percent of the total procurement value which includes cost of the commodity procured plus permitted overhead expenses. Under the Scheme, in accordance with MIS guidelines, a pre-determined quantity at a fixed Market Intervention Price (MIP) is procured by the National Agricultural Cooperative Marketing Federation (NAFED) as the Central agency and the agencies designated by the State Government for a fixed period or till the prices are stabilized above the MIP whichever is earlier. The area of operation is restricted to the concerned state only.

9.9 Price Support Scheme (PSS)

The Price Support Scheme (PSS) is implemented by the Government of India to ensure a Minimum Support Price of the produce to the farmers. The Government has notified various agencies such as Food Corporation of India (FCI), NAFED, Central Warehousing Corporation (CWC), Small Farmers' Agri-business Consortium (SFAC), etc., for this purpose. -10-

The Department of Agriculture and Cooperation implements the PSS for procurement of oil seeds, pulses and cotton, through NAFED which is the Central Nodal Agency, at the Minimum Support Price (MSP) declared by the Government. The NAFED undertakes procurement of oil seeds, pulses and cotton under the PSS as and when prices fall below the MSP. Procurement under PSS is continued till prices stabilize at or above the MSP. Losses, if any incurred by the NAFED in undertaking MSP operations are reimbursed by the Central Government. Profit, if any, earned in undertaking MSP operations is credited to the Central Government9.

9.10 AGRICULTURE MARKETING

While production programmes are important to raise productivity and overall production in the country, it is equally important to have efficient agri-markets. This is critical to keep the cultivators incentivized in production. An efficiently functioning market enables the producers to get a better price for their produce while simultaneously it can make goods available to consumers at a lower price. This can normally be achieved by ensuring that agri-markets are well integrated and unified at national level, exports and imports are reasonably open, there is ample competition amongst buyers and sellers avoiding any monopsony, be it from the state or private players, the price discovery mechanisms are transparent, infrastructure is developed and modern, and intermediaries between the producers and consumers are minimized.

Organised marketing of agricultural commodities has been promoted in the country through a network of regulated markets to ensure reasonable gains to the farmers and consumers by creating conducive market environment for fair play of the forces of demand and supply. There is huge variation in the density of regulated markets in different parts of the country, which varies from 103 sq km. in Punjab to 11215 sq km. in Meghalaya. Such low density of market spread in the States creates problem of market access for small and marginal farmers. Moreover, these state controlled/regulated markets do not have required facilities/amenities available therein due to resource constraint.

To bring reforms in Agricultural marketing section, the Agriculture Produce Marketing Committee (APMC) Act 2003 was formulated and circulated to all States and Union Territories. So far, 16 State Governments have amended their respective APMC Act12.

In order to provide a higher share of consumer prices to the farmers, there is a need to reduce the multiple layers of intermediation by providing alternative marketing channels. Several States have taken the initiatives in this regard. Farmers' markets, like, '*Apni Mandi*' (Punjab), '*Kisan Mandi*' (Rajasthan), 'Hadaspur Vegetable Market' (Pune), '*Rythu Bazaars*' (Andhra Pradesh), *Uzhawar Santhai* (Tamil Nadu) and '*Krushak Bazaars*' (Orissa) have been established as part of this initiative. These markets are beneficial to both farmers and consumers.

9.11 CHECK YOUR PROGRESS

i. The Price Support Scheme (PSS) is implemented by the Government of India to ensure a __________________________of the produce to the farmers.

ii. Farmers get external financial assistance from two sources namely, ___________________and______________________.

iii. There are two types of money lenders in rural areas: ___________ and _______________________________.

9.12 OBSERVATIONS BY THE COMPTROLLER AND AUDITOR GENERAL

The Comptroller and Auditor General (CAG) has observed that while determining the cost of production for each crop, CACP followed a set procedure. No specific norm was, however, followed for arriving and fixing of Minimum Support Price over the cost of production leading to large year on year variation. The difference of all India weighted average cost of production and the MSP fixed by the Government of India during the period 2006-07 to 2011-12 is given as under.

The margin of MSP fixed over the cost of production varied widely between 29 per cent and 66 per cent in case of wheat, and between 14 per cent and 60 per cent in case of paddy during the period 2006-07 to 2011-1214.

Cultivation costs vary widely from one region to another; they are usually far higher in States such as Punjab, Haryana and Andhra Pradesh due to higher wages, land value and input use. A uniform MSP across the country, therefore, leaves farmers in the surplus generating intensive farming areas dissatisfied. Therefore, the market should play a more meaningful role in price determination.

The Committee under the chairmanship of Ramesh Chand, Director of the National Centre for Agricultural Economics and Policy Research, has been asked to study the cost concepts of fixing MSP and to suggest whether there is a need to reposition CACP, owing to the liberlisation of Indian agriculture. The new Committee would consider whether the methods to determine the value of family labour, the rental value of land, the interest on capital, the depreciation of fixed assets, etc., - factors vital to calculating MSP – are appropriate. The Committee would have representatives from the State Governments of Andhra Pradesh, Uttar Pradesh, Farmers organisations and the Department of Economic Affairs.

9.13 CONCLUSION

The Government's Price Policy for agricultural produce seeks to ensure remunerative prices to growers for their produce with a view to encourage higher investment and production as well as safeguarding the interests of consumers by making available supplies at reasonable prices. The price policy also seeks to evolve a balanced and integrated price structure in the perspective of the overall needs of the economy. To achieve this end, the Government in each season announces Minimum Support Prices (MSPs) for major agricultural commodities and organizes purchase operations, wherever required, through public, cooperative, and other designated agencies to ensure that prices do not fall below that level. It decides on the support prices for various agricultural commodities taking into account the recommendations of the CACP, the views of State Governments and Central Ministries as well as such other relevant factors as are considered important for fixation of support prices.

The MSP being uniform throughout the country, the Commission had to arrive at an all-India weighted average cost as an input to price policy formulation. Since price policy was a resultant of informed judgement of various factors, there could not be any mechanical formula of how much weight was to be given to each factor in the exercise of price policy formulation. The margin of MSP over the cost of production varied widely and no norms had been prescribed for fixing the margin over the cost of production. Thus, there is a need for greater transparency in the method of arriving at MSP over the cost of production.

The key findings from the analysis of agricultural credit and finance is that informal credit has certainly declined as a percentage of total debt, and both professional and agricultural moneylenders have reduced their share over time. Informal/non-institutional finance was gradually declining during the 1960s and was nearly broken during the 1970s with the

institutional agencies venturing into the rural areas with nationalization of major commercial banks and setting up of regional rural banks with initiatives of the Reserve Bank. The decline in the share of moneylenders reflects in part the Government's efforts to register and regulate professional moneylenders.

At the all India level, among the institutional credit agencies, the co-operative societies and the commercial banks were the two most important agencies in the rural sector. These two agencies together shared 91 per cent of the entire amount of debt advanced by the institutional agencies, accounted for 52 per cent of the outstanding cash debt, with co-operative societies (27.3 per cent) accounting for a greater share than the Banks (24.5 per cent). The above facts indicate that the cooperatives, commercial banks, and other formal financial sector programs in rural areas have not displaced informal sources of credit altogether as 43 per cent of rural households continue to rely on informal finance in 2002.

The most important reason for continuation of informal rural credit market is that the existing financial institutions tend to restrict their lending activities to more risky field of lending to the agricultural sector. Those in the rural credit market prefer to use informal sources of credit despite the fact that the interest rates are much higher. Informal sources do not insist on punctual repayment as banks or cooperative societies do. Usually, it is possible to obtain loans for such purposes as marriage and litigation only from informal sources. There are generally no intricate and complicated rules governing the granting of loans by the village moneylenders. And informal sources are willing to lend money more freely without collateral and on the borrower's mere promise to repay.

As reported in Malegam Committee Report, the impact of microfinance on the lives of the poor is inconclusive. The micro surveys create fears that in some cases microfinance has created credit dependency and cyclical debt. The analysts expressed doubt as to whether lending agencies have in all cases remained committed to the goal of fighting poverty or whether they are solely motivated by financial gain. This augurs well for the regulation of microfinance as a tool of financial inclusion and greater well being of the society.

9.14 ANSWERS TO CHECK YOUR PROGRESS/SAQ'S

i. Minimum Support Price
ii. non-institutional or unorganized agencies, institutional or organized agencies.
iii. agricultural money lenders, professional money lender.

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9.16 TERMINAL AND MODEL QUESTIONS

1. Write a note on Agricultural Price Policy in India.
2. Critically Evaluate the agricultural Finance system in India
3. How are Minimum support Prices determined in India?
4. What is the role played by Commission for Agricultural Costs and Prices (CACP)?

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CHAPTER-10

INDIAN PUBLIC FINANCE

10.1 OBJECTIVES

After reading this lesson you will be able to:

1. Understand the meaning of Fiscal Policy
2. Discuss about the nature and significance of Fiscal Policy in India.
3. Understand the tools/Instruments of Fiscal Policy
4. Know about the recent fiscal Policy interventions in the Indian economy.
5. Evaluate the Taxation system of India
6. Understand the nature of direct and indirect taxes.

10.2 INTRODUCTION

The economic development of a nation is reflected by the progress of the various economic units, broadly classified into corporate sector, government and household sector. There are areas or people with surplus funds and there are those with a deficit. A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit. A Financial System is a composition of various institutions, markets, regulations and laws, practices, money manager, analysts, transactions and claims and liabilities. Financial system comprises of set of subsystems of financial institutions, financial markets, financial instruments and services which helps in the formation of capital. It provides a mechanism by which savings are transformed to investment.

10.3 FINANCIAL SYSTEM

The word "system", in the term "financial system", implies a set of complex and closely connected or interlinked institutions, agents, practices, markets, transactions, claims, and liabilities in the economy. The financial system is concerned about money, credit and finance -the three terms are intimately related yet are somewhat different from each other. Indian

financial system consists of financial market, financial instruments and financial intermediation.

10.3.1 Meaning of Financial System

A financial system functions as an intermediary between savers and investors. It facilitates the flow of funds from the areas of surplus to the areas of deficit. It is concerned about the money, credit and finance. These three parts are very closely interrelated with each other and depend on each other. A financial system may be defined as a set of institutions, instruments and markets which promotes savings and channels them to their most efficient use. It consists of individuals (savers), intermediaries, markets and users of savings (investors).

According to Prasanna Chandra, *"financial system consists of a variety of institutions, markets and instruments related in a systematic manner and provide the principal means by which savings are transformed into investments".*

Thus financial system is a set of complex and closely interlinked financial institutions, financial markets, financial instruments and services which facilitate the transfer of funds. Financial institutions mobilise funds from suppliers and provide these funds to those who demand them. Similarly, the financial markets are also required for movement of funds from savers to intermediaries and from intermediaries to investors. In short, financial system is a mechanism by which savings are transformed into investments.

10.3.2 Functions of Financial System

The financial system of a country performs certain valuable functions for the economic growth of that country. The main functions of a financial system may be briefly discussed as below:

i. *Saving function:* An important function of a financial system is to mobilise savings and channelize them into productive activities. It is through financial system the savings are transformed into investments.

ii. *Liquidity function*: The most important function of a financial system is to provide money and monetary assets for the production of goods and services.

iii. Monetary assets are those assets which can be converted into cash or money easily without loss of value. All activities in a financial system are related to liquidity-either provision of liquidity or trading in liquidity.

iv. *Payment function*: The financial system offers a very convenient mode of payment for goods and services. The cheque system and credit card system are

the easiest methods of payment in the economy. The cost and time of transactions are considerably reduced.

v. *Risk function*: The financial markets provide protection against life, health and income risks. These guarantees are accomplished through the sale of life, health insurance and property insurance policies.

vi. *Information function*: A financial system makes available price-related information. This is a valuable help to those who need to take economic and financial decisions. Financial markets disseminate information for enabling participants to develop an informed opinion about investment, disinvestment, reinvestment or holding a particular asset.

vii. *Transfer function*: A financial system provides a mechanism for the transfer of the resources across geographic boundaries.

viii. *Reformatory functions:* A financial system undertaking the functions of developing, introducing innovative financial assets/instruments services and practices and restructuring the existing assts, services etc, to cater the emerging needs of borrowers and investors (financial engineering and re engineering).

ix. *Other functions*: It assists in the selection of projects to be financed and also reviews performance of such projects periodically. It also promotes the process of capital formation by bringing together the supply of savings and the demand for investible funds.

10.3.3 Role and Importance of Financial System in Economic Development

i. It links the savers and investors. It helps in mobilizing and allocating the savings efficiently and effectively. It plays a crucial role in economic development through saving-investment process. This savings – investment process is called capital formation.

ii. It helps to monitor corporate performance.

iii. It provides a mechanism for managing uncertainty and controlling risk.

iv. It provides a mechanism for the transfer of resources across geographical boundaries.

v. It offers portfolio adjustment facilities (provided by financial markets and financial intermediaries).

vi. It helps in lowering the transaction costs and increase returns. This will motivate people to save more.
vii. It promotes the process of capital formation.
viii. It helps in promoting the process of financial deepening and broadening.
ix. Financial deepening means increasing financial assets as a percentage of GDP and financial broadening means building an increasing number and variety of participants and instruments.
x. In short, a financial system contributes to the acceleration of economic development. It contributes to growth through technical progress.

10.4 STRUCTURE OF INDIAN FINANCIAL SYSTEM

Financial structure refers to shape, components and their order in the financial system. The Indian financial system can be broadly classified into formal (organised) financial system and the informal (unorganised) financial system. The formal financial system comprises of Ministry of Finance, RBI, SEBI and other regulatory bodies. The informal financial system consists of individual money lenders, groups of persons operating as funds or associations, partnership firms consisting of local brokers, pawn brokers, and non-banking financial intermediaries such as finance, investment and chit fund companies.

The formal financial system comprises financial institutions, financial markets, financial instruments and financial services. These constituents or components of Indian financial system may be briefly discussed as below:

10.4.1 Financial Institutions

Financial institutions are the participants in a financial market. They are business organizations dealing in financial resources. They collect resources by accepting deposits from individuals and institutions and lend them to trade, industry and others. They buy and sell financial instruments. They generate financial instruments as well. They deal in financial assets. They accept deposits, grant loans and invest in securities.

Financial institutions are the business organizations that act as mobilises of savings and as purveyors of credit or finance. This means financial institutions mobilise the savings of savers and give credit or finance to the investors. They also provide various financial services to the community. They deal in financial assets such as deposits, loans, securities and so on.

On the basis of the nature of activities, financial institutions may be classified as:

(a) Regulatory and promotional institutions,

(b) Banking institutions, and

(c) Non-banking institutions.

10.4.1.1 Regulatory and Promotional Institutions:

Financial institutions, financial markets, financial instruments and financial services are all regulated by regulators like Ministry of Finance, the Company Law Board, RBI, SEBI, IRDA, Dept. of Economic Affairs, Department of Company Affairs etc. The two major Regulatory and Promotional Institutions in India are Reserve Bank of India (RBI) and Securities Exchange Board of India (SEBI). Both RBI and SEBI administer, legislate, supervise, monitor, control and discipline the entire financial system. RBI is the apex of all financial institutions in India. All financial institutions are under the control of RBI. The financial markets are under the control of SEBI. Both RBI and SEBI have laid down several policies, procedures and guidelines. These policies, procedures and guidelines are changed from time to time so as to set the financial system in the right direction.

10.4.1.2 Banking Institutions:

Banking institutions mobilise the savings of the people. They provide a mechanism for the smooth exchange of goods and services. They extend credit while lending money. They not only supply credit but also create credit. There are three basic categories of banking institutions. They are commercial banks, co-operative banks and developmental banks.

10.4.1.3 Non-banking Institutions:

The non-banking financial institutions also mobilize financial resources directly or indirectly from the people. They lend the financial resources mobilized. They lend funds but do not create credit. Companies like LIC, GIC, UTI, Development Financial Institutions, Organisation of Pension and Provident Funds etc. fall in this category. Non-banking financial institutions can be categorized as investment companies, housing companies, leasing companies, hire purchase companies, specialized financial institutions (EXIM Bank etc.) investment institutions, state level institutions etc. Financial institutions are financial intermediaries. They intermediate between savers and investors. They lend money. They also mobilise savings.

10.4.2 Financial Markets

Financial markets are another part or component of financial system. Efficient financial markets are essential for speedy economic development. The vibrant financial market enhances the efficiency of capital formation. It facilitates the flow of savings into investment. Financial markets bridge one set of financial intermediaries with another set of players. Financial markets are the backbone of the economy. This is because they provide monetary

support for the growth of the economy. The growth of the financial markets is the barometer of the growth of a country's economy. Financial market deals in financial securities (or financial instruments) and financial services. Financial markets are the centres or arrangements that provide facilities for buying and selling of financial claims and services. These are the markets in which money as well as monetary claims is traded in.

Financial markets exist wherever financial transactions take place. Financial transactions include issue of equity stock by a company, purchase of bonds in the secondary market, deposit of money in a bank account, transfer of funds from a current account to a savings account etc. The participants in the financial markets are corporations, financial institutions, individuals and the government. These participants trade in financial products in these markets. They trade either directly or through brokers and dealers. In short, financial markets are markets that deal in financial assets and credit instruments.

10.4.3 Functions of Financial Markets:

The main functions of financial markets are outlined as below:

i. To facilitate creation and allocation of credit and liquidity.
ii. To serve as intermediaries for mobilisation of savings.
iii. To help in the process of balanced economic growth.
iv. To provide financial convenience.
v. To provide information and facilitate transactions at low cost.
vi. To cater to the various credits needs of the business organisations.

10.4.4 Classification of Financial Markets:

There are different ways of classifying financial markets. There are mainly five ways of classifying financial markets.

A. *Classification on the basis of the type of financial claim*: On this basis, financial markets may be classified into debt market and equity market.

Debt market: This is the financial market for fixed claims like debt instruments.

Equity market: This is the financial market for residual claims, i.e., equity instruments.

B. Classification on the basis of maturity of claims: On this basis, financial markets may be classified into money market and capital market.

Money market: A market where short term funds are borrowed and lend is called money market. It deals in short term monetary assets with a maturity period of one year or less. Liquid funds as well as highly liquid securities are traded in the money market. Examples of money market are Treasury bill market, call money market,

commercial bill market etc. The main participants in this market are banks, financial institutions and government. In short, money market is a place where the demand for and supply of short term funds are met.

Capital market: Capital market is the market for long term funds. This market deals in the long term claims, securities and stocks with a maturity period of more than one year. It is the market from where productive capital is raised and made available for industrial purposes. The stock market, the government bond market and derivatives market are examples of capital market. In short, the capital market deals with long term debt and stock.

C. Classification on the basis of seasoning of claim: On this basis, financial markets are classified into primary market and secondary market.

Primary market: Primary markets are those markets which deal in the new securities. Therefore, they are also known as *new issue markets*. These are markets where securities are issued for the first time. In other words, these are the markets for the securities issued directly by the companies. The primary markets mobilise savings and supply fresh or additional capital to business units. In short, primary market is a market for raising fresh capital in the form of shares and debentures.

Secondary market: Secondary markets are those markets which deal in existing securities. Existing securities are those securities that have already been issued and are already outstanding. Secondary market consists of stock exchanges. Stock exchanges are self regulatory bodies under the overall regulatory purview of the Govternment /SEBI.

D. Classification on the basis of structure or arrangements: On this basis, financial markets can be classified into organised markets and unorganized markets.

Organised markets: These are financial markets in which financial transactions take place within the well established exchanges or in the systematic and orderly structure.

Unorganised markets: These are financial markets in which financial transactions take place outside the well established exchange or without systematic and orderly structure or arrangements.

E. Classification on the basis of timing of delivery: On this basis, financial markets may be classified into cash/spot market and forward / future market.

Cash / Spot market: This is the market where the buying and selling of commodities happens or stocks are sold for cash and delivered immediately after the purchase or sale of commodities or securities.

Forward/Future market: This is the market where participants buy and sell stocks/commodities, contracts and the delivery of commodities or securities occurs at a pre-determined time in future.

F. Other types of financial market: Apart from the above, there are some other types of financial markets. They are foreign exchange market and derivatives market.

Foreign exchange market: Foreign exchange market is simply defined as a market in which one country's currency is traded for another country's currency. It is a market for the purchase and sale of foreign currencies.

Derivatives market: The derivatives are most modern financial instruments in hedging risk. The individuals and firms who wish to avoid or reduce risk can deal with the others who are willing to accept the risk for a price. A common place where such transactions take place is called the derivative market. It is a market in which derivatives are traded. In short, it is a market for derivatives. The important types of derivatives are forwards, futures, options, swaps, etc.

10.4.5 Financial Instruments (Securities)

Financial instruments are the financial assets, securities and claims. They may be viewed as financial assets and financial liabilities.

Financial assets represent claims for the payment of a sum of money sometime in the future (repayment of principal) and/or a periodic payment in the form of interest or dividend.

Financial liabilities are the counterparts of financial assets. They represent promise to pay some portion of prospective income and wealth to others. Financial assets and liabilities arise from the basic process of financing.

Some of the financial instruments are tradable/ transferable. Others are non tradable/non-transferable. Financial assets like deposits with banks, companies and post offices, insurance policies, NSCs, provident funds and pension funds are not tradable. Securities (included in financial assets) like equity shares and debentures, or government securities and bonds are tradable. Hence they are transferable. In short, financial instruments are instruments through which a company raises finance.

The financial instruments may be *capital market instruments or money market instruments or hybrid instruments*. The financial instruments that are used for raising capital through the capital market are known as *capital market instruments*. These include equity shares, preference shares, warrants, debentures and bonds. These securities have a maturity period of more than one year.

The financial instruments that are used for raising and supplying money in a short period not exceeding one year through money market are called *money market instruments*. Examples are treasury bills, commercial paper, call money, short notice money, certificates of deposits, commercial bills, money market mutual funds.

Hybrid instruments are those instruments which have both the features of equity and debenture. Examples are convertible debentures, warrants etc.

Financial instruments may also be classified as *cash instruments and derivative instruments*. Cash instruments are financial instruments whose value is determined directly by markets. Derivative instruments are financial instruments which derive their value from some other financial instrument or variable.

Financial instruments can also be classified into primary instruments and secondary instruments. *Primary instruments* are instruments that are directly issued by the ultimate investors to the ultimate savers. For example, shares and debentures directly issued to the public. *Secondary instruments* are issued by the financial intermediaries to the ultimate savers. For example, UTI and mutual funds issue securities in the form of units to the public.

10.4.6 Characteristics of Financial Instruments

The important characteristics of financial instruments may be outlined as below:

1. Liquidity: Financial instruments provide liquidity. These can be easily and quickly converted into cash.
2. Marketing: Financial instruments facilitate easy trading on the market. They have a ready market.
3. Collateral value: Financial instruments can be pledged for getting loans.
4. Transferability: Financial instruments can be easily transferred from person to person.
5. Maturity period: The maturity period of financial instruments may be short term, medium term or long term.
6. Transaction cost: Financial instruments involve buying and selling cost. The buying and selling costs are called transaction costs. These are lower.
7. Risk: Financial instruments carry risk. This is because there is uncertainty with regard to payment of principal or interest or dividend as the case may be.
8. Future trading: Financial instruments facilitate future trading so as to cover risks due to price fluctuations, interest rate fluctuations etc.

10.5 FINANCIAL SERVICES

The development of a sophisticated and matured financial system in the country, especially after the early nineties, led to the emergence of a new sector. This new sector is known as financial services sector. Its objective is to intermediate and facilitate financial transactions of individuals and institutional investors. The financial institutions and financial markets help the financial system through financial instruments. The financial services include all activities connected with the transformation of savings into investment. Important financial services include lease financing, hire purchase, instalment payment systems, merchant banking, factoring, forfeiting etc.

10.6 GROWTH AND DEVELOPMENT OF INDIAN FINANCIAL SYSTEM

At the time of independence in 1947, there was no strong financial institutional mechanism in the country. The industrial sector had no access to the savings of the community. The capital market was primitive and shy. The private and unorganised sector played an important role in the provision of liquidity. On the whole, there were chaos and confusions in the financial system. After independence, the government adopted mixed economic system. A scheme of planned economic development was evolved in 1951 with a view to achieve the broad economic and social objective. The government started creating new financial institutions to supply finance both for agricultural and industrial development. It also progressively started nationalizing some important financial institutions so that the flow of finance might be in the right direction. The following developments took place in the Indian financial system:

1. ***Nationalisation of financial institutions***: RBI, the leader of the financial system, was established as a private institution in 1935. It was nationalized in 1949. This was followed by the nationalisation of the Imperial bank of India. One of the important mile stone in the economic growth of India was the nationalisation of 245 life insurance Corporation in 1956. As a result, Life Insurance Corporation of India came into existence on 1st September, 1956. Another important development was the nationalisation of 14 major commercial banks in 1969. In 1980, 6 more banks were nationalized. Another landmark was the nationalisation of general insurance business and setting up of General Insurance Corporation in 1972.

2. ***Establishment of Development Banks***: Another landmark in the history of development of Indian financial system is the establishment of new financial institutions to supply institutional credit to industries. In 1949, RBI undertook a detailed study to find out the need for specialized institutions. The first development bank was established in 1948. That was Industrial Finance Corporation of India (IFCI). In 1951, Parliament passed State Financial

Corporation Act. Under this Act, State Governments could establish financial corporation's for their respective regions. The Industrial Credit and Investment Corporation of India (ICICI) were set up in 1955. It was supported by Government of India, World Bank etc. The UTI was established in 1964 as a public sector institution to collect the savings of the people and make them available for productive ventures. The Industrial Development Bank of India (IDBI) was established on 1st July 1964 as a wholly owned subsidiary of the RBI. On February 16, 1976, the IDBI was delinked from RBI. It became an independent financial institution.

It co-ordinates the activities of all other financial institutions. In 1971, the IDBI and LIC jointly set up the Industrial Reconstruction Corporation of India with the main objective of reconstruction and rehabilitation of sick industrial undertakings. The IRCI was converted into a statutory corporation in March 1985 and renamed as Industrial Reconstruction Bank of India. Now its new name is Industrial Investment Bank of India (IIBI).

In 1982, the Export-Import Bank of India (EXIM Bank) was set up to provide financial assistance to exporters and importers. On April 2, 1990 the Small Industries Development Bank of India (SIDBI) was set up as a wholly owned subsidiary of IDBI. The SIDBI has taken over the responsibility of administrating the Small Industries Development Fund and the National Equity Fund.

3. ***Establishment of Institution for Agricultural Development***: In 1963, the RBI set up the Agricultural Refinance and Development Corporation (ARDC) to provide refinance support to banks to finance major development projects, minor irrigation, farm mechanization, land development etc. In order to meet credit needs of agriculture and rural sector, National Bank for Agriculture and Rural Development (NABARD) was set up in 1982. The main objective of the establishment of NABARD is to extend short term, medium term and long term finance to agriculture and allied activities.

4. ***Establishment of institution for housing finance***: The National Housing Bank (NHB) has been set up in July 1988 as an apex institution to mobilise resources for the housing sector and to promote housing finance institutions.

5. ***Establishment of Stock Holding Corporation of India (SHCIL)***: In 1987, another institution, namely, Stock Holding Corporation of India Ltd. was set up to strengthen the stock and capital markets in India. Its main objective is to provide quick share transfer facilities, clearing services, support services etc. to investors.

6. ***Establishment of mutual funds and venture capital institutions***: Mutual funds refer to the funds raised by financial service companies by pooling the savings of the public and

investing them in a diversified portfolio. They provide investment avenues for small investors who cannot participate in the equities of big companies. Venture capital is a long term risk capital to finance high technology projects. The IDBI venture capital fund was set up in 1986. The ICICI and the UTI have jointly set up the Technology Development and Information Company of India Ltd. in 1988 to provide venture capital.

7. ***New Economic Policy of 1991:*** Indian financial system has undergone massive changes since the announcement of new economic policy in 1991. Liberalisation, Privatisation and Globalisation has transformed Indian economy from closed to open economy. The corporate industrial sector also has undergone changes due to delicensing of industries, financial sector reforms, capital markets reforms, disinvestment in public sector undertakings etc. Since 1990s, Government control over financial institutions has diluted in a phased manner. Public or development financial institutions have been converted into companies, allowing them to issue equity/bonds to the public. Government has allowed private sector to enter into banking and insurance sector. Foreign companies were also allowed to enter into insurance sector in India.

10.7 WEAKNESSES OF INDIAN FINANCIAL SYSTEM

Even though Indian financial system is more developed today, it suffers from certain weaknesses. These may be briefly stated below:

1. ***Lack of co-ordination among financial institutions***: There are a large number of financial intermediaries. Most of the financial institutions are owned by the government. At the same time, the government is also the controlling authority of these institutions. As there is multiplicity of institutions in the Indian financial system, there is lack of co-ordination in the working of these institutions.

2. ***Dominance of development banks in industrial finance***: The industrial financing in India today is largely through the financial institutions set up by the government. They get most of their funds from their sponsors. They act as distributive agencies only. Hence, they fail to mobilise the savings of the public. This stands in the way of growth of an efficient financial system in the country.

3. ***Inactive and erratic capital market:*** In India, the corporate customers are able to raise finance through development banks. So, they need not go to capital market. Moreover, they do not resort to capital market because it is erratic and inactive. Investors too prefer investments in physical assets to investments in financial assets.

4. ***Unhealthy financial practices***: The dominance of development banks has developed unhealthy financial practices among corporate customers. The development banks provide most of the funds in the form of term loans. So there is a predominance of debt in the financial structure of corporate enterprises. This predominance of debt capital has made the capital structure of the borrowing enterprises uneven and lopsided. When these enterprises face financial crisis, the financial institutions permit a greater use of debt than is warranted. This will make matters worse.

5. ***Monopolistic market structures***: In India some financial institutions are so large that they have created a monopolistic market structures in the financial system. For instance, the entire life insurance business is in the hands of LIC. The weakness of this large structure is that it could lead to inefficiency in their working or mismanagement. Ultimately, it would retard the development of the financial system of the country itself.

6. ***Other factors***: Apart from the above, there are some other factors which put obstacles to the growth of Indian financial system.

Examples are: a. Banks and Financial Institutions have high level of NPA. b. Government burdened with high level of domestic debt. c. Cooperative banks are labelled with scams. d. Investors confidence reduced in the public sector undertaking etc., e. Financial illiteracy.

10.8 FISCAL POLICY AND TAXATION

Fiscal policy is the means by which a government adjusts its spending levels and tax rates to monitor and influence a nation's economy. It is the sister strategy to monetary policy through which a central bank influences a nation's money supply. These two policies are used in various combinations to direct a country's economic goals. Here we look at how fiscal policy works, how it must be monitored and how its implementation may affect different people in an economy. Before the Great Depression, which lasted from Sept. 4, 1929 to the late 1930s or early 1940s, the government's approach to the economy was laissez-faire. Following World War II, it was determined that the government had to take a proactive role in the economy to regulate unemployment, business cycles, inflation and the cost of money. By using a mix of monetary and fiscal policies (depending on the political orientations and the philosophies of those in power at a particular time, one policy may dominate over another), governments are able to control economic phenomena.

10.8.1 Balance between Tax Rates and Public Spending:

The idea, however, is to find a balance between changing tax rates and public spending. For example, stimulating a stagnant economy by increasing spending or lowering taxes runs

the risk of causing inflation to rise. This is because an increase in the amount of money in the economy, followed by an increase in consumer demand, can result in a decrease in the value of money - meaning that it would take more money to buy something that has not changed in value.

Let's say that an economy has slowed down. Unemployment levels are up, consumer spending is down and businesses are not making substantial profits. A government thus decides to fuel the economy's engine by decreasing taxation, which gives consumers more spending money, while increasing government spending in the form of buying services from the market (such as building roads or schools). By paying for such services, the government creates jobs and wages that are in turn pumped into the economy. Pumping money into the economy by decreasing taxation and increasing government spending is also known as "pump priming." In the meantime, overall unemployment levels will fall.

With more money in the economy and fewer taxes to pay, consumer demand for goods and services increases. This, in turn, rekindles businesses and turns the cycle around from stagnant to active. If, however, there are no reins on this process, the increase in economic productivity can cross over a very fine line and lead to too much money in the market. This excess in supply decreases the value of money while pushing up prices (because of the increase in demand for consumer products). Hence, inflation exceeds the reasonable level. For this reason, fine tuning the economy through fiscal policy alone can be a difficult, if not improbable, means to reach economic goals. If not closely monitored, the line between a productive economy and one that is infected by inflation can be easily blurred.

10.8.2 When the Economy Needs to Be Curbed

…When inflation is too strong, the economy may need a slowdown. In such a situation, a government can use fiscal policy to increase taxes to suck money out of the economy. Fiscal policy could also dictate a decrease in government spending and thereby decrease the money in circulation. Of course, the possible negative effects of such a policy in the long run could be a sluggish economy and high unemployment levels. Nonetheless, the process continues as the government uses its fiscal policy to fine-tune spending and taxation levels, with the goal of evening out the business cycles.

10.8.3 Whom Does Fiscal Policy Affect?

Unfortunately, the effects of any fiscal policy are not the same for everyone. Depending on the political orientations and goals of the policymakers, a tax cut could affect only the middle class, which is typically the largest economic group. In times of economic decline and rising

taxation, it is this same group that may have to pay more taxes than the wealthier upper class. Similarly, when a government decides to adjust its spending, its policy may affect only a specific group of people. A decision to build a new bridge, for example, will give work and more income to hundreds of construction workers. A decision to spend money on building a new space shuttle, on the other hand, benefits only a small, specialized pool of experts, which would not do much to increase aggregate employment levels. One of the biggest obstacles facing policymakers is deciding how much involvement the government should have in the economy. Indeed, there have been various degrees of interference by the government over the years. But for the most part, it is accepted that a degree of government involvement is necessary to sustain a vibrant economy, on which the economic well-being of the population depends.

10.8.4 Meaning of Fiscal Policy

The fiscal policy is concerned with the raising of government revenue and incurring of government expenditure. To generate revenue and to incur expenditure, the government frames a policy called budgetary policy or fiscal policy. Fiscal policy has to decide on the size and pattern of flow of expenditure from the government to the economy and from the economy back to the government. So, in broad term fiscal policy refers to "that segment of national economic policy which is primarily concerned with the receipts and expenditure of central government." The importance of fiscal policy is high in underdeveloped countries. The state has to play active and important role. In a democratic society direct methods are not approved. So, the government has to depend on indirect methods of regulations. In this way, fiscal policy is a powerful weapon in the hands of government by means of which it can achieve the objectives of development.

10.8.5 Fiscal Policy Strategy Statement

After a brief impact of the global economic slowdown in 2008-09, Indian economy recovered quickly recording 8.4 per cent GDP growth in 2009-10and 9.3 per cent GDP growth in 2010-11. The recovery, however, was short lived as growth rate slowed down substantially in the following year, 2011-12 to 6.2 per cent. Fiscal expansionary response which continued since 2008-09 to arrest the growth decline resulted in high fiscal deficits. The continued Euro Zone crisis and gloomy economic trends in major economies contributed adversely, impacting India's exports negatively. This along with the elevated levels of crude prices and high levels of gold imports led to t*he widening of trade gap and Current Account Deficit.* Macroeconomic analysis of India during the years 2010-11 and 2011-12 therefore showed a

trend of rising current account deficit, sticky inflation, falling savings rates, falling investments and even consumption. The uncertainty in global economy along with the monetary policy tightening measures led to a perceptible negative impact on economic growth. As a result of these factors, the growth is estimated to come down to a decade low of 5 per cent of GDP, as per CSO's advance estimates. Last time sub 6 per cent growth was seen in 2002-03, when the growth in GDP was registered at 4 per cent.

The widening trade gap, falling investment and difficult economic situation both domestically and abroad have added to negative outlook on the Indian economy. The rigid inflationary conditions and consequent tightening measures on monetary policy along with negative sentiment on investments and savings have had a deep impact on industrial growth. Discouraging trends in economic growth called for immediate corrective measures and appropriate policy response. Public debate centered around the fact that high fiscal deficit tends to heighten inflation, reduces room for monetary policy actions, and dampens private investment. The sustained high levels of fiscal deficit though required as a counter- cyclical measure to spur growth, has also caused diverse forms of macroeconomic imbalances, which could not be overlooked and immediate corrective measures were called for to contain the likely growth in fiscal deficit during 2012-13 and onwards.

Mid-year course correction with suitable policy response became imminent in the emerging scenario. Fiscal consolidation by way of regulating deficits and cutting expenditure to create positive business environment was immediate need of the hour. Government accordingly appointed Kelkar Committee in August, 2012 to suggest 'Roadmap for Fiscal Consolidation' within one month's time period. Kelkar committee held series of meetings with Ministry of Finance, concerned line ministries and Planning Commission to finalize its report within the given timeframe. Deliberating on various issues facing the economy, Kelkar committee suggested a set of measures to contain the rising trend of fiscal deficit. The committee observed that deficit financing through domestic sources tends to be inflationary. At the same time, twin deficits hypothesis implies that, given a certain level of private savings, an increase in fiscal deficit will have to be balanced by either a reduction in private investment or an increase in the current account deficit. The Indian economy has been witnessing both.

The fiscal stress in the 'do-nothing' scenario as per Kelkar committee report was fast approaching unsustainable levels. On revenue side, slower pace of economic growth implied shortfall in both direct taxes - both corporation and income tax - due to lower profits and incomes. Similarly, slower pace of economic growth meant shortfall on custom duty, being directly linked to imports and excise duty due to slower pace growth in production. Another

matter of concern related to expected shortfall in Non-tax revenue by at least Rupees 30,000 crore on account of lower realization from 2G spectrum following court litigation and poor response to auctions. It was estimated by the committee that the revenue collections in the current year, Tax and Non-tax put together will take a hit by at least Rupees 60,000 crore from the budgeted targets in BE 2012-13. Similarly, international crude prices remained at high levels in the range of US $ 110 to 115 per barrel peaking to above US $ 120 per barrel for some time. As India imports bulk of its crude requirements and the pricing of petroleum products by oil marketing companies(OMCs) for the purpose of calculating under-recoveries are benchmarked to the international prices, there was a significant increase in the estimated under-recovery of OMCs. In tandem with high crude price, prices of most of the petroleum products in the international market went up sharply, and fertilizer bill ballooned due to rising Urea prices. Therefore, it was estimated that the subsidy expenditure would rise by about Rupees 70,000 crore. Accordingly, it was estimated that unless immediate corrective measures are taken the deficit will be well above 6.1 per cent of GDP.

The net effect would be 'crowding-out' of private sector financing for investment due to large gross borrowing requirement. In an extremely fragile world market financing of this magnitude would be creating huge risks for macroeconomic and external stability. Against this scenario and aided by Kelkar committee recommendations, government undertook the task of meeting the challenge. As a first credible step towards fiscal consolidation, the fiscal deficit target was revised from 5.1 per cent to 5.3 per cent for the current year. As per the roadmap of fiscal consolidation laid down by the government the fiscal deficit in 2013-14 has been projected at 4.8 per cent, to be reduced by 0.6 per cent every year to achieve 3.0 per cent target by the end of the plan period, viz. 2016-17. In order to achieve the target for Disinvestment, committee of secretaries was constituted in the Ministry of Finance. Similarly, efforts were made to mop up revenues both tax and non-tax to contain the fiscal deficit within the projected targets. However, shortfall in the customs duty on indirect side and non- realization of targeted. Accordingly, government undertook major exercise of rationalizing both Plan and Non-plan spending to match the revenues. Therefore, with a view to rationalize of expenditure and optimize available resources, measures for economy cut, reduction in plan and non-plan expenditure to reprioritize releases based on implementation schedule and actual requirements based on pace of expenditure etc. were taken to contain public spending within the available resource limits and targeted levels of fiscal deficit. While, government took major steps towards containing its spending and mopping up resources in keeping with fiscal discipline, important steps were also taken to infuse

confidence in the market for growth revival. Government took important administrative decisions including allowing FDI up to 49 per cent in Insurance sector, permitting FDI in multi brand retailing, carrying out amendment in banking regulation laws to allow foreign banks, deferring General Anti-Avoidance Rule etc. Government's pro- active stance in carrying forward reforms along with credible steps to limit spending and contain fiscal deficit has been instrumental in reviving the market sentiments and infusing fresh confidence in the Indian economy, the result of which will be seen to some extent in the next financial year. Revenues from Spectrum sale on the Non-tax side had increase in tax to GDP ratio coupled with lower to be factored in.

10.9 ROADMAP FOR FISCAL CONSOLIDATION

On the expenditure side, government took major decisions to contain government spending on subsidy.The choice was between the devil and the deep sea. Raising diesel and LPG prices to meet the widening gap would have been inflationary in the short run but not passing on the price escalation and thereby increasing fiscal deficit would have only enhanced the fiscal strains. As a result, Government was forced to take corrective measures for increasing in the price of diesel by Rupees five per litre, allowing oil marketing companies (OMCs) to raise diesel prices by small amounts regularly, and a cap on the number of subsidized LPG cylinders. The rationale was that the current level of fuel subsidy was unsustainable and a gradual increase in prices over extended period of than budgeted expenditure has demonstrated government's ability to rein in the escalating fiscal deficit. The step was much needed and removed substantial gloom in the market, as it provided some leg-room for easing of monetary policy measures by the RBI. Firm action to control public spending and easing of inflationary pressure led to downward revision of interest rates by the Reserve Bank in January, 2013. Easing of 25 basis points on the interest rates, first since April 2012, combined with lowering of Cash Reserve Ratio by another 25 bps provided the much needed fillip to the market sentiments. The mid-course correction undertaken during the year and proposed to be sustained during 2013-14 has been a much needed catalyst much needed for revival of the market confidence and economic growth.

Time would ease the impact on inflation. Reform process under taken in the current year, meant that though the decision will ease pressure on forms the basis of fiscal policy of the government subsidies in due course, in the immediate future during 2013-14. Proactive policy decisions, contained government spending to provide space for private investment, along with reforms to attract capital inflows are expected to be key drivers of growth revival during

2013-14. Accordingly, having made the base corrections on expenditure front, fiscal policy of the government in 2013-14 is aimed at continuing with

the trend by providing for an affordable and realistic growth of 6.6 per cent for Plan expenditure. At the same time, revenues are targeted to grow at an improved 10.9 per cent of the GDP, through additional resource mobilization as well as bringing out improvements in overall tax administration, thereby bringing down the fiscal deficit to the projected levels of 4.8 per cent.

10.9.1 FRBM Act - Rules Notified

As part of amendments to the FRBM Act, 2003, carried out as part of the Finance Bill, 2012 one of the key changes related to the laying of a Medium Term Expenditure Framework (MTEF) in the Parliament, in the Session immediately following the Budget session. The objective of the MTEF statement is to have a closer integration between the expenditure and medium term fiscal targets planned by the Government. The MTEF sets forth a three-year rolling target for the expenditure indicators along with specification of underlying risks and assumptions involved. Projections made by the Government over a three year framework are vertically expanded for the expenditure side in the statement for various sectors. The statement gives confidence to administrative Ministries / Department of certainty of allocations over a medium term framework for better planning of activities under various government programmes.

In pursuance of the above amendments MTEF statement was laid for the first time in Monsoon session in September, 2012 before the Parliament. The statements contained a three year expenditure framework for various sectors viz. Education, Health, Energy, Rural and Urban development and Transport etc. and were shown separately for revenue and capital expenditure. The fiscal deficit targets adopted in the roadmap formed the basis of the new FRBM Rules notified. Accordingly, government laid down that the fiscal deficit will be contained within 5.3 per cent in 2012-13, with gradual reduction of 0.5 per cent to achieve 4.8 per cent in the year 2013-14 and followed by 0.6 per cent reduction in subsequent years to achieve the target of 3.0 per cent level in 2016-17. Further, the target of Revenue deficit have been reset to bring it down to below 2.0 per cent by 2015-16 and to eliminate Effective Revenue Deficit in the same time period.

The concept of effective revenue deficit was introduced in the Budget 2010-11. It effectively brings out structural problems in the revenue expenditure in federal set-up and attempts to resolve these by laying greater emphasis on development related expenditure at field level.

Coupled with fiscal deficit target, this fiscal indicator would ensure allocation of borrowed resources in productive sector through creation of capital assets and at the same time would bring the debt and liabilities as percentage of GDP to a more sustainable level. The emphasis to eliminate effective revenue deficit by 2015-16, and generate adequate surplus thereafter would help in augmenting resources for financing investment and capital expenditure (including grants for creation of capital assets).

The Budget 2013-14 is being presented in the backdrop of a decade low GDP growth rate and continuing uncertainties in the global economic scenario. Government is faced with the unenviable task of providing a kick start to the revival of growth process by continuing reforms to attract investments and manufacturing while at the same time vacate space for private investments through adequate fiscal consolidation measures.

10.10 FISCAL POLICY FOR 2013-14

The fiscal policy of 2013-14 has been calibrated with two fold objectives - first, to aid economy in growth revival; and second, to bring down the deficit from 2012-13 level so as to leave space for private sector credit as the investment cycle picks up. Having undertaken mid-year course correction to contain government spending within sustainable limits during the current financial year, Budget 2013-14 provides for a measured increase in plan expenditure by 6.6 per cent over the budgeted estimates of last year. However, this marks an increase of 29.6 per cent over the revised estimates of 2012-13. A growth of 10.8 per cent has been provided for Non-plan expenditure in BE 2013-14 over RE 2012-13 keeping in view the requirements for Defence, Subsidies, Interest payments, Finance Commission Grants and increase in salaries and pensionary payments etc. This would result in overall expenditure increase of 16.3 per cent in BE 2013-14 over RE 2012-13. As a result of these measures, fiscal deficit is estimated to come down to 4.8 per cent of GDP, in keeping with the revised roadmap for fiscal consolidation announced by the government. As percentage of GDP, total expenditure is estimated to remain at same level in BE 2013-14 as in RE 2012-13 at 14.3 per cent.

Apart from containing growth in expenditure, the reduction in fiscal deficit is planned to be achieved in conjunction with targeted revenue augmentation both through tax and non-tax revenues. Tax to GDP ratio estimated at 10.7 per cent of GDP in BE 2012-13 is estimated to fall to 10.4 per cent of GDP in RE 2012-13, due to slowdown in economic growth. Tax to GDP ratio is estimated to increase to 10.9 per cent in BE 2013-14, with the growth of 19.1 per cent over RE 2012-13. Substantial growth of 32.8 per cent has been provided for non-tax

revenue in BE 2013-14 as compared to RE 2012-13. However, this has to be seen against the fact that RE 2012-13 was substantially lower than BE 2012-13 due to shortfall from 2G spectrum sale. Compared to BE 2012-13, an increase of 4.6 per cent has been provided which is as per the trend for Non-tax receipts over last several years.

On the expenditure front, apart from measures taken to control increase in spending, certain key policy decisions relating to subsidies have been taken by the Government. Apart from measures taken to reduce fuel subsidy through deregulation of diesel prices in a phased manner and capping of subsidized LPG, there is need to look at revision of Kerosene prices also. These measures are expected to substantially bring down under recoveries and the resultant fuel subsidy requirements to sustainable levels. On the fertilizer side, decision to move towards nutrient based subsidy (NBS) regime along with recent trends of softening in the rates of imported fertilizers is expected to contain the requirements on fertilizer subsidy in 2013-14. Further measures by revision of prices are overdue.

As regards Food subsidy, Government stands committed to extending food security to all and take adequate measures to carve out fiscal space for its adequate provisioning. 'National Food Security Bill' was introduced in Parliament in 2011 and was subsequently referred to Standing Committee on Food, Consumer Affairs and Public Distribution in January, 2012. After completing the process of deliberation with various stakeholders viz. State Government / UT administration, Central Ministries/ Departments and other individuals / organization, the Standing Committee presented its report on the Bill in January, 2013. Various recommendations related to coverage, entitlement, improvement in identification process and delivery systems have been made by the Standing Committee. Government after giving due consideration to the recommendation will be making suitable changes to the 'National Food Security Bill'.

While there will be additional funding requirements on account of the proposed 'National Food Security Bill' it will be the endeavor of the Government to ensure better coverage through improved operational efficiency. In this regard Government has taken measures to reduce the cost of working capital of Food Corporation of India (FCI) by extending Ways and Means advance at lower cost. Measures will also be taken to reduce the administrative cost of FCI in food grains delivery to offset the additional food subsidy requirements to the extent feasible. As per the recommendations of the Standing Committee, Government will support non-procuring States to strengthen their procurement machinery by creating suitable institutional mechanism and by adopting Decentralized Procurement Scheme (DPS) and also by leveraging food credit facilities offered by RBI. Government shall be pursuing with the

State Governments to adopt DPS system for more efficient food grains management and lower cost of delivery to entitled population. Sufficient provision has been made to accommodate additional food subsidy requirements on account of the National Food Security Bill, planned to be implemented during the financial year 2013-14. It is estimated that the incremental requirement on account of Food Security Bill in the initial year will be limited, but will go up in the subsequent years after full scale implementation.

10.11 TAX POLICY

During the fiscal consolidation period, the tax- GDP ratio improved significantly from 9.2 per cent in 2003-04 to 11.9 per cent in 2007-08. This has been achieved through rationalization of the tax structure (moderate levels and a few rates), widening of the tax base, and reduction in compliance costs through improvement in tax administration. The extensive adoption of information technology solutions and reengineering of business processes has also fostered a less intrusive tax system and encouraged voluntary compliance. These measures resulted in increased buoyancy in tax revenues till 2007-08 and helped in achieving fiscal consolidation through revenue measures alone. Due to the stimulus measures undertaken largely on the tax side during the global economic crisis in 2008-09 and 2009-10, as a measure to insulate Indian economy from the adverse impacts of global economic crisis and slow down in domestic growth, the gross tax revenue as percentage of GDP declined sharply to 9.7 per cent in 2009-10.

Further, due to high international prices and as a measure to insulate consumers and to reduce under recoveries government had to further reduce taxes/ duty on petroleum products in 2011-12. As a result the gross tax receipts as percentage of GDP in 2011-12 declined to 9.9 per cent from 10.2 per cent in 2010-11. However, with partial roll back of stimulus measures in indirect taxes, it was estimated that tax receipt as percentage of GDP would improve to 10.7 per cent in 2012-13. With moderation of growth rate in 2012-13, the tax-GDP ratio has been revised to 10.4 per cent. Continuing on the path of fiscal consolidation with a view to narrow the gap in government spending and resources, the tax-GDP ratio has been targeted at 10.9 per cent in the BE 2013-14 with a growth rate of 19.1 per cent. This includes additional resource mobilization, while maintaining pro-growth stance.

10.11.1 Indirect Taxes

In keeping with the overall thrust of fiscal policy, in the realm of indirect taxes also, the stance during 2013-14 would be in favour of further fiscal consolidation, stability in duty rates, rationalization of duty structure by way of withdrawal of certain exemptions without

increasing the tax burden on common man. This is in line with the medium term objective of enhancing the tax-GDP ratio both through base expansion as well as administrative improvement.

In the medium term, the most significant step from the point of view of broadening the tax base and improving revenue efficiency through better compliance is the introduction of Goods and Services Tax (GST). As far as Central taxes viz. Central Excise duties and Service Tax are concerned, a fair amount of integration has already been achieved, especially through the cross-flow of credits across the two taxes. It would be possible to realize full integration of the taxation of goods and services only when the State VAT is also subsumed and a full-fledged GST is launched.

There are several specific proposals in the Budget 2013-14 to recalibrate the tax effort on indirect taxes so that fiscal consolidation may be achieved in the short term. The important and revenue significant proposals include:

- ♦ Increase in excise duty on mobile phones of retail sale price exceeding Rupees 2000 from 1 per cent to 6 per cent.
- ♦ Increase in excise duty on SUVs from 27 per cent to 30 per cent.
- ♦ Increase in basic customs duty on high end motor cars from 75 per cent to 100 per cent.
- ♦ Increase in excise duty on cigarettes.
- ♦ Increase in basic customs duty on Set Top Boxes from 5 per cent to 10 per cent.
- ♦ Imposition of basic customs duty on steam coal at 2 per cent, and CVD at 2 per cent. On bituminous coal, basic customs duty is being reduced from 5 per cent to 2 per cent and CVD from 6 per cent to 2 per cent.
- ♦ Increase in basic customs duty on raw silk from 5 per cent to 15 per cent.
- ♦ Levy of export duty on bauxite and unprocessed ilmenite at 10 per cent, and on upgraded ilmenite at 5 per cent.
- ♦ Increase in excise duty on marble slabs and tiles from Rs. 30 per square metre to Rs. 60 per square metre.
- ♦ To allow one time voluntary compliance encouragement scheme by way of waiver of interest and penalty, to stop filers, non-filers, non-registrant and service providers who have not disclosed true liability in the returns filed by them during the period from October 2007 to December 2012.
- ♦ Imposition of service tax on all air-conditioned restaurants.

Government had earlier revised the customs duty on standard gold bars from 4 per cent to 6 per cent, with a view to contain the impact of gold imports on the Current Account Deficit. It is expected that the decision will also have a favourable impact on revenue collections in the immediate future. It is Government's objective to provide non-adversarial tax administration by simplifying, rationalizing and modernizing customs, central excise and Service tax procedures.

10.11.2 Direct Taxes

Government policy on Direct taxes has been to achieve growth while maintaining a regime of moderate tax rates. Tax collection is the product of two factors - tax rates and tax base. There will be no change in the rate of personal income tax and the rate of tax for the domestic and foreign companies in respect of income earned in the financial year 2013-14. Additionally, surcharge has been proposed under various categories.

Expansion of tax base is a continuous process and involves measures on both legislative and administrative fronts. Major policy proposals in the Union Budget 2013-14 intended to broaden tax base are:

- ♦ Tax Deduction at Source at the rate of 1 per cent on immovable property (other than agricultural land) having value exceeding Rs. 50 lakhs.
- ♦ Final withholding tax on unlisted companies at the rate of 20 per cent on the income distributed to shareholders through buy back of shares.
- ♦ Commodities Transaction Tax is proposed to be levied on sale of commodity derivative at the rate of 0.01 per cent.
- ♦ Tax on payments by way of royalty and fees for technical services to non-residents to be raised from 10 per cent to 25 per cent, however, DTAA rates if lower will apply.
- ♦ It is proposed to provide that where the stamp duty value on transfer of immovable property held as stock in trade is greater than the sale consideration, the stamp duty value will be considered as full value of consideration.
- ♦ General Anti-Avoidance Rule has been deferred till 31st March, 2016.

The administrative and information technology initiatives are:

- ♦ Extensive use of technology is being made for collection of information without intrusive methods. 360 degree profiling of taxpayers and potential taxpayers is being done for gathering information regarding their sources of income and spending habits. Information technology tools are being developed for exhaustive collection of information and maintenance of database. Information collected from returns of

income and other sources is collated and specific targeted action can be taken against tax evaders.

♦ The large tax payer units are being expanded. The CPC at Bangaluru has become fully functional and CPC-TDS at Vaishali Ghaziabad has also gone live recently.

Tax buoyancy has come down to less than one, meaning thereby that tax collection has failed to keep pace with the growth in GDP. This is more pronounced in the corporate tax collection than in Personal Income tax collection. It is mainly due to the fact that net profitability of businesses and trade has been diminishing on account of rising inflation as compared to real GDP growth rate and higher cost of funds borrowed. These factors of inflation do not affect wages which mainly contributes to personal income tax collection.

10.11.3 Contingent and other Liabilities

The FRBM Act mandates the Central Government to specify the annual target for assuming contingent liabilities in the form of guarantees. Accordingly, the FRBM Rules prescribe a ceiling of 0.5 per cent of GDP for incremental guarantees that the Government can assume in a particular financial year. The Central Government extends guarantees primarily for the purpose of improving viability of projects or activities undertaken by the Government entities with significant social and economic benefits, to lower the cost of borrowing as well as to fulfill the requirement in cases where sovereign guarantee is a precondition for bilateral / multilateral assistance.

For better management of contingent liabilities, Government guarantee policy enumerates various principles which need to be followed before new contingent liabilities in the form of Sovereign Guarantees are undertaken. As guarantees extended by Government have the risk of its devolution on Government, the proposals are examined in the manner of a loan being taken directly by Government. The principles enunciated in the policy lay down framework for minimization of risk exposure of sovereign while undertaking these contingent liabilities. The principles include assessment of risk including the probability of a future payout, priority of the activity, institutional limits on guarantee for limiting exposure towards select sectors and reviewing the requirement of guarantee vis a vis other forms of budgetary support or comfort. Additional measures to further streamline the process of assuming risk could include charging of risk based premia disincentive for willful default, other part sharing of risk by the Government and insisting on guaranteed debt cost to be near the bench marked Government Securities rate.

The Stock of contingent liabilities in the form of guarantees given by government has increased in absolute terms from Rupees 1,07,957 crore at the beginning of the FRBM Act regime in 2004-05 to Rupees 1,90,518.70 crore at the end of 2011-12. FRBM ceiling on guarantees which can be assumed by Government during a FY has resulted in reduced contingent liability to GDP ratio. Ratio which stood at 3.3 per cent in 2004-05 is now reduced to 2.1 per cent in 2011-12.

The disclosure statement on outstanding Guarantees as prescribed in FRBM Rules, 2004 is appended in the Receipts Budget at Annex 5(iii). During the year 2011-12, net accretion to the stock of guarantees was Rupees 39, 515.70 crore, amounting to 0.44 per cent of GDP, which is within the limit of 0.5 per cent set under the FRBM Rules.

Government is also assuming liabilities for financing its activities by entering into annuity projects in respect to some infrastructure development activities. The commitments so made in these projects will occupy the fiscal space for future Governments and due care needs to be exercised in assuming these liabilities for the sake of intergenerational equity. As part of amended FRBM Rules, Government discloses its committed liabilities towards such projects including project costs and annual payouts under the annuity projects. These commitments on account of ongoing Annuity Projects under Ministries/ Departments are disclosed in the prescribed format in Receipts Budget at Annexure-8. The annuity projects contracted by Government have a total committed value of Rupees 1,01,146.69 crore with annual payment of Rupees 6,530.63 crore.

10.11.4 Government Borrowings, Lending and Investments

Status Paper on Government Debt is published annually to improve transparency in dissemination of information related to public debt. The third edition of the document will be published in March, 2013. Prudent debt management is corner stone of good economic policy and experience in other part of the world has shown that vulnerability of debt profile to international shocks needs to be closely monitored in emerging global economic order. In India, debt policy is driven by the principle of gradual reduction of public debt to GDP ratio so as to further reduce debt servicing risk and create fiscal space for developmental expenditure. Indian debt profile is characterized by reliance on domestic market borrowings, with market determined rates rather than administered rates. Development of deep and wide secondary market for Government securities is one of the key reforms in this regard. Another important decision is to establish an independent Debt Management Office (DMO) in Ministry of Finance. While government is in process of introducing necessary legislation,

Middle Office has been established in the interlude. The office is assisting government in issuance of calendar for borrowing and advice on selection of instruments and other related matters. One of the key features on country's debt profile is diminishing proportion of external debt as percentage of total borrowing. Proportion of external debt in the Central Government debt has declined consistently in the recent years from 10 per cent in 2005-06 to 7.9 per cent in 2010-11. External borrowing is limited to bilateral / multilateral loans from select development partners for financing development projects. It has been decreasing in view of their exposure norms and income norms and the only significant bilateral partner as on date is Japan. The external funding has reduced significantly in RE 2012-13, as many projects are in inception stage and could not come up for payments while repayments were as per schedule, resulting in decline of net financing. The BE 2013-14 for external debt has been retained at BE 2012-13 level. With gradual decline in net inflow from Multilateral Institutions in the coming years, government would have the option of exploring other sources of external debt for example in the form of sovereign bond issuance to maintain a reasonable mix of domestic and external debt in its portfolio.

Apart from greater focus on market borrowings, the *Government is also moving toward alignment of administered interest rates with the market rates*. Interest rates on small savings are now linked with yields in secondary market for dated securities. The interest rates for every financial year are notified before 1st April. Collections under various small saving schemes, net of withdrawals, during the financial year form the source of funds for National Small Savings Fund (NSSF). The net collection is invested in Central and State Government Securities as per the recommendation of the Committee on Small Savings constituted in July, 2010. Redemption of these securities is reinvested in Central and State Government Securities in 50:50 ratio at prevailing rate of interest. States are provided excess interest relief based on their compliance with fiscal targets in respective FRBM Act. Interest payment to subscribers and cost of management constitute the expenditure under the fund and interest on Central and State Government Securities forms the income of the fund.

In 2012-13, net market borrowings at Rs. 4,79,000 crore were budgeted to finance 93.3 per cent of gross fiscal deficit during 2012-13. Other sources of financing such as external assistance, state provident funds and National Small Savings Fund (NSSF) were budgeted to finance the remaining 6.7 per cent of GFD. During 2012-13, there was net inflow in the small savings account. However, as the net collection is invested in Central and State Securities as per the committee's recommendation and Thirteenth Finance Commission (FC-XIII) norms, the amount was required to be invested in State securities and net financing for Central

government was reduced at the RE stage. As a result of lower realization than budgeted from external debt and small savings, and also to meet revised fiscal deficit target of 5.2 per cent, the net borrowing from Auction Treasury Bills (ATBs) was increased by Rs. 20,000 crore viz. from BE 2012-13 of Rupees 9,000 crore to Rupees 29,000 crore.

However, fiscal position during the year remained mostly within the budgeted framework as a result of Government initiatives towards containing expenditure through economy measures and rationalization of plan and non-plan expenditure as well as optimum revenue mobilisation through improved compliance. The finances of State governments also reflect contained fiscal deficit as indicated by build-up of cash balances and increased investments in Central Government treasury bills. In 2012-13 Central Government also had additional cushion of higher opening cash balance at the beginning of the year. These factors enabled the Central Government to reduce its market borrowing for the year by Rupees 12,000 crore to Rupees 4,67,000 crore for fiscal year 2012-13. Borrowings programme for the year was completed smoothly in line with preannounced calendar for borrowings. The weighted average yield of primary issuance of dated securities during 2012-13 was lower at 8.36 per cent as compared with 8.52 per cent in the previous year while weighted average maturity increased to 13.50 years as against 12.66 years in the previous year.

Pursuing with Government's commitment to carry on with the fiscal consolidation measures, the fiscal deficit for 2013-14 is budgeted to decline to 4.8 per cent of GDP. Total borrowing requirement for 2013-14 has been budgeted at Rupees 5,42,499 crore or 4.8 per cent of GDP. Net market borrowings of Rupees 4,84,000 crore has been budgeted to finance nearly 89 per cent of fiscal deficit. In absolute terms, net borrowing is increasing by 3.6 per cent over the previous year. In terms of GDP, however, they are budgeted to decline to 4.3 per cent as compared with 4.7 per cent in the previous year. Borrowings under other sources of financing are budgeted to remain relatively insignificant during 2013-14. A large share of market borrowings is subscribed by the commercial banks, which maintains investment in government securities at around 30 per cent of their aggregate deposits. As year on year growth in aggregate deposits of banks at 13.1 per cent (as on January 25, 2013) much higher than the growth of 3.6 per cent in estimated market borrowings, it is expected that the budgeted market borrowings for 2013-14 will not put any pressure on the markets and ample resources will be available for private investment.

In terms of debt financing, the borrowings strategy during 2013-14 will continue to rely on domestic sources with external sources financing only 2.4 per cent of the fiscal deficit. About 97.6 per cent of GFD of Rupees 5,42,499 crore would be financed from the domestic

sources. Borrowing strategy will continue its focus on raising resources through on market oriented instruments to meet both the short-term and medium term borrowings requirements of the Government. Apart from Rupees 4,84,000 crore proposed to be raised through dated securities, a provision of Rupees 20,000 crore is also made to be realised through treasury bills. In addition to providing a greater manoeuvrability for cash management, treasury bills also provide benchmark and momentum to trading activity in the money market therefore facilitating the financial and corporate sector in meeting their short term cash requirements. In addition, Small Savings, State Provident Fund and other receipts from Public Account would finance remaining portion of the deficit, about 6.3 per cent of the deficit.

There is no balance estimated at the end of financial year 2012-13 under Market Stabilization Scheme (MSS). Net accretion in MSS to the tune of Rupees 20,000 crore is however estimated in BE 2013-14. 41. Total liabilities of the Government, as a percentage of GDP, will also see a decline continuing with the trend in the recent past. At end of 2012-13, a total liability of the Government is estimated at 45.9 per cent of GDP which will reduce to 45.7 per cent by the end of 2013-14. Continuing the declining trend it is likely to reduce to 44.3 per cent in 2014-15 and 42.3 per cent in 2015-16. A progressive reduction in debt-GDP ratio of the Government will ease the interest burden and allow more space for the government to spend particularly on infrastructure development without taking recourse to additional borrowings.

Gross fiscal deficit is projected to decline progressively to 4.8 per cent of GDP in 2013-14. The MTFP statement projects a further decline in GFD to 4.2 per cent by 2014-15 and to 3.6 per cent by 2015-16. Assuming market borrowings financing at about 90 per cent of the GFD, the net market borrowings are likely to decline significantly in next three years to 4.3 per cent of GDP in 2013-14, 3.8 per cent in 2014-15 and 3.2 per cent in 2015-16. With contraction of government deficit there will be more room for private investment and capital inflows. This will also ease inflationary pressure providing comfort to RBI for easing monetary policy.

As part of debt management strategy it has been decided to introduce buy-back / switches of government securities in order to reduce the redemption pressure from the maturity buckets 2014-15 to 2018-19. The decision has to be seen in the context that redemption presently in the range of Rupees 90,000 crore will continue at level of Rupees 95,000 crore in 2013-14. However, it will rise to Rupees 1,68,000 crore in 2014-15 and maintain above Rupees 2,00,000 crore thereafter. Buy-back is essentially liability management option which is not only budget neutral but also cash neutral. Only impact that it will have is to the extent of

premium discount on net issuance. Since securities are swapped or re-issued, the transaction will have no net impact on monetary liquidity. Buy back options helps in managing rollover risk and to create space for issuance in corresponding years. Consequently, provision has been made for undertaking buy-back in 2013-14. However, actual operational matters such as amount and timing of buy back will be by the government at appropriate stage, depending on fiscal and market situation.

As per the decision taken by the Government disinvestment proceeds from Central PSUs from the financial year 2013-14 onwards will be used only for select capital investments. Accordingly, specific schemes financed till now from National Investment Fund (NIF) will henceforth be financed from the gross budgetary support. It has now been decided by Government that disinvestment proceeds from FY 2013-14 will get credited to the public account under the head National Investment Fund (NIF), and would remain there until withdrawn/invested only for the approved purposes. During 2013-14, Government proposes to finance "Recapitalization of Public Sector Banks (PSBs)" and investments in Railways for modernization and other capital projects from NIF. By using disinvestment proceeds for above purposes Government will only change the nature of capital assets owned by it as the disinvestment proceeds by reduction in capital assets of Government on one side will be matched by increase in the stock of its capital assets in other approved areas.

10.11.5 Initiatives in Public Expenditure Management

The most important public expenditure management initiative taken by the Government relates to its reversal of policy from fiscal expansion to fiscal consolidation. The public expenditure management through fiscal consolidation required major initiatives to contain government spending without affecting developmental and welfare programmes. With economic growth rate slowing, it was imperative that government spending particularly for the vulnerable section of the society continues, to provide effective protection against inflation in a difficult year. Thus the rationalization of expenditure had to be carried out judiciously rather than indiscriminately. A number of important initiatives have been taken towards fiscal consolidation largely with the aim of containing fiscal deficit, by taking appropriate measures particularly on the front of expenditure control, as brought out in earlier paragraphs and optimization of revenue collections both on the tax and non-tax side.

The quarterly exchequer control based cash and expenditure management system which inter alia involves preparing a Monthly Expenditure Plan (MEP) was extended initially from 23 Demands for Grants during 2011-12 to additional 23 Demands for Grants with effect from

2012-13. However, it was subsequently extended to all Demands for Grants. Further, IT based application with the MIS system from e-lekha/Central Plan Scheme Monitoring System (CPSMS) of the Controller General of Accounts was effectively used to monitor and evenly pace the plan expenditure during the year and also to avoid rush of expenditure at the year end. The practice of restricting the expenditure in the month of March to 15 per cent of budget allocation within the fourth quarter ceiling of 33 per cent was not only enforced rigorously, but also made applicable to Schemes-wise expenditure rather than limiting it to Demand as a whole. The emphasis was on right pacing plan expenditure by ensuring adequate resources for execution of budgeted schemes. Instructions were issued for strict adherence to rules on Utilization Certifications including linking of releases to the utilization of existing funds. This helped in prioritization of spending and avoiding undue parking of funds during the year. It was ensured that all programmes at implementation stage are provided adequate funds but at the same time avoiding excess releases merely on account of allocations. With modern technology at command, there is no need for withdrawing funds much in advance of actual expenditure requirements. It was impressed upon Ministries/Departments that funds may be released keeping in view the actual requirements. Austerity measures on Non-plan expenditure were also strictly enforced. Surplus funds lying with implementing agencies were also asked to be accounted for mandatorily at the stage of next release. Defence expenditure was also rationalized through reprioritization and keeping in view the actual fund requirements by taking into account the unutilized balances lying with its PSEs from the earlier government advances.

Rationalization of expenditure exercise thus undertaken also needs to be seen against the fact that a very ambitious plan outlay was provided in BE 2012-13, which was 22.1 per cent higher than RE 2011-12 and 26.3 per cent above 2011-12 Actuals. However, 2012-13 being the first year of the twelfth five year plan, many of the new schemes were at the preparatory/ take-off stage and it was not possible to incur expenditure of full scale magnitude in the very first year. Further, in many cases the releases were being made in advance of actual expenditure requirements leading to piling of funds in the pipeline. Given the fact that on the amount being kept idle in pipeline, government has to incur additional interest liability, it became imperative to curb such tendencies. With the help of modern technology and the real time availability of information on status of fund utilization and balances available, it became easier to improve the cash/fiscal management through timely release of adequate funds and avoidance of parking of funds without actual requirement. Further, exercise on prioritization of expenditure was undertaken to implement need based releases without compromising on

thrust programmes/ areas. The approach yielded result, and helped in containing government spending within the targeted levels of fiscal deficit. The aforementioned steps not only helped in rationalizing government spending but also enabled base correction essential to contain government spending at sustainable levels. Having achieved the task, it was imperative that the consolidation thus achieved is carried forward in 2013-14. Task of fiscal consolidation has accordingly been carried out yielding good results in terms of containing fiscal deficit as per projections made, providing positive outlook to the economy as a whole.

While designing programmes and schemes for the XII Five Year Plan, government would be benefitted from the recommendations of the Expert Committee to streamline various Centrally Sponsored Schemes and reduce their numbers only to the critical areas. Further, the recommendation of the Expert Committee on the issue of plan and non-plan classification is being examined. The recommendation regarding direct releases to State Treasury would be gradually encouraged for various Centrally Sponsored Schemes. The proposal is being implemented by Planning Commission in consultation with line Ministries and is expected to make Central schemes more lean and effective.

Government has taken important decisions to streamline petroleum subsidy. However, there is need to target both fuel and fertilizer subsidy to benefit directly to the deserving. The Government of India provides Kerosene at subsidized prices to BPL families under the Public Distribution System (PDS). There is overwhelming evidence that this approach is resulting in waste, leakage, adulteration and inefficiency. Therefore, it is imperative that the system of delivering the subsidized Kerosene be reformed urgently. The system of provision and delivery of subsidized LPG to intended beneficiaries needs to be similarly reformed. Fertilizer subsidy, as it exists today, is available to all farmers. It is not possible to differentiate the segments for which the subsidy should be given in this sector. There is a need to evolve a suitable mechanism for direct subsidies to individuals who are entitled to them. Similarly, delays and leakages in respect of various welfare schemes of the Government have been an area of concern. As a result Government felt urgent need to evolve a suitable mechanism for transferring subsidies and benefits directly to the entitled individuals/families. Based on the decision taken in the meeting of the National Committee on Direct Cash Transfers held by the Prime Minister, Direct Benefit Transfers has been rolled out from 1st January 2013 in 43 identified districts. The purpose of Direct Benefits Transfer is to ensure that benefits go to individual's bank accounts electronically, cutting down delays, channels and diversions. Further, Pilot projects in respect of direct transfer of subsidy for LPG and Kerosene have been undertaken. Similar projects for Fertilizers are also being

considered. Based on the lessons learnt there from, Government shall decide about nationwide rollout of the programme. With direct transfer of benefits to the end users, delivery of subsidies can be streamlined through better targeting and administration.

10.12 RAILWAY BUDGET

Railway Budget is presented separately however, the earnings and expenditure and all other major financial figures are incorporated in the General Budget. Government support is provided to Railways in the form of Gross Budgetary Support (GBS) and a return on this investment, called Dividend, is paid every year. The rate of Dividend is determined by the Railway Convention Committee and is presently proposed at 4 per cent. There has been no default in the payment of dividend in the last ten years. Railway revenues are primarily earned through two major traffic streams, passenger and freight. Some earnings are also contributed by parcels, commercial utilization of land, siding charges, advertisement and dividend paid by Railways' PSUs. The earnings are utilized to meet the operating expenses called Ordinary Working Expenses (OWE) and pensionary charges. The remaining surplus is used to pay dividend and balance is ploughed back as plan investment for meeting safety and development needs of the system.

Railways finances improved in the last decade in as much as that it attained the Operating Ratio of 75.9 per cent in 2007-08. This was primarily due to buoyancy in the national economy getting reflected in railway traffic also and the average growth in railway expenditure. However, after 2007-08, the OWE and pension payment soared consequent upon implementation of the 6th Central Pay Commission (CPC), whereas the momentum of growth in earnings witnessed earlier could not be maintained. As a result the Operating Ratio deteriorated to the extent of 95 per cent. The Railway Plan could be sustained by drawing down from the Railway Reserve Funds. In fact, the balances in Railway Reserve Funds became negative to the extent of Rupees 2,100 crore and Rupees 385 crore during 2010-11 and 2011-12 respectively. Ministry of Finance provided a loan of Rupees 3,000 crore in 2011-12 to bridge the negative balances in the Railway Funds. Due to various measures taken including additional resource mobilization through rationalizing the fare and freight tariffs, the financial position of the Railways has started showing signs of improvement in the current year. The revenue earnings of the Railways at Rupees 1,25,680 crore are likely to register a growth of 20.6 per cent in RE 2012-13 over the previous year, whereas the OWE and the pension expenditure at Rupees 1,04,400 crore is estimated to increase by 13.2 per cent. The internal resource generation may improve from Rupees 7,682 crore in 2011-12 to

Rupees 17,469 crore in RE 2012-13. The Operating Ratio in RE 2012-13 is likely to improve to 88.7 per cent. The entire loan of Rupees 3,000 crore has also been returned with interest to general revenues. Traditionally the passenger services of railways have been loss making and the under recovery has exceeded Rupees 20,000 crore. However, some correction has been carried out in 2012-13 in the budget and subsequently in January, 2013. It is likely to generate additional revenues of nearly Rupees 7000 crore in 2013-14.

The plan investment in railways is funded through GBS, internal resources and extra budgetary resources (EBR). The 12th Five Year Plan for railways has been approved at Rupees 5.19 lakh crore, targeting investment of Rupees 1.94 lakh crore through GBS, Rupees 1.05 lakh crore of internal resources and Rupees 2.20 lakh crore of EBR. An amount of Rupees 63,363 crore has been provided in BE 2013-14, as against investment of Rupees 52,265 crore in RE 2012-13. The plan resources are also targeted to be invested judiciously and operationally important projects will be provided assured funding during the 12th Plan. This will help the railways in not only removing the infrastructure bottlenecks but also augment the revenue earning capacity of the system.

10.13 POLICY EVALUATION

The mid-year course fiscal correction led to complete policy reversal from fiscal expansionary model to that of fiscal consolidation. While, in the initial year of global financial crisis in 2008-09, fiscal expansionary policies helped in reviving the growth, subsequent developments called for contraction of government spending. This became especially true with the growing impact of twin deficits, which loomed large on the horizon and there was much debate on government's rising fiscal deficit putting inflationary pressures leading to tightening of monetary policy measures. It was felt that the fiscal expansionary policy will drive economic growth domestically and offset the impact of global crisis was valid in the initial years. However, developments since 2009 have shown that sharp reduction in fiscal deficit coupled with loosening of monetary policy may be the prescription more suitable in present context.

Against this backdrop, Government announced roadmap for fiscal consolidation with a view to limit government spending and provide enough room for encouraging private investment along with continuing reforms process to attract capital investment / inflows. The strategy was to provide confidence to market, reduce inflationary pressure and create room for easing of monetary policy. Government worked towards this goalpost in later part of 2012-13 and intends to take forward the process in 2013-14.

The expenditure and revenues have been thus targeted at realistic levels to retain net market borrowing of the government within comfortable levels. With net borrowing increasing by 3.6 per cent y-o-y basis, there will be sufficient room for banking sector to provide funds for private investments.

Having carried out base correction in 2012-13 to contain public spending and followed with major decisions such as deregulation of diesel prices, capping subsidized LPG etc. the fiscal policy for 2013-14 is aimed at further consolidation of these measures by providing realistic increase in the Plan and Non-plan expenditure. Resource mobilization has also been given due care to narrow the existing gap between potential and actual tax to GDP ratio. The strategy adopted for revival of the economy has the twin objectives of containing government spending to achieve the projected fiscal deficit targets and to carry forward the reforms process to kick start a fresh investment cycle and revive the growth process.

10.14 MAIN OBJECTIVES OF FISCAL POLICY IN INDIA

The fiscal policy is designed to achive certain objectives as follows :-

1. Development by effective Mobilisation of Resources

The principal objective of fiscal policy is to ensure rapid economic growth and development. This objective of economic growth and development can be achieved by Mobilisation of Financial Resources. The central and the state governments in India have used fiscal policy to mobilise resources.

The financial resources can be mobilised by :-

i. *Taxation :* Through effective fiscal policies, the government aims to mobilise resources by way of direct taxes as well as indirect taxes because most important source of resource mobilisation in India is taxation.
ii. *Public Savings* : The resources can be mobilised through public savings by reducing government expenditure and increasing surpluses of public sector enterprises.
iii. *Private Savings* : Through effective fiscal measures such as tax benefits, the government can raise resources from private sector and households. Resources can be mobilised through government borrowings by ways of treasury bills, issue of government bonds, etc., loans from domestic and foreign parties and by deficit financing.

2. Efficient allocation of Financial Resources

The central and state governments have tried to make efficient allocation of financial resources. These resources are allocated for Development Activities which includes

expenditure on railways, infrastructure, etc. While Non-development Activities includes expenditure on defence, interest payments, subsidies, etc.

But generally the fiscal policy should ensure that the resources are allocated for generation of goods and services which are socially desirable. Therefore, India's fiscal policy is designed in such a manner so as to encourage production of desirable goods and discourage those goods which are socially undesirable.

3. Reduction in inequalities of Income and Wealth

Fiscal policy aims at achieving equity or social justice by reducing income inequalities among different sections of the society. The direct taxes such as income tax are charged more on the rich people as compared to lower income groups. Indirect taxes are also more in the case of semi-luxury and luxury items, which are mostly consumed by the upper middle class and the upper class. The government invests a significant proportion of its tax revenue in the implementation of Poverty Alleviation Programmes to improve the conditions of poor people in society.

4. Price Stability and Control of Inflation

One of the main objective of fiscal policy is to control inflation and stabilize price. Therefore, the government always aims to control the inflation by Reducing fiscal deficits, introducing tax savings schemes, Productive use of financial resources, etc.

5. Employment Generation

The government is making every possible effort to increase employment in the country through effective fiscal measure. Investment in infrastructure has resulted in direct and indirect employment. Lower taxes and duties on small-scale industrial (SSI) units encourage more investment and consequently generates more employment. Various rural employment programmes have been undertaken by the Government of India to solve problems in rural areas. Similarly, self employment scheme is taken to provide employment to technically qualified persons in the urban areas.

6. Balanced Regional Development

Another main objective of the fiscal policy is to bring about a balanced regional development. There are various incentives from the government for setting up projects in backward areas such as Cash subsidy, Concession in taxes and duties in the form of tax holidays, Finance at concessional interest rates, etc.

7. Reducing the Deficit in the Balance of Payment

Fiscal policy attempts to encourage more exports by way of fiscal measures like Exemption of income tax on export earnings, Exemption of central excise duties and customs,

Exemption of sales tax and octroi, etc. The foreign exchange is also conserved by Providing fiscal benefits to import substitute industries, Imposing customs duties on imports, etc. The foreign exchange earned by way of exports and saved by way of import substitutes helps to solve balance of payments problem. In this way adverse balance of payment can be corrected either by imposing duties on imports or by giving subsidies to export.

8. Capital Formation

The objective of fiscal policy in India is also to increase the rate of capital formation so as to accelerate the rate of economic growth. An underdeveloped country is trapped in vicious (danger) circle of poverty mainly on account of capital deficiency. In order to increase the rate of capital formation, the fiscal policy must be efficiently designed to encourage savings and discourage and reduce spending.

9. Increasing National Income

The fiscal policy aims to increase the national income of a country. This is because fiscal policy facilitates the capital formation. This results in economic growth, which in turn increases the GDP, per capita income and national income of the country.

10. Development of Infrastructure

Government has placed emphasis on the infrastructure development for the purpose of achieving economic growth. The fiscal policy measure such as taxation generates revenue to the government. A part of the government's revenue is invested in the infrastructure development. Due to this, all sectors of the economy get a boost.

11. Foreign Exchange Earnings

Fiscal policy attempts to encourage more exports by way of Fiscal Measures like, exemption of income tax on export earnings, exemption of sales tax and octroi, etc. Foreign exchange provides fiscal benefits to import substitute industries. The foreign exchange earned by way of exports and saved by way of import substitutes helps to solve balance of payments problem.

10.15 SUMMARY

The objectives of fiscal policy such as economic development, price stability, social justice, etc. can be achieved only if the tools of policy like Public Expenditure, Taxation, Borrowing and deficit financing are effectively used. Though there are gaps in India's fiscal policy, there is also an urgent need for making India's fiscal policy a rationalised and growth oriented one. The success of fiscal policy depends upon taking timely measures and their effective administration during implementation.

10.16 CHECK YOUR PROGRESS

i. A financial system may be defined as a set of institutions, instruments and markets which promotes_____________and channels them to their most efficient use.

ii. A market where short term funds are borrowed and lent is called ____________.

iii. Primary markets are those markets which deal in the new securities and are also known as _______________.

iv. Fiscal policy refers to that segment of national economic policy which is primarily concerned with the_______and__________of central government.

10.17 GLOSSARY

Fiscal Policy: Fiscal policy implies that segment of national economic policy which is primarily concerned with the receipts and expenditure of central government.

Twin Deficits Hypothesis: Twin Deficits Hypothesis implies that, given a certain level of private savings, an increase in fiscal deficit will have to be balanced by either a reduction in private investment or an increase in the current account deficit.

10.18 ANSWER TO CHECK YOUR PROGRESS:

i. savings
ii. money market
iii. new issue markets
iv. receipts , expenditure

10.19 REFERENCES/BIBLIOGRAPHY/ SUGGESTED READINGS

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10.20 TERMINAL AND MODEL QUESTIONS

1. Critically analyse the Fiscal Policy in India.
2. What is the impact of fiscal changes in the economy?
3. Distinguish between money market and capital market.
4. Briefly explain the functions of merchant banks.
5. Discuss the role and functions of Securities and Exchange Board of India.
6. Explain the role and functions of financial system. Also explain the defects of Indian financial system

CHAPTER 11

EXTERNAL SECTOR

11.1 OBJECTIVES

After going through this unit you should be able to :

1. Discuss the role of foreign trade in a country's economic development;
2. Describe the effect of economic growth on a country's structure of foreign trade;
3. Explain the relationship between national income and exports, and national income and imports;
4. Comment on the changing composition of India's exports and imports;
5. Examine the changing character of India's trading partners; and
6. Evaluate the changing structure of India's foreign trade.

11.2 INTRODUCTION

Modern day economies are all open economies; i.e., every country cultivates and promotes economic relations with the rest-of-the-world. Economic isolation and self-sufficiency are things of the past; instead global division of labour is the rule. In face of on-going Information-Technology revolution the world is becoming only a global village. This again underlines the fact that the economic welfare of a country depends as much upon the external environment that a country faces as upon domestic policy changes. A major component of the external sector is foreign trade. We begin the present unit with an understanding of the role of foreign trade in a country's economic growth. We will also examine subsequently in the same unit the changing structure of India's foreign trade and its implications for India's growth process.

11.3 ROLE OF FOREIGN TRADE IN ECONOMIC GROWTH

Foreign trade has worked as an "engine of growth" in the past (Witness Great Britain in the 19th Century and Japan in the 20th, besides others), and even in more recent times, the outward Oriented growth Strategy, adopted by the Newly Industrialising Economies of Asia, Viz. Hong Kong, Singapore, Taiwan and South Korea, has enabled them to overcome the resource constraints of small resource poor underdeveloped economies.

11.3.1 Contribution to Growth

Foreign trade contributes to economic development in a number of ways:

First, foreign trade explores means of procuring imports of capital goods, without which no process of development can start.

Secondly, it provides for free flow of technology, which allows for increases in total factor productivity, and some short run multiplier effects for countries with unemployed labour.

Thirdly, foreign trade generates pressure for dynamic change through (a) competitive pressure from imports, (b) pressure of competing for export markets and (c) a better allocation of resources.

Fourthly, exports allow fuller utilisation of capacity, increased exploitation of economies of scale, separation of production patterns from domestic demand, and increasing familiarity with absorption of new technologies.

Fifthly, foreign trade increases domestic workers' welfare. It does so at least in three ways: (a) larger exports translate into higher wages; (b) since workers are also consumers, trade brings them immediate gains through cheaper imports; and (c) foreign trade enables most workers to become more productive as the goods they produce increase in value.

Finally, increased openness to trade has been strongly associated with the reduction of poverty in most developing countries.

11.3.2 Barriers to Trade

As seen above, foreign trade can make manifold contributions to growth. However, most of the non-oil-producing developing countries, including India, are finding themselves face to face with a number of difficulties on the foreign trade as an "engine of growth". Among these we may specifically mention the following:

Firstly, the demand for primary commodities, which form the principal exports of a developing economy, has not kept pace with the growth of world trade or with income levels in different countries. The world trade in primary commodities has been declining for the last four and a half decades. Primary commodities formed more than 50 per cent of the total exports of the world in the year 1955. This share came down to 35 per cent in 1977 and further 25 per cent in 1998. Four possible factors can explain the phenomenon of the fall in world trade in primary commodities:

(a) the increasing tendency of the market economies to protect their agriculture by imposing tariffs and non-tariff barriers (NTBs, the insistence on 'eco-labelling or similarly the proposed German ban on the use of harmful chemicals in textile goods, are the latest instances);

(b) an inadequate increase in demand for primary commodities in the developed market economies in the wake of industrialisation;

(c) development of synthetic substitutes; and

(d) developed country population growth rates are now at or near the replacement level so that little expansion can be expected from this source.

Secondly, exports of developing economies as a group have been slow to develop. As a result, the share of developing economies in the total world trade has maintained a downward trend. Thus, whereas this share was as high as 31 per cent in 1950, it came down to 14 per cent in 1960 and further to 4.2 per cent in 1993. This decline has been caused by factors like the emergence of trade blocs, restrictive commercial policies and the growth of monopolies. These trends are indicative of the fact that the developing economies have to face foreign trade as a barrier, to overcome, which they may require concerted efforts.

Thirdly, the declining demand for primary products in the developed markets has given rise to the problem of worsening terms of trade of the developing economies. Whereas prices of manufactured goods, especially capital goods, have been rising in the world markets, there has been a tendency for a gradual fall in prices of primary goods. For example, according to a recent UN report, in the past developing countries could get a tractor by exporting two tones sugar, now they have to export seven tones of sugar to get the same tractor. Similarly, according to another estimate 1 to 3 per cent of the GNP was lost by the developing countries due to decreasing prices of non-oil raw materials during the 1980s. Any adverse foreign trade price change works as check on economic development.

Finally, restrictive trade policies adopted by industrialised countries affect prospects for developing country exports of manufactures. Industrialised countries themselves have been faced with serious adjustment problems as a consequence of increased globalisation. Their reaction to this development has taken the form of their insistence on "fair" trade. It is a major development that tends to make it more difficult for developing countries to pull their income levels up by relying to a great extent on international trade and foreign investment.

In short, developing economies face many difficulties in their foreign trade operations. The numerous multilateral initiatives, which have been mounted to tackle these problems, have left them largely unresolved. Therefore, in the given circumstances the developing economies have to evolve a suitable trade policy-mix that may create export outlets and as well may assure supplies of essential imports.

11.4 TRADE POLICY

The term trade policy refers to all the policies that have either direct or indirect bearing on the trade behaviour of a country. The details of the various policies depend upon the broad trade strategy adopted in the country; the trade strategy, in turn, depends upon the broad strategy of development adopted by the planners. For example, if the development strategy is one of giving relatively greater emphasis on development of industry rather than of agriculture, then the trade strategy should be suitably adopted to this development strategy. Two broad types of trade strategies discussed in the literature are the following:

(a) inward-oriented strategy, and

(b) outward-oriented strategy.

Inward orientation is often identified with protectionism and import substitution; outward orientation with free trade and exports promotion. However, in a broader framework, inward-looking and outward-looking strategies may be defined to encompass wider range of activities than mere trade in goods. Inward-looking strategy may then refer to all the policies, which discourage reliance on foreign resources. Under this strategy, in its extreme form, no foreign aid is permissible, no movement of factors of production to or from outside, no multi-national corporation and no freedom in international communication. Such a strategy in some form was in vogue in Russia during its Iron-Curtain Age immediately after the Second World War. However, in the present world economy, such an extreme form of inward orientation hardly exists in any country. The opposite of this extreme form of inward-orientation is the form of outward-orientation in which free movement of capital, labour goods, multinational enterprises, open communication of inward and outward orientation in different degrees are observed. Advocates of outward-orientation argue that openness is useful to bring about good educational effects, new ideas and new techniques, growth of new form of organisation, etc. They believe that free trading encourages learning by trade and implies achievements of dynamic transformation of the economy into higher standards of living. Quotas and other quantitative restrictions on the other hand, interfere with the price mechanism, involve allocative and X-inefficiencies (e.g. failure to minimise costs) create distortions and impede the progress of competitive firms and industries.

As against these arguments the advocates of inward-orientation plead that inward looking policies encourage, indigenous talent, learning to do things by oneself, domestic technological development and suitable range of products, avoiding all the ill-effects of demonstration from the outside world. Given gaps of development between the developing and the developed countries, inward-orientation is advocated as an inevitable policy. Effects

of these two types of strategies on growth of output, employment, income generation and income inequalities could also be of diverse nature, and no general inference can be drawn in this context.

Foreign trade has played a crucial role in India's economic growth. The composition and direction of India's foreign trade has undergone substantial changes, particularly, after the liberalization process which began in the early 1990s. Our major exports now includes manufacturing goods such as Engineering goods, Petroleum products Chemicals and related products, Gems and Jewellery Textiles etc. which constitute over 80 per cent of our export basket. On the other side, major import items constitute capital goods and intermediates which not only support the manufacturing sector but also supply raw materials for the export oriented units.

11.4.1 Trade Policy in India During the Post Independence Period

During the first five years after independence, the country had to led wartime controls. Since our Balance of payment with the dollar area was heavily adverse and an effort was made to screen imports from hard currency areas and boost up exports to this area so as to bridge the gap. This also necessitated India to devalue her currency in 1949. Consequently, the import policy continued to be restrictive during this period. Since then, liberalization of foreign trade was adopted as the goal of the trade policy. Import license were granted liberally. The export policy were also encouraged by relaxing export controls, reducing export duties, abolishing export quotas and providing incentives to exports. This liberalized policy led to a huge increase in our imports but export did not rise appreciably which might have led to fast deterioration in India's foreign exchange reserve then. After assuming the need for reversal of trade policy a re-orientation was made to meet the requirements of planned economic development. A very restrictive import policy was adopted and a vigorous export promotion drive was launched. The trade policy assumed that a lasting solution to the balance of payments problem lies in the promotion and diversification of our export trade. Similarly, import substitution industries should also be encouraged so that dependence on foreign countries is lessened. It was this period that India's trade policy was thoroughly reviewed by the Mudaliar Committee in 1962. The committee felt that developmental and maintenance imports were both essential for a growing economy like India. Therefore the recommendation of the committee led to an import policy of restriction of non-essential goods on the one side and liberalization of imports of essential good on the other was successful to a large extent.

So that the imports were controlled and exports were pushed up. This policy helped to reverse the persistent trade deficit.

Trade policy in India since 1991was mainly aimed to cut down administrative controls and barriers which acted as obstacles to the free flow of export and imports. Therefore, the Government of India decided that while all essential imports like POL, fertilizer and edible oil should be protected; all other imports should be linked to exports by enlarging and liberalizing the replenishment license system. With a view to increase India's share in the international trade, Government of India has been making consistent efforts through various policy initiates an reform measures. Accordingly, foreign trade policy underwent a comprehensive change since 1991. Tariff restrictions have been considerably moderated and presently it is the competition that prevails and not the quotas and tariffs. Efficiency is the benchmark of growth, not merely expansion. Trade policy after 1991 is to facilitate integration of the Indian markets with the rest of the world with a view to enhancing economic growth through global competition and non-competitive controls and protection.

11.4.2 New Foreign Trade Policy(2009-14)

The Union Commerce Ministry, Government of India announces the integrated Foreign Trade Policy (FTP) every year five years. This is also called EXIM policy. This policy is updated every year with some modifications and new schemes. New schemes come into effect on the first day of financial year ie. April 1,every year. The foreign Trade Policy which was announced on August 28, 2009 is integrated policy for the period 2009-14. The policy aims at developing export potential, improving export performance, boosting foreign trade and earning valuable foreign exchange. FTP assumes great significance this year as India's exports have been battered by the global recession.

The major objectives of Foreign Trade Policy 2009-14 are the following

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 export 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 per cent 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 rationalization and efforts for enhance market access across the world and diversification of export markets.

11.4.3 Special Economic Zones (SEZ)

Another major policy issue in the trade sector which created a lot of heat was that of Special Economic Zones. SEZ are growth engines that can boost manufacturing, augment export and generate employment. The Act of SEZ-2005 supported by SEZ rules, came into effect on February 2006. The main objectives of the SEZ Act are generation of additional economic activity, promotion of exports of goods and services, promotion of investment from domestic and foreign sources, creation of employment opportunities and development of infrastructure facilities.

The SEZ require special fiscal and regulatory regime in order to impart a hassle free operational regime encompassing the state of the art infrastructure and support services. The policy is to provide an internationally competitive and hassle free environment for exports and are expected to give a further boost to the country's export. The SEZ rules also provide for simplified procedures for development, operation and maintenance of the SEZ and setting up units in SEZs, single window clearance both relating to Central as well as State governments for setting up of an SEZ and units in a SEZ. Various incentives and facilities are offered to both-units in SEZs for attracting investments into SEZ and for SEZ developer. These incentive and facilities are expected to trigger a large flow of foreign and domestic investment in SEZs, particularly in infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities

11.5 ANALYSIS OF THE GROWTH OF INDIA'S FOREIGN TRADE

A proper analysis of a country's foreign trade can be attempted in its three components part, viz., (a) Volume of trade (b) Composition of grade, and (c) Direction of trade.

11.6.1 Volume of Trade

The volume of trade relates to the size of international transactions. Since a large number of commodities enter in international transactions and their aggregate can be found only by finding their money value, the volume of trade can be measured by finding its value. The trends in the value of trade help to identify the basic forces that may be operating at different periods in the economy. However, mere absolute changes in the value of trade may not be satisfactory guide, hence it is necessary to find the change of value of trade by relating them to two variables, viz.,

(i) share of exports/imports in GDP, and

(ii) share of exports/imports in world trade.

The share of exports/imports in GDP indicters the degree of outward-orientation or openness of the economy in regard to the trade activity. This share reflects in a broad way the nature of trade strategies adopted in the country. The ratio of exports to GDP could be interpreted also to mean supply capability of the economy in regard to exports. It can be called as average propensity to export. The similar ratio between imports and GDP gives the average propensity to import. The share of exports in the world trade indicates the importance of the country as a nation in the world economy. It reflects the market thrust that the country maintains in the world market. Changes in this ratio thus indicate the shift in the position of the comparative advantage of the country.

Further, changes in the value of exports may be compared to the changes in the value of imports. The relationship between these two variables is known as the terms of trade, i.e., the terms at which exports exchange for imports; if the exports value in terms of imports value shows an increase, the terms of trade are said to be favourable. Favourable terms of trade imply that for a given value of exports, a country can import more goods. Conversely, if the terms of trade are unfavourable a country has to give up more exports to procure a given volume of imports.

As provided in our development plans the volume of merchandise trade has been on the rise-trade to GDP ratio has gone up from about 8 per cent in 1950 to about 20 per cent presently. The increase has been caused both by exports and imports.

Table-11.1: Evolution of India's Trade Balances(Rs.Crores)

Period	*Exports*	*Imports*	*Trade balance*	*Trade balance as % of GDP*
1951-52	716	890	-174	1.7
1956-57	605	841	-236	4.8
1961-62	642	1122	-480	3.7
1966-67	1157	2078	-921	3.1
1971-72	1608	1825	-217	4.7
1976-77	5142	5074	68	0.1
1981-82	6711	12,549	-5838	3.8
1986-87	10,895	19,658	-8763	3.1
1991-92	32,553	43,198	-10,645	2.1
1996-97	118,817	138,920	-20, 103	1.6
1997-98	130,100	154,176	-24,076	1.7
1998-99	139,753	178,332	-38,580	2.4
1999-00	159, 561	215,236	-55,675	3.1
2000-01	203, 571	230,873	-27,302	1.4
2001-02	209, 018	245,200	-36,181	1.7
2002-03	255,137	297, 206	-42,069	1.8
2003-04	293, 367	359,108	-65, 741	2.6
2004-05	375,340	501, 065	-125, 725	4.4
2005-06	456,418	660,409	-203,991	6.2
2006-07	571,779	840, 506	-268, 727	7.1
2007-08	655,864	1,0123,12	-356448	7.8
2008-09	840,755	1,374,436	-533,680	10.1
2009-10	845,534	1,363,736	-518,202	8.5

Source: Economic Survey; Ministry of Finance, Government of India (2010-11)

Table-1 below presents the growth rates of exports and imports during each of the plans.

11.6.1.1 Value of Exports

India total exports have increased by about 240 times during the last about five decades, from Rs.606 crore in 1950-51 to over Rs.1,41,604/- crore in 1998-99. However, the increase has not been uniform over the period. We can look at plan wise increase in the value of exports to have a clear understanding of the underlying trends. The relevant data is summarised in Table-11.2 below:

Table-11.2 : Annual Average Value of India's Exports During the each of the Plans (Rs. Crore)

PLAN	**VALUE**
First	605.4
Second	605.8
Third	752.8
Fourth	1810.0
Fifth	5346.0
Sixth	8967.0

Seventh	15582.0
Eighth	86270.0

It would be seen that India’s exports were relatively stagnant during the first three plan periods; they picked up some momentum during the Fourth plan period, and in more recent period there has been a dramatic increase in the total value of exports from India. But, as stated earlier, absolute values of exports do not convey much about the state of the economy. For one thing, all of these values are at current prices. These, therefore, do not indicate anything about the change in the total quantum of exports. Secondly, the absolute values do not bring out the changing significance of the export sector *vis-à-vis* rest of the economy. Therefore, in analysing the export performance, we must study the *relative position*. We can employ, presently, two types of comparisons for this purpose, viz.

(a) a comparison with the growth of NNP, and

(b) a comparison with the growth of world exports.

The relevant data for the purpose of two comparisons is given in table 3 below:

Table-11.3: Selected Export Ratio of India

Year	India’s Exports as per cent of	
	World's Export	India's National Income
1950-51	2.20	6.8
1960-61	1.05	4.2
1970-71	0.64	3.8
1980-81	0.42	5.4
1990-91	0.52	6.9
1994-95	0.58	8.9
1995-96	0.64	9.2
1997-98	0.60	9.0

a) Comparison with the growth of National Income

That the rate of growth of exports was slower than the rate of growth of National Income during the initial stages of economic planning is clearly brought out by the fact that the India’s exports as a percentage of India’s National Income fell from 6.2 in 1950-51 to 3.6 in 1970-71.

Table 11.4: India's Exports, Export Growth and share in GDP

Period	Exports (Rs. Crores)	Annual change (%)	Export as % of GDP
1950-51	606	-	6.2
1960-61	642	0.5	3.9
1970-71	1535	9.7	3.6
1980-81	6711	16.3	5.0
1990-91	32, 553	17.5	6.4
1991-92	44,041	35.3	7.5
1992-93	53,688	21.9	7.5
1993-94	69,551	29.9	8.9
1994-95	82,674	18.5	9.1
1995-96	106,353	28.6	9.9
1996-97	118,817	11.7	9.5
1997-98	130,100	9.5	10.4
1998-99	139,752	7.4	8.7
1999-00	159,561	14.2	9.0
2000-01	203,571	27.6	10.7
2001-02	209,018	2.7	10.1
2002-03	255,137	22.1	11.4
2003-04	293,367	15.0	11.6
2004-05	375,340	27.9	13.1
2005-06	456,418	21.6	14.0
2006-07	571,779	25.3	15.3
2007-08	655864	14.71	14.32
2008-09	845534	28.2	15.92
2009-10	845534	0.6	13.79

Source: Economic Survey, Government of India, 2010-11

Subsequently, however, this share has been increasing. It reflects the growing significance of the exports sector in the Indian economy

b) Comparison with the growth of world exports

Again it would be seen from table 3 that India's share in world's total exports nosedived in the initial stages. During the eighties and the nineties, in the wake of picking up by India's exports, there has been some improvement in the ratio, which has varied between 0.50 and 0.65 per cent. These trends indicate the vast possibilities of growth available in the export sector. Many developing countries have recorded export growth rates much higher than that of India. Thus, whereas India's exports (estimated at $ 33,613 million during 1987-89) increased at an annual average rate of 5.9per cent in dollar terms between 1980-92 the corresponding growth rates for some other developing countries like China, South Korea, Malaysia, Pakistan, etc. exceeded 11 per cent. While China's exports have been grown from $ 22 billion in early 1980s

to $ 125 billion now, India's exports have grown from $ 10 billion to $ 25 billion in the same period. India's ranking among the world's export nations slipped form 16th in 1953 to 20th in 1983 and further to 30th presently. It is inspite of the country's natural comparative advantages: low wages, ready access to tropical agro-produce and intelligent and educated workforce, artificially low price of inputs like raw cotton, and, of course, preferential access to OECD markets.

11.6.1.2 Causes of Slow Growth of Exports

We can identify the following as the major causes of the slow growth of India's exports. *First*, India's exports have suffered due to a shortage of supplies and inadequate exportable surpluses. If India is to exploit the situation in the world markets to her best advantage, supplies should not only match demand, but should also leave a cushion in capacity, especially in products where we have a price advantage. In the case of important agriculture commodities there should be built up buffer stocks of adequate size. In manufactured products, it always takes time to create new capacity and a country, which cannot increase supplies at a short notice, may lose markets and sometimes the loss may be beyond repair. It is, therefore, necessary that some built-in surplus capacity, which can take advantage of the world situation at short notice, is kept ready in selected export industries, particularly in those units, which are exporting a sizeable portion of their production.

Secondly, among the fastest growing export products have been the new technology goods such goods formed about half of the total world trade in 1980, a decade and a half- later these constitute more than two-thirds. India has yet to make its mark as an exporter of such goods, except for some recent break through in software exports.

Thirdly, intimately linked with the problem of exportable surplus is the problem of quality control. If the quality satisfies consumer preference, even a higher priced product can be sold in competitive markets. India has not been able to create an image as a supplier of quality goods. The trade is generally opposed to compulsory quality and/or pre-shipment inspection. Sometimes, even after quality control and re-shipment inspection, there have been complaints which suggest that quality control is not thorough. Nothing harms the exports market more than a bad reputation for quality.

Fourthly, the phenomenal technological advance, coupled with the structural diversification of industries, has strengthened the competitive ability of rival

producers in the international markets. Indian exports have been facing acute competition from the newly emerging rival countries, which are quoting prices much lower than what India can. This is primarily because of the fact that the domestic cost of production in India is much higher than what obtains in many other countries. Indian industries have not adequately felt the need to be cost-conscious as they have enjoyed a protected market due to restrictions on imports, high protective duties and a shortage of domestic supplies. Moreover, the productivity in Indian industry is much lower than that of its competitors. Even in the labour-intensive products the Indian cost price structure is not competitive.

Fifthly, inadequate transportation and shipping facilities have stood in the way of export promotion. Although in absolute terms, Indian shipping has made good progress since the planning began, looking at it from the angle of our needs and he vast development of the shipping industry outside, our progress is not encouraging. In addition most of our exports have severe restrictions in respect of berth facilities, navigational aids, harbour and channel depths, communications and handling equipment, which add to delays and increase transport costs. Finally, India's exports like exports from other developing countries are pitted against tariff and non-tariff barriers imposed by the developed countries. Exports are also saddled against emerging regional trading blocs like the EU, NAFTA, Asia-Pacific Rim etc. These will open up opportunities as well as set limitations, but for us there would be plenty of scope only if we can gear up ourselves.

11.6.2 Value of Imports

India's total imports have increased more than two hundred and fifty fold during the last four and a half decades, from Rs.608 crore in 1950-51 to Rs.1,76,099 crore in 1998-99. We can have a look at overall trend in imports during the plan period, as shown in Table 4.

Table-11.4: Annual Average Values of Imports during each Plan Rs. Crore

Plan/Period	Value
First	735
Second	973
Third	1240
Fourth	1973
Fifth	6463
Sixth	14683
Seventh	25114
Eighth	96235

The overall trend of imports has been that of an increase right since 1954-55. While exports have been mainly dependent on world demand and availability of exportable surpluses and very imperfectly amendable to domestic policy measures, imports have been largely a matter of Government policy. The Government's import policy since 1950-51 has fallen into two distinct phases: The first phase extends up to 1957, which broadly corresponds to the period of the First Five Year Plan. In this period a comfortable foreign exchange position, resulting from the release of the sterling balances, led to a progressive liberalization; apart from the discriminating treatment arising out of the universal dollar shortage, imports were largely freed from controls. But they remained at a comparatively low level, the maximum level of Rs.970 crore was reached in 1951-52. The second phase began with 1957-58. Around this time, as is well known, the development strategy adopted by Indian pitched around import substitution.

There were two alternative approaches to the implementation of import substitution:

(a) Use of fiscal and monetary policies such as tariffs, taxes, interest rate policies, etc. which could provide adequate protection to the domestic industry or encouraging competitive production for import substitution

(b) Adoption of physical interventionist policies such as licensing, quotas, banning, etc. of imports and also adopting some tariff measures for providing protection. Import trade control became a regular feature of the country's development strategy. Since then the policy of import trade control has been regularly practised; of course, the degree of control has varied depending upon the circumstances obtaining in the economy.

Initially, the main objective of the import trade control was to save foreign exchange. Over the years, the import trade control has acquired a more positive and wider role in the economic development and industrial growth of the economy. It seeks to facilitate the availability of such imported inputs, which are needed to broaden the base of industrial production and its growth, more especially production for exports.

11.6.3 Imports and National Income:

In discussing the level of imports it is useful to observe the relationship between imports and National Income. In planned economies the development effort is likely to increase imports faster than National Income, because investment as a proportion of national income is stepped up and the import content of investment is high in the early stages of development. This, together with the increased requirements of raw materials, intermediate and capital maintenance imports more than offset the restrictions on consumer goods imports.

The relationship between imports and GDP in India has been more or less stable; imports during the first 30 years of planning generally varied between 6.5 per cent and 8.5 per cent of national income. Again, since 1979-80, this ratio has established itself at a higher level; between 8 and 11 per cent. The stability in import ratio would suggest that there has been little change in imports required per unit of domestic product. It is, however, possible that imports required per unit of output have declined in certain categories and increased in other keeping the overall ratio constant.

11.6.4 Composition of Trade

The composition of trade is indicative of the structure and level of development of an economy. For instance, most of the developing countries depend for their export earnings on a few primary commodities; these countries export raw materials of agriculture origin and import manufactured or industrial products, thus denying themselves the benefits of value added. As an economy develops its trade gets diversified; it no more remains dependent on a few primary commodities. It begins to export more of manufactured industrial goods and import industrial raw materials, capital equipment and technical knowledge how.
The following questions need be analysed in this regard:

(i) What is the degree of concentration of the composition of exports/imports? Has there been any change in the degree of concentration over time ?
(ii) Is there any shift in the share of the primary products and manufactured products in the total export or import trade?
(iii) The commodities entering trade could also be classified by various other criteria such as value added per unit of output, productivity of labour, capital intensity in production, the strength of backward and forward linkages, etc.

The shifts in the commodity composition of trade in these categories would bring out the nature of structural changes in regard to income generation, employment effect and overall industrialization through linkages effects etc. The picture that emerges from the aggregate behaviour of trade value, volumes and prices gets reflected in the composition of trade also.

11.6.4.1 Composition of Exports

The changing composition of exports is brought out by data presented in Table-11.5 below:

Table-11.5: Composition of India's Exports (million)

Groups	1960-61	1970-71	1980-81	1990-91	1998-99	2000-01	2009-10
Agriculture and allied products	284 (44.23)	487 (31.73)	2057 (30.65)	6317 (19.57)	5996 (17.8)	6256 (13.5)	6878 (9.0)
Ores & minerals	52 (0.81)	164 (10.68)	414 (6.17)	1497 (4.60)	891 (2.6)	906 (2.6)	2851 (3.7)
Manufactured goods	219 (45.33)	772 (50.30)	3747 (58.33)	23736 (72.91)	25797 (76.6)	35181 (78.0)	52967 (69.2)
Mineral fuels & lubricants	7 (0.01)	13 (0.01)	28 (0.04)	948 (2.91)	89 (0.3)	1931 (4.2)	10859 (14.2)
Total	642 (100.0)	1535 (100.0)	6711 (100.0)	32539 (100.0)	33,659 (100.0)	31797 (100.0)	76589 (100.0)

Source:Economic Survey, Government of India(various issues)

In Table 11.6 we have grouped the various items of exports in five categories. It would be observed from that

(a) the relative share of agriculture and allied products in total exports in on the decline; and

(b) the relative share of manufactured goods is on the rise.

For more penetrating analysis, we can classify the various exports in three groups, viz.,

i. Export-oriented manufactures, viz., exports through industries which are significantly export-dependent;
ii. domestic-oriented manufactures, viz., exports through industries which largely cater to domestic needs, and
iii. non-manufactures, viz., products which are of a natural or agricultural sector. The relative share of the three groups in total exports has been 53 per cent, 12 per cent and 35 per cent respectively. Apparently, manufactures, and there in too the export-oriented manufactures, have come to dominate our export basket.

For a country aspiring to industrialize, a shift in favour of manufactured exports is good. Rather than diversification being a source of growth for them, our manufactured exports have increasingly got concentrated in a few items. From about a half in 1984-85 close to two-thirds

of all manufactured exports in 1998-99 were accounted for by just three product categories, viz., leather and leather products, textiles and garments, and gems and jewellery.

This can be interpreted both in a positive and a negative manner. On the positive side, the potential of these items, undoubtedly, has by no means been exhausted. In fact, given low wage rates, the country will continue to enjoy its natural competitive advantage in these labour intensive manufactures and we should promote their exports with vigour. But, at the same time, it is obvious by now that future thrust in exports will have to come through items other than these labour-saving manufactures.

Rapid growth in exports can come only through new products in the category of manufactured exports. And within this, for reasons more than one the most dynamic option is offered by the engineering industry.

One, the base of the engineering industry is quite diverse and the country is capable of offering a large variety of finished products and components.

Two, India's engineering exports are barely visible in the global market. This presents a tremendous opportunity for the Indian engineering industry to penetrate the global market.

Three, market penetration is all the easier for we can be competitive in a number of engineering products.

The industry so far as failed globally because it has tried to export products developed for an unsophisticated Indian market. The key to the success lies in how soon the engineering industry can start manufacturing specifically for foreign markets.

11.6.4.2 Composition of Imports

Imports, as already seen above, have been largely governed by the import trade control policy of the Government. Apparently, the composition of imports has been changing in response to the needs of the economy. India's imports can be classified into three parts, viz., (a) consumer goods, (b) raw materials and intermediates, and (c) Capital goods. While the imports of consumer goods have been totally restricted and have been permitted only when required to meet domestic shortage, imports of raw materials, intermediate goods and capital goods have generally increased.

We can observe different trends form Table11.6 below:

Table-11.6: India's Principal Imports Classified by Use (percentage share)

Group	1950-51	1955-56	1960-61	1965-66	1970-71	1975-76	1990-91	1998-99	2000-01	2008-09
Consumer Goods	26.2	19.9	23.9	22.8	13.0	25.3	3.5	5.5	3.7	3.5
Raw Materials & Goods Intermediate	53.6	51.4	46.6	19.8	54.6	52.4	77.8	72.6	33.2	33.2
Capital goods	20.2	28.7	29.5	45.5	24.7	18.3	15.0	21.9	11.0	14.3

Source: Economic Survey, Government of India(various issues)

a) The imports of consumer goods, as already stated, have been allowed when they are required to meet domestic shortages. Among these the more important have been cereals, especially wheat, and pulses. Hence, these imports do not show any systematic pattern. They have been usually high in the year succeeding the bad crop year. Since 1976-77, and these imports have been negligible, primarily because of growing large food grains production during the period 2008-09.

b) The imports of capital goods like machinery and other industrial equipment short up very rapidly between 1995-56 and 1965-66, which correspond to the period covered by the Second Third Plans. It may be remembered that the strategy of growth adopted in our Five Year Plans leaned heavily on the growth of the capital goods industries. This objective could be realised, in the initial stages, only with the help of imports since the domestic industrial structure was not geared to the task. These imports helped to develop capital goods industries, and in course of time the country was in a position to dispense with the imports of these commodities. As a consequence, the share of the capital goods in total imports has shown a continuous fall during the period 1965-90. With the on-set of the economic reforms programme, technological improvement and efficiency became the keyword for industrial survival in the emerging competitive environment. Reduction in custom duties added fuel to the already surcharged economic environment. The response of the Indian entrepreneur has been to equip himself with the latest technology. This has translated into higher imports of capital goods during the period 1991-2009.

c) The group of commodities which has been growing in importance over the years consists of raw materials and intermediate goods most of which are in the nature of maintenance imports. As the growth process moved, shortage and scarcities of different types of raw

materials and intermediate goods began to be felt. These shortages would adversely affect the utilisation of capital goods, but for their imports. Hence, the large imports of these commodities have been allowed. Among these imports, the most significant have been crude oil and petroleum products, fibres, fertilisers and chemical products, iron and steel, and non-ferrous metals.

Maintenance imports include four different categories of imports, viz.,

(i) Raw materials and components required for operating:

  (a) existing industrial and allied capacities at their present level and,

  (b) additions to these capacities which may be expected to take place over a specified period.

(ii) intermediate products such as crude petroleum required for the production of various petroleum products.

(iii) Fertilisers, pesticides and machinery required for increasing agricultural production.

(iv) food imports required for meeting anticipated gaps at existing levels of nutrition.

11.6.5 Direction of Trade

The direction of trade, similarly, is indicative of the structure and level of economic development. As a country develops and its trade gets diversified, it has to seek new outlets for its exports. Its horizon of choice in terms of imports also gets widened. The country begins to trade with an increasingly large number of countries. In this regard, one could ask whether there has been a concentration or dispersion of the markets for exports and sources of supply for imports. It is in terms of these components that we have to study the trends in India's foreign trade during the last four and a half decades of economic planning.

During 2008-09, Asia and ASEAN region accounted for 58 per cent of India's total trade of exports and imports, and is India's largest trading partner region. Europe and America together together accounted for around 43 per cent, with America(North America, Latin America and Carribean region) remaining stable at 12.5 per cent. The regional direction of India's exports has experienced significant changes between 2000 and 2008. First, the share of India's exports in traditional markets such as the EU and North America witnessed a significant decline.

Second, there was a structural shift in favour of Latin America, ASEAN, West Asia, North Africa and South Asia. In terms of growth, India's exports to developing countries accounted for the largest downturn to (-) 0.5 per cent during 2008-09 from 33.6 per cent in 2007-08, which was mainly driven by a sharp fall in exports to China. The second largest deceleration in growth of India's exports was to OECD countries during 2008-09. The US led the

deceleration in exports to OECD countries during 2008-09; nevertheless, the US continued to be the single largest contributor to India's exports.

The UAE has displaced the USA as the topmost destination of India's exports in 2008-09 and 2009-10 with an export share of 13.1 per cent and 14.4 per cent, respectively. India's exports to all the top three export destinations- the UAE followed by the USA and China- registered negative growth of(-)28.7,(-) 25.3 and (-) 21.9 per cent, respectively.

Since the opening up of the Indian economy, imports are increasingly sourced from a wider range of countries. Traditional key trading partners like Germany, Japan, UK and US have subsidised in terms of their market share and new import partners from East Asia(especially China) have emerged. Another important development has been a gradual dissipation of the East European countries as a major source of India's imports. The high share of OPEC countries in the recent period reflects the magnitude of crude oil imports due to the rising oil-intensity of the Indian economy and high oil prices. Finally, imports from China have increased significantly during recent years from almost miniscule level in the early 1990s.

In 2009-10, Asia and ASEAN continued to be the major source of India's imports accounting for 61.3 per cent of the total. Country-wise, China remained the largest source with a share of of 12 per cent in India's total imports followed by the USA(5.95 per cent), UAE(5.93 per cent) and Saudi Arabia (5.5 per cent). As a result of global recession, India's import growth from 14 of the top 15 trading partners was negative, Indonesia being the exception.

11.6.5.1 Direction of Imports

The direction of imports has been largely influenced by the development of the economy. In the initial stages of growth, a large part of the development process was financed through foreign aid, which was primarily in the form of tied aid. As a result, a large part of imports originated from the aid-giving countries. For example, in 1965-66 more than 35 per cent of India's total imports came from the USA, since then the share of the USA has declined although it continues to be our largest supplier, accounting as it does for about 8per cent of our imports.

This can be seen from Table-11.7 below:

Table-11.7: Direction of India's Imports(2007-10)in US million $

(in US $ million)

	Region / Country	2007-08	2008-09	% Change	Share 2008-09 (%)	April-September			
						2008	2009	% Change	Share 2009 (%)
	1	2	3	4	5	6	7	8	9
I.	**Europe**	**51579**	**57262**	**11.0**	**18.9**	**35015**	**23712**	**-32.3**	**19.1**
	a. EU	38450	42733	11.1	14.1	24716	16805	-32.0	13.5
	a.1 Germany	9885	12006	21.5	4.0	6325	4751	-24.9	3.8
	a.2 UK	4954	5872	18.5	1.9	3360	2099	-37.5	1.7
II.	**Africa**	**14928**	**18904**	**26.6**	**6.2**	**11961**	**8657**	**-27.6**	**7.0**
III.	**America**	**29606**	**30984**	**4.7**	**10.2**	**17796**	**11740**	**-34.0**	**9.5**
	a. North America	23048	21020	-8.8	6.9	11382	8328	-26.8	6.7
	a.1 USA	21067	18561	-11.9	6.1	10197	7393	-27.5	6.0
	b. Latin America	6557	9964	52.0	3.3	6414	3411	-46.8	2.7
IV.	**Asia and ASEAN**	**149949**	**188474**	**25.7**	**62.1**	**115879**	**76188**	**-34.3**	**61.3**
	a. East Asia	8356	11788	41.1	3.9	6857	5409	-21.1	4.4
	b. ASEAN	22675	26203	15.6	8.6	14621	11857	-18.9	9.5
	c. Wana	72015	90208	25.3	29.7	60034	33695	-43.9	27.1
	d. North East Asia	44785	58456	30.5	19.2	33297	24443	-26.6	19.7
	d.1 China P RP	27146	32497	19.7	10.7	18853	14907	-20.9	12.0
	d.2 Japan	6326	7886	24.7	2.6	4448	3123	-29.8	2.5
	e, South Asia - SAARC	2117	1818	-14.1	0.6	1070	783	-26.8	0.6
V	**CIS and Baltics**	3788	6627	75.0	2.2	3681	2813	-23.6	2.3
VI.	**Unspecified Region**	**1805**	**1445**	**-20.0**	**0.5**	**663**	**1085**	**63.6**	**0.9**
	Total Imports	**251654**	**303696**	**20.7**	**100.0**	**184996**	**124194**	**-32.9**	**100.0**

Source: GOI, *Economic Survey 2009-10*, pp. A90 - A94.

Table 11.8 :Direction of India's Imports by Regions(1995-2008)

(in US $ million)

	Group / Region	1995-96	2000-01	2005-06	2007-08	CAGR (%) during		
						1996-01	2001-06	2006-08
1	2	3	4	5	6	7	8	9
I.	**OECD Countries**	**19209 (52.4)**	**20158 (39.9)**	**51797 (34.7)**	**87445 (34.8)**	**1.0**	**20.8**	**29.9**
	a. EU	10303 (28.1)	10510 (20.8)	25151 (16.8)	36810 (14.7)	0.4	19.1	21.0
	b. North America	4243 (11.6)	3412 (6.8)	10375 (7.0)	22992 (9.1)	-4.3	24.9	48.9
	c. Asia & Oceania	3552 (9.7)	2984 (5.9)	9226 (6.2)	14496 (5.8)	-3.4	25.3	25.3
	d. Other OECD Countries	1112 (3.0)	3251 (6.4)	7045 (4.7)	13147 (5.2)	23.9	16.7	36.6
II.	**OPEC**	**7644 (20.8)**	**2689 (5.3)**	**11171 (7.5)**	**76076 (30.2)**	**-18.9**	**33.0**	**61.0**
III.	**Eastern Europe**	**1674 (4.6)**	**850 (1.7)**	**3794 (2.6)**	**5264 (2.1)**	**-12.7**	**34.9**	**17.8**
IV.	**Developing Countries**	**8145 (22.2)**	**11156 (22.1)**	**37891 (25.4)**	**80648 (32.0)**	**6.5**	**27.7**	**45.9**
	a. Asia	6426 (17.5)	8460 (16.8)	30451 (20.4)	64142 (25.5)	5.7	29.2	45.1
	(i) SAARC	257 (0.7)	466 (1.0)	1413 (0.9)	2111 (0.8)	12.6	24.8	22.2
	(ii) Other Asian developing countries	6169 (16.8)	7994 (15.8)	29037 (19.5)	62030 (24.7)	5.3	29.4	46.2
	b. Africa	1132 (3.1)	1996 (3.9)	4742 (3.2)	10356 (4.1)	12.0	18.9	47.8
	c. Latin America	587 (1.6)	701 (1.4)	2698 (1.8)	6151 (2.4)	3.6	30.9	51.0
V.	**Other / Unspecilfied countries**	**3 (-)**	**15683 (31.0)**	**44514 (29.8)**	**2221 (0.9)**	**-----**	**23.2**	**-77.7**
	Grand Total	**36675 (100)**	**50537 (100)**	**149166 (100)**	**251654 (100)**	**6.6**	**24.2**	**29.9**

Note: Figures in parentheses indicate percentage share to column totals. Compound annual growth rate (CAGR) has been worked out for specified periods.

Source : RBI (2009), *Handbook of Statistics on Indian Economy 2008-09*, Mumbai.

The share of the UK in India's imports has also sharply declined although it continues to be a major supplier. Among the other major countries that have made inroads in our imports trade are Belgium, Canada, Germany and, Japan. The EU as a group accounts for about 24 per cent of our imports. With the inclusion of three more countries from January1,1995, the share of the EU is expected to increase further.

Among the centrally planned economies, the former USSR was an important purchasing centre for us. But in recent years, as already earlier noted, the importance of these countries is on the decline. Russia along with other Eastern European countries presently accounts for not more than 2 per cent of India's total imports. A more significant development has been the emergence of oil-producing countries as a significant purchasing centre for us. This has been largely because of oil products. The OPEC alone accounts for about 22 per cent of our total imports.

11.6.5.2 Direction of Exports

A ringside view of the direction of India's direction of exports can be had from Table-11.8 below

Table-11.9: Direction of India's Exports (1995-2008)

(in US $ million)

	Group / Region	1995-96	2000-01	2005-06	2007-08	CAGR (%) during		
						1996-01	2001-06	2006-08
1	2	3	4	5	6	7	8	9
I.	**OECD Countries**	**17705 (55.7)**	**23474 (52.7)**	**45837 (44.5)**	**62643 (38.4)**	**5.8**	**14.3**	**16.9**
	a. EU	8708 (27.4)	10411 (23.4)	22385 (21.7)	32861 (20.1)	3.6	16.5	21.2
	b. North America	5826 (18.3)	9962 (22.3)	18375 (17.8)	21977 (13.5)	11.3	13.0	9.4
	c. Asia & Oceania	2652 (8.3)	2264 (5.1)	3444 (3.4)	5162 (3.2)	-3.1	8.8	22.4
	d. Other OECD Countries	519 (1.6)	838 (1.9)	1633 (1.6)	2642 (1.6)	10.1	14.3	27.2
II.	**OPEC**	**3079 (9.7)**	**4850 (10.9)**	**15242 (14.8)**	**26671 (16.4)**	**9.5**	**25.7**	**32.3**
III.	**Eastern Europe**	**1340 (4.2)**	**1318 (3.0)**	**1980 (1.9)**	**3384 (2.1)**	**-0.3**	**8.5**	**30.7**
IV.	**Developing Countries**	**9198 (28.9)**	**13013 (29.2)**	**39736 (38.5)**	**69572 (42.6)**	**7.2**	**25.0**	**32.3**
	a. Asia	7308 (23.0)	10038 (22.5)	30981 (30.0)	51477 (31.6)	6.6	25.3	28.9
	(i) SAARC	1721 (5.4)	1929 (4.3)	5548 (5.4)	9617 (5.9)	2.3	23.5	31.7
	(ii) Other Asian developing countries	5587 (17.6)	8109 (18.2)	25434 (24.7)	41860 (25.7)	7.7	25.7	28.3
	b. Africa	1513 (4.8)	1956 (4.4)	5699 (5.5)	12494 (7.7)	5.3	23.8	48.1
	c. Latin America	378 (1.2)	1018 (2.3)	3056 (3.0)	5601 (3.4)	21.9	24.6	35.4
V.	**Other / Unspecified countries**	**472 (1.5)**	**1906 (4.3)**	**295 (0.3)**	**863 (0.5)**	**32.2**	**-31.1**	**71.0**
	Grand Total	**31795 (100)**	**44560 (100)**	**103091 (100)**	**163132 (100)**	**7.0**	**18.3**	**25.8**

Note: Figures in parentheses indicate percentage share to column totals. Compound annual growth rate (CAGR) has been worked out for specified periods.

Source : RBI (2009), *Handbook of Statistics on Indian Economy 2008-09* , Mumbai.

Table 11.10 : Direction of India's Exports by Regions and Countries(2007-10)

(in US $ million)

	Region / Country	2007-08	2008-09	% Change	Share 2008-09 (%)	April-September 2008	2009	% Change	Share 2009 (%)
	1	2	3	4	5	6	7	8	9
I.	**Europe**	**37288**	**42076**	**12.5**	**22.7**	**23730**	**16406**	**-30.9**	**21.4**
	a. EU	34535	29351	13.9	2.2	22035	15345	-30.4	20.0
	a.1 UK	6706	6650	-0.8	3.6	3676	2808	-23.6	3.7
	a.2 Germany	5122	6389	24.7	3.4	3469	2343	-32.4	3.1
II.	**Africa**	**11540**	**11391**	**-1.3**	**6.1**	**6745**	**4912**	**-27.2**	**6.4**
III.	**America**	**27671**	**28686**	**3.7**	**15.5**	**16358**	**11708**	**-28.4**	**15.3**
	a. North America	21998	22514	2.3	12.2	12491	9323	-25.4	12.2
	a.1 USA	20731	21150	2.0	11.4	11766	8794	-25.3	11.5
	b. Latin America	5673	6172	8.8	3.3	3867	2385	38.3	3.1
IV.	**Asia and ASEAN**	**84338**	**96605**	**14.5**	**52.1**	**58183**	**42120**	**-27.6**	**55.0**
	a. East Asia	1413	1754	24.2	0.9	1013	780	-23.0	1.0
	b. ASEAN	16414	19141	16.6	10.3	11568	8331	-28.0	10.9
	c. Wana	30372	41694	37.3	22.5	26014	18668	-28.2	24.4
	d. North East Asia	26502	25449	-4.0	13.7	14527	10821	-25.5	14.1
	d.1 China P RP	10871	9354	-14.0	5.0	4998	3903	-21.9	5.1
	d.2 Japan	3858	2026	-21.6	1.6	1680	1420	-15.0	1.9
	e. South Asia - SAARC	9638	8567	-11.1	4.6	5061	3521	-30.4	4.6
V.	**CIS and Baltics**	**1740**	**1925**	**10.6**	**1.0**	**1154**	**693**	**-39.9**	**0.9**
VI.	**Unspecified Region**	**555**	**4612**	**730.3**	**2.5**	**2736**	**749**	**-72.6**	**1.0**
	Total Exports	**163132**	**185295**	**13.6**	**100.0**	**108907**	**76589**	**-29.7**	**100.0**

Source: GOI, *Economic Survey 2009-10*, pp. A05 - A09.

The shift in favour of these countries implies that Indian exporters have at last concentrated in markets closer home to capitalise on the advantage from lower freight cost. It is also an evidence of the outward orientation being imparted to the economy by reforms.

11.6 TRADE DEFICITS AND TERMS OF TRADE

Except during 1972-73 and 1976-77, India's imports have exceeded her exports, the size of trade deficit has been continuously increasing. The gap assumed menacing proportions with the onset of the eighties. The deficit averaged Rs.5716 crore over 1980-85, Rs.7671 crore over 1985-90 and Rs.6,600 crore during 1990- 94 and Rs.21,028 crore during 1994-99. Till the seventies, a part of the deficit was accounted for by deteriorating terms of trade. The large and the widened trade deficits in the eighties are attributable to the sharp rise in the volume of imports relative to the small increase in the volume of exports.

The contribution of the movements in the unit values was to moderate the size of the deficits through improvement in the terms of trade of the country. Over the period 1980-81 and 1990-91, the net barter terms of trade improved by 30 per cent. Subsequently, during the period 1991-96, the net barter terms of trade further, improved, as would be seen from table 5 below

Table-11.11: Net Barter Terms of trade (Base 1978-79 = 100)

Year	**1990-91**	**91-92**	**92-93**	**93-94**	**94-95**	**95-96**	**96-97**
Terms of Trade	109.3	119.5	127.3	144.9	152.4	137.9	126.2

The year 1993-94 witnessed an improvement in the trade account that surpassed the most optimistic projections. (It prompted trade analysts to pronounce that the trade sector has

slowly crossed the threshold of the famous-J-Curve and is now on its upward slope). The J-curve thesis explains that things get worse before they make a dramatic improvement. It terms of foreign trade it implies that initially the country experiences rising BOT deficits, but ultimately there emerge BOT surpluses. Sweeping tariff cuts and liberalisation of both exports and imports were undertaken as part of the reform process. Exports grew at over 20 per cent, whereas imports grew at a lower rate of 6.5 per cent. The result is that the trade deficit shrank. Exports maintained their upward trend in 1994-95 and 1995-96 also although without much change in the export basket. During this period, imports also went up. As a result the size of trade deficits is also beginning to grow. But unlike in the past, the present trade deficits are manageable.

11.6.6 Diversification or Concentration :

Nine countries, viz., the UK Germany, the then USSR, Japan, Iraq, Iran, Australia and Canada had a lion's share ranging between 51-62 per cent of our exports and 56 to 75 per cent of imports during the three decades from 1951-52 to 1979-80. In 1990-91 their share of exports was as high as 56.7 per cent while their share in imports has fallen down to 47.6 per cent. More recently, in 1998-99, 36 per cent of our total exports found their destination in the EU, the USA and Japan. Likewise, about 41.5 per cent of our total imports originated from the EU, the USA and Japan.

It is clear that India's foreign trade is not diversified. This can create a problem in the long run. Some recent international events like changes in economic set-up of East European countries, consolidating. Europe, etc. will rather force India to consider new areas for her trade. On the positive side, however, accounting to recent report of International Finance corporation, Japan and United Europe will provide a huge market for India's exports. Similarly, India should establish market arrangements with these countries, getting raw materials from them and in turn supplying finished goods. Proper planning of our direction of trade will help in solving our balance of payments problems.

11.7 CHECK YOUR PROGRESS

i. ________________________is identified with protectionism and import substitution;

ii. ________________________with free trade and exports promotion.

iii. The_________________relates to the size of international transactions

11.8 SUMMARY

In this unit, we described the composition, volume, direction and growth of India's foreign trade. During the last five decades significant changes have been observed in the volume,

composition and direction of trade. Although most of these changes have been in consonance with the development needs of the economy, one or two problems need immediate attention. The first is the problem of the deficits in the balance of trade. Growing trade deficits did post problems of resource mobilisation for the Indian planners till the recent past and, therefore, need be monitored continuously Secondly, our share in world trade has been showing a gradual fall. This tendency need be reversed if India is to play its rightful role in the international division of labour.

The composition of India's foreign trade reflects, to a great extent, the structural changes that the Indian economy has experienced during the last four and a half decades. It is no longer an exporter of primary commodities and an importer of manufactured goods. It exports manufactured goods and imports raw materials, intermediate goods and capital goods.

11.9 KEY WORDS

Composition of Trade: Refers to the nature of goods traded between the countries.

Direction of Trade: Refers to the countries with which a country exchanges goods.

Non-tariff Barriers: Different types of restrictions imposed by a country on imports from other countries.

Primary Commodities: The commodities that are extracted from nature like crops, marine products, minerals, etc.

Tariffs : Import duties imposed by a country.

Terms of Trade: Refers to the ratio of prices of exports to the prices of imports.

Trade Policy: Refers to all the policies that have either direct or indirect bearing on the trade behaviour of a country.

Value of Trade: The monetary value of goods traded between countries.

Volume of Trade: The physical quantity of goods traded between countries.

11.10 SUGGESTED READINGS/ REFERENCES

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Joshi, Vijay and IMD Little : India's Economic Reforms 1991 2001 (Oxford, New Delhi,1996)

Reserve Bank of India : Report on Currency and Finance(Annual) (various issues)

Jalan, Bimal : India's Economic Policy (1996)

11.11 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

i. Inward orientation
ii. outward orientation
iii. The volume of trade relates to the size of international transactions

11.12 TERMINAL/MODEL QUESTIONS

1. Explain the meaning of Foreign Trade. Why is it important for a developing economy like India?
2. Discuss the composition of India's foreign trade.
3. Evaluate the direction and volume of India's foreign trade.

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CHAPTER 12

INDIA'S BALANCE OF PAYMENTS PROBLEM

12.1 OBJECTIVES

After you have read the lesson you should be able to:

- Compare and contrast the Current and Capital Accounts
- Explain the concept of balance of payments and its importance;
- Discuss the need for export promotion;
- Evaluate the export promotion programme of the Government of India; and
- Evaluate various steps taken by the Government to solve the balance of payments difficulties.

12.2 INTRODUCTION

The balance of payments position of the country reflects on its economic health. The balance of payments of any country is a comprehensive and systematic accounts of all the different transactions occurred between the residents of a country and the rest of the world during a particular period of lime.

The balance of payments maintains detailed classified records of different types of receipts against exports of goods, services and all the capital received by its residents on the one hand and also of all the payments made by the residents against imports of goods and services received along with the capital transferred to non-residents and foreigners, on the other hand. Thus the balance of payments is much wider than the balance of trade which refers to only merchandise exports and imports.

12.2.1 Classification of Balance of Payments

The balance of payments is broadly classified into two components which are described below:

(a) Current account and

(b) Capital account.

The current account includes: visible exports and import; invisible items relating to receipts and payments for various services like banking, insurance, shipping, travel etc. and other unilateral transfer of payments like donations, grants, taxes etc.

The capital accounts of balance of payments include all the current economic transaction for the country's international financial position resulting changes in the foreign financial assets and liabilities. The capital transaction includes both private, banking and official transactions.

The balance of payment account is maintained on the basis of double entry system of book keeping. If a country faces deficits in the current account of its balance of payment then such deficit is normally met either by liquidating its assets or through borrowing from abroad. Thus a persistent deficit in the balance of payments of a country results in a heavy debt burden on the economy.

12.2.2 The Balance of Payment Position of India on Current Account since Independence:

With the introduction of planning in India, the balance of payments position of the country has been recording considerable changes with the continuous changes in its imports and exports.

12.2.2.1 Balance of Payments (BOP) Position during the First Four Plans:

The balance of payments position during the First Plan period was quite satisfactory as the country experienced a deficit in its current account only to the extent of Rs. 42.3 crore. In this period, the inflow of foreign capital was only Rs. 13.6 crore and the foreign exchange reserve was about Rs. 127 crore.

During the Second Plan, the deficit in the balance of trade was to the tune of Rs. 2,339 crore and the surplus of invisibles and donations ultimately reduced the deficit in balance of payment to Rs. 1,725 crore. This higher deficit in the balance of payment, during the Second Plan was resulted from heavy imports of capital goods, huge imports of food grains and raw materials and lesser expansion of exports and higher maintenance imports.

During the Third Plan the country experienced a current account deficit in its BOP to the extent of Rs. 1,941 crore which was financed by loans from foreign countries under various schemes. During the Fourth Plan, the Government introduced both export promotion and import substitution measures for wining out the deficits in the BOP. Moreover, due to sudden increase in the invisibles accounts receipts to the extent of Rs. 1,680 crore in 1973-74, the plan ended with a surplus of Rs. 100 crore in its BOP.

12.2.2.2 BOP During the Fifth Plan:

During the Fifth Plan period, due to the applicability of two factors like hike in oil prices arid increase in the value of exports due to promotional measures, although a surplus in trade balance was attained in 1976-77 (Rs. 316 crore) but the plan experienced an increasing trend in trade

deficit to the extent of Rs. 3,179 crore. But due to higher entry of net invisibles, the Fifth Plan ended with surplus of Rs. 3,082 crore.

12.2.2.3 BOP During the Sixth to Tenth Plan:

The balance of payments position has recorded a total change since 1979-80. India started to record a heavy deficit in its balance of payments since 1979- 80. Table 7.6 shows the growing deficit in trade balance along with the growing deficit in its balance of payments position during the Sixth to Tenth Plan.

Table 12.1: Balance of Payments of India on Current Account since 1979-80(Rs.Crore)

Year	Trade Balance	Net Invisibles	Balance of Payments
1979-80	− 3,374	+ 3,140	− 254
Sixth Plan :			
1980-81	− 5,967	+ 4,310	− 1,657
1981-82	− 6,121	+ 3,804	− 2,317
1982-83	− 5,776	+ 3,480	− 296
1983-84	− 5,871	+ 3,609	− 2,262
1984-85	− 6,721	+ 3,869	− 2,852
Seventh Plan :			
1985-86	− 9,586	+ 3,630	− 5,956
1986-87	− 9,354	+ 3,524	− 5,830
1987-88	− 9,296	+ 3,003	− 6,293
1988-89	− 13,555	+ 1,975	− 11,580
1989-90	− 12,413	+ 1,025	− 11,388
1990-91	− 16,934	− 435	− 17,369
1991-92	− 6,495	+ 4,258	− 2,237
Eighth Plan Onwards :			
1992-93	− 17,238	+ 4,474	− 12,764
1993-94	− 12,723	+ 9,087	− 3,636
1994-95	− 28,420	+ 17,837	− 10,583
1995-96	− 38,061	+ 18,454	− 19,607
1996-97	− 52,559	+ 36,720	− 15,839
Ninth Plan :			
1997-98	− 57,806	+ 36,921	− 20,885
1998-99	− 55,478	+ 38,690	− 16,788
1999-2000	− 77,359	+ 57,028	− 20,331
2000-01	− 65,376	+ 53,945	− 11,431
2001-02	− 54,955	+ 71,381	+ 16426
Tenth Plan :			
2002-03	− 51,697	+ 82,357	+ 30,660
2003-04	− 63,386	+ 1,27,369	+ 63,983
2004-05	− 1,64,542	+ 1,39,756	− 24,786
2005-06	− 2,29,426	+ 1,88,704	− 40,722
2006-07	− 2,86,276	+ 2,40,933	− 45,343
2007-08	− 3,67,664	+ 3,04,185	− 63, 479
2008-09	− 5,43,158	+ 4,11,544	− 1,31,614

Thus the table reveals that due to the mounting deficit in trade balance, i.e., from Rs. 5,967 crore in 1980-81 to Rs. 6,721 crore in 1984-85, India maintained a huge deficit in its balance of payments to the extent of Rs. 11,384 crore during the Sixth Plan period. Again due to a persistent growing deficit in trade balance the cumulative deficits in the balance of payment during the Seventh Plan rose further to Rs. 38,313 crores, showing the annual average deficit of Rs. 7,662 crore.

Again in 1990-91, total amount of deficits in the balance of payments was as high as Rs. 17,369 crore. But in 1999-2000 and 2000-2001, the total amount of deficits in the balance of payments was Rs. 20,331 crore and Rs. 11,431 crore respectively. In 2001-02, total surplus in BOP was Rs. 16,426 crore and the total surplus further increased to Rs. 47,952 crore in 2003-04. In 2008-09, total deficit in BOP was Rs. (-) 1,31,614 crore.

This huge deficit in the balance of payments position during the entire Sixth, Seventh and Eighth and Ninth Plan periods was the result of tremendous rate of growth of imports accompanied by a poor rate of growth of exports. The trade deficits during these four plans were so heavy that it could not be offset by the flow of funds under net invisibles. The following table depicts a clear picture about the amount of deficits in the balance of payments from the First Plan to the Ninth Plan.

Table 12.2: Balance of Payments of Current Account since the First Plan

Period	*Trade Deficit*	*Net Invisibles*	*Balance of Payments*
First Plan	– 542	+ 500	– 42
Second Plan	– 2,339	+ 614	– 1,725
Third Plan	– 2,382	+ 431	– 1,951
Annual Plan	– 2,067	+ 52	– 2,015
Fourth Plan	– 1,564	+ 1,664	+ 100
Fifth Plan	– 3,179	+ 6,221	– 3,082
Sixth Plan	– 30,456	+ 19,072	– 11,384
1985-86 to 1989-90 Seventh Plan	– 54,204	+ 15,891	– 38,313
1990-91	– 16,934	– 435	– 17,369
Eighth Plan	– 1,49,001	+ 86,572	– 62,429
Ninth Plan	– 3,16,446	+ 2,53,730	– 62,716

12.2.2.4 Recovery in Balance of Payments Position in India since 1991-92:

The balance of payments position, which had reached a point of near collapse in June 1991, gradually stabilized during the course of 1991-92. In 1990-91, foreign currency reserves had declined to $ 1.1 billion despite heavy borrowing from the IMF. In order to restore international confidence, the Government negotiated a stand by arrangement with the IMF in October 1991 for $ 2.3 billion over a 20 month period, a Structural Adjustment Loan with the World Bank of $ 500 billion and a Hydrocarbon Sector Loan with ADB for $ 250 million.

Along with this effort, the Government also launched the India Development Bonds aimed at mobilizing NRI sources of funds. With the assurance of external support through these efforts, the balance of payments position was gradually stabilized in 1991-92 and the foreign exchange reserves were restored to the level of $ 5.6 billion at the end of March 1992.

Thus, the balance of payments position in India showed a steady improvement since 1991-92 with exports covering a larger proportion of imports than in the earlier years. The export-import ratio has averaged nearly 90 per cent during 1991-92 to 1993-94 compared to an average of about 65 per cent for the preceding three years.

In 1994-95, this export-import ratio stood at 91.9 per cent. The current account deficit has also declined, averaging about 0.7 per cent of GDP for these three years (1991-94), compared to an average of about 2.6 per cent of GDP in the preceding three years.

In this connection, Economic Survey, 1995-96 observed, “The development in India’s trade and payments over the past five years mark a noticeable structural change towards a more stable and sustainable balance of payments. During the post-liberalization period, there has been a sharp improvement in the coverage of import payments through export earnings. The coverage ratio has averaged around 88 per cent since 1992-93, compared with only 52.4 per cent at the beginning of the 1980’s and about 70 per cent at the end of the 1980’s. There has also been a marked improvement in the flow of invisible receipts. Together, these changes brought about a sharp reduction in the ratio of the current account deficit to GDP from an unsustainable level of 3.2 per cent in 1990-91 to 0.8 per cent in 1994-95.”

There has been a structural change in the capital account in terms of a sharp reduction in debt creating flows and an increased recourse to non-debt creating foreign investment flows. For example, debt creating flows, as a percentage of total capital flow in the balance of payments, averaged as much as 97 per cent during the Seventh Plan Period (1985-86 to 1989-90).

But the ratio declined very sharply to less than 18 per cent in 1994-95. This declining trend is shared by all the major components of debts flows, namely external assistance, commercial borrowing and non-resident deposits. This favourable shift, away from recourse to debt creating flows for financing the current account deficit, has obvious implications for moderating and reducing future debt service liabilities.

During the recent years, the balance of payments position of the country experienced a mixed scenario. The year 2004-05 marked a significant departure in the structural composition of India's balance of payment (BOP), with the current account, after three consecutive years of surplus, turning into a deficit. In a significant transformation, the current account deficit, observed for 24 years since 1977-78, had started shrinking from 1999-2000.

The contraction gave way to a surplus in 2001-02, which continued until 2003-04. However, from a surplus of US $14.1 billion in 2003-04, the current account turned into a deficit of US $5.4 billion in 2004-05. This deficit was caused by a burgeoning excess of merchandise imports over exports, which was left uncompensated by the net surplus in invisibles.

Which the magnitude of deficit is one of the highest in recent times, it underscored the rising investment demand in the economy. As a proportion of LSDPP, the turnaround in the current account balance was from a surplus equivalent to 2.3 per cent in 2003-04 to a deficit of 0.8 per cent in 2004-05.

The turnaround in the current account during 2004-05 was accompanied by a significant strengthening of more than 80 per cent in the capital account resulting in continued reserve accretion. Compared with 2003-04, when loan inflows and turned not net outflows, such inflows shot up rapidly during 2004-05 and bolstered the rise of the capital account surplus with good support from robust foreign investment inflows. Reserve accumulation during 2004-05, at around four-fifths of such accumulation during 2003-04, maintained India's status as one of the largest reserve holding economies in the world.

12.2.2.5 Rise in Trade Deficit during 1995-96 and Thereafter:

India's trade deficit during 1995-96 swelled to $ 4,538 billion—more than double of the deficit of $ 2.027 billion in the previous financial year. The country's exports during 1995-96 were estimated at $ 31,830 billion signifying growth of 21.38 per cent over the exports during the previous fiscal year valued at $ 26,623 billion.

Against a target of 18 to 20 per cent growth rate for the year 1995- 96, the actual achievement were considerably higher at 21.4 per cent in dollar terms. Import during 1995-96 were estimated at $ 36,369 billion against $ 28,251 billion during the previous fiscal year reflecting a growth of 28.74 per cent. Thus the rise in the trade deficit during 1995-96 has been resulted mostly from the sudden spurt in imports, in spite of attaining a considerable higher growth in exports.

1996-97:

The balance of payments position of India has been experiencing some changes in the year 1996-97 as India's exports went up by only 4.01 per cent and imports grew by 5.99 per cent during 1996-97 as compared to that of 21.58 per cent and 28.74 per cent recorded respectively during 1995-96.

1998- 99:

The balance of payments (BOP) position of India has been gradually improving in recent years. India's BOP remained comfortable in 1998-99 partly due to anticipatory policy action's, such as issue of Resurgent India Bonds. The deficit in the current account of the BOP in 1998-99 had declined to about 1.0 per cent of GDP as against 1.7 per cent in 1995-96 and 1.4 per cent in 1997- 98, mainly reflecting sharp declines in POL and non-customs imports.

Reflecting the trends in exports and imports, the deficit on the trade account of BOP in 1998-99 narrowed to US $ 13.25 billion from US $ 15.51 billion in 1997-98 or from 3.8 per cent of GDP in 1997-98 to 3.1 per cent of GDP in 1998-99.

1999- 2000:

India's Balance of payments position in 1999-2000 remained comfortable. The current account deficit in 1999-2000 was contained to 0.9 per cent of GDP, despite an unfavourable international trade and financial backdrop including a near two-third like in India's oil import bill.

2000- 01:

India's balance of payments (BOP) position in 2000-01 remained comfortable and the external sector experienced a distinct improvement. There were, however, some pressures on the BPO during the first half of the year on account of significant hardening of international oil prices, the sharp downturn in international equity prices and successive increases in interest rates in the United Suites and Europe; but the situation cased with the mobilization of funds under the India Millennium Deposits, which helped to revert the declining trend in reserves and enhanced

confidence in the strength of India's external sector. As a result, the BOP situation experienced a turn around 0.5 per cent of GDP from 1.1 per cent of GDP in 1999-2000.

2001- 02:

India's balance Of payments in 2001-02 exhibited mixed developments. While exports, on BOP basis, remained stagnant at previous year's level, but imports declined by 2.8 per cent, thus resulting in a decline in merchandise trade deficit, as per cent of GDP, from 3.1 per cent in 2000-01 to 2.6 per cent in 2001-02. Moreover, the current account BPO turned into a surplus in 2001-02, after a gap of 24 years (last recorded in 1977-78).

2007-08 and 2008-09:

Both the year 2007-08 and 2008-09 were marked by adverse developments in the external sector of the economy, reflecting impact of global financial crisis on the emerging economies including India. India's BOP exhibited considerable resilience during fiscal 2008-09 despite one of the severest external shock.

The current account balance [(-) 2.4 per cent of GDP in 2008-09 vis-a-vis (—) 1.3 per cent in 2007-08] remained well within sustainable limits and there was limited use of foreign exchange reserves despite massive decline in net capital flows to US $ 7.2 billion in 2008-09 as against US $ 106.6 billion in 2007-08. As a result, the total net capital account of BOP as per cent of GDP stood at only 0.6 per cent in 2008-09 as compared to that of 8.8 per cent in 2007-08.

12.2.3 Convertibility of Rupee:

For the first time, the Union Budget for 1992-93 made the Indian rupee partially convertible. This was an inevitable move for the expeditious integration of Indian economy with that of the world In order to face the serious current account deficit in the balance of payments, the Government of India introduced the partial convertibility of rupee from March 1, 1992.

Under this system, which remained in operation for a period of one year, 60 per cent of the exchange earnings were convertible in rupees at market determined exchange rate and the remaining 40 per cent earnings were convertible in rupees at the officially determined exchange rate.

The entire foreign exchange requirement for meeting import obligations was required to be purchased at market determined exchange rate, excepting a few specified imports and imports on the government account.

The term convertibility of a currency indicates that it can be freely converted into any other currency. Convertibility can also be identified as the removal of quantitative restrictions on trade and payments on current account. Convertibility establishes a system where the market place determines the rate of exchange through the free interplay of demand and supply forces.

In India, hawala trade normally handle about 4 billion dollars a year. Until recently, this was traceable to the increasing differential between official and hawala exchange rates. This convertibility of rupee has bridged this gap and in check the hawala trade effectively.

12.2.3.1 Current Account Convertibility:

Current account convertibility is the next phase for attaining full convertibility of rupee. Current account convertibility relates to the removal of restrictions on payments relating to the international exchange of goals, services and factor incomes, while capital account convertibility refers to a similar liberalization of a country's capital transactions such as loans and investment, both short term and long term.

The International Monetary Fund (IMF) which works towards the establishment of multilateral system of payments, requires member countries to move towards restoration of current account convertibility, but permits them to restrict convertibility for capital transactions.

Current account convertibility has been defined as the freedom to buy or sell foreign exchange for the following international transactions:

(a) All payments due in connection with foreign trade, other current business, including services and normal short term banking and credit facilities;

(b) Payments due as interest on loans and as net income from other investments;

(c) Payments of moderate amount of amortization of loans or for depreciation of direct investment; and

(d) Moderate remittances for family living expenses.

12.2.3.2 Capital Account Convertibility:

The next and final step in this line is the convertibility of rupee on capital account. But we must draw a sharp distinction between currency convertibility in the current and capital accounts. Capital account convertibility refers to a liberalization of a country's capital transactions such as loans and investment, both short term and long term as well as speculative capital flows.

When it comes to capital account convertibility, one has to be more prudent and be very much sure about its capacity to launch such a system. If the country can build a large stock of

international reserves, then only this system could provide a bonus. Confidence in the financial system and a steady macro-economic environment are very much essential to the introduction of capital account convertibility of rupee in near future.

Capital account convertibility in India can be introduced in stages by gradually widening access to resident Indians to external financial markets. In the light of historical experience, the general view is that opening up of the capital account should occur late in the sequencing of stabilization and structural reforms.

Capital account convertibility is likely to be sustainable only if it is supported by credible macro-economic policies, listing reduction in fiscal deficit, moderation in inflation and a flexible financial system which can adapt to changing situations as some of the essential pre-conditions for capital account convertibility. Thus capital account convertibility implies the right to transact in financial assets with foreign countries without restrictions. Although the rupee is not fully convertible on the capital account, convertibility exists in respect of certain constituent elements which are as follows:

(a) Capital account convertibility exists for foreign investors and Non-Resident Indians (NRIs) for undertaking direct and portfolio investment in India.

(b) Indian investment abroad up to US $ 4 million is eligible for automatic approval by the RBI subject to certain conditions.

(c) In September 1995, the RBI appointed a special committee to process all applications involving Indian direct foreign investment abroad beyond US $ 4 million or those not qualifying for fast track clearance.

But in the context of the need for attracting higher capital inflows into the country, it is also important for the Government to introduce convertibility on capital account, as foreign investors may enter confidently only when there is an assurance that the exit doors will always remain open.

The Budget 2002-03 has adopted a cautious step towards Capital Account Convertibility by allowing NRI to repatriate their Indian income. Considering the present condition along with the comfortable foreign exchange reserve of the country at present, the government is now favouring a make towards fuller capital account convertibility in the context of changes in the last two decades. For the mean time on 18th March, 2006 Prime Minister Dr. Manmohan Singh asked the Finance Ministry and RBI to work out a roadmap for fuller capital account convertibility based

on current realities. Dr. Singh is of the view that such roadmap for fuller capital account convertibility would attract greater foreign investments into the country.

Thus it is expected that the Government of India and the RBI are going to announce a roadmap soon for the attainment of fuller capital account convertibility of the country. However, while taking decision for full convertibility of rupee, the Government should take adequate care of its possible consequences.

In the mean time on 29th March, 2006, 160 renowned Indian economists asked the government to desist from moving towards full convertibility of rupee as it was brought with dangerous consequences. They argued, "We urge the UPA government from such an unnecessary and dangerous measure……. This (full float of rupee) would expose Indian economy to extreme volatility".

The statement made by about 160 leading economists from various institutions across the country and signed by Prof. Prabhat Patnaik of JNU, Delhi also expressed apprehension that to expose the country to unpredictable movements in capital flows would create a potential for fragility and crisis and particularly when the stock market is witnessing a speculative boom.

12.2.3.3 Tara-pore Committee's Second Report on Capital Account Convertibility:

With the growing strength of balance of payments in the post-1991 period and with external sector remaining robust and gaining strength every year and the relative macro economic stability with high growth providing a conducive environment relaxation of capital controls, RBI, in pursuance of the announcement the Prime Minister constituted a committee on March 20, 2006 with Mr. S.S. Tarapore as its chairman for setting out a roadways towards fuller capital account convertibility. The committee submitted its Report to the RBI on July 31, 2006.

Keeping itself conscious of the risks involved in the movement towards fuller convertibility of the Rupee as emanating from cross country experiences in this regard the committee calibrated the liberalization road map to the specific contexts of preparedness—namely, a strong macroeconomic framework, sound financial systems and markets and prudential regulatory and supervisory architectures.

After making review of the existing capital controls, it detailed a broad five year time frame for movement towards fuller convertibility in three phases: Phase-I (2006-07); Phase II (2007-08 to, 2008-09) and Phase III (2009-10 to 2010-11).

The report recommended the meeting of certain indicators/targets as a concomitant to the movement in: meeting FRBM targets; shifting from the present measures of fiscal deficit to a measure of the Public Sector Borrowing Requirement (PSBR); segregating government debt management and monetary policy operations through the setting up of the office of Public Debt independent of the RBI; imparting greater autonomy and transparency in the conduct of monetary policy; and slew of reforms in banking sector including a single banking legislation and reduction in the share of Government/RBI in the capital of public sector bank.

Keeping the current account deficit to GDP ratio under 3 per cent; and evolving appropriate indicators of adequacy of reserves to cover not only import requirements, but also liquidity risks associated with present types of capital flows, short-term debt obligations and broader measures including solvency.

Thus, the committee recommended a three phase strategy for moving towards capital account convertibility. Although, RBI has not been taken any final decision on acceptance of the recommendations in totality but it has initiated measures on an on-going basis beginning with the announcement in Mid-term Review of the Annual Policy Statement for 2007

12.3 BALANCE OF PAYMENTS AND DEVELOPING ECONOMIES

It is well known in development economics that UDCs invariably start as debt or economies. In the process of development itself, these economies have to import a great deal of capital goods, consumer goods, food and raw materials and spares and components. They also have to import some new technologies and, hence, the total exchange outgo cannot be matched by export earnings. But, it is expected that in a decade or two, as the new capital goods and technologies begin to become effective and their products are directed towards exports, export goods and services become competitive in cost and quality. In that case, the volume of exports expands and, in due course, begins to overtake imports. A developing economy then moves on from being a debt or economy to a balanced one in terms of balance of payments and, finally, becomes a credit or economy, exporting more than it imports and giving credit to buyers. Thus, from being a net debt or in the beginning, it becomes a net credit or in the end and, in fact, begins to invest abroad rather than have others lending to and investing in it.

12.4 TRENDS IN INDIA'S BALANCE OF PAYMENTS

India has faced pressures on BOP from time to time either due to certain domestic compulsions or due to external factors. The whole period, covering nearly the four and a half decades, can be divided into four sub-periods depending on

(i) the nature of BOP problem,

(ii) the overall macro-economic environment, and

(iii) the external aid situation.

The four sub-periods are as follows:

a. upto 1975-76 (Period I),
b. 1976-77 to 1979-80 (Period II),
c. 1980-81 to 1989-90 (Period III), and
d. the recent phase of 1990-98 (period IV).

a. Period I (Up to 1975-76)

The entire period was very difficult for India's BOP, partly because of slow growth of exports in relation to import requirements and partly because of adverse external factors. Despite tight import controls (through quantitative restrictions) and foreign exchange regulations the current account deficit was 1.8 per cent of the GDP.

Foreign exchange reserves were at low levels, generally less than necessary to cover three months imports. Almost the entire current account deficit (92 per cent) was financed by inflows of external assistance on highly concessional terms. There was hardly any commercial deficit.

b. Period II (1976-77 to 1979-80)

These few years stand out as the golden years for India's BOP. India had a small current account surplus (0.6 per cent of the GDP on an average) and foreign exchange reserves equivalent to about seven months' imports. Export growth was good but the primary reason for the sharp improvement in BOP was the dramatic improvement in net invisibles. Net invisibles increased from a paltry Rs.193 crore in 1974-75 to Rs.2,486 crore in 1979-80.

c. Period III (1980-81 to 1989-90)

The period broadly corresponds to the period of the Sixth Plan and Seventh Plan. The Sixth Plan was launched when the economy was faced with severe BOP difficulties. In 1981, India entered into an arrangement with the International Monetary Fund for a loan for SDR 5 billion under the Extended Fund Facility. The amount was to be disbursed over a three-year period. The BOP

deficits were particularly acute during the Seventh Plan period. The current account deficit during the whole plan period was as high as 2.2 per cent of the GDP as against 1.3 per cent of the GDP during the Sixth Plan Period.

d. Period IV (1990-91 onwards)

The BOP crisis reached its climax during 1990-91; current account deficits reached a maximum of 3.26 per cent of the GDP, as would be seen from table-1 below:

Table-12.3: Key Indicators of India's Balance of Payments (As percent of GDP)

Year	Exports (a)	Imports (b)	Trade Balance (c)	Net Current Invisibles (d= b-c)	A/c deficit (f = d+e)
Average of					
1985-90	5.1	8.3	-3.2	0.9	-2.3
1990-91	6.2	9.4	-3.2	-0.1	-3.2
1991-92	7.3	8.3	-1.1	0.7	-0.4
1992-93	7.8	9.8	-2.0	0.2	-1.8
1993-94	8.8	9.7	-0.9	0.5	-0.4
1994-95	8.8	10.5	-1.6	0.8	-0.8
1995-96	8.9	12.0	-3.1	1.5	-1.6
1996-97	8.6	12.3	-3.7	2.6	-1.2
1997-98	8.5	12.2	-3.7	2.3	-1.3
1998-99	8.2	11.4	-3.2	2.2	-1.0

India was faced with a serious BOP crisis. In view of this, a comprehensive strategy to deal with it was put in place. Although the BOP continued to be under pressure during 1992-93, there was a distinct improvement compared to the crisis situation prevailing in the middle of 1991. Since then the BOP situation has continued to register improvement, although we have not come out of the shadows completely.

12.5 CAUSES OF BALANCE OF PAYMENTS DEFICITS

The BOP deficits have come to stay with us for long. We will take an overall view of the causes responsible for these deficits, and would like to identify them more particularly in light of receipt happening.

Balance of Trade Deficits: The first and the foremost cause of balance of payments deficit in India has been the trade deficits that India has had to encounter right since the beginning of the

growth process. The import needs of the economy went on increasing without a corresponding increase in exports, resulting in mounting trade deficits.

Even in more recent times there is sufficient evidence to indicate that the import intensity of Indian industry is rising under pressure of global competition, and with search for advanced technology this trend is certain to continue. Thus, there is apprehension that unless it is matched by high export growth there may be some risk of a substantial drain of foreign exchange reserves.

Declining Surpluses on Account of Invisibles: A marked feature of India's BOP has been that it has been earning a net surplus on account of trade in invisibles. Large earnings on account of invisibles have been due to remittances from Indians working abroad and surplus earnings on travel services. In the long run, the net position on invisibles would depend on the outcome of two opposing sets of forces-one being the surplus earnings on travel services, government transfers and private transfers and the other being the deficit on investment income. Interaction of these two sets of opposing forces would not, however, change the trend in the immediate future and invisible trade would generate surplus for some more time to come. But there exists a strong possibility that in the long run the negative forces of investment income would outweigh the positive impact of the rest of the items, leading to a deficit in invisible trade thereby creating further complications in the BOP.

Mounting Burden of External Debt Servicing: Another factor behind the increasing pressure on the BOP has been steadily mounting burden of external debt servicing. This is estimated to have increased from about $ 7.6 billion in 1989-90 to about 10.73 billion in 1998-99. Not only has the total volume of external debt been increasing rapidly, the share of short-term commercial borrowing-at market rates of interest as against concessional official development assistance (ODA)- and NRI deposits designated in foreign currencies has been increasing rapidly. With the hardening of interest rates abroad, this newly evolving pattern of external liabilities has steadily pushed up the debt service liability. Indeed, it is the increasing payment of interest on external debt – payment on current account arising from the increasing total debt liability, which has added to the need for external borrowing.

Dim Prospects of Getting Concessional Aid : During the earlier course of economic development, current account deficits could easily be founded by concessional aid both from bilateral and multilateral sources. But towards the end of eighties the various sources of

concessional assistance were drying up, whereas current account deficits were mounting up. The prospects for getting concessional aid on an increasing scale appear to be bleak under the given economic circumstances, mainly because of the following four factors:

(a) the generally worsening climate for official development Assistance (ODA)- most developed nations have been unwilling to increase and, in some cases, even maintain the size of their contribution,

(b) the view that the Indian economy is now will equipped to tap commercial sources of foreign exchange finance;

(c) the entry of new claimants on the pool, such as China and other nations of East Europe,

(d) and emergence of new independent nations, like Estonia, Lithuania, Latvia, Ukraine etc. Since commercial borrowings are quite a costly proposition there is a limit, beyond which it may not be possible for the Government to borrow. Even in case of such loans care must be taken that they should be raised for projects, which are carefully selected, speedily executed and which have direct impact on increasing our exports or reducing the magnitude of imports.

12.6 MEASURES ADOPTED TO SOLVE THE PROBLEM

From the point of view of the measures adopted by the government to solve the problem of BOP deficits the whole period since 1950-51 can be divided in two parts, viz. (1) 1951-91 and (2) since 1991.

1) ***Till 1991***, BOP deficits were sought to be controlled by measures like

(i) promoting the growth of import substitution type of industries,

(ii) putting physical restrictions on imports,

(iii) extending assistance for export promotion,

(iv) providing incentives for increasing foreign exchange earnings on account of invisibles.

The fact that these measures could only moderately be successful is brought out clearly by the fact that the country was faced with BOP crisis of unprecedented dimensions.

2) Since 1991 India has put in practice a comprehensive strategy to overcome BOP deficits. The main elements of this strategy can be identified as follows:

a) ***Fiscal and Monetary Discipline:*** Strict fiscal and monetary discipline has been sought to be adopted to control aggregate demand. The central fiscal deficit stands reduced from 8.4 per cent of GDP in 1990-91 budget to 4.5 per cent in 1999-2000.

Monetary policy has aimed at slowing down the growth of money supply. The rate of growth of money supply has been brought down from 18.5 per cent in 1991- 92 to 13.2 per cent in1995-96, and 17.8 per cent in 1998-99.

b) ***Exchange Rate Policy and Foreign Trade Policy Reforms:*** Till 1993, the exchange rate of the Indian rupee was fixed by Government. Since March 1, 1993, a new system of exchange rate determination has been introduced. This is known as the unified exchange rate system or UERS. Under this system, all payments and receipts of foreign exchange are converted in rupees at market rate of exchange.

Further, Union Budget for 1994-95 introduced full convertibility on current account that makes many trade transactions relatively free of controls. As a part of foreign trade policy reforms, imports restrictions on capital goods, raw materials and components have been virtually eliminated. Thus, excess import demand will be reflected in a higher market exchange rate and self-correcting mechanism will operate to keep trade deficit in check. Along with this considerable reductions in peak tariffs, especially tariffs on capital goods, have been affected. Cash margins and interest surcharge on import credit have been abolished. Harmonised system of customs classification has been introduced.

c) ***Structural Reforms***: Among these we may briefly mention as follows:

(i) substantial deregulation of trade and industry;

(ii) delicensing of many industries;

(iii)promotion of competition by the opening up of many areas previously reserved for the public sector to private and foreign investment;

(iv) policies put in place of attract foreign direct and port-folio investment;

(v) amendment of SICA to permit public enterprises to be examined by BIFR ;

(vi) financial sector reformers including deregulation of interest rates, dismantling of directed credit, reforming the banking system, improving the functioning of the capital market including the government securities market, etc.

d) ***Mobilisation of Exceptional Financing*** : Steps have been taken to mobilize exceptional finance from multilateral agencies and bilateral donors. (Exceptional financing need is defined as the requirement felt over and above the inflows of official project aid, commercial borrowings, and NRI deposits). Among other related measures are: stand-by arrangement with the IMF, structural adjustment and social safety net loans negotiated with Asian Development Bank, etc.

The present strategy to overcome BOP crisis is all comprehensive and well coordinated. The results of this type of strategy have been quick to appear. The pressures of BOP have considerably eased as is brought out by the fact that the foreign exchange reserves, which touched a low of # 30,000 million in late 1900s as shown in Table 12.4 below:

Table –12.4 : India's Foreign Exchange Reserves

End of March	Amount million	Import cover (no. of months)	Current Payments cover (no. of month)
1951	1914	16.8	14.6
1961	390	2.0	1.7
1971	584	2.9	2.2
1981	5850	4.5	4.0
1991	2236	1.0	0.8
1995	20708	8.2	5.9
1996	16018	5.44	3.8
1997	21261	7.00	4.0
1998	25975	7.50	4.5
1999	29522	7.50	4.5

It would be seen that whereas in 1991 we were left with meagre reserves sufficient to cover only one month's imports and 0.8 month's current payments, now we have accumulated reserves that cover about 7 months of imports and 4 months of current payments. This order of reserves is a good cushion and provides big flexibility to policy makers.

To conclude, India has formulated a successful strategy to overcome BOP limitations on growth. But, all the same, it need be remembered that a lasting solution to the BOP problem still eludes us. Our current account deficits are still large and are once again set to rise. Large current account deficits imply that we have to take resort to external borrowings, which in turn put further pressure on BOP deficits.

A lasting solution to the BOP deficits is to be found only in generation of large current account surpluses. Generation of current account surpluses, at the present stage of economic development, by and large, means that we should go in a big way to expand our exports. Rapid expansion in exports is the only way to find a permanent solution to our balance of payment problem.

12.7 CHECK YOUR PROGRESS

1. A situation in which a country's total earnings of foreign exchange fall short of its obligations of foreign exchange during a year is known as______________.
2. A marked feature of India's BOP has been that it has been earning a net surplus on account of.
3. The ratio of imports in total cost of inputs used in the production of a commodity is known as___________.

12.8 EXPORT PROMOTION IN INDIA-A LSTING SOLUTION TO BOP PROBLEM IN INDIA

"Export or Perish" has never been so relevant during the last four and a half decades as now.

12.8.1 Rationale of Export Promotion

Among the factors that make it almost compulsive that we increase the level of our exports, the following may be mentioned .

First, the import needs of the economy are likely to increase in future unless, as already stated, we are ready to slow down our process of growth; specifically the bill on account of direct oil imports and the investment-induced imports of foreign technology and capital put together, is likely to assume an enormous magnitude in the future. It will also be necessary to reckon with the additional deficits on account of non-oil imports.

Secondly, in the context of our past experience it may no longer sound proper to depend upon external assistance to finance essential imports. As long as such assistance is available it should be made use of, but in the process, we should not burn our own sails. Instead efforts should be on to take control of the situation whenever the external pipelines get choked up .

Thirdly, our debt-servicing burden has already assumed serious proportions and is projected to grow more serious. It may not be possible or advisable any more to contract new loans to pay off the old ones.

Fourthly, given the types of technology available, which favours large production units by bringing in economies of scale, our production structure, at least in a few important sectors, may become necessary to widen the market base by exploring new market abroad.

Fifthly, exports may also be needed to raise the earnings capacity for import of essential consumer goods like edible oil food grains (if required, at any time in future), sugar etc., whose domestic shortages have very often in the past, created serious instabilities in the economy.

Finally, the existence of a highly diversified industry, with a large entrepreneurial base experienced in assimilating technology, is providing the on-going reform process with the opportunity to generate rapid expansion in manufactured exports. Such rapid expansion of manufactured exports would not only increase the growth rate, insulate the economy from the dangers of another round of austerity necessitated by a BOP crisis, and more importantly, provide the most direct and powerful means for eradicating poverty. As the exports basket is widened to cover a greater range of labour-intensive manufactured goods and these experience similar if not higher, rate of growth, the impact on India's poor would be as dramatic as it has been in miracle East Asian economies. In short, the export sector is being regarded 'second only to defense'. This expresses the need for a vigorous export drive.

12.8.2 Measures for Export Promotion

Export promotion is a multi-dimensional activity. As such export promotion measures adopted by the Government have embraced a number of areas like production for export, quality control, packaging export credit and finance, export incentives and assistance, export marketing organisational set-up etc. We shall review the various measures undertaken under these different heads.

12.8.3 Export Production

The production for export has been given a special treatment by the Government, Industrial units in the priority sector exporting 10 per cent or more of their production are granted preferred sources of supply and facilities for further expansion of their export production.

Special treatment is also being accorded to 10 per cent export-oriented units (EOUs). The EOUs can be located anywhere in the country and are eligible for duty-free imports of capital goods, raw materials and components. Likewise, Export Processing Zones (EPZs) on the lines of Free Trade Zones (FTZs) of Singapore and Hong-Kong have been sent up to facilitate free imports and exports. Each zone provides basic Infrastrutural facilities like developed land, standard design factory buildings, built up sheds, roads, power, water supply and drainage, in addition to whole range of fiscal incentives.

12.8.4 Quality Control:

Intimately connected with the problem of exportable surplus is the problem of quality control. The Government has enforced quality control and pre-shipment inspection through the provision of the Export (Quality Control and Inspection)Act, 1983. Under the provisions of the Act, the

Export Inspection Council has been set up to discharge all the functions relating to quality control. There is compulsory export inspection for specified products. Packaging: Attractive packaging is as important as the quality of a product. In order to promote research in development cheap, sound and attractive packaging, the government has set up the Indian Institute of Packaging.

12.8.5 Export Credit and Finance

Short-term export credits in the form of pre-shipment and post-shipment finance are provided by the commercial banks, which are authorised dealers in foreign exchange. These credits have been covered by a special refinance scheme of the Reserve Bank of India and are provided at a concessional rate of interest.

12.8.6 Exim Bank:

The government has set up the Export-import Bank wide functions to finance, promote and develop foreign trade. It came into being on January 1, 1982.

Exim Bank is the principal financial institution engaged in coordinating the working of institutions engaged in financing and promoting export and import of goods. The Bank provides financial assistance to promote Indian exports through direct financial assistance, overseas investment finance, term finance for production and export development, pre-shipment credit, buyers, credit, line of credit, relending facility, export bill rediscounting, refinance to commercial banks, finance for computer software exports, marketing and bulk import finance for computer software exports, marketing and bulk import finance to commercial banks. The diversified lending programmes of Exim Bank now cover various stages of exports i.e., from the development of exports markets to expansion of production capacity for exports, production for exports and post-shipment financing. Exim Bank's focus is on export of manufactured goods projects.

12.8.7 Export Incentives and Assistance

Various types of export incentives have been evolved; these have been altered and modified from time to time to meet varying conditions. Broadly, these incentives can be classified into three categories, viz.,

(i) fiscal incentives,

(ii) financial incentives, and

(iii) special incentives schemes.

i) ***Fiscal incentives***. Under fiscal incentives the important measures that have been in vogue are income tax concessions, customs drawback, refund of excise duty, exemption from sales tax, provision for export under bond, and facility for manufacture under bond.

ii) ***Financial Incentives***. These incentives refer to the provision of cash assistance for specified export promotional efforts and export facilities.

iii) ***Special Incentives Schemes***. Easy access to imported inputs through instruments like the Open General Licence (OGL), Engineering Products Export Scheme, exemption from income tax for profit from exports lowering of the tariffs, etc. are some of the measures designed as incentives to the exporters.

12.8.8 Organisational Set-Up

The Government has established several specialized organizations for export promotion like

(i) The Central Advisory Board on Trade, (ii) The Trade Development Authority,

(iii) The Federation of Indian Export Organisations,

(iv) Export Promotion Councils,and

(v) Commodity Boards like Rubber Board, Coffee Board, Tea Board, Tobacco Board and Spices Board. Etc.

In addition, for increasing State participation in foreign trade, a number of public sector agencies have been set up, among which the more important are: The State Trading Corporation and the Minerals and Metals Trading Corporation. The STC group now includes, besides the STC, the Cashew Corporation of India, the Handicrafts and Handlooms Export Corporation, the Project and Equipment Corporation, the State Chemicals and Pharmaceuticals corporation and the Central Cottage Industries Export Corporation.

In short, the export promotion programme of the Government covers a very broad spectrum. To an extent these measures have been successful in as much as they have made stagnant Indian exports move, although at a slow rate. A consequence of the slow growth of exports has been that India's share in world exports has been falling gradually; presently, it stands at no more than 0.60 per cent. While, on the one hand, it reflects the poor performance of exports, on the other it also indicates, given proper opportunities, the vast potentialities for growth. Let us identify our basic limitations and suggest remedies for their removal.

12.8.9 Flaws in Export Promotion

i) A major flaw in our export promotion system is that we have been giving undue emphasis to improving price competitiveness of export products and profitability of export operations. Various fiscal, financial and other incentives have been evolved mainly for reducing cost disadvantage of export products and augmenting profitability of export marketing operations. While price plays an important role in influencing the buying decisions, other factors such as quality of the product, ability of the exporters to comply with the delivery schedule etc., also are important factors influencing foreign buyers. Therefore, export promotion measures can be effective only if they are duly co-ordinated to meet the export marketing needs in all respects i.e. distribution channels, quality of the product, etc.

(ii) though many export promotion bodies and export services institutions facilitate compilation and dissemination of international marketing information, vital information directly affecting export-marketing opportunities does not get properly compiled, analysed and systematically disseminated. Also, resources constraints inhibit individual firm to effectively act on market information received.

(iii) the levy of indirect taxes on export products and later the refund of the same is a wasteful process as the amount to be refunded gets unnecessarily blocked with the national exchequer thereby delaying its productive use.

(iv) availing of promotional measures involves various procedural formalities, which are complicated and also time-consuming. As long as the average producer is bitten by the bug "export and perish" nothing really can be achieved.

12.9 EXPORT STRATEGY

A sound strategy of export promotion need incorporate the following features:

Building up a Sound Export Production Base

Till the recent past very little has been done to build up a stable and viable export production base and supportive infrastructural facilities to cope effectively with a growing export demand. Supply constraints and infrastructural bottlenecks have, therefore, become stumbling blocks to export efforts as an integral part of the total production programme in the export oriented sectors. Therefore, it is necessary to make a deliberate production plan and to earmark a part of production for export even if there is a pressure of domestic demand on export supplies . In this connection, D.V. Kapur Committee has suggested: (i) inducing domestic producers through more

incentives to export, (ii) building in an advantage in attaining economies of scale, and (iii) further liberalisation of the licensing policies aimed at injecting intense competition.

Supply of Adequate Technology

It must be realised that a mere expansion of capacity for export production is not enough; it must be based on appropriate technology to enable us produce 6-Sigma quality products (6-Sigma indicates virtually zero defect product) so that products can stand competition in international markets. There is a growing technology gap between the world and us. Our technology may be appropriate to our needs but not for exports where updated technology is necessary. India's success in agricultural, space and nuclear research shows that it has the capacity to develop the most modern technologies if necessary resources of men and material and proper incentives are provided. While talking of technology, we should also keep in mind the need for the upgradation of packaging standards. Packaging is an integral part of the product and an important element of success of exports.

Concessional Supply of Intermediate Goods

A major hindrance to exports is the high costs of basic industrial inputs-steel, metals, plastics, glass, etc. – in the country. The only way to enable our exporters to compete fairly with their counterparts abroad is to ensure that these basic goods are available to everyone-exporters, potential exporters and non-exporters – international prices.

Selectivity in Exports

In the past we had a tendency to try and export whatever we could produce in excess of our requirements. In that context and particularly in terms of planned effort it was important that we should produce for whatever could find a market. The principle is still valid; but a glance at the range of goods that figure in world imports is sufficient to show that we cannot possibly produce all the goods for which world markets exist. Some additional criteria are, therefore, required to determine what goods India should try to produce for export. India should avoid, to the maximum extent possible, goods that are capital-intensive, energy-intensive or transport-intensive or which use domestically produced inputs that themselves are capital-intensive, energy-intensive or transport-intensive. There are many industries where India has an advantage because of relatively lower costs of all forms of manpower— whether it is professional or factory labour.

However, while this can given an initial advantage, it should not be taken for an enduring advantage. **One**, as products become more sophisticated, labour as a cost factor becomes less and less important. **Two**, the differences in cost are narrowed down through higher levels of automation. **Three**, in processes that require large number of cheap labour, the industry is bound to shift its operation along the line of the ever-declining scale of poorer countries. So a poorer country than Indian can eventually overtake us with yet cheaper labour. Therefore, when one has established an export market on the basis of cheaper manpower, one has to be vigilant to make sure that one builds up other advantages to compensate for the inevitable loss of this temporary advantage.

Expansion of Warehousing Facilities

Warehousing facilities should be expanded in important commercial centres abroad, specially for fast-moving consumer goods. Nowadays, foreign buyers are reluctant to keep a high level of inventories and want the exporters to do so in order to enable them to buy the product in smaller quantities and at short notice. Although warehousing is an expensive operation, it pays good dividends in the long run and helps establish closer and more stable relations with the market.

Supply of Trade Information

A well directed foreign trade policy should be based on accurate trade information supported by reliable data. We have yet to conceive of a system by which this can be done. At present trade statistics are based on highly loaded information supplied by the Export Promotion Councils to obtain maximum advantage of duty drawbacks and export subsidies.

Efforts to Widen and Diversity the Markets

Indian entrepreneurs have to constantly bear in mind the fast changing trade trends and reorient their strategies, to aim at deriving higher yield by way of larger shares in the markets and better unit realisation by way of higher levels of quality and value added products. The three pronged thrust on their part would call for:

a. a relentless attempt at recovering the last ground by wresting a larger share in the world markets for sectors of traditional strength like tea, spices, jute, leather, mica and other miscellaneous agro-based products;
b. a concerted move for maintaining and enhancing the momentum gained by commodities like oil meals, basmati rice,
c. marine products, etc; and

d. a sustained focus being kept on the sectors which have lately fared well- chemicals, engineering components, jewellery, fabrics, handicrafts, and software.

Finally, we have to realise that healthy export sector can be built up only on a strong domestic economic structure. A sound domestic economy is a must if we want a self-sustaining buoyant export sector. In this context it may be stressed that export promotion and import substitution are neither mutually exclusive nor alternative strategies of development. They represent two sides of the same coin. The factors and policies which would be necessary to bring about an acceleration in export growth would also lead to efficient import substitution: Whether it is a better management of the public sector and an alleviation of infrastructural bottlenecks, on the other hand, or an improvement in the performance of the agricultural sector and a revival of industrial growth, on the other. In other words, the economic determinants of the balance of payments must be related to development at a national level rather than the external sector alone, i.e., the balance of payments prospects should not be considered in isolation from the growth prospects of the economy.

12.10 SUMMARY

A developing economy needs more of imports to meet the development requirements of the economy. Since the exports fail to keep pace with the import requirements the deficit is met by foreign borrowings. This has created balance of payments difficulties for India. The ultimate solution to the problem lies in promoting exports on a big scale. This needs a well-formulated strategy.

12.11 GLOSSARY

Balance of Payments: A systematic record of all international economic transactions, visible and invisible, of a country during a year.

Balance of Trade: It is an account of exports and imports of goods only of a country.

Capital Account*:* Presents transfers of money and other capital items and changes in the country’s assets and liabilities resulting from the transactions in the current account

Current Account: It is an annual statement of income of a nation from the rest of the world. It states the net amount receivable or payable on account of transactions in goods and services both.

Current Account Deficit*:* A situation in which a country's total earnings of foreign exchange fall short of its obligations of foreign exchange during a year.

Concessional aid: Borrowing from an external source on easy terms.

Import Intensity: The ratio of imports in total cost of inputs used in the production of a commodity.

Portfolio Investment: Investment in the purchase of equity shares and debentures, etc.

12.12 ANSWERS TO CHECK YOUR PROGRESS/SAQ'S

1. Current account deficit
2. trade in invisibles
3. Import Intensity

12.13 BIBLIOGRAPHY/REFERENCES/SUGGESTED READINGS

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12.14 TERMINAL AND MODEL QUESTIONS

1. Discuss the important features of a sound Export Strategy.
2. What do you understand by the term 'Balance of Payments'. What is the significance of this concept in developing economies like India.
3. Evaluate various steps taken by the Government to solve the balance of payments difficulties.

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CHAPTER 13
INDIAN TRADE POLICY

13.1 OBJECTIVES

After studying this lesson you will be able to:

1. Understand the context and objectives of EXIM Policy in India
2. Understand the salient features of EXIM Policy of 2002-07
3. Understand the salient features of EXIM Policy of 2009-14
4. Identify the components of foreign capital and explain the role of foreign capital in economic growth;
5. Describe the characteristics of multinational corporations;
6. Prepare a case for multinational corporations in a developing economy;
7. Comment upon the need for liberal attitude towards foreign capital in India; and
8. Examine the response of domestic enterprises and foreign capital to recent policy changes
9. Evaluate the role played by MNCs in India.
10. Understand the difference between FERA and FEMA.

13.2 INTRODUCTION

The Govt. of India, Ministry of Commerce and Industry announce Export Import Policy every five years. The Export Import Policy (Foreign Trade Policy) is updated every year on the 31st of March and the modifications, improvements and new schemes are effective w.e.f. 1st April of every year.

13.3 CONTEXT OF TRADE POLICY

For India to become a major player in world trade, an all encompassing, comprehensive view needs to be taken for the overall development of the country's foreign trade. While increase in exports is of vital importance, we have also to facilitate those imports which are required to stimulate our economy. Coherence and consistency among trade and other economic policies is important for maximizing the contribution of such policies to development. Thus, while incorporating the existing practice of enunciating an annual Exim Policy, it is necessary to go much beyond and take an integrated approach to the developmental requirements of India's foreign trade. This is the context of the new Foreign Trade Policy. Trade is not an end in itself, but a means to economic growth and national development. The primary purpose is not the mere

earning of foreign exchange, but the stimulation of greater economic activity. **The Foreign Trade Policy is rooted in this belief and built around two major objectives**. These are:

(i) To double our percentage share of global merchandise trade within the next five years; and

(ii) To act as an effective instrument of economic growth by giving a thrust to employment generation.

13.4 STRATEGY OF TRADE POLICY

These objectives are proposed to be achieved by adopting, among others, the following strategies:

(i) Unshackling of controls and creating an atmosphere of trust and transparency to unleash the innate entrepreneurship of our businessmen, industrialists and traders.

(ii) Simplifying procedures and bringing down transaction costs.

(iii) Neutralizing incidence of all levies and duties on inputs used in export products, based on the fundamental principle that duties and levies should not be exported.

(iv) Facilitating development of India as a global hub for manufacturing, trading and services.

(v) Identifying and nurturing special focus areas which would generate additional ...

The Foreign Trade Policy 2009-14 of the Govt. of India is a "holistic strategy, driving export growth to new markets and addressing issues of labour-intensive export and intensive export and transaction cost effectively."

13.4.1 Objectives of last 2 policies of Foreign Trade of Government of India:

FOREIGN TRADE POLICY 2004-2009 :

The last 5 years (2004-09) FTP was released on 1st September in the year 2004.

i) To double India's share of global merchandise trade within next 5 years of policy and

ii) To act as an effective instrument of economic growth and generation of additional employment opportunity.

We won commendably on both the fronts over the last five years as the performance bears out.

FOREIGN TRADE POLICY 2009-2014

The current new FTP of 5 years (2009-14) FTP was released late on 27th August, 2009. There are three set targets.

i) In the short-term, to reach US $200 billion exports, growing 15 per cent over the next two years

ii) Over 2011-14 double the exports of goods and services from the current level, growing at 25 per cent over the three years.

iii) Long-term objective of 2020 – earmarked to double our Indian share of global trade in goods and shares from 1.65 per cent to 3.2 per cent.

Thrust Areas:

This current Foreign Trade Policy 2009-14 concentrates on five specific main areas and it is in many ways different from what had been done in the past. The first main pillar is stability and continuity in that :

- it continued the existing DEPB scheme for one more year,
- extended 10A/10B IT exemption to EOUs and to SITP units to one year,
- increased the EPCG coverage to 95 per cent

Salient Features

- Comprehensive Foreign Trade Policy to make India a global trade player - focus on employment generation, along with massive push to exports.
- Target plus scheme to achieve quantum increase in exports. Special package for agriculture - new scheme "Vishesh Krishi Upaj Yojana"(VKUY) to boost exports.
- All goods and services exported exempt from service tax, all exporters with minimum turnover of Rs 5 crore exempt from bank guarantee requirement, major procedural simplification and rationalisation measures.
- Improvements and additional flexibilities in EPCG scheme, DEPB to continue till replaced by suitable alternative.
- Free trade warehousing zone to make India a global trading hub. EOUs exempted from service tax.
- New rationalised scheme of status holder categorisation introduced. Special focus initiatives introduced in five areas.
- Bio-technology parks to be set up.
- Major thrust to service exports - "served from India" scheme - Export Promotion Council for Services.
- New mechanism for grievance redressal.

- Board of Trade to be revamped and given dynamic role.

13.5 FEATURES OF FOREIGN TRADE POLICY 2002-07

Union Commerce and Industry Minister Mr. Murasoli Maran announced the Exim policy for the 5 year period (2002-07) on March 31, 2002. The main thrust of the policy is to push India's exports aggressively by undertaking several measures aimed at augmenting exports of farm goods, the small scale sector, textiles, gems and jewellery, electronic hardware etc. Besides these, the policy aims to reduce transaction cost to trade through a number of measures to bring about procedural simplifications. In addition, the Exim policy removes quantitative restrictions (QRs) on exports, except a few sensitive items.

1. Special Economic Zones (SEZs):-

i. Offshore Banking Units (OBUs) shall be permitted in Special Economic Zones (SEZs).

ii. Units in SEZ would be permitted to undertake hedging of commodity price risks, provided such transactions are undertaken by the units 'on stand alone' basis.

iii. Units in SEZ shall be permitted External Commercial Borrowings (ECBs) for a tenure of less than three years.

iv. Four existing EPZs have been converted into SEZs and 13 New SEZs have already been given approval.

2. ***Employment Oriented Measures***:- Exim (2002-07) policy initiated a number of measures which would help employment orientation. Among them were the following:

Agriculture :

i. Removal of quantitative and packaging restrictions on wheat and its products, butter, pulses, grain and flour of barley, maize, bajra, ragi and jowar.

ii. Removal of restrictions on export of all cultivated (other than wild) varieties of seed, except jute and onion.

iii. Agricultural Export Zones have been notified.

iv. Transport subsidy for export of fruits, vegetables, floriculture, poultry and dairy products.

v. 43 per cent special DEPB rate for primary and processed foods exported in retail packaging of 1 kg. or less.

Cottage Sector and Handicrafts :

i. An amount of Rs. 5 crore under Market Access Initiative (MAl) has been earmarked for promoting cottage sector exports coming under the Khadi and Village Industries Commission (KVIC).
ii. Market Access Initiative (MAI) scheme for the development of website for virtual exhibition of products from the handicrafts sector. ,
iii. Entitlement for Export House Status at Rs. 5 crore instead of Rs.15 crore for others.
iv. Entitlement to duty free imports of an enlarged list of items as embellishments upto 3 per cent of FOB value of exports

Small Scale Industry :

With a view to encouraging further development of centres of economic and export excellence such as Tirpur for hosiery, woolen blankets in Panipat, woollen knitear in Ludhiana, following benefits would be available to small-scale sector.

i. EPCG facility for the common service providers in these areas.
ii. Market Access Initiative (MAl) for creating focused technological services and marketing
iii. broad to the recognised associations of units in SSI.
iv. Entitlement for Export House Status at Rs. 5 crore instead of Rs.15 crore for others.

Leather:-

i. Duty free imports upto 3 per cent of f.o.b. value combined to leather garments has been extended to all leather products.

Textiles :

i. Sample fabrics permitted duty free within the 3 per cent limit for trimmings and embellishments.
ii. Additional items such as zip fasteners, inlay cards, eyelets, rivets, toggles, Velcro tape, cord and cord stopper included in input output norms.
iii. Duty Entitlement Passbook (DEPB) rates for all kinds of blended fabrics permitted.

Gem and Jewellery :

i. Import of rough diamonds is allowed freely at 0 per cent customs duty.
ii. Licensing regime for rough diamond is being abolished.

iii. Value addition norms for export of plain jewellery reduced to 7 per cent and for all merchandised unstudded jewellery to 3 per cent. .

iv. Personal carriage of jewellery allowed through Hyderabad and Jaipur airport as well.

3.Technology Oriented

Electronic Hardware:-

i. Conversion of the Electronic Hardware Technology Park (EHTP) into zero duty regime under the ITA (Information Technology Agreement)-I

ii. Net Foreign Exchange as Percentage of Exports (NEEP) to be made positive in 5 years.

iii. No other export obligation for units in EHTP.

Chemicals and Pharmaceuticals :

i. 65 per cent of DEPB rate for pesticides formulations.

ii. No limit on export of samples. .

iii. Reimbursement of 50 per cent of registration fees on registration of drugs.

Projects:

i. Free import of equipment and other goods used abroad for more than one year.

4.*Growth* Oriented

Strategic Package for Status Holders:

i. License, certificate, permissions. and customs clearances for both imports and exports on self-declaration basis.

ii. Priority finance for medium and long term capital requirement as per conditions notified by the RBI.

iii. Exemption from compulsory negotiation of documents through banks, However, the remittance would continue to be received through banking channels.

iv. 100 per cent retention of foreign exchange in Exchange Earner's Foreign Currency (EEFC) account.

v. Enhancement in normal repatriation period from 180 days to 360 days,

Diversification of Markets :

i. Setting up of "Business Centre" in Indian missions abroad for visiting Indian exporters/businessmen.

ii. ITPO portal to host a permanent virtual exhibition of Indian export products.

iii. Focus Latin American Countries (LAC) has been extended upto March 2003.

iv. Focus Africa has been launched for developing trade relations with the Sub-Saharan African region. The exporters exporting to these markets shall be given Export House Status on export of Rs. 5 crore.

v. Links with the Commonwealth of Independent States (CIS) countries to be revived.

North Eastern States, Sikkim and Jammu and Kashmir :

i. Transport subsidy for exports to be given to units located in North East, Sikkim and-Jammu and Kashmir so as to offset the disadvantage of being far from ports.

Neutralising High Fuel Cost:-

i. Fuel costs to be rebated for all export products. This would enhance the cost competitiveness of our export products.

PROCEDURAL REFORMS

DIRECTOR GENERAL OF FOREIGN TRADE (DGFT)

i. The new 8 digit commodity classification for imports introduced by the Director General of Foreign Trade (DGFT) would also be adopted by the Customs and Director General of Commercial Intelligence and Statistics (DGCI&S) shortly. This will eliminate the classification disputes and hence reduce transaction costs and time.

ii. The maximum fee limit for electronic application under various schemes has been reduced from Rs. 1.5 lakh to Rs. 1.00 lakh.

iii. Same day licensing introduced in all regional offices.

(b) *CUSTOMS* :

i. Adoption and harmonisation of the 8 digit Indian Trade Classification (ITC) Harmonised System (HS) code.

ii. The percentage of physical examination of export cargo has already been reduced to less than 10 per cent except for a few sensitive destinations.

iii. Fixation of special brand rate of drawback within 15 days.

BANKS :

i. Direct negotiation of export documents to be permitted.

ii. 100 per cent retention in Exchange Earners Foreign Currency (EEFC) accounts.

iii. Enhancement in normal repatriation period from 180 days to 360 days.'

TRUST BASED

i. Import and export of samples to be liberalised for encouraging product up gradation
ii. Penal interest rate for bonafide defaults to be brought down from 24 per cent to 15 per cent.
iii. No penalty for non-realisation of export proceeds in respect of cases covered by ECGC insurance package.
iv. No seizure of stock in trade so as to disrupt the manufacturing process affecting delivery schedule of exporters.
v. Foreign Inward Remittance Certificate (FIRC) to be accepted in lieu of Bank Realisation Certificate for documents negotiated directly.
vi. Optional facility to convert from one scheme to another scheme. In case the exporter is denied the benefit under one scheme, he shall be entitled to claim benefit under some other scheme.
vii. Newcomers to be entitled for licences without any verification against execution of Bank

13.6 FEATURES OF FOREIGN TRADE POLICY 2009-14

- DEPB Scheme upto December 2010.
- To encourage value addition in our manufactured exports and towards this end, have stipulated a minimum 15 per cent.
- 100 per cent export oriented units for one additional year till 31st March 2011.
- The Government seeks to promote Brand India through six or more 'Made in India' shows to be organized across the world every year.
- Foreign Trade Policy is to help exporters for technological upgradation export sector infrastructure, 'Towns of Export Excellence' and units located therein would be granted additional focused support and incentives.
- To encourage production and export of 'green products' through measures such as phased manufacturing programme for green vehicles, zero duty EPCG scheme and incentives for exports.
- e-Trade project would be implemented in a time bound manner to bring all stake holders on a common platform. Additional ports/locations would be enabled on the Electronic Data Interchange over the next few years.

- Incentive available under Focus Market Scheme (FMS) has been raised from 2.5 per cent to 3 per cent.
- Incentive available under Focus Product Scheme(FPS) has been raised from 1.25 per cent to 2 per cent.
- 26 new markets have been added under Focus Market Scheme. These include 16 new markets in Latin America and 10 in Asia-Oceania.
- 153 ITC(HS) Codes at 4 digit level Product classified for Market Linked Focus Product Scheme (MLFPS)
- Focus Product Scheme benefit extended for export of ‘green products’; and for exports of some products originating from the North East.
- To accelerate exports and encourage technological upgradation, additional Duty Credit Scrips shall be given to Status Holders @ 1 per cent of the FOB value of past exports.
- Income Tax exemption to 100 per cent EOUs and to STPI units under Section 10B and 10A of Income Tax Act, has been extended for the financial year 2010-11 in the Budget 2009-10.
- In Tea Sector Minimum value addition under advance authorisation scheme for export of tea has been reduced from the existing 100 per cent to 50 per cent.
- DTA sale limit of instant tea by EOU units has been increased from the existing 30 per cent to 50 per cent.
- EOUs will now be allowed CENVAT Credit facility for the component of SAD and Education Cess on DTA sale.
- 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.
- Duty Free Import of samples by exporters, number of samples/pieces has been increased from the existing 15 to 50.
- Exemption for up to two stages from payment of excise duty in lieu of refund, in case of supply to an advance authorisation holder (against invalidation letter) by the domestic intermediate manufacturer.
- Reduce transaction costs, dispatch of imported goods directly from the Port to the site has been allowed under Advance Authorisation scheme for deemed supplies.

- Free Sale Certificate has been simplified and the validity of the Certificate has been increased from 1 year to 2 years.

Higher Support for Market and Product Diversification

i. Incentive schemes under Chapter 3 of the policy have been expanded by way of addition of new products and markets.

ii. 26 new markets have been added under Focus Market Scheme. These include 16 new markets in Latin America and 10 in Asia-Oceania.

iii. The incentive available under Focus Market Scheme (FMS) has been raised from 2.5 per cent to 3 per cent.

iv. The incentive available under Focus Product Scheme(FPS) has been raised from 1.25 per cent to 2 per cent.

v. A large number of products from various sectors have been included for benefits under FPS. These include, Engineering products (agricultural machinery, parts of trailers, sewing machines, hand tools, garden tools, musical instruments, clocks and watches, railway locomotives etc.), Plastic (value added products), Jute and Sisal products, Technical Textiles, Green Technology products (wind mills, wind turbines, electric operated vehicles etc.), Project goods, vegetable textiles and certain Electronic items.

vi. Market Linked Focus Product Scheme (MLFPS) hasbeen greatly expanded by inclusion of products classified under as many as 153 ITC(HS) Codes at 4 digit level. Some major products include; Pharmaceuticals, Synthetic textile fabrics, value added rubber products, value added plastic goods, textile madeups, knitted and crocheted fabrics, glass products, certain iron and steel products and certain articles of aluminium among others. 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).

vii. MLFPS benefits also extended for export to additional new markets for certain products. These products include auto components, motor cars, bicycle and its parts, and apparels among others.

viii. A common simplified application form has been introduced for taking benefits under FPS, FMS, MLFPS and VKGUY.

ix. Higher allocation for Market Development Assistance (MDA) and Market Access Initiative (MAI) schemes is being provided.

Technological Upgradation

x. To aid technological upgradation of our export sector, EPCG Scheme at Zero Duty has been introduced. This Scheme will be available for engineering & electronic products, basic chemicals & pharmaceuticals, apparels & textiles, plastics, handicrafts, chemicals & allied products and leather & leather products (subject to exclusions of current beneficiaries under Technological Upgradation Fund Schemes (TUFS), administered by Ministry of Textiles and beneficiaries of Status Holder Incentive Scheme in that particular year). The scheme shall be in operation till 31.3.2011.

xi. Jaipur, Srinagar and Anantnag have been recognised as 'Towns of Export Excellence' for handicrafts; Kanpur, Dewas and Ambur have been recognised as 'Towns of Export Excellence' for leather products; and Malihabad for horticultural products.

EPCG Scheme Relaxations

xii. To increase the life of existing plant and machinery, export obligation on import of spares, moulds etc. under EPCG Scheme has been reduced to 50 per cent of the normal specific export obligation.

xiii. 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

xiv. Focus Product Scheme benefit extended for export of 'green products'; and for exports of some products originating from the North East.

Status Holders

xv. To accelerate exports and encourage technological upgradation, additional Duty Credit Scrips shall be given to Status Holders @ 1 per cent of the FOB value of past exports. The duty credit scrips can be used for procurement of capital goods with Actual User condition. 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) [subject to exclusions of current beneficiaries under Technological Upgradation Fund Schemes (TUFS)]. This facility shall be available upto 31.3.2011.

xvi. Transferability for the Duty Credit scrips being issued to Status Holders under paragraph 3.8.6 of FTP under VKGUY Scheme has been permitted. This is subject to the condition that transfer would be only to Status Holders and Scrips would be utilized for the procurement of Cold Chain equipment(s) only.

Stability/ Continuity of the Foreign Trade Policy

xvii. To impart stability to the Policy regime, Duty Entitlement Passbook (DEPB) Scheme is extended beyond 31-12- 2009 till 31.12.2010.

xviii. Interest subvention of 2 per cent for pre-shipment credit for 7 specified sectors has been extended till 31.3.2010 in the Budget 2009-10.

xix. Income Tax exemption to 100 per cent EOUs and to STPI units under Section 10B and 10A of Income Tax Act, has been extended for the financial year 2010-11 in the Budget 2009-10.

xx. The adjustment assistance scheme initiated in December, 2008 to provide enhanced ECGC cover at 95 per cent, to the adversely affected sectors, is continued till March, 2010.

Marine sector

xxi. Fisheries have been included in the sectors which are exempted from maintenance of average EO under EPCG Scheme, subject to the condition that Fishing Trawlers, boats, ships and other similar items shall not be allowed to be imported under this provision. This would provide a fillip to the marine sector which has been affected by the present downturn in exports.

xxii. Additional flexibility under Target Plus Scheme (TPS) / Duty Free Certificate of Entitlement (DFCE) Scheme for Status Holders has been given to Marine sector.

Gems & Jewellery Sector

xxiii. To neutralize duty incidence on gold Jewellery exports, it has now been decided to allow Duty Drawback on such exports.

xxiv. In an endeavour to make India a diamond international trading hub, it is planned to establish “Diamond Bourse (s)”.

xxv. A new facility to allow import on consignment basis of cut & polished diamonds for the purpose of grading/ certification purposes has been introduced.

xxvi. To promote export of Gems & Jewellery products, the value limits of personal carriage have been increased from US$ 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.

Agriculture Sector

xxvii. To reduce transaction and handling costs, a single window system to facilitate export of perishable agricultural produce has been introduced. The system will involve creation of multi-functional nodal agencies to be accredited by APEDA.

Leather Sector

xxviii. Leather sector shall be allowed re-export of unsold imported raw hides and skins and semi finished leather from public bonded ware houses, subject to payment of 50 per cent of the applicable export duty.

xxix. Enhancement of FPS rate to 2 per cent, would also significantly benefit the leather sector.

Tea

xxx. Minimum value addition under advance authorisation scheme for export of tea has been reduced from the existing 100 per cent to 50 per cent.

xxxi. DTA sale limit of instant tea by EOU units has been increased from the existing 30 per cent to 50 per cent.

xxxii. Export of tea has been covered under VKGUY(Vishesh Krishi Gram Udyog Yojana) Scheme benefits.

Pharmaceutical Sector

xxxiii. Export Obligation Period for advance authorizations issued with 6-APA as input has been increased from the existing 6 months to 36 months, as is available for other products.

xxxiv. Pharma sector extensively covered under MLFPS for countries in Africa and Latin America; some countries in Oceania and Far East.

Handloom Sector

xxxv. To simplify claims under FPS, requirement of 'Handloom Mark' for availing benefits under FPS has been removed.

EOUs

xxxvi. EOUs have been allowed to sell products manufactured by them in DTA upto a limit of 90 per cent instead of existing 75 per cent, without changing the criteria of 'similar goods', within the overall entitlement of 50 per cent for DTA sale.

xxxvii. To provide clarity to the customs field formations, DOR shall issue a clarification to enable procurement of spares beyond 5 per cent by granite sector EOUs.

xxxviii. EOUs will now be allowed to procure finished goods for consolidation along with their manufactured goods, subject to certain safeguards.

xxxix. During this period of downturn, Board of Approvals (BOA) to consider, extension of block period by one year for calculation of Net Foreign Exchange earning of EOUs.

xl. EOUs will now be allowed CENVAT Credit facility for the component of SAD and Education Cess on DTA sale.

Thrust to Value Added Manufacturing

xli. To encourage Value Added Manufactured export, a minimum 15 per cent value addition on imported inputs under Advance Authorization Scheme has now been prescribed.

Coverage of Project Exports and a large number of manufactured goods under FPS and MLFPS.

DEPB

DEPB rate shall also include factoring of custom duty component on fuel where fuel is allowed as a consumable in Standard Input-Output Norms.

Flexibility provided to exporters

Payment of customs duty for Export Obligation (EO) shortfall under Advance Authorisation / DFIA / EPCG Authorisation has been allowed by way of debit of Duty Credit scrips. Earlier the payment was allowed in cash only.

Import of restricted items, as replenishment, shall now be allowed against transferred DFIAs, in line with the erstwhile DFRC scheme.

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.

Transit loss claims received from private approved insurance companies in India will now be allowed for the purpose of EO fulfillment under Export Promotion schemes. At present, the facility has been limited to public sector general insurance companies only.

In cases, where RBI specifically writes off the export proceeds realization, the incentives under the FTP shall now not be recovered from the exporters subject to certain conditions.

Simplification of Procedures

To facilitate duty free import of samples by exporters, number of samples/pieces has been increased from the existing 15 to 50. Customs clearance of such samples shall be based on declarations given by the importers with regard to the limit of value and quantity of samples.

To allow exemption for up to two stages from payment of excise duty in lieu of refund, in case of supply to an advance authorisation holder (against invalidation letter) by the domestic intermediate manufacturer. It would allow exemption for supplies made to a manufacturer, if such manufacturer in turn supplies the products to an ultimate exporter. At present, exemption is allowed upto one stage only.

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.

To reduce transaction costs, dispatch of imported goods directly from the Port to the site has been allowed under Advance Authorisation scheme for deemed supplies. At present, the duty free imported goods could be taken only to the manufacturing unit of the authorisation holder or its supporting manufacturer.

Disposal of manufacturing wastes / scrap will now be allowed after payment of applicable excise duty, even before fulfillment of export obligation under Advance Authorisation and EPCG Scheme.

Regional Authorities have now been authorised to issue licences for import of sports weapons by ‘renowned shooters’, on the basis of NOC from the Ministry of Sports & Youth Affairs. Now there will be no need to approach DGFT(Hqrs.) in such cases.

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. This will solve the problems faced by the medical devices industry.

Automobile industry, having their own R&D establishment, would be allowed free import of reference fuels (petrol and diesel), upto a maximum of 5 KL per annum, which are not manufactured in India.

Acceding to the demand of trade & industry, the application and redemption forms under EPCG scheme have been simplified.

Reduction of Transaction Costs

No fee shall now be charged for grant of incentives under the Schemes in Chapter 3 of FTP. Further, for all other Authorisations/ licence applications, maximum applicable fee is being 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).

To further EDI initiatives, Export Promotion Councils/ Commodity Boards have been advised to issue RCMC through a web based online system. It is expected that issuance of RCMC would become EDI enabled before the end of 2009.

Electronic Message Exchange between Customs and DGFT in respect of incentive schemes under Chapter 3 will become operational by 31.12.2009. This will obviate the need for verification of scrips by Customs facilitating faster clearances.

For EDI ports, with effect from December '09, double verification of shipping bills by customs for any of the DGFT schemes shall be dispensed with.

In cases, where the earlier authorization has been cancelled and a new authorization has been issued in lieu of the earlier authorization, application fee paid already for the cancelled authorisation will now be adjusted against the application fee for the new authorisation subject to payment of minimum fee of Rs. 200.

An Inter Ministerial Committee will be formed to redress/ resolve problems/issues of exporters.

An updated compilation of Standard Input Output Norms (SION) and ITC (HS) Classification of Export and Import Items has been published.

Directorate of Trade Remedy Measures

To enable support to Indian industry and exporters, especially the MSMEs, in availing their rights through trade remedy instruments, a Directorate of Trade Remedy Measures shall be set up.

13.7 FOREIGN CAPITAL AND MULTI NATIONAL CORPORATIONS

Inflow of capital from abroad is vital for growth of a developing economy, especially in the initial stages of its economic development. Modern economic history abounds with examples of countries that have successfully drawn upon the capital resources of more advanced countries for the sake of economic development. Even later, several Asian countries have performed similar feats. Let us examine India's experience in this regard.

13.7.1 Components of Foreign Capital

The inflow of capital from abroad may take either in the form of (a) foreign aid, or (b) private investment. Foreign aid includes loans and grants from foreign governments and institutions. This source of foreign capital, especially loans, has an important limitation in the form of repayments obligations. As regards private foreign capital investment, the intense academic debate relating to its effects remains inconclusive. The opponents of foreign investment have drawn attention to several imperfections and adverse effects, such as capital intensity of such investment, inappropriate technology, the possible adverse effects on income distribution, transfer pricing and the negative contribution that such investment often makes to the BOP.

The advocates of foreign investment, on the other hand, have highlighted the beneficial effects in terms of encouragement to the development of technology, managerial expertise, integration with the world economy, exports and higher growth. It has also been claimed that debt financing generates fixed debt servicing obligations, while equity needs to be serviced only after profits are made. There is also substantial empirical evidence, which can be presented to support both points of view. For example, in recent years, foreign private investment seems to have contributed enormously to the growth of several Asian newly industrialising countries (e.g. Thailand, Malasia and Singapore). There are examples, particularly from Latin America and Africa, where the contribution of foreign investment has not been so encouraging.

The two important sources of private capital investment are:

i) Direct Business Investment: It may comprise any of the following forms:

a. investment by branches of foreign companies,
b. investment by subsidiaries of foreign companies, and
c. investment by other foreign controlled companies.

ii) Portfolio Investment: It may comprise:

a. equity holdings by non-residents in the recipient country's joint stock companies;

b. creditor capital from private sources abroad invested in recipient country's joint stock companies, and
c. creditor capital from official sources in recipient country's joint stock companies.

Investment and Collaborations although foreign investment and collaboration with foreign parties are very closely interrelated, they are not one and the same thing. Foreign investment may take place without collaboration and vice versa. Capital participation refers to the foreign partner's stake in the capital of the recipient country's company while technical collaboration refers to such facilities provided by the foreign partner as technical services, licensing, franchise, trade marks and patents (against which he gets lump sum or royalty payments for a specified period).In modern times, multinational corporations (MNCs) have become the major carries of foreign capital and technical know-how. We shall examine in brief the major characteristics of this form of organisation.

13.8 MULTINATIONAL CORPORATIONS

An MNC is one, which undertakes foreign direct investment, i.e., it owns or controls income generation assets in more than one country, and in so doing produces goods and services outside its country of origin, i.e., engages in international production. As per the estimates made available by the UN Centre on Transnational Corporations there are in operation about 11 thousand subsidiaries abroad.

13.8.1 Characteristics of Multinational Corporations

The MNCs have certain characteristics, among which the more important are as follows:

Giant Size: The assets and sales of MNCs run into billions of dollars and they also make supernormal profits. For example, the foreign assets of Royal Dutch Shell, the world's largest MNC, are estimated to be $ 69 billion, larger than the GDP of Pakistan ($ 40 billion), Nigeria ($ 34 billion), or the Philippines ($ 45 billion).

International Operations: In such a corporation control resides in the hands of a single institution. But its interests and operations sprawl across national boundaries. An MNC operates through a parent corporation in the home country. It may assume the form of a branch or a subsidiary in the home country. If it is a branch, it acts for the parent corporation without any local capital or management assistance. If it is subsidiary, the majority control is still exercised by the foreign parent company, although it is incorporated in the home country. The foreign control may range anywhere between the minimum of 51 per cent to the full 100 per cent . An

MNC thus combines ownership with control. The branches and subsidiaries of an MNC operate under the united control of the parent company.

iii) *Oligopolistic Structure*: Through the process of merger and takeover, etc., in course of time an MNC acquires awesome power. This coupled with its giant size makes it Oligopolistic in character.

iv) *Spontaneous Evolution:* MNCs usually grow in a spontaneous and unconscious manner. Very often they develop through " creeping increments". Many firms have become international by accident. At times, firms have also established and better opportunities prevailing in the home country.

v) *Collective Transfer of Resources:* An MNC facilitates a multilateral transfer of resources. Usually this transfer takes place in the form of a "package" which includes technical know-how, equipments and machinery, raw materials, finished product, managerial services, and so on. MNCs are composed of a complex of widely varied modern technology ranging from production and marketing to management and finance .

13.8.2 Significance of Multinational Corporations

The MNCs have revolutionary effect on the international economic system. It is so because the growth of international transactions of the MNCs has affected the more traditional flows and international trade for many economies. Moreover, with the retreat of socialism, and failure of aid as an instrument of economic development, there has been a greater realisation of the capacity of MNCs to deliver an efficient package of practices. In the 1970s MNCs were seen as pariahs, not saviours objects of harm, not instruments for good. These attitudes have changed in the last few years. Today they constitute a powerful force in the world economy. One estimate suggests that the biggest 500 MNCs control about 10 per cent of world trade, 80 per cent of foreign investment and about 30 per cent of world GDP. Indeed the MNCs have become the main agents in the economy and in trade so much so that production and trade statistics in the form of national aggregates have become obsolete.

13.8.2.1 The Case for Multinational Corporations

There are several advantages, which arise as a result of the operations of MNCs. In fact, it has been emphasised that MNCs are an economic phenomenon, which no one can wish away except at the cost of remaining on a Robinson Crusoe island in an ocean of prosperity.

The benefits of MNCs may briefly be discussed as follows:

i) The UDCs are technology backward. They lack sufficient pre-sources to carry on research and development. From this point of view, MNCs have offered a great boon. They have served as agents for the transfer of superior technology. They have provided advanced technological know-how, sophisticated manufacturing processes and improved skills to UDCs.

ii) The MNCs have helped the UDCs to secure capital from the developed countries.

iii) The UDCs do not have a sufficient degree of "linkage" with other industries. The MNCs usually produce "linking effects" in the host country. They also help in the creation of "linked industries". Such linkages may be either forward or backward. The MNCs help to build up "knowledge base" and thus serve the development of human resources. They serve as carriers of knowledge and experience.

iv) The MNCs also help to build up "knowledge base" and they serve the development of human resources.

v) The operations of MNCs have a favourable effect on the balance of payments of the host country. As "Global Scanners" they possess a global marketing organisation through which they can promote exports from the developing countries.

vi) The MNCs also help in creating large scale employment opportunities by setting up their branches and subsidiaries in the host countries. Employment generation is a function of mainly two variables, first the rate of growth of investment, and secondly, the nature of technology. Investment by MNCs is, therefore, encouraged in the UDCs.

vii) In a situation where a country is already faced with a heavy debt servicing burden further borrowing by it may only push it into what may be called 'debt trap'. Private investment will help it get necessary foreign exchange resources, whereas it will help avoid adding to the debt-servicing burden.

13.8.2.2 The Case Against Multinational Corporations

First, MNCs are primarily profit-oriented. They tend to concentrate more on the technology–intensive branches of manufacturing, not only because they tend to capitalise on their cost advantage but also to protect their market for certain commodities. Thus, the role of MNCs in the underdeveloped world does not serve the purpose as required, because the sectors in which they invest create relatively few jobs and thus fail to help eradicate unemployment and poverty two chronic problems of the south.

Secondly, MNCs bring in their own technology, which is usually capital intensive, and hence more suitable to advanced parent countries. They make no effort to adapt an appropriate technology suitable to the needs, circumstances and environment of the host country. They strive to make industry permanently dependent on overseas expertise and technology. It may be added, however, that if a country is as big as of India's size, there is no reason to fear that such investment can ever reach at levels which would threaten the country with the unenviable status of a banana republic.

Thirdly, the transfer of technology proves extremely costly. The MNCs charge exorbitantly in the form of fee, royalty and other charges, which put a severe drain on the foreign exchange resources of a UDC. There seems to be a historical formula in use: 70 per cent more of a given inflow of foreign capital per year flows out from the host country in the visible forms of profit and dividend. Also, MNCs are being accused of creating a major brain drain in the country, for they whisk away the top skilled manpower available in the country.

Fourthly, MNCs promote regional economic disparities. These create islands of development and prosperity in the ocean of underdevelopment.

Fifthly, the presence of MNCs may prove detrimental to the long-run industrial development of the country. If a strong MNC is operating in a particular field, the local firms may find it difficult to compete with it.

Sixthly, although MNCs could have played a catalytic role in the promotion of research and development in the developing economies, their performance in this connection is far from satisfactory. They expenditure on scientific research in negligible.

Seventhly, in the business operations the MNCs very often take resort to undesirable and corrupt practices. A report of the UN have given a lucid account of many of such practices, rigging of bids, price fixing and other forms of market distortions. They also take resort to devious means to increase their profit, e.g., recent moves by MNCs in India to diver high-profit activities to their 100% owned subsidiaries from the listed affiliates in which they have simple majority equity stake.

Eighthly, MNCs prefer to participate in the production of mass consumption and non-essential items. A plethora of international brands selling junk food, designer jeans and sunglasses do not make for meaningful investment.

Finally, once financial liberalisations are in place and freer movement allowed, international capital could quickly make a developing country bend to its will by destablising, for example, the currency market and forcing devaluations or withdrawing support to Government bonds and endangering the continuance of the Government itself.

In a partial response to the above arguments it may be stated that many of the old myths are no longer valid. Present day Third World Governments are not exactly powerless like those of yesteryears, nor are the modern MNCs unscrupulous, insensitive and interventionist. They have transformed themselves into modern MNCs, which acknowledge their responsibility to the concerns and interests of the host countries and basically operate on the basis of maturity of interest of both. MNCs are increasingly losing the sense of loyalty to their home country to provide employment. They are in search of bases where they can produce their products most competitively. The slogans “Think global, act local” and “multi-domestic” are working reality with most multinationals today. In view of this, there has been a perceptible change in the attitude of the UDCs towards the MNCs.

13.8.3 Regulation of Multinational Corporations

In view of the fact that MNCs do possess a potential that can be gainfully exploited, most of the UDCs have chosen to regulate their activities rather than to dispense with them altogether an effort to separate the gold from the dross.

First, the threat of nationalisation is an effective tool of regulation. Although nationalisation should be resorted to only in the extreme situation, the very fact that it can be exercised makes the corporations act in a disciplined manner.

Secondly, the Government may allow collaboration in certain selected industries or certain selected regions where the operation of MNC is felt highly suitable.

Thirdly, MNCs many be allowed to invest for specific period. Thus, after a certain period of time restrictions may be imposed on foreign holdings, or there may be provision for gradual disinvestment.

Fourthly, a multi-tax system may be followed by the Government. The MNCs be taxed at a higher rate. Fifthly, the host country may lay down certain export criteria.

Finally, MNCs may be asked to carry out a minimum fixed share of their total research and development activities within the host countries.

13.9 GOVERNMENT POLICY TOWARDS FOREIGN CAPITAL IN INDIA

In the planned economy of India, foreign capital has been assigned a significant role, although it has been changing over time. In the earlier phase of planning, foreign capital was looked upon as a means to supplement domestic investment. Many a concession and incentives were given to foreign investors. Later on, however, the emphasis shifted to encouraging technological collaborations between Indian entrepreneurs and foreign entrepreneurs. In more recent times, efforts are on to invite free flow of direct foreign investment. It would be instructive in this background to examine the Government's policy towards foreign capital before we analyse the role of foreign capital in the Indian economy. Foreign investment in India is subject to the same industrial Policy as all other business ventures, plus some additional policies and rules specially governing foreign collaborations.

The first articulate expression of free India's attitude towards foreign capital was embodied in the IPR, 1948, which emphasised, at once, the need for carefully regulating as well as inviting private foreign capital. It laid special stress, inter alia, on the need to ensure that in all cases of foreign collaboration, the majority interest was always India. This was followed by the Fiscal Commission of 1949-50 which

recommended that foreign investment may be permitted, first, in the public sector projects needing imported capital goods, and secondly, in new private industries where no indigenous capital or technical know how was likely to be available. This was followed by a statement on policy towards foreign capital made by the Government on April 6, 1949. The underlying principles of the policy by and large are valid even now. These may be enumerated as follows:

i) Foreign capital once admitted will be treated as par with indigenous capital.

ii) Facilities for remittance of profits abroad will continue.

iii) As a rule, the major interest in ownership and effective control of an undertaking should be in Indian hands.

iv) If an enterprise is acquired, compensation will be paid on a fair and equitable basis.

v) The Government would not object to foreign capital having control of a concern for a limited period and each individual case will be dealt with on its merits.

In short, the Government promised non-discriminatory treatment of foreign investment and free remittance facilities for both profit and capital. An emphasis was laid on the employment and training of Indians in higher positions. In keeping with these guidelines, the general policy was

to allow such foreign investment and collaborations as were in line with the priorities and targets of the Five Year Plans. The policy was to restrict foreign collaboration to those cases which would being technical know-how indigenously for developing new lines of production. These principles define the broad contours within which the State Policy towards foreign capital has been framed all through the different Five Year Plans. Beginning with the First Plan in 1951, four distinct phases can be marked. The First Phase lasted till 1965, and was characterised by a liberal attitude towards foreign capital. Many concessions and incentives were given to foreign capital participation in the industrial development of the country. In the Second Phase beginning with the mid-sixties, the liberal attitude of the State yielded place to strict controls and the broad policy was to restrict the area of operations of foreign capital. In the Third phase, beginning towards the end of the decade of seventies, the policy was marked by a certain liberalization. The policy changes eased the restrictions on FDI inflows. The Fourth phase, beginning with the adoption of economic reforms programme since July 1991, has adopted a liberal attitude towards foreign capital and has aimed at attracting a free flow of direct foreign capital and has aimed at attracting a free flow of direct foreign investment. This preference for private flows over aid is basically accounted for by the fact that the world is now aid- foreign godfathers left to bail us out.

Foreign investment and enterprises which are branches or subsidiaries of foreign companies as well as joint ventures involving foreign collaboration are subject to all the laws governing Indian enterprises – the companies Act, the MRTP Act, the Income Tax Act — as well as industrial regulations under Industries (Development and Regulation) Act along with the rules framed by the Government of India. Of direct relevance to foreign enterprises is the FERA (1973) , which came into effect from January 1, 1974.

13.10 FERA VS FEMA

FERA was enacted in September 1973 and it came in force from January 1, 1974. It was amended by the Foreign Exchange Regulation (Amendment) Act 1993 and later in 2000, was replaced by FEMA. FERA applied to all citizens of India, all over India. The idea was to regulate the foreign payments, regulate the dealings in Foreign Exchange & securities and conservation of Foreign exchange for the nation. Important features of FERA are as follows: RBI can authorize a person / company to deal in foreign exchange. RBI can authorize the dealers to do transact the Foreign Currencies, subject to review and RBI was given power to revoke the authorization in

case of non-compliancy RBI would authorize the persons as Money Changers who will convert the currency of one nation to currency of their nation at rates "Determined by RBI" NO person, other than "authorized dealer" would enter in any transaction of the foreign currency. For whatever purpose Foreign exchange was required, it was to be used only for that purpose. If he feels that he cannot use the currency of that particular purpose, he would sell it to a authorized dealer within 30 days. No person in India, without "permission from RBI" shall make payments to a person resident outside India and receive any payment from a person from outside India. No person shall draw issue or negotiate any bill of exchange in which a right to receive payment outside India is created. No person shall make any credit in an account of a person resident out of India. No person except authorized by RBI shall send foreign currency out of India. A person who has right to receive the foreign exchange would have not to delay the receipt of the foreign exchange. To sum up, in FERA "anything and everything" that has to do something with Foreign Exchange was regulated. The Experts called it a "Draconian Act" which hindered the growth and modernization of Indian Industries. The Important aspect of FEMA, in contrast with FERA is that it facilitates Trade, while that of FERA was that it "prevented" misuse. The focus was shifted from Control to Management.

Exchange regulations have always remained at the centre of Indian economy. Exchange controls were first introduced in India during the Second World War (1942). Soon after independence, they were formally reaffirmed in form of the first Foreign Exchange Regulation Act, 1949 (FERA). This was followed by FERA, 1973. The control framework under FERA was essentially transaction based in terms of which all transactions in foreign exchange including those between residents to non-residents were prohibited unless specifically permitted. Transformation from control-to-management: FERA to FEMA. The 1970s and 1980s saw the rise of large external sector imbalances on account of persistent increase in adverse balance of payments situation. There was over dependence on official foreign aid. It was this balance of payment crisis that triggered the wave of economic liberalization. The Indian rupee became market determined in 1993. The need was felt to consolidate and amend the law relating to foreign exchange with the objectives of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.

Accordingly, on June 1, 2000, the Foreign Exchange Management Act, 1999 (FEMA) was brought in force to replace the then existing Foreign Exchange Regulation Act, 1973 (FERA). FEMA has been enacted with an objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market tin India. As such it is quite opposed to FERA which was enacted to regulate or control the foreign exchange. FEMA provided a de jure status to the shift in policies with regard to the external sector reforms that began in 1990-91.

STRUCTURE OF FEMA The present framework of exchange controls in India, consist of basic legislation (FEMA, 1999) and Notifications, Rules and Circulars [known as Authorized Persons Directions – AP (Dir Series)] issued by RBI.

FEMA applies to the whole of India and all branches, offices and agencies outside India which are owned or controlled by a person resident in India. It also applies to any contraventions committed outside India by any person to whom FEMA applies. There are 49 sections under FEMA, of which 9 sections (section 1 to 9) are substantive and the rest are procedural / administrative provisions as tabulated below:

Section 1 Application and Commencement of FEMA

2 Definitions

3 to 9 Provisions relating to Regulations and Management of Foreign Exchange

10 to 12 Provisions relating to Authorized Person

13 to 15 Provisions relating to Contraventions and Penalties

16 to 38 Provisions relating to Adjudication, Appeal and Directorate of Enforcement

39 to 49 Miscellaneous Provisions Section 46 of FEMA grants power to the Central Government to make rules to carry out the provisions of FEMA and Section 47 of FEMA grants power to the Reserve Bank of India (RBI) to make regulations to implement provisions and the rules made under FEMA.

Thus RBI is entrusted with the administration and implementation of FEMA.

CAPITAL ACCOUNT TRANSACTION AND CURRENT ACCOUNT TRANSACTION: In August 1994 India accepted Article VIII of the Articles of agreement of the International Monetary Fund and became fully convertible on the current account. Since India is fully convertible on the current account, all current account transactions (barring a small list of restricted items) are allowed through the normal banking channels. In case of capital account transactions, only the transactions which are explicitly enabled under the guidelines are allowed, remaining require specific approvals under FEMA.

Accordingly it is very important to understand the concept of Capital and Current Account Transactions to Comprehend FEMA.

A. Capital Account Transaction: "Capital Account transaction" is defined under section 2(e) of FEMA as 'a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6.' Thus any transaction as a result of which the assets or liabilities outside India of a person who is resident in India and assets or liabilities in India of a person who is resident outside India are altered i.e. either increased or decreased, is a capital account transaction.

Prohibited Capital Account Transactions:

General Prohibition: A person shall not undertake or sell or draw foreign exchange to or from an Authorized person for any capital account transactions other than those permitted in the Schedules, provided the transaction is within the limit.

Special Prohibition: No person resident outside India shall make investment in India, in any form, in any company or partnership firm or proprietary concern or any entity, whether incorporated or not, which is engaged or proposes to engage- In the business of chit fund, or• As nidhi company, or• In agricultural or plantation activities, or• In real estate business, or construction of farm houses, or• In trading in Transferable Development Rights (TDRs)•(real estate shall not include development of townships, construction of residential/commercial premises, roads or bridges).

B. Current Account Transaction: "Current account transaction" is defined under section 2(j) of FEMA to mean 'a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes,- (i) payments due in connection with foreign trade, other current business, services and shortterm banking and credit facilities in the ordinary course of business, (ii) payments due as interest on loans and as net income from investments, (iii) remittances for living expenses of parent, spouse and children residing abroad, and (iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children.' All Current Account transactions are generally permitted unless specifically prohibited whereas all Capital Account transactions are generally prohibited unless specifically permitted. Current Account transactions are divided into 3 schedules in Current Account Transaction rules:

Schedule I – Prohibited Transactions

Schedule II – Transactions requiring prior approval of Government of India

Schedule III – Transactions requiring prior approval of RBI:

a. Import of Machinery on hire purchase: In this transaction the person has created future obligation for making payment to nonresident and hence has liability towards the non-resident. Therefore the said transaction is a capital account transaction.

b. Transaction representing creation or acquisition of wealth, shares, loans or immovable properties: Since such types of transactions would lead to creation of assets in or outside India by person resident outside or in India, as the case may be, the same are in nature of capital account transactions.

c. Remittances out of winnings from lottery: This comes under Prohibited list (Schedule I) of the Current account transaction. Hence although the same is in nature of current account such transactions are prohibited. However, an entity engaged in lottery business, imports any software or machinery to be utilized in lottery business in India, the same is a permissible transaction. Import of software or machinery will not result in violation of FEMA regulations in relation to current account transactions. But any type of technical collaboration for lottery business including licensing for franchise, trademark, brand name, management contract or any contract

for payment of royalty as such for such collaboration is prohibited under both current account transaction rules and also under FDI Policy. Hence, such transactions are not permissible.

d. Options premium payable under NASDAQ: Options premium is the price paid by a person to buy an option contract, whether it is a call or put. So option premium is paid to acquire only specified rights for a contract. Under option contract there is no future obligation in addition to option premium paid at the time of entering into contract so it does not result into creation of any contingent liability and hence is a current account transaction. Whereas future contract would be a capital account transaction. Option contract may result into creation of contingent asset, and such contingent asset is not covered in the definition of Capital Account transaction.

e. Opening a branch outside India: Opening a branch outside India is a current account transaction as it does not result into alteration of any assets and liabilities overseas, since overseas branch would be regarded as Resident of India.:

i. Foreign currency accounts opened and maintained by such a person when he was resident outside India.

ii. Income earned through employment or business or vocation outside India taken up or commenced, or from investments made, or from gift or inheritance received while such a person was resident outside India.

iii. Foreign exchange including any income arising there from, and conversion or replacement or accrual to the same, held outside India acquired by way of inheritance from a person resident outside India.

iv. A person resident in India may freely utilize all their eligible assets abroad as well as income on such assets or sale proceeds thereof received after their return to India for making any payments or to make any fresh investments abroad without prior approval of RBI.

13.11 CHECK YOUR PROGRESS

Pick up the correct statements among the following:

i) India has never allowed foreign capital to enter India.

ii) Since 1991 all foreigners are absolutely free to set up shop in India without any permission from the

Government.

iii) Foreign Exchange Regulation Act, 1973 applies only to foreigners and not to Indians.

iv) Foreign capital need be regularly serviced in the form of interest payments.

13.12 SUMMARY

For India to become a major player in world trade, an all encompassing, comprehensive view needs to be taken for the overall development of the country's foreign trade. While increase in exports is of vital importance, we have also to facilitate those imports which are required to stimulate our economy. Coherence and consistency among trade and other economic policies is important for maximizing the contribution of such policies to development. Thus, while incorporating the existing practice of enunciating an annual Exim Policy, it is necessary to go much beyond and take an integrated approach to the developmental requirements of India's foreign trade. This is the context of the new Foreign Trade Policy. Trade is not an end in itself, but a means to economic growth and national development. The primary purpose is not the mere earning of foreign exchange, but the stimulation of greater economic activity.

In view of the growth strategy adopted in our plans it was necessary to make use of foreign capital. Foreign capital has been required to fill different types of gaps a developing economy is normally faced with. During the first four decades of planned economic development, foreign resources were sought to be tapped by way of external borrowings. But the overall experience with external borrowings was non-too-happy. Since 1991 there has been a dramatic change in attitude towards foreign capital—foreign capital is now being more freely permitted to set up a short here. Foreign investment, both direct and portfolio, is a favoured channel of foreign resources now than external borrowings.

13.13 KEY WORDS

Technology Gap: The distance between the state-of-art technology and technology available to a developing economy.

Portfolio Investment: Expenditure on the purchase of shares and debentures issued by the corporate sector.

Multinational Corporation: A corporate body which controls income generating assets in more than one country.

Nationalisation: Government take-over of the assets hitherto owned by private enterprise and capital.

13.14 GLOSSARY

EPCG Scheme Relaxations

i. To increase the life of existing plant and machinery, export obligation on import of spares, moulds etc. under EPCG Scheme has been reduced to 50 per cent of the normal specific export obligation.

ii. 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

Technological Upgradation

i. To aid technological upgradation of our export sector, EPCG Scheme at Zero Duty has been introduced. This Scheme will be available for engineering & electronic products, basic chemicals & pharmaceuticals, apparels & textiles, plastics, handicrafts, chemicals & allied products and leather & leather products (subject to exclusions of current beneficiaries under Technological Upgradation Fund Schemes (TUFS), administered by Ministry of Textiles and beneficiaries of Status Holder Incentive Scheme in that particular year). The scheme shall be in operation till 31.3.2011.

ii. Jaipur, Srinagar and Anantnag have been recognised as 'Towns of Export Excellence' for handicrafts; Kanpur, Dewas and Ambur have been recognised as 'Towns of Export Excellence' for leather products; and Malihabad for horticultural products.

13.15 ANSWER TO CHECK YOUR PROGRESS:

All statements are false.

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13.17 TERMINAL AND MODEL QUESTIONS

1. What is the significance of EXIM policy in the economic scenario of any country?
2. Critically evaluate the EXIM Policy of 2009-2014.
3. Differentiate between FERA and FEMA.
4. What are MNCs ? What is the role played by MNCs in a developing economy like India?
5. What is the role played by Foreign Capital in the growth of an economy?

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CHAPTER 14
FOREX MARKETS

14.1 OBJECTIVES

After studying this lesson you should be able

1. Understand the Foreign Exchange Market.
2. Understand the transactions in inter-bank Market.
3. Evaluate the functions of Foreign Exchange Market.
4. Evaluate the nature of Indian Foreign Exchange Market.
5. Understand the methods of measuring Exchange Rate Determination
6. Understand the impact of Exchange Rates and determinants of Exchange Rate.
7. Understand the currency depreciation and devaluation.

14.2 INTRODUCTION

A Foreign exchange market is a market in which currencies are bought and sold. It is to be distinguished from a financial market where currencies are borrowed and lent.

14.2.1 OTC Market:

Foreign exchange market is described as an OTC (Over the counter) market as there is no physical place where the participants meet to execute their deals. It is more an informal arrangement among the banks and brokers operating in a financing centre purchasing and selling currencies, connected to each other by telecommunications like telex, telephone and a satellite communication network, SWIFT.

The term foreign exchange market is used to refer to the wholesale a segment of the market, where the dealings take place among the banks. The retail segment refers to the dealings take place between banks and their customers. The retail segment is situated at a large number of places. They can be considered not as foreign exchange markets, but as the counters of such markets. The leading foreign exchange market in India is Mumbai, Calcutta, Chennai and Delhi is other centers accounting for bulk of the exchange dealings in India. The policy of Reserve Bank has been to decentralize exchanges operations and develop broader based exchange markets. As a result of the efforts of Reserve Bank Cochin, Bangalore, Ahmadabad and Goa have emerged as new centre of foreign exchange market.

14.2.2 Size of the Market

Foreign exchange market is the largest financial market with a daily turnover of over USD 2 trillion. Foreign exchange markets were primarily developed to facilitate settlement of debts arising out of international trade. But these markets have developed on their own so much so

that a turnover of about 3 days in the foreign exchange market is equivalent to the magnitude of world trade in goods and services. The largest foreign exchange market is London followed by New York, Tokyo, Zurich and Frankfurt.

The business in foreign exchange markets in India has shown a steady increase as a consequence of increase in the volume of foreign trade of the country, improvement in the communications systems and greater access to the international exchange markets. Still the volume of transactions in these markets amounting to about USD 2 billion per day does not compete favourably with any well developed foreign exchange market of international repute. The reasons are not far to seek. Rupee is not an internationally traded currency and is not in great demand. Much of the external trade of the country is designated in leading currencies of the world, Viz., US dollar, pound sterling, Euro, Japanese yen and Swiss franc. Incidentally, these are the currencies that are traded actively in the foreign exchange market in India.

14.2.3 Working 24 hours a day

The markets are situated throughout the different time zones of the globe in such a way that when one market is closing the other is beginning its operations. Thus at any point of time one market or the other is open. Therefore, it is stated that foreign exchange market is functioning throughout 24 hours of the day. However, a specific market will function only during the business hours. Some of the banks having international network and having centralized control of funds management may keep their foreign exchange department in the key centre open throughout to keep up with developments at other centers during their normal working hours In India, the market is open for the time the banks are open for their regular banking business. No transactions take place on Saturdays.

14.2.4 Efficiency

Developments in communication have largely contributed to the efficiency of the market. The participants keep abreast of current happenings by access to such services like Dow Jones Telerate and Teuter. Any significant development in any market is almost instantaneously received by the other market situated at a far off place and thus has global impact. This makes the foreign exchange market very efficient as if the functioning under one roof.

14.2.5 Currencies Traded

In most markets, US dollar is the vehicle currency, Viz., the currency used to denominate international transactions. This is despite the fact that with currencies like Euro and Yen gaining larger share, the share of US dollar in the total turn-over is shrinking.

14.2.6 Physical Markets

In few centers like Paris and Brussels, foreign exchange business takes place at a fixed place, such as the local stock exchange buildings. At these physical markets, the banks meet and in the presence of the representative of the central bank and on the basis of bargains, fix rates for a number of major currencies. This practice is called ***fixing***. The rates thus fixed are used to execute customer orders previously placed with the banks. An advantage claimed for this procedure is that exchange rate for commercial transactions will be market determined, not influenced by any one bank. However, it is observed that the large banks attending such meetings with large commercial orders backing up, tend to influence the rates.

14.2.7 Participants

The participants in the foreign exchange market comprise;

(i) Corporates

The business houses, international investors, and multinational corporations may operate in the market to meet their genuine trade or investment requirements. They may also buy or sell currencies with a view to speculate or trade in currencies to the extent permitted by the exchange control regulations. They operate by placing orders with the commercial banks. The deals between banks and their clients form the retail segment of foreign exchange market. In India the foreign Exchange Management (Possession and Retention of Foreign Currency) Regulations, 2000 permits retention, by resident, of foreign currency up to USD 2,000.

Foreign Currency Management (Realisation, Repatriation and Surrender of Foreign Exchange) Regulations, 2000 requires a resident in India who receives foreign exchange to surrender it to an authorized dealer:

(a) Within seven days of receipt in case of receipt by way of remuneration, settlement of lawful obligations, income on assets held abroad, inheritance, settlement or gift: and

(b) Within ninety days in all other cases.

Any person who acquires foreign exchange but could not use it for the purpose or for any other permitted purpose is required to surrender the unutilized foreign exchange to authorized dealers within sixty days from the date of acquisition. In case the foreign exchange was acquired for travel abroad, the unspent foreign exchange should be surrendered within ninety days from the date of return to India when the foreign exchange is in the form of foreign currency notes and coins and within 180 days in case of travellers cheques. Similarly, if a resident required foreign exchange for an approved purpose, he should obtain from and authorized dealer.

(ii) Commercial banks:

Commercial Banks are the major players in the market. They buy and sell currencies for their clients. They may also operate on their own. When a bank enters a market to correct excess or sale or purchase position in a foreign currency arising from its various deals with its customers, it is said to do a cover operation. Such transactions constitute hardly 5 per cent of the total transactions done by a large bank. A major portion of the volume is accounted buy trading in currencies indulged by the bank to gain from exchange movements. For transactions involving large volumes, banks may deal directly among themselves. For smaller transactions, the intermediation of foreign exchange brokers may be sought.

(iii) *Exchange brokers* , :

Exchange brokers facilitate deal between banks. In the absence of exchange brokers, banks have to contact each other for quotes. If there are 150 banks at a centre, for obtaining the best quote for a single currency, a dealer may have to contact 149 banks. Exchange brokers ensure that the most favourable quotation is obtained and at low cost in terms of time and money. The bank may leave with the broker the limit up to which and the rate at which it wishes to buy or sell the foreign currency concerned. From the indents of other banks, the broker will be able to match the requirements of both. The names of the counter parties are revealed to the banks only when the deal is acceptable to them. Till then anonymity is maintained. Exchange brokers tend to specialize in certain exotic currencies, but they also handle all major currencies.

In India, banks may deal directly or through recognized exchange brokers. Accredited exchange brokers are permitted to contract exchange business on behalf of authorized dealers in foreign exchange only upon the understanding that they will conform to the rates, rules and conditions laid down by the FEDAI. All contracts must bear the clause ―subject to the Rules and Regulations of the Foreign Exchanges Dealers Association of India'.

(iv) Central Bank:

It may intervene in the market to influence the exchange rate and change it from that would result only from private supplies and demands. The central bank may transact in the market on its own for the above purpose. Or, it may do so on behalf of the government when it buys or sell bonds and settles other transactions which may involve foreign exchange payments and receipts. In India, authorized dealers have recourse to Reserve Bank to sell/buy US dollars to the extent the latter is prepared to transact in the currency at the given point of time. Reserve Bank will not ordinarily buy/sell any other currency from/to authorized dealers. The contract can be entered into on any working day of the dealing room of Reserve Bank. No transaction is entered into on Saturdays. The value date for spot as well as forward delivery

should be in conformity with the national and international practice in this regard. Reserve Bank of India does not enter into the market in the ordinary course, where the exchange rates are moving in a detrimental way due to speculative forces, the Reserve Bank may intervene in the market either directly or through the State Bank of India.

14.2.8 Settlement of Transactions

Foreign exchange markets make extensive use of the latest developments in telecommunications for transmitting as well settling foreign exchange transaction, Banks use the exclusive network SWIFT to communicate messages and settle the transactions at electronic clearing houses such as CHIPS at New York.

SWIFT:SWIFT is a acronym for Society for Worldwide Interbank Financial Telecommunications, a co operative society owned by about 250 banks in Europe and North America and registered as a co operative society in Brussels, Belgium. It is a communications network for international financial market transactions linking effectively more than 25,000 financial institutions throughout the world which have been allotted bank identified codes. The messages are transmitted from country to country via central interconnected operating centers located in Brussels, Amsterdam and Culpeper, Virginia. The member countries are connected to the centre through regional processors in each country. The local banks in each country reach the regional processors through the national net works. The SWIFT System enables the member banks to transact among themselves quickly:

(i) international payments

(ii) Statements, and

(iii) other messages connected with international banking.

Transmission of messages takes place within seconds, and therefore this method is economical as well as time saving. Selected banks in India have become members of SWIFT. The regional processing centre is situated at Mumbai. The SWIFT provides following advantages for the local banking community:

- Provides a reliable (time tested) method of sending and receiving messages from a vast number of banks in a large number of locations around the world.
- Reliability and accuracy is further enhanced by the built in authentication facilities, which has only to be exchanged with each counterparty before they can be activated or further communications.
- Message relay is instantaneous enabling the counterparty to respond immediately, if not prevented by time differences.

- Access is available to a vast number of banks global for launching new cross border initiatives.
- Since communication in SWIFT is to be done using structure formats for various types of banking transactions, the matter to be conveyed will be very clear and there will not be any ambiguity of any sort for the received to revert for clarifications. This is mainly because the formats are used all over the world on a standardized basis for conducting all types of banking transactions. This makes the responses and execution very efficient at the receiving banks end thereby contributing immensely to quality service being provided to the customers of both banks (sending and receiving).

Usage of SWIFT structure formats for message transmission to counterparties will entail the generation of local banks internal records using at least minimum level of automation. This will accelerate the local banks internal automation activities, since the maximum utilization of SWIFT a significant internal automation level is required.

CHIPS: CHIPS stands for Clearing House Interbank Payment System. It is an electronic payment system owned by 12 private commercial banks constituting the New York Clearing House Association. A CHIP began its operations in 1971 and has grown to be the world‘s largest payment system. Foreign exchange and Euro dollar transactions are settled through CHIPS. It provides the mechanism for settlement every day of payment and receipts of numerous dollar transactions among member banks at New York, without the need for physical exchange of cheques/funds for each such transaction.

It may be noted that settlement of transactions in the New York foreign exchange market takes place in two stages,

First clearance at CHIPS and arriving at the net position for each bank.

Second, transfer of fedfunds for the net position. The real balances are held by banks only with Federal Reserve Banks (Fedfunds) and the transaction is complete only when Fedfunds are transferred. CHIPS help in expediting the reconciliation and reducing the number of entries that pass through Fedwire.

CHAPS: CHAPS is an arrangement similar to CHIPS that exists in London. CHAPS stands for Clearing House Automated Payment System.

Fedwire:The transactions at New York foreign exchange market ultimately get settled through Fedwire. It is a communication network that links the computers of about 7000 banks to the computers of federal Reserve Banks. The fedwire funds transfer system, operate by the Federal Reserve Bank, are used primarily for domestic payments, bank to bank and third

party transfers such as interbank overnight funds sales and purchases and settlement transactions. Corporate to corporate payments can also be made, but they should be effected through banks. Fed guarantees settlement on all payments sent to receivers even if the sender fails.

14.3 TRANSACTIONS IN INTERBANK MARKETS

The exchange rates quoted by banks to their customer are based on the rates prevalent in the interbank market. The big banks in the market are known as market makers, as they are willing to buy or sell foreign currencies at the rates quoted by them up to any extent. Depending buy or sell foreign currencies at the rates quoted by them up to any extent. Depending upon its resources, a bank may be a market maker in one or few major currencies. When a banker approaches the market maker, it would not reveal its intention to buy or sell the currency. This is done in order to get a fair price from the market maker. Two Way Quotations, typically, the quotation in the interbank market is a two – way quotation. It means the rate quoted by the market maker will indicate two prices. One at which it is willing to buy the foreign currency, and the other at which it is willing to sell the foreign currency. For example, a Mumbai bank may quote its rate for US dollar as under

USD 1 = Rs 48.1525/1650.

More often, the rate would be quoted as 1525/1650 since the players in the market are expected to know the 'big number' i.e., Rs 48. In the given quotation, one rate is Rs.48.1525 per dollar and the other rate is Rs.48.1650. per dollar.

Direct Quotation

It will be obvious that the quoting bank will be willing to buy dollars at Rs 48.1525 and sell dollars at Rs 48.1650. If one dollar bought and sold, the bank makes a gross profit of Rs. 0.0125. In a foreign exchange quotation, the foreign currency is the commodity that is being bought and sold. The exchange quotation which gives the price for the foreign currency in terms of the domestic currency is known as direct quotation. In a direct quotation, the quoting bank will apply the rule: —*Buy low; Sell high.*

Indirect Quotation:

There is another way of quoting in the foreign exchange market. The Mumbai bank quotes the rate for dollar as: Rs. 100 = USD 2.0762/0767.

This type of quotation which gives the quantity of foreign currency per unit of domestic currency is known as *indirect quotation*. In this case, the quoting bank will receive USD 2.0767 per Rs.100 while buying dollars and give away USD 2.0762 per Rs.100 while selling

dollars. In other world, he will apply the rule: ―Buy high: Sell low. The buying rate is also known as the 'bid rate' and 'selling rate' as the 'offer' rate. The difference between these rates is the gross profit for the bank and is known as the 'Spread'.

Spot and Forward transactions

The transactions in the interbank market may place for settlement

(a) on the same day; or

(b) two days later; or

(c) some day late; say after a month

Where the agreement to buy and sell is agreed upon and executed on the same date, the transaction is known as *cash or ready transaction*. It is also known as *value today*. The transaction where the exchange of currencies takes place two days after the date of the contact is known as the spot transaction. For instance, if the contract is made on Monday, the delivery should take place on Wednesday. If Wednesday is a holiday, the delivery will take place on the next day, i.e., Thursday. Rupee payment is also made on the same day the foreign currency is received.

The transaction in which the exchange of currencies takes places at a specified future date, subsequent to the spot date, is known as a *forward transaction*. The forward transaction can be for delivery one month or two months or three months etc. A forward contract for delivery one month means the exchange of currencies will take place after one month from the date of contract. A forward contract for delivery two months means the exchange of currencies will take place after two months and so on.

Forward Margin/Swap points

Forward rate may be the same as the spot rate for the currency. Then it is said to be 'at par' with the spot rate. But this rarely happens. More often the forward rate for a currency may be costlier or chapter tan its spot rate. The rate for a currency may be costlier or cheaper than nits spot rate. The difference between the forward rate and the spot rate is known as the 'forward margin' or swap points. The forward margin may be either at 'premium' or at 'discount'. If the forward margin is at premium, the foreign correct will be costlier under forward rate than under the spot rate. If the forward margin is at discount, the foreign currency will be cheaper for forward delivery then for spot delivery. Under direct quotation, premium is added to spot rate to arrive at the forward rate. This is done for both purchase and sale transactions. Discount is deducted from the spot rate to arrive at the forward rate.

14.4 FACTORS DETERMINING SPOT EXCHANGE RATES

1. Balance of Payments:

Balance of Payments represents the demand for and supply of foreign exchange which ultimately determine the value of the currency. Exports, both visible and invisible, represent the supply side for foreign exchange. Imports, visible and invisible, create demand for foreign exchange. Put differently, export from the country creates demand for the currency of the country in the foreign exchange market. The exporters would offer to the market the foreign currencies they have acquired and demand in exchange the local currency. Conversely, imports into the country will increase the supply of the currency of the country in the foreign exchange market. When the balance of payments of a country is continuously at deficit, it implies that the demand for the currency of the country is lesser than its supply. Therefore, its value in the market declines. If the balance of payments is surplus continuously it shows that the demand for the currency in the exchange market is higher than its supply therefore the currency gains in value.

(2) Inflation:

Inflation in the country would increase the domestic prices of the commodities. With increase in prices exports may dwindle because the price may not be competitive. With the decrease in exports the demand for the currency would also decline; this in turn would result in the decline of external value of the currency. It may be noted that unit is the relative rate of inflation in the two countries that cause changes in exchange rates. If, for instance, both India and the USA experience 10 per cent inflation, the exchange rate between rupee and dollar will remain the same. If inflation in India is 15 per cent and in the USA it is 10 per cent, the increase in prices would be higher in India than it is in the USA. Therefore, the rupee will depreciate in value relative to US dollar. Empirical studies have shown that inflation has a definite influence on the exchange rates in the long run. The trend of exchange rates between two currencies has tended to hover around the basic rate discounted for the inflation factor. The actual rates have varied from the trend only by a small margin which is acceptable. However, this is true only where no drastic change in the economy of the country is. New resources found may upset the trend. Also, in the short run, the rates fluctuate widely from the trend set by the inflation rate. These fluctuations are accounted for by causes other than inflation.

(3) Interest rate:

The interest rate has a great influence on the short – term movement of capital. When the interest rate at a centre rises, it attracts short term funds from other centers. This would

increase the demand for the currency at the centre and hence its value. Rising of interest rate may be adopted by a country due to tight money conditions or as a deliberate attempt to attract foreign investment. Whatever be the intention, the effect of an increase in interest rate is to strengthen the currency of the country through larger inflow of investment and reduction in the outflow of investments by the residents of the country.

(4) Money Supply

An increase in money supply in the country will affect the exchange rate through causing inflation in the country. It can also affect the exchange rate directly. An increase in money supply in the country relative to its demand will lead to large scale spending on foreign goods and purchase of foreign investments. Thus the supply of the currency in the foreign exchange markets is increased and its value declines. The downward pressure on the external value of the currency then increases the cost of imports and so adds to inflation. The effect of money supply on exchange rate directly is more immediate than its effect through inflation. While in the long run inflation seems to correlate exchange rate variations in a better way, in the short run exchange rates move more in sympathy with changes in money supply. One explanation of how changes in money supply vary the exchange rate is this; the total money supply in the country represents the value of total commodities and services in the country. Based on this the outside world determines the external value of the currency. If the money supply is doubles, the currency will be valued at half the previous value so as to keep the external value of the total money stock of the country constant. Another explanation offered is that the excess money supply flows out of the country and directly exerts a pressure on the exchange rate. The excess money created, the extent they are in excess of the domestic demand for money, will flow out of the country. This will increase the supply of the currency and pull down its exchange rate.

(5) National Income:

An increase in national income reflects increase in the income of the residents of the country. This increase in the income increases the demand for goods in the country. If there is underutilized production capacity in the country, this will lead to increase in production. There is a chance for growth in exports too. But more often it takes time for the production to adjust to the increased income. Where the production does not increase in sympathy with income rise, it leads to increased imports and increased supply of the currency of the country in the foreign exchange market. The result is similar to that of inflation, viz., and decline in the value of the currency. Thus an increase in national income will lead to an increase in investment or in consumption, and accordingly, its effect on the exchange rate will change.

Here again it is the relative increase in national incomes of the countries concerned that is to be considered and not the absolute increase.

(6) Resource Discoveries

When the country is able to discover key resources, its currency gains in value. A good example can be the have played by oil in exchange rates. When the supply of oil from major suppliers, such as Middles East, became insecure, the demand fro the currencies of countries self sufficient in oil arose. Previous oil crisis favoured USA, Canada, UK and Norway and adversely affected the currencies of oil importing countries like Japan and Germany. Similarly, discovery oil by some countries helped their currencies to gain in value. The discovery of North Sea oil by Britain helped pound sterling to rise to over USD 2.40 from USD 1.60 in a couple of years. Canadian dollar also benefited from discoveries of oil and gas off the Canadian East Coast and the Arctic.

(7) Capital Movements

There are many factors that influence movement of capital from one country to another. Short term movement of capital may be influenced buy the offer of higher interest in a country. If interest rate in a country rises due to increase in bank rate or otherwise, there will be a flow of short term funds into the country and the exchange rate of the currency will rise. Reverse will happen in case of fall in interest rates. Bright investment climate and political stability may encourage portfolio investments in the country. This leads to higher demand for the currency and upward trend in its rate. Poor economic outlook may mean repatriation of the investments leading to decreased demand and lower exchange value for the currency of the country. Movement of capital is also caused by external borrowing and assistance. Large scale external borrowing will increase the supply of foreign exchange in the market. This will have a favorable effect on the exchange rate of the currency of the country. When repatriation of principal and interest starts the rate may be adversely affected.

(8) Political factors

Political stability induced confidence in the investors and encourages capital inflow into the country. This has the effect of strengthening the currency of the country. On the other hand, where the political situation in the country is unstable, it makes the investors withdraw their investments. The outflow of capital from the country would weaken the currency. Any news about change in the government or political leadership or about the policies of the government would also have the effect of temporarily throwing out of gear the smooth functioning of exchange rate mechanism.

14.5 FUNCTIONS OF FOREIGN EXCHANGE MARKET

The foreign exchange market is a market in which foreign exchange transactions take place. The various functions of Forex market are as follows:

14.5.1 Transfer of Purchasing Power

The Primary function of a foreign exchange market is the transfer of purchasing power from one country to another and from one currency to another. The international clearing function performed by foreign exchange markets plays a very important role in facilitating international trade and capital movement.

14.5.2 Provision of credit

The credit function performed by foreign exchange markets also plays a very important role in the growth of foreign trade, for international trade depends to a great extent on credit facilities. Exporters may get pre shipment and post shipment credit. Credit facilities are available also for importers. The Euro dollar market has emerged as a major international credit market.

14.5.3 Provision of Hedging Facilities

The other important of the foreign exchange market is to provide hedging facilities. Heding refers to covering of foreign trade risks, and it provides a mechanism to exporters and importers to guard themselves against losses arising from fluctuations in exchange rates.

14.6 METHODS OF AFFECTING INTERNATIONAL PAYMENTS

There are important methods to effect international payments.

Transfers Money may be transferred from a bank in one country to a bank in another part of the world be electronic or other means.

Cheques and Bank Drafts: International payments may be made by means of cheques and bank drafts. The latter is widely used.

A *bank draft* is a cheque drawn on a bank instead of a customer‘s personal account. It is an acceptable means of payment when the person tendering is not known, since its value is dependent on the standing of a bank which is widely known, and not on the credit worthiness of a firm or individual known only to a limited number of people.

Foreign Bill of Exchange

A bill of exchange is an unconditional order in writing, addressed by one person to another, requiring the person to whom it is addressed to pay a certain sum or demand or on a specified future date. There are two important differences between inland and foreign bills.

The date on which an inland bill is due for payment is calculated from the date on which it was drawn, but the period of a foreign bill runs from the date on which the bill was accepted. The reason for this is that the interval between a foreign bill being drawn and its acceptance may be considerable, since it may depend on the time taken for the bill to pass from the drawers country to that of the acceptor.

The second important difference between the two types of bill is that the foreign bill is generally drawn in sets of three, although only one of them bears a stamp and of course one of them is paid. Now days it is mostly the documentary bill that is employed in international trade. This is nothing more than a bill of exchange with the various shipping documents the bill of lading, the insurance certificate and the consular invoice attached to it. By using this the exporter can make the release of the documents conditional upon either

(a) payment of the bill if it has been drawn at sight or

(b) Its acceptance by the importer if it has been drawn for a period.

14.7 TRANSACTIONS IN THE FOREIGN EXCHANGE MARKET

A very brief account of certain important types of transactions conducted in the foreign exchange market is given below:

Spot and Forward Exchanges

Spot Market

The term spot exchange refers to the class of foreign exchange transaction which requires the immediate delivery or exchange of currencies on the spot. In practice the settlement takes place within two days in most markets. The rate of exchange effective for the spot transaction is known as the spot rate and the market for such transactions is known as the spot market.

Forward Market

The forward transactions is an agreement between two parties, requiring the delivery at some specified future date of a specified amount of foreign currency by one of the parties, against payment in domestic currency be the other party, at the price agreed upon in the contract. The rate of exchange applicable to the forward contract is called the *forward exchange rate* and the market for forward transactions is known as the *forward market*.

The foreign exchange regulations of various countries generally regulate the forward exchange transactions with a view to curbing speculation in the foreign exchanges market. In India, for example, commercial banks are permitted to offer forward cover only with respect to genuine export and import transactions. Forward exchange facilities, obviously, are of

immense help to exporters and importers as they can cover the risks arising out of exchange rate fluctuations be entering into an appropriate forward exchange contract.

With reference to its relationship with spot rate, the forward rate may be *at par, discount or premium*. If the forward exchange rate quoted is exact equivalent to the spot rate at the time of making the contract the forward exchange rate is said to be at par. The forward rate for a currency, say the dollar, is said to be at premium with respect to the spot rate when one dollar buys more units of another currency, say rupee, in the forward than in the spot rate on a per annum basis.

The forward rate for a currency, say the dollar, is said to be at discount with respect to the spot rate when one dollar buys fewer rupees in the forward than in the spot market. The discount is also usually expressed as a percentage deviation from the spot rate on a per annum basis.

The forward exchange rate is determined mostly be the demand for and supply of forward exchange. Naturally when the demand for forward exchange exceeds its supply, the forward rate will be quoted at a premium and conversely, when the supply of forward exchange exceeds the demand for it, the rate will be quoted at discount.

When the supply is equivalent to the demand for forward exchange, the forward rate will tend to be at par.

Futures

While a focus contract is similar to a forward contract, there are several differences between them. While a forward contract is tailor made for the client be his international bank, a future contract has standardized features the contract size and maturity dates are standardized. Futures cab traded only on an organized exchange and they are traded competitively. Margins are not required in respect of a forward contract but margins are required of all participants in the futures market an initial margin must be deposited into a collateral account to establish a futures position.

Options

While the forward or futures contract protects the purchaser of the contract from the adverse exchange rate movements, it eliminates the possibility of gaining a windfall profit from favourable exchange rate movement. An option is a contract or financial instrument that gives holder the right, but not the obligation, to sell or buy a given quantity of an asset as a specified price at a specified future date. An option to buy the underlying asset is known as a *call option* and an option to sell the underlying asset is known as a *put option*. Buying or selling the underlying asset via the option is known as *exercising the option*. The stated price

paid (or received) is known as the *exercise or striking price*. The buyer of an option is known as *the long* and the seller of an option is known as the writer of the option, or *the short*. The price for the option is known as *premium*.

Types of options:

With reference to their exercise characteristics, there are two types of options, American and European. *A European option cab* is exercised only at the maturity or expiration date of the contract, whereas *an American option* can be exercised at any time during the contract.

Swap operation

Commercial banks who conduct forward exchange business may resort to a swap operation to adjust their fund position. The term swap means simultaneous sale of spot currency for the forward purchase of the same currency or the purchase of spot for the forward sale of the same currency. The spot is swapped against forward. Operations consisting of a simultaneous sale or purchase of spot currency accompanies by a purchase or sale, respectively of the same currency for forward delivery are technically known as swaps or double deals as the spot currency is swapped against forward.

Arbitrage

Arbitrage is the simultaneous buying and selling of foreign currencies with intention of making profits from the difference between the exchange rate prevailing at the same time in different markets.

Forward Contract

Forward contracts are typical OTC derivatives. As the name itself suggests, forward are transactions involving delivery of an asset or a financial instrument at a future date. One of the first modern to arrive contracts as forward contracts were known was agreed at Chicago Boar of Trade in March 1851 for maize corn to be delivered in June of that year.

Characteristics of forward contracts

The main characteristics of forward contracts are given below;

They are *OTC contracts*¬ Both the buyer and seller are committed to the contract. In other words, they have to take and deliver respectively, the underlying asset on which the forward contract was entered into. As such, they do not have the discretion as regards completion of the contract.

Forwards are *price fixing* in nature. Both the buyer and seller of a forward¬ contract are fixed to the price decided upfront. Due to the above two reasons, the pay off profiles of the borrower and seller in a forward contract, are linear to the price of the underlying.

The presence of *credit risk* in forward contracts makes parties wary of each other. Consequently forward contracts are entered into between parties who have good credit standing. Hence forward contracts are not available to the common man.

14.8 EXCHANGE RATE SYSTEMS

Over the ages, currencies have been defined in terms of gold and other items of value, and the international monetary system has been subject to a variety of international agreements. A brief history of these systems provides useful perspective against which to compare today's system and to evaluate weaknesses and proposed changes in the present system. In the following sections various monetary standards that were in practice since 19th century were briefly explained. The international monetary system has evolved historically from the gold standard (1876-1913) of fixed exchange rates, to the interwar years and World War II (1914-1944) with floating exchange rates, to fixed exchange rates (1945-1973) under the Bretton Woods Agreement, to the present eclectic currency arrangement (1973- present) of fixed, floating, and managed exchange rates. In the following sections an attempt has been made to explain them briefly for understanding of their significance in international monetary environment.

14.9 THE GOLD STANDARD (1876 – 1913):

A system of setting currency values whereby the participating countries commit to fix the prices of their domestic currencies in terms of a specified amount of gold. The gold standard as an international monetary system gained acceptance in Western Europe in the 1870s. The United States was something of a latecomer to the system, not officially adopting the standard until 1879. The ―rules of the game‖ under the gold standard were clear and simple. Each country set the rate at which its currency (paper or coin) could be converted to a weight of gold. The United States, for example, declared the dollar to be convertible to gold at a rate of $20.67/ounce of gold (a rate in effect until the beginning of World War 1). The British pound was pegged at £4.2474/ounce of gold. As long as both currencies were freely convertible into gold, the dollar/pound exchange rate was: $20.67/ounce of gold = $4.8665/£ £4.2474/ounce of gold Because the government of each country on the gold standard agreed to buy or sell gold on demand to anyone at its own fixed parity rate, the value of each individual currency in terms of gold, and therefore the fixed parities between currencies, was

set. Under this system it was very important for a country to maintain adequate reserves of gold to back its currency‘s value. The system also had the effect of implicitly limiting the rate at which any individual country could expand its money supply. The growth in money was limited to the rate at which additional gold could be acquired by official authorities. The gold standard worked adequately until the outbreak of World War 1 interrupted trade flows and the free movement of gold. This caused the main trading nations to suspend the operation of the gold standard.

Advantages of Gold Standard:

Several advantages are claimed for the gold standard, especially when it is adopted simultaneously by a number of countries, i.e., international gold standard.

(i) It is an objective system and is not subject to the changing policies of the government or the whims of the currency authority.

(ii) Gold standard enables the country to maintain the purchasing power of its currency over long periods. This is so because the currency and credit structure is ultimately based on gold in possession of the currency authority.

(iii) Another important advantage claimed for gold standard is that it preserves and maintains the external value of the currency (rate of exchange) within narrow limits. As a matter of fact, within the gold standard system, it provides fixed exchanges, which is a great boon to traders and investors. International division of labour is greatly facilitated.

(iv) It gives, in fact, all the advantages of a common international currency. It establishes an international measure of value. As Marshall pointed out before the Fowler Committee (Report on Indian Currency) in 1898, the change to a gold basis is like a movement towards bringing the railway gauge on the side branches of the world‘s railway into unison with the main lines. This greatly facilitates foreign trade, because fluctuations in rates of exchange hamper international trade.

(v) It is further claimed that gold standard helps to adjust the balance of payments between countries automatically. How this happens may be illustrated by a simple example. Suppose England and America are both on gold standard and only trade with each other, and that a balance of payments is due from England to America. Gold will be exported from England to America. The Bank of England will lose gold. This will contract currency in England and bring about a fall in the British price level. Price level in America will rise due to larger reserves and the expansion of currency and credit. England will become a good market to buy from and a bad market to sell in. Conversely, America will become a good market to sell in and a bad market to buy from. British exports will be encouraged and imports discouraged.

American exports will be discouraged and imports encouraged. The balance of payments will tend to move in favour of Britain until equilibrium is reached. It is in this way, that movement of gold, by affecting prices and trade, keeps equilibrium among gold standard countries.

Disadvantages of Gold Standard:

(i) Gold standard is costly and the cost is unnecessary. We only want a medium of exchange, why should it be made of gold? It is a luxury. —The yellow metal could tickle the fancy of savages only.

(ii) Even the value of gold has not been found to be absolutely stable over long periods.

(iii) Under the gold standard, currency cannot be expanded in response to the requirements of trade. The supply of currency depends on the supply of gold. But the supply of gold depends on the success of the mining operations, which may have nothing to do with the factors affecting the growth of trade and industry in the country.

(iv) Gold standard has also been charged with sacrificing internal stability to external (exchange) stability. It is the international aspect of the gold standard which has been paid more attention to.

(v) Another disadvantage is that, under gold standard gold movements lead to changes in interest rates, so that investment is stimulated or checked solely in order to expand or reduce money income.

(vi) A country on a gold standard cannot follow an independent policy. In order to maintain the gold standard or to restore it (as in England after World War I), it may have to deflate its currency against its will. Deflation spells ruin to the economy of a country. It brings, in its wake, large-scale unemployment, closing of works and untold suffering attendant on depression.

Causes of the Break-down of the Gold Standard

The gold standard broke down in country after country soon after its rehabilitation during the post-1914-18 war decade. There were several reasons for this development:

(1) Gold was very unevenly distributed among the countries in the inter-war period. While the U.S.A. and France came to possess the bulk of it, other countries did not have enough to maintain a monetary system based in gold.

(2) Owing to general political unsettlement, a habit arose on the part of certain Continental countries to keep their funds for short periods in foreign central banks, especially in Great Britain. These funds were liable to be withdrawn at the earliest danger signal.

Withdrawal of such funds from Britain on the part of France led to gold standard being suspended in 1931 in the former country. The Bank of England could not afford to lose its gold resources in large quantities at such a short notice.

(3) International trade was not free. Some countries often imposed stringent restrictions on imports, which created serious balance of payments problems for other countries. Not having enough gold to cover the gap, they threw the gold standard overboard. This specially happened during the Great Depression of early thirties.

(4) International obligation in the form of reparations and war debts arose out of World War I. Since the creditor countries refused to accept payments in the form of goods and also refused to continue lending to the debtors countries, the debts had to be cleared through gold movements. This led to concentration of 34 per cent of the world's gold in the U.S.A. and France, the two chief creditor countries. The gold left with the other countries was not enough to enable them to maintain gold standard successfully.

(5) The gold-receiving countries did not ―play the game of the gold standard‖. They (especially the U.S.A.) did not allow this gold to have any effect on their price levels. The gold was ―sterilised‖ or made ineffective. Had prices risen in these countries, imports would have been encouraged and exports discouraged and an unfavourable balance of trade would have led to movement of gold in the reverse direction. Since this was not allowed to happen, the gold standard failed to work automatically.

(6) Gold standard failed also because the economic structure of the countries concerned had become less and less elastic after the World War of 1914-18. This was due to several reasons: The enormous growth in the indebtedness of governments and local authorities resulted in a mass of interest payments fixed by contract over a long period of years. The huge expenditure in the form of payment to social services could not be easily reduced. The trade unions were now able to offer a much stronger resistance to wage cuts than before 1914. The prices of raw materials and finished goods were becoming more and more fixed by partial monopolies, cartel agreements, etc. The result was that prices no longer moved in the directions warranted by gold movements and equilibrium failed to be restored as of old.

(7) Another weakness that was discovered in the gold standard in practice was that it was always liable to collapse in a crisis. It has often been called a 'fair weather standard' only.

(8) Another objection that was frequently urged against the system was that gold movements caused inconvenient changes in interest rates.

Deflation, for instance, may be made necessary at a time of crisis to prevent suspension of the standard. But deflation, which involves falling wages and prices, may prove a cause of serious trouble. Wage cuts are resisted by trade unions, and falling prices increase the burden of fixed payments which the government or the people may have to make. Moreover, falling prices discourage enterprise and create unemployment. A large volume of short-term capital was moving for safely from one financial centre to another. Big flows of this hot money necessitated large gold movements, which the slender gold reserves of the countries could not maintain. Hence, gold standard was given up. Thus, it was that country after country bandoned the Gold Standard in the inter-war period (1914-1944).

14.10 BRETTON WOODS (1944):

In 1944, as World War II drew toward a close, the Allied Powers met at Bretton Woods, New Hampshire, in order to create a new post-war international monetary system. The Bretton Woods Agreement, implemented in 1946, whereby each member government pledged to maintain a fixed, or pegged, exchange rate for its currency vis-à-vis the dollar or gold. These fixed exchange rates were supposed to reduce the riskiness of international transactions, thus promoting growth in world trade. The Bretton Woods Agreement established a US dollar-based international monetary system and provide for two new institutions, The IMF and the World Bank. The IMF aids countries with balance of payments and exchange rate problems. The International Bank for Reconstruction and Development (World Bank) helped post-war reconstruction and since then has supported general economic development. The IMF was the key institution in the new international monetary system, and it has remained so to the present. The IMF was established to render temporary assistance to member countries trying to defend their currencies against cyclical, seasonal, or random occurrences. It also assists countries having structural trade problems if they take adequate steps to correct their problems. However, if persistence deficits occur, the IMF cannot save a country from eventual devaluation. In recent years it has attempted to help countries facing financial crises. It has provided massive loans as well as advice to Russia and other former Russian republics, Brazil, Indonesia, and South Korea, to name but a few. Under the original provisions of the Bretton Woods Agreement, all countries fixed the value of their currencies for gold. Only the dollar remained convertible into gold (at $35 per ounce). Therefore, each country decided what it wished its exchange rate to be vis-à-vis the dollar and then calculated the gold per value of its currency to create the desired dollar exchange rate. Participating countries agreed to try to maintain the value of their currencies within 1 per cent (later expanded to 2 ¼ per

cent) of par by buying or selling foreign exchange or gold as needed. Devaluation was not to be used as a competitive trade policy, but if a currency became too weak to defend, a devaluation of up to 10 per cent was allowed without formal approval by the IMF. Larger devaluations required IMF approval.

14.11 THE SPECIAL DRAWING RIGHTS (SDRS):

The Bretton Woods also known as IMF system was an improvement on the gold standard. The IMF system had all the merits of the gold standard minus its demerits. It ensured exchange stability without the country having to undergo the expense of maintaining a costly currency system. Under the IMF system, exchange parities were fixed in gold but it was unnecessary to keep large gold reserves for currency purposes. Besides gold stocks and current output were utterly inadequate to meet the requirements of over-expanding volume of international trade, thus giving rise to the serious problem of international liquidity. The IMF sought to provide multilaterism. The IMF quota facilitated foreign exchange transactions and there was no need to export gold to meet a trade deficit. It also facilitated convertibility of currencies and provided adequate and convenient currency reserve for the use of member countries. However, fast changing circumstances are necessitated changes in the IMF system. In September 1967, the Board of Governors approved a plan for a new type of international asset known as the SDRs (Special Drawing Rights). SDRs is an international reserve asset created by the IMF to supplement existing foreign exchange reserves. It serves as a unit of account for the IMF and other international and regional organizations, and it is also the base against which some countries peg the rate of exchange for their currencies. Defined initially in terms of a fixed quantity of gold, the SDR has been redefined several times. It is currently the weighted value of currencies of the five IMF members having the largest exports of goods and services. Individual countries hold SDRs in the form of deposits in the IMF. These holdings are part of each country‘s international monetary reserves, along with official holdings of gold, foreign exchange, and its reserve position at the IMF. Members may settle transactions among themselves by transferring SDRs. Under the Scheme, the IMF is empowered to allocate to various member countries SDR‘s on a specified basis, which in effect amounts to raising the limit to which a member country can draw from the IMF in time of need. Besides, the SDR‘s supplement gold, dollars and pounds sterling most countries use as monetary reserves. They can be used unconditionally by the participating countries to meet their liabilities and they are not backed by gold. They are meant to be used by the Central banks of the Fund‘s member countries. With the SDR‘s, the Central banks can buy whatever

currencies they need for settling their balance of payments deficits. The resources of the new scheme are not a pool of currencies but simply the obligation of participating members to accept the SDR‘s for settlement of payments between them. Thus, SDR‘s serve as an international money as good as other reserve currencies. But a nicely and diligently built up system of exchange stability by the IMF collapsed like a house of cards. This was caused by the dollar crisis created by the adverse American balance of payments. Among the measures taken by the American administration, there was one which delinked dollar from gold. The delinking of dollar from gold knocked out the very foundation of the IMF. In January 1975, the IMF abolished the official price of gold and SDR‘s have instead become the basis of the present international monetary standard. The SDR‘s are not convertible into gold; that is why alternatively the present standard may also be referred to as Paper Gold Standard.

14.12 FIXED VS FLOATING EXCHANGE RATE SYSTEMS:

14.12.1 Fixed Exchange Rates, (1945-1973)

The currency arrangement negotiated at Bretton Woods and monitored by the IMF worked fairly well during the post-World War II period of reconstruction and rapid growth in world trade. However, widely diverging national monetary and fiscal policies, differential rates of inflation, and various unexpected external shocks eventually resulted in the system‘s demise. The U.S. dollar was the main reserve currency held by central banks and was the key to the web of exchange rate values. Unfortunately, the United States ran persistent and growing deficits on its balance of payments. A heavy capital outflow of dollars was required to finance these deficits and to meet the growing demand for dollars from investors and businesses. Eventually, the heavy overhang of dollars held abroad resulted in a lack of confidence in the ability of the United States to meet its commitment to convert dollars to gold. On August 15, 1971, President Richard Nixon was forced to suspend official purchases or sales of gold by the U.S. Treasury after the United States suffered outflows of roughly one-third of its official gold reserves in the first seven months of the year. Exchange rates of most of the leading trading countries were allowed to float in relation to the dollar and thus indirectly in relation to gold. By the end of 1971 most of the major trading currencies had appreciated vis-à-vis the dollar. This change was – in effect – a devaluation of the dollar. In early 1973, the U.S. dollar came under attack once again, thereby forcing a second devaluation on February 12, 1973, this time by 10 per cent to $42.22 per ounce. By late February 1973, a fixed –rate system no longer appeared feasible given the speculative flows of currencies. The major foreign exchange markets were actually closed for several weeks in March 1973. When they reopened, most currencies were allowed to float to levels determined

by market forces. Par values were left unchanged. The dollar had floated downward an average of 10 per cent by June 1973.

14.12.2 An Eclectic Currency Arrangement, 1973-Present

Since March 1973, exchange rates have become much more volatile and less predictable than they were during the ―fixed‖ exchange rate period, when changes occurred infrequently. In general the dollar has been volatile and has weakened somewhat over the long run. On the other hand, the Japanese yen and German mark have strengthened. The emerging market currencies have been exceptionally volatile and have generally weakened. In the wake of the collapse of the Bretton Woods exchange rate system, the IMF appointed the Committee of Twenty which suggested various options for the exchange rate arrangement. These suggestions were approved at Jamaica during February 1976 and were formally incorporated into the text of the Second Amendment to the Articles of Agreement, which came into force from April 1978. The options were broadly:

1. Floating Rate System:

In a floating-rate system, it is the market forces that determine the exchange rate between two currencies. The advocates of the floating rate system put forth two major arguments. One is that the exchange rate varies automatically according to the changes in the macroeconomic variables. As a result, there is no gap between the real exchange rate and the nominal exchange rate. The country does not need any adjustment, which is often required in a fixed rate regime and so it does not have to bear the cost of adjustment. The other argument is that this system possesses insulation properties, meaning that the currency remains isolated from the shocks emanating from other counties. It also means that the government can adopt an independent economic policy without impinging upon the external sector performance. In case of Managed Floating with no preannounced path for the exchange rate, the monetary authority influences the movements of the exchange rate through active intervention in the foreign exchange market without specifying, or precommiting to, a pre-announced path for the exchange rate. In case of Independent Floating, the exchange rate is market-determined, with any foreign exchange intervention aimed at moderating the rate of change and preventing undue fluctuations in the exchange rate, rather than at establishing a level for it.

2. Pegging of Currency:

Normally, a developing country pegs its currency to a strong currency or to a currency with which it conducts a very large part of its trade. Pegging involves fixed exchange rate with the result that trade payments are stable. But in case of trading with other countries, stability

cannot be guaranteed. This is why pegging to a single currency is not advised if the country's trade is diversified. In such cases, pegging to a basket of currencies is advised. But if the basket is very large, multi-currency intervention may prove costly. Pegging to SDR is not different insofar as the value of the SDR itself is pegged to a basket of five currencies.

3. Crawling Peg:

Again, a few countries have a system of a crawling peg. Under this system, they allow the peg to change gradually over time to catch up with changes in the market-determined rates. It is a hybrid of fixed-rate and flexible rate systems. So this system avoids too much of instability and too much of rigidity. In some of the countries opting for the crawling peg, crawling bands are maintained within which the value of currency is maintained. The currency is adjusted periodically in small amounts at a fixed, preannounced rate or in response to changes in selective quantitative indicators.

4. Target Zone Arrangement:

In a target zone arrangement, the intra-zone exchange rates are fixed. An opposite example of such an arrangement was found in European Monetary Union (EMU) before coming in of Euro. However, there are cases where the member countries of a currency union do not have their own currency, rather they have a common currency. Under this group, come the member countries of the Eastern Caribbean Currency Union, the Western African Economic and Monetary Union, and the Central African Economic and Monetary Community. The member countries of the European Monetary Union too came under this group with the Euro substituting their currency in 2002.

5. Others:

Apart from the models discussed above there do different countries follow some more practices. They are:

a) Currency Board Arrangements: A monetary regime based on an implicit legislative commitment to exchange domestic currency for a specified foreign currency at a fixed exchange rate, combined with restrictions on the issuing authority to ensure the fulfillment of its legal obligation.

b) Dollarization: Several countries that have suffered for many years from currency devaluation, primarily as a result of inflation, have taken steps towards dollarization, the use of the U.S. dollar as the official currency of the country.

14.13 GLOBAL SCENARIO OF EXCHANGE RATE ARRANGEMENTS:

Firms engaged in international business must have an idea about the exchange rate arrangement prevailing in different countries as this will facilitate their financial decisions. In

this context, it can be said that over a couple of decades, the choice of the member countries has been found shifting from one form of exchange rate arrangement to the other, but, on the whole, preference for the floating rate regime is quite evident. At present as many as 35 of a total of 187 countries have an independent float, while the other 51 countries have managed floating system. The other 7 countries have a crawling peg, while 53 countries have pegs of different kinds. The EMU and other 20 countries of Africa and the Caribbean region come under some kind of economic and monetary integration scheme in which they have a common currency. Lastly, nine countries do not have their own currency as legal tender.

The recent developments in the field of international monetary environment are worth mentioning. They are launch of Euro as the single currency for 11 of European countries and the currency crises in emerging markets. They are briefly mentioned below:

14.13.1 The Launch of Euro

On January 1, 1999, 11 member states of the EU initiated the European Monetary Union. They established a single currency, the Euro, which replaced the individual currencies of the participating member states. On December 31, 1998, the final fixed rates between the 11 participating currencies and the Euro were put into place. On January 4, 1999, the Euro was officially traded. The 15 members of the European Union are also members of the European Monetary System. According to the EU, EMU is a single currency area, now known informally as the Euro Zone, within the EU single market in which people, goods, services and capital move without restrictions. In December 1991, the members of the European Union met at Maastricht, the Netherlands and concluded a treaty that changed Europe‘s currency future. The Maastricht Treaty specified a timetable and a plan to replace all individual currencies with a single currency, now called the Euro. Other steps were adopted that would lead to a full European Economic and Monetary Union. The growth of global markets and the increasing competitiveness of the Americas and Asia drove the members of the EU in the 1980s and 1990s to take actions that would allow their residents and their firms to compete globally. The reduction of barriers across all members countries to allow economies of scale (size and cost per unit) and scope (horizontal and vertical integration) was thought to be Europe‘s only hope of not being left behind in the new millennium. The successful implementation of a single, strong, and dependable currency for the conduct of life could well alter the traditional dominance of the U.S. dollar as the world‘s currency.

14.13.2 Emerging Market Crises:

After a number of years of relative global economic tranquility, the second half of the 1990s was racked by a series of currency crises that shook all emerging markets. The devaluation of the Mexican peso in December 1994 served as a harbinger of crises to come. The Asian crisis of July 1997, the Russian ruble's collapse in August 1998, and more recently the fall of the Brazilian real in January 1999 provide a spectrum of emerging market economic failures, each with its own complex causes and unknown outlooks. These crises also illustrate the growing problem of capital flight and short-run international speculation in currency and securities markets.

14.26.1.1 The Asian crisis of 1997

The roots of the Asian currency crisis extended from

- a fundamental change in the economics of the region, the transition of many Asian nations from net exporters to net importers. The most visible roots of the crisis were in the excesses of capital flows into Thailand in 1996 and early 1997. As the investment ―bubble‖ expanded, some participants raised questions about the economy's ability to repay the rising debt. The bath came under sudden and severe pressure. The Asian crisis – for it was more than just a currency collapse- had many roots besides the traditional balance-of-payments difficulties. The complex structures combining government , society, and business throughout the Far East provide a backdrop for understanding the tenuous linkage between business, government, and society.

14.26.1.2 The Russian crisis of 1998.

The loss of the relatively stable ruble, once considered the cornerstone and symbol of success of President Boris Yeltsin's regime, was a potential death blow to the current Russian government and economic system. If nothing else, Russian borrowers may find themselves persona non grata for years to come in the international capital markets.

14.26.1.3 The Brazilian crisis of 1999.

Potentially the mildest of the three currency collapses, the Brazilian real's fall in January 1999 was the result of a long expected correction in an ill-conceived currency policy. Because so many major Brazilian firms are publicly traded, this crisis serves as an excellent example of how equity markets revalue firms that are exposed to currency devaluations and vice versa.

14.14 ATTRIBUTES OF THE IDEAL CURRENCY:

If the ideal currency existed in today's world, it would possess three attributes:

Fixed value.

The value of the currency would be fixed in relationship to other major currencies so that trades and investors could be relatively certain of the foreign exchange value of each currency in the present and into the near future.

Convertibility.

Complete freedom of monetary flows would be allowed, so that traders and investors could willingly and easily move funds from one country and currency to another in response to perceived economic opportunities or risks.

Independent monetary policy.

Domestic monetary and interest rate policies would be set by each individual country so as to pursue desired national economic policies, especially as they might relate to limiting inflation, combating recessions, and fostering prosperity and full employment. Unfortunately, these three attributes usually cannot be achieved at the same time. For example, countries whose currencies are pegged to each other are in effect agreeing to both a common inflation rate and a common interest rate policy. If inflation rates differ but the peg (i.e., fixed exchange rate) is maintained, one country‘s goods become cheaper in the other countries. This will lead to unemployment in the high-inflation country. If one country‘s interest rates are higher than the others and the peg is maintained, investors will move funds from the low-rate country to the high-rate country, creating ever more difficulty in maintaining the peg.

14.15 CURRENCY DEPRECIATION AND DEVALUATION

14.15.1 Depreciation of currency

Depreciation of currency happens in those currencies which are linked to floating exchange rate and it is likely to change / vary on day to day basis (in actual practice popular currency rates change almost every few minutes / seconds). A floating exchange rate means that the global investment market determines the value of a country's currency. These countries allow supply and demand to determine the value of their currency relative to the currencies of other countries. Depreciation occurs when the forces of supply and demand cause the value of their currency to drop. To check the high volatility, as a prudent measure, almost all central banks of the respective countries try to influence the exchange rates through various means so as to curb such volatility, yet in the end it is the free market that determines the exchange rate of all the currencies linked to floating exchange rate. These days all major economies use a floating exchange rate. Thus, Appreciation / Depreciation (only marginal change) of all such currencies regularly occurs number of time during the period market remains open.. It is only in rare cases, that currency depreciates or appreciates by a wide margin. Such changes happen if something major happens on economic / political front of such country or in the global markets. If a country’s currency has depreciated it will mean

that this country's money has less purchasing power in other countries because of the depreciation.

14.15.2 Devaluation of Currency :

Devaluation of a currency happens in countries with a fixed exchange rate (or also where it is managed floating rate). In a fixed-rate economy, it is the government that decides what its currency should be worth compared with that of other countries. In this case, usually the government pledges to buy and sell as much of its currency as needed to keep its exchange rate the same. The exchange rate can change only when the government decides to change it. If a government decides to make its currency less valuable, the change is called devaluation.

In cases where a country's economy is not performing good, and its government does not allow free rate mechanism, the country's currency will look strong only on paper and its economy will suffer more as it will not be able to export at inflated price of the currency. Slowly a day comes when the government is forced to devalue its currency so as to make it more tuned to the realities of the FEX rates.

14.15.3 Impact of depreciation or devaluation of the currency on economy of the country:

Broadly speaking both have similar impact in the short term. Both of these (i.e. depreciation or devaluation) help the companies which are exporting goods as a drop in the value of the home currency allows the other countries to import goods at a cheaper price from the country whose value has depreciated / devalued. Thus, exports from country whose currency has devalued / depreciated are likely to increase. On the other hand, the citizens will find it costly to buy goods which are imported from other countries as such goods will become costly. Thus, this is likely to benefit the economy to remain competitive in the international market. These events are good for companies that sell the goods produced from domestic raw material, and also to companies that export to other countries.

A drop in home currency exchange rate makes it more expensive for local people to buy goods from other countries, as import of such goods becomes costlier after depreciation / devaluation. Thus, they will either buy more goods manufactured by domestic companies or reduce their consumption of goods from abroad.

14.15.4 Long Term Impact of Depreciation or Devaluation of the Currency :

Depreciation of the currency is a slow process and value of the currency automatically gets adjusted by the market forces. Thus, once the currency of a country has depreciated, the investors from other countries will see an opportunity and are likely to shift from other economies. This will help in boosting the economy which may in the long run even push back the value of the currency.

On the other hand in case of devaluation, there is less trust in the economy and once currency is devalued, Government finds it very difficult to revalue the same by government dictate as there will be fear that such revaluation can backfire and put the economy in risk mode.

Devaluation of Yuan (China's currency) in August 2015:

Now let us try to understand the difference in these two terms on the basis of recent happenings in the FEX market :-

It was in the mid August 2015, that China in a surprise move devalued Yuan by about 3.5% over a period of three days. This sent jitters across world stock markets and FEX markets. It sent signals to the global markets about the continued weakening of the China's market, and its desperate move to remain competitive in export market as exports have started declining since last few quarters. We know China is the world's largest exporter and its exports formed 13.7per cent of the global exports and close to one-and-a-half times United States' exports last year. Thus this move to devalue is currency (Yuan) is a move to boost its exports and continue its share in export market. Thus, here the value of the currency of China dropped on account of measures of Government. This is called *devaluation*.

However, soon after the announcement of devaluation of Yuan, FEX markets across the world started readjusting the prices of currencies which are linked to floating exchange rates. Indian Rupee two depreciated by about 3per cent immediately. Thus there was depreciation of INR. Although there was no direct devaluation by Indian Government, but INR depreciated due to market forces which have changed after the announcement of devaluation of Yuan by China.

14.16 ESSENTIALS OF A SOUND CURRENCY SYSTEM

Broadly speaking, a sound currency system must fulfil the following conditions:

(i) It must maintain a reasonable stability of prices in the country. This means that its internal value (or purchasing power in terms of goods and services in the country concerned) must not fluctuate too violently. This involves regulation of the amount of money in circulation to suit the requirements of trade and industry in the country.

(ii) A sound currency system must maintain stability of the external value of the currency. This means that its purchasing power over goods and services in foreign countries, through its command over a definite amount of foreign currency, should remain constant.

(iii) The system must be economical. A costly medium of exchange is a national waste. It is unnecessary. That is why all countries use mostly paper money.

(iv) The currency must be elastic and automatic so that it expands or contracts in response to the requirements of trade and industry.

(v) The currency system must be simple so that an average man can understand it. A complicated system cannot inspire public confidence.

14.17 IMPACTS OF EXCHANGE RATES

The relationship between the BOP and exchange rates can be illustrated by use of a simplified equation that summarizes BOP data: BOP = (X-M) + (CI-CO) + (FI-FO) +FXB

Where:

X is exports of goods and services,

M is imports of goods and services,

(X-M) is known as Current Account Balance

CI is capital outflows,

CO is capital outflows,

(CI-CO) is known as Capital Account Balance

FI is financial inflows,

FO is financial outflows,

(FI-FO) is known as Financial Account Balance

FXB is official monetary reserves such as foreign exchange and gold

The effect of an imbalance in the BOP of a country works somewhat differently depending on whether that country has fixed exchange rates, floating exchange rates, or a managed exchange rate system.

a) Fixed Exchange Rate Countries.

Under a fixed exchange rate system, the government bears the responsibility to ensure a BOP near zero. If the sum of the current and capital accounts does not approximate zero, the government is expected to intervene in the foreign exchange market by buying or selling official foreign exchange reserves. If the sum of the first two accounts is greater than zero, a surplus demand for the domestic currency exists in the world. To preserve the fixed exchange rate, the government must then intervene in the foreign exchange market and sell domestic currency for foreign currencies or gold so as to bring the BOP back near zero. It the sum of the current and capital accounts is negative, an exchange supply of the domestic currency exists in world markets. Then the government must intervene by buying the domestic currency with its reserves of foreign currencies and gold. It is obviously important for a government to maintain significant foreign exchange reserve balances to allow it to intervene effectively. If the country runs out of foreign exchange reserves, it will be unable to buy back its domestic currency and will be forced to devalue. For fixed exchange rate countries, then, business managers use balance-of-payments statistics to help forecast devaluation or revaluation of the official exchange rate. Normally a change in fixed exchange rates is technically called ―devaluation‖ or ―revaluation, while a change in floating exchange rates is called either ―depreciation or ―appreciation.

b) *Floating Exchange Rate Countries.*

Under a floating exchange rate system, the government of a county has no responsibility to peg the foreign exchange rate. The fact that the current and capital account balances do not sum to zero will automatically (in theory) alter the exchange rate in the direction necessary to obtain a BOP near zero. For example, a country running a sizable current account deficit with the capital and financial accounts balance of zero will have a net BOP deficit. An excess supply of the domestic currency will appear on world markets. As is the case with all goods in excess supply, the market will rid itself of the imbalance by lowering the price. Thus, the domestic currency will fall in value, and the BOP will move back toward zero. Exchange rate markets do not always follow this theory, particularly in the short-to-intermediate term.

c) *Managed Floats*.

Although still relying on market conditions for day-to-day exchange rate determination, countries operating with managed floats often find it necessary to take actions to maintain their desired exchange rate values. They therefore seek to alter the market‘s valuation of a specific exchange rate by influencing the motivations of market activity, rather than through direct intervention in the foreign exchange markets. The primary action taken by such governments is to change relative interest rates, thus influencing the economic fundamentals of exchange rate determination. A change in domestic interest rates is an attempt to alter capital account balance, especially the short-term portfolio component of these capital flows, in order to restore an imbalance caused by the deficit in current account. The power of interest rate changes on international capital and exchange rate movements can be substantial. A country with a managed float that wishes to defend its currency may choose to raise domestic interest rates to attract additional capital from abroad. This will alter market forces and create additional market demand for domestic currency. In this process, the government signals exchange market participants that it intends to take measures to preserve the currency‘s value within certain ranges. The process also raises the cost of local borrowing for businesses, however, and so the policy is seldom without domestic critics. For managed-float countries, business managers use BOP trends to help forecast changes in the government policies on domestic interest rates.

14.18 EXCHANGE RATE DETERMINANTS

There are many potential exchange rate determinants. Economists have traditionally isolated several of these determinants and theorized how they are linked with one another and with spot and forward exchange rates. These linkages are called parity conditions. They are useful in explaining and forecasting the long-run trend in an exchange rate.

Prices and Exchange Rates:

If the identical product or service can be sold in two different markets, and no restrictions exist on the sale or transportation costs of moving the product between markets, the product‘s price should be the same in both markets. This is called the law of one price. A primary principle of competitive markets is that prices will equalize across markets if frictions or costs of moving the products or services between markets do not exist. If the two markets are in two different countries, the product‘s price may be stated in different currency terms, but the price of the product should still be the same. Comparison of prices would only require a conversion from one currency to the other.

Purchasing Power Parity and the Law of One Price:

If the law of one price were true for all goods and services, the purchasing power parity exchange rate could be found from any individual set of prices. By comparing the prices of identical products denominated in different currencies, we could determine the ―real‖ or PPP exchange rate which should exist if markets were efficient. The hamburger standard, as it has been christened by The Economist, is a prime example of this law of one price. Assuming that the Big Mac, food item sold by McDonalds is indeed identical in all countries, it serves as one means of identifying whether currencies are currently trading at market rates that are close to the exchange rate implied by Big Macs in local currencies. A less extreme form of this principle would say that, in relatively efficient markets, the price of a basket of goods would be the same in each market. This is the absolute version of the theory of purchasing power parity. Absolute PPP state that the spot exchange rate is determined by the relative prices of similar baskets of goods.

Relative Purchasing Power Parity:

If the assumptions of the absolute version of PPP theory are relaxed a bit more, we observe what is termed relative purchasing power parity. This more general idea is that PPP is not particularly helpful in determining what the spot rate is today, but that the relative change in prices between two countries over a period of time determines the change in the exchange rate over that period. More specifically, if the spot exchange rate between two countries starts in equilibrium, any change in the differential rate of inflation between them tends to be offset over the long run by an equal but opposite change in the spot exchange rate.

14.19 EXCHANGE RATE INDICES:

Real and Nominal: Any single country in the current global market trades with numerous partners. This requires tracking and evaluating its individual currency value against all other currency values in order to determine relative purchasing power, that is, whether it is ―overvalued or ―undervalued in terms of PPP. One of the primary methods of dealing with

this problem is the calculation of exchange rate indices. These indices are formed by trade-weighting the bilateral exchange rates between the home country and its trading partners. The nominal effective exchange rate index calculates, on a weighted average basis, the value of the subject currency at different points in time. It does not really indicate anything about the ―true value‖ of the currency, or anything related to PPP. The nominal index simply calculates how the currency value relates to some arbitrarily chosen base period. The real effective exchange rate index indicates how the weighted average purchasing power of the currency has changed relative to some arbitrarily selected base period.

14.20 INTEREST RATES AND EXCHANGE RATES

In this section we see how interest rates are linked to exchange rates.

The Fisher Effect:

The Fisher effect, named after economist Irving Fisher, states that nominal interest rates in each country are equal to the required real rate of return plus compensation for expected inflation.

The International Fisher Effect:

The relationship between the percentage change in the spot exchange rate over time and the differential between comparable interest rates in different national capital markets is known as the international Fisher effect. Fisher-open as it is often termed, states that the spot exchange rate should change in an amount equal to but in the opposite direction of the difference in interest rates between two countries. Empirical tests lend some support to the relationship postulated by the international Fisher effect, although considerable sort-run deviations occur. However, a more serious criticism has been posed by recent studies that suggest the existence of a foreign exchange risk premium for major currencies. Also, speculation in uncovered interest arbitrage, such as ―carry trade‖, creates distortions in currency markets. Thus the expected change in exchange rates might be consistently more than the difference in interest rates.

Interest Rate Parity:

The theory of interest rate parity (IRP) provides the linkages between the foreign exchange markets and the international money markets. The theory states that the difference in the national interest rates for securities of similar risk and maturity should be equal to, but opposite in sign to, the forward rate discount or premium for the foreign currency, except for transaction costs.

Covered Interest Arbitrage:

The spot and forward exchange markets are not, however, constantly in the state of equilibrium described by interest rate parity. When the market is not in equilibrium, the potential for ―riskless‖ or arbitrage profit exists. The arbitrager who recognizes such an imbalance will move to take advantage of the disequilibrium by investing in whichever currency offers the higher return on a covered basis. This is called covered interest arbitrage (CIA).

Forward Rate as an Unbiased Predictor of the Future Spot Rate:

Some forecasters believe that for the major floating currencies, foreign exchange markets are ―efficient‖ and forward exchange rates are unbiased predictors of future spot exchange rates. Intuitively this means that the distribution of possible actual spot rates in the future is centered on the forward rate. The forward exchange rate‘s being an unbiased predictor does not, however, mean that the future spot rate will actually be equal to what the forward rate predicts. Unbiased prediction simply means that the forward rate will, on average, overestimate and underestimate the actual future spot rate in equal frequency and degree. The forward rate may, in fact, never actually equal the future spot rate.

The Asset Market Approach

Along with the BOP approach to long-term foreign exchange rate determination, there is an alternative approach to exchange rate forecasting called the asset market approach. The asset approach to forecasting suggests that whether foreigners are willing to hold claims in monetary form depends partly on relative real interest rates and partly on a country‘s outlook for economic growth and profitability. For example, during the period 1981-1985 the US dollar strengthened despite growing current account deficits. This strength was due partly to relatively high real interest rates in the US. Another factor, however, was the heavy inflow of foreign capital into the US stock market and real estate, motivated by good long-run prospects for growth and profitability in the US.

Technical Analysis

Technical analysts traditionally referred to as chartists focus on price and volume data to determine past trends that are expected to continue into the future. The single most important element of time series analysis is that future exchange rates are based on the current exchange rate. Exchange rate movements, like equity price movements, can be subdivided into periods:

(1) day-to-day movement that is seemingly random;
(2) short-term movements extending from several days to trends lasting several months;
(3) long-term movements, which are characterized by up and down long-term trends.

The longer the time horizon of the forecast, the more inaccurate the forecast is likely to be. Whereas forecasting for the long-run must depend on economic fundamentals of exchange rate determination, many of the forecast needs of the firm are short-to medium-term in their time horizon and can be addressed with less theoretical approaches. Time series techniques infer no theory or causality but simply predict future values from the recent past. Forecasters freely mix fundamental and technical analysis, presumably because in forecasting, getting close is all that counts.

14.21 SUMMARY

The international monetary system can be defined as the structure within which foreign exchange rates are determined, international trade and capital flows are accommodated, and balance of payments adjustments made. It also includes all the instruments, and agreements that link together the world's currency, money markets, securities, real estate, and commodity markets. The international monetary system has evolved historically from the gold standard (1876-1913) of fixed exchange rates, to the interwar years and World War II (1914-1944) with floating exchange rates, to fixed exchange rates (1945-1973) under the Bretton Woods Agreement, to the present eclectic currency arrangement (1973-present) of fixed, floating, and managed exchange rates. The key monetary institution is the International Monetary Fund (IMF). It was first proposed in 1944 at Bretton Woods, New Hampshire, with the purpose of being a lender of last resort to countries facing temporary balance of payments difficulties. Contemporary currency regimes vary from rigidly fixed rates to managed floating to independently floating exchange rates. Several countries, such as Argentina and Hong Kong, utilize currency boards as a means of fixing their exchange rates. Another alternative being considered is dollarization, which entails the use of the U.S. dollar as the main domestic currency. The argument over the appropriateness of fixed rates versus flexible rates continues, as shown by the variety of currency regimes in use across the globe. Eleven of the 15 member countries of the European Union successfully launched a single currency effective January 1, 1999. Called the Euro, this single currency will replace the 11 national currencies of the participant countries completely by mid-2002. The European Central Bank in Frankfurt, Germany conducts monetary policy for the 11 member countries of the EMU. The devaluation of the Mexican peso in 1994 and the subsequent tequila effect was a harbinger of crises to come. The second half of the 1990s was racked by a series of currency crises that shook all emerging markets. Three recent crises – the Asian crisis (starting in

Thailand in July 1997), the Russian crisis (August 1998), and the Brazilian crisis (January 1999) - demonstrate the critical roles of currencies in the global economy.

14.22 CHECK YOUR PROGRESS

1. When the country is able to discover key resources, its currency_______in value.
2. The difference between the forward rate and the spot rate is known as the ________or___________.
3. An option to buy the underlying asset is known as a________and an option to sell the underlying asset is known as a___________.
4. The theory of interest rate parity (IRP) provides the linkages between the________________and___________________.

14.23 GLOSSARY

Gold Standard: A system of setting currency values whereby the participating countries commit to fix the prices of their domestic currencies in terms of a specified amount of gold.

Bretton Woods Agreement: The Bretton Woods Agreement, implemented in 1946, whereby each member government pledged to maintain a fixed, or pegged, exchange rate for its currency vis-à-vis the dollar or gold. These fixed exchange rates were supposed to reduce the riskiness of international transactions, thus promoting growth in world trade.

Free Float: An exchange rate system characterized by the absence of government intervention. Also known as a clean float.

Special Drawing Rights (SDRs): A new form of international reserve assets, created by the IMF in 1967, whose value is based on a portfolio of widely used currencies.

Hot Money: Money which moves internationally from one currency and / or country to another in response to interest rate differences, and moves away immediately when the interest advantage disappears.

14.24 ANSWERS TO CHECK YOUR PROGRESS/SAQ'S

1. Gains
2. 'forward margin' , swap points.
3. call option, put option.
4. foreign exchange markets , the international money markets

14.25 BIBLIOGRAPHY/REFERENCES/SUGGESTED READINGS

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14.26 TERMINAL /MODEL QUESTIONS

1. Explain how foreign exchange rates are determined?
2. Differentiate between currency depreciation and devaluation. What are its short term and long term impacts on the economy?
3. Discuss the nature of Indian Foreign Exchange Market.
4. What are the determinants of Foreign Exchange and how does Foreign Exchange impact the economy?