BUSINESS ENVIRONMENT

M.B.A., (HRM) First Year

Semester – I, Paper-III

Lesson Writer

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FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging ahead in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining 'A+' grade from the NAAC in the year 2024, Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 221 affiliated colleges spread over the two districts of Guntur and Prakasam.

The University has also started the Centre for Distance Education in 2003-04 with the aim of taking higher education to the doorstep of all the sectors of the society. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even to housewives desirous of pursuing higher studies. Acharya Nagarjuna University has started offering B.Sc., B.A., B.B.A., and B.Com courses at the Degree level and M.A., M.Com., M.Sc., M.B.A., and L.L.M., courses at the PG level from the academic year 2003-2004 onwards.

To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers involved respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.

It is my aim that students getting higher education through the Centre for Distance Education should improve their qualification, have better employment opportunities and in turn be part of country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Academic Coordinators, Editors and Lesson-writers of the Centre who have helped in these endeavors.

Prof.K.GangadharaRao
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UNIT -I Concept, significance and nature of business environment; Internal and External; Changing dimensions of business environment, Techniques of environmental scanning and monitoring; Planning Commission- NITI Aayog

UNIT -II

Economic Environment - Significance and elements of economic environment, Problems of Growth: Unemployment, Inflation, Regional imbalances and Social Injustice. Industrial Policy Resolution, Monetary Policy, Fiscal Policy, Balance of Payments, National Manufacturing Policy, MSME, Significance, Growth, challenges& Strategies,

UNIT -III

Political Environment- Concept and Meaning of Political Environment Political and Government Environment-Role of Government in Business-The Indian Political System-Political System- Political Institutions

UNIT- IV

Demographic and Socio cultural Environment, Size of the population, Age structure, population Control policy, Human Development in India - The Concept and Measures of Human Development, National Human Development Report, Poverty in India; Unemployment in India; Human development, Rural Development, Business Ethics, Corporate Governance and Corporate Social Responsibility

UNIT -V

International Business Environment – Liberalization- Privatization- Globalization IBRD(World Bank), IMF, GATT, WTO: the WTO agreement, TRIPS, TRIMS, Non-Tariff Barriers and Dispute Settlement Mechanism, MNCs,

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Business Environment

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LESSON- 1

ECONOMIC AND SOCIAL ENVIRONEMNT

Introduction

Business cannot exist in vacuum. It is surrounded by various factors called business environment. Every business depends on these factors which ultimately decide its success or failure. Hence, it is the most important aspect for business as well as to the entrepreneur running the business. Suppliers, competitors, media, government, customers, economic conditions, investors and multiple other institutions working externally are the forces which constitute the business environment. Business environment greatly helps in recognising its opportunities and threats. It helps in tapping useful resources, assists in planning, and improves the overall performance, growth, and profitability of the business. Business Environment means all of the internal and external factors that affect the functioning of an organisation.

Definition of Business Environment can be stated as sum total of all internal and external factors such as employees, customers' needs and expectations, supply and demand, management, clients, suppliers, owners, activities by government, innovation in technology, social trends, market trends, economic changes, etc. These factors affect the function of the company and how a company works directly or indirectly. Some of these factors influence the companies or business organisations' environment and situation.

Environment of business

As discussed above, the term environment refers to the totality of all the factors, some of them are within the control of management and some are beyond its control. The environmental factors vary from one country to the other. The environment that is typical to India may not be found in other countries like China, UK, and Russia. There are several classifications for business environment. Sometimes the environment may be classified into market environment and non-market environment basing on market forces like demand, supply, number of competing firms and the resulting price competition or non-price competition etc., or by non-market forces like legislations and social traditions and customs etc. which impact business. But many problems are involved in the identification, description, explanation and prediction of environmental factors. So, it is difficult to conceptualise and or quantify the proportion of change as well as the direction of change in environmental factors.

Importance of Business Environment

1. It enables the business organisation to identify opportunities to its advantage much earlier to its competitors.
2. It helps the organisation to take timely action by identifying threats and early warning signals which are likely to hinder its performance.
3. It helps in tapping useful resources and accordingly design policies that allow it to get the resources that it needs.
4. As the managers are able to understand and examine the environment, It helps in coping with rapid changes and develop appropriate action.

5. Planning and policy making is done by understanding and analysing the environment, that can be the basis for deciding the future course of action or decision making it is important.
6. Continuous monitoring of the environment helps in improving performance of an enterprise.

There are certain basic propositions to describe and analyse business environment namely, business is an economic activity, business firm is an economic unit and business decision-making is an economic process.

1. Business is an economic activity: Task of adjusting the resources to meet the optimum requirements of the organisation is an economic activity. The nature of business differs, basing on the form of economic activity an organisation undertakes.

2. Business firm is an economic unit: While a business organisation transforms inputs into outputs it may undertake different types of activities such as mining, manufacture, farming, trading, transport, banking etc. The firm therefore, carefully plans the optimum allocation of resources such as men, money, materials, machines time and energy etc., to get optimum production. The entire process of creating, mobilising and utilising the surplus, constitutes economic activity of the business firm.

3. Business decision-making is an economic process. Decision is made by selecting from a set of alternative courses of action. The choice/decision making is at the root of all economic activity.

Economic environment of business is the primary consideration in formulating the business policies, business strategies and business tactics of a corporate entity as business is an economic activity, a business organisation is an economic unit and business decision-making is an economic process.

Types of Business Environment

There are mainly two types of business environment; Micro Environment and Macro Environment. Further, it can be classified into internal environment and external environment.

External Micro Environment

External micro forces have impact on business operations of a firm. However, all micro forces may not have the same effect on all firms in the industry. For example, suppliers are willing to supply the materials at relatively lower prices to big business firms but do not do the same to small business organisations. This example holds good even in case if price war. Usually competing firm does not resort to a price war if the competitor is big enough to retaliate the move whereas it might fo so in case of small business organisation. Hence, it is necessary to understand important factors or forces of micro-level external environment.

Suppliers

Suppliers are an important factor in the external environment of a firm, who supply inputs such as raw materials and components. Business firms need uninterrupted supply of raw materials for a smooth and efficient functioning. If supply of raw materials is uncertain, then a firm will have to keep a large stock of raw materials to continue manufacturing process without any interruption. This will raise its cost of production and reduce its profit margin. To ensure regular supply of inputs such as raw materials some firms adopt a strategy of backward integration and set up captive production plants for producing raw materials themselves. It is not a good strategy to depend on a single supplier of inputs. If there is disruption in production of the supplier firm due to labour strike or lock-out, it will adversely affect the production work of a firm. Therefore, to reduce risk and uncertainty, business firms prefer to keep multiple suppliers of inputs.

Customers

It is sine qua non for any business, big or small, to keep its customers satisfied. Since sale of a product/service is critical for the survival and growth of an organisation, it is necessary to keep the customers satisfied. A firm has different categories of customers. For instance, a car manufacturing Company will have individuals, companies, institutions, government as its customers. Therefore, is catering to the needs of all these varieties of customers by producing different varieties and models of cars.

Business firm has to compete with rival firms to attract customers and increase the demand for its product thereby increase the market share. Because of the intense competition a firm will be required to spend huge amounts on advertisements for creating new customers as well as retaining the old ones. For this purpose, a business firm has also to launch new products or models.

Customers' satisfaction is of paramount importance because of intense competition and the consumers have the option of buying from many available sellers. Business organisations are now trying to delight the customers rather than simply satisfying them. Therefore, to survive and succeed, a firm has to make continuous efforts to improve the quality of its products.

Middlemen

Marketing intermediaries sell and distribute its products to the end consumer. They include agents and merchants such as distribution firms, wholesalers, retailers. Marketing intermediaries are responsible for stocking and transporting goods from their production site to their destination, i.e., end consumers. These middlemen play a pivotal role in establishing a link between the consumer and the business organisation. Non-cooperation by the marketing intermediaries would adversely affect the business.

Competitors

Business firms compete with each other not only for sale of their products but also in other areas of business activity. Except in case of public utilities where monopoly exists, there will be no competition because of monopoly such as power distribution, gas distribution etc. Generally, markets of monopolistic competition and differentiated oligopolies exist in the real world. In these kinds of competitive situations different firms in an industry compete and may be on the basis of pricing of their products. Firms involve not only on price competition but also on non-price competition. Non-price competition includes advertising, sponsoring events like cricket matches to create brand image for the sale of their products, each claiming the superiority of its products.

For example, competition for a firm producing TVs does not come only from other brands of TV manufacturers, but also from manufacturers of air conditioners, refrigerators, cars, washing machines etc. All these goods compete for attracting disposable incomes of the final consumers. Competition among these diverse products is generally referred to as a desired competition as all these goods fulfil the various desires of the consumers who have limited disposable incomes.

An interesting case study in competition is provided hereunder;

On 3rd September 2007 India's giant two-wheeler manufacturers, Bajaj Auto Ltd. and TVS Motor Company Ltd. involved in a verbal feud. TVS accused Bajaj of making malicious allegation against TVS in an effort to tarnish its reputation. TVS threatened to sue Bajaj for Rs.250 crore if it did not withdraw its allegations and express regret. The controversy had started with Baja accusing TVS of using its patented twin spark technology. Bajaj contended that the Controlled Combustion Variable technology used in TVS new 125 CC motorbike "Flame" infringed on its digital twin spark ignition on its Digital twin spark Ignition patent (DTSi). Most of the two wheelers of Bajaj including the high volume Pulsar, Discover and Avenger were largely based on the DTSi platform.

Bajaj had filed a final claim for patent of its DTSi technology on July 3, 2003, describing it as "An improved internal combustion engine for efficient burning of lean air fuel mixture used in engines working in four stroke principle.

The above case reveals that competition is not confined to price-war or quality but also in the disputes like patent infringement.

Publics

According to Philip Kotler, public, "is any group that has an actual or potential interest in or impact on a company's ability to achieve its objective". Environmentalists, media groups, women associations, consumer protection groups, local groups, citizens associations are some important examples of publics which have an important bearing on environment of the firms. Thus, people are an important force in external micro environment.

For example, a Delhi based voluntary organisation discovered that some soft drinks had a higher content of pesticides which posed threat to human health and life. The findings of this organisation produced adverse effect on the sale of these products in 2003-04. The Indian laws are being amended to ensure that these drinks must not contain pesticides beyond European safety standards. Similarly, environmentalists have been campaigning against polluting industries which pollute the environment causing health hazards. Women organised anti-liquor movement in Andhra Pradesh and Haryana. Many citizen groups are actively campaigning against cigarette manufactures for their advertising campaigns luring the people to indulge in smoking. Thus, publics influence the working of business firms and compel them to be socially responsible.

External Macro Environment

Not only micro-environment, business organisations face large external environmental forces. The external macro environment determines the opportunities for a firm to exploit for promoting its business and also presents threats to it in the sense that it can put restrictions on the expansion of business activities. The macro-environment has thus both positive and negative aspects. An important fact about external macro-environmental forces is that they are uncontrollable by the management of a firm. Because of the uncontrollable nature of macro forces a firm has to adjust or adapt itself to these external forces.

External macro-environmental factors are classified into;

(1) Economic,

(2) Social,

(3) Technological,

(4) Political

(5) Legal, and

(5) Demographic.

Let us discuss below all these factors determining external macro-environment:

1. Economic Environment

Economic environment includes the type of economic system that exists in the economy, the nature and structure of the economy, the phase of the business cycle (for example, the conditions of boom or recession), the fiscal, monetary and financial policies of the Government, foreign trade and foreign investment policies of the government. These economic policies of the government present both the opportunities as well as the threats (i.e. restrictions) for the business firms.

The type of the economic system i.e., socialist, capitalist or mixed provides institutional framework within which business firm have to work. For example, before 1991, the Indian economic system was of the type of a mixed economy with pronounced orientation towards the public sector. Prior to 1991 private sector's role in India's mixed economy was greatly restricted. Many industries were reserved exclusively for investment and production by the public sector.

Private sector operations were limited mainly to the consumer goods industries. Even in these goods the private sector production and operation was controlled by industrial licensing system, Monopolies and Restrictive Trade Practices (MRTP) Commission. The private sector was also subjected to various export and import-restrictions. High tariffs were imposed to protect domestic industries and to pursue import substitution strategy of industrial growth.

Now, there have been significant changes in the economic policies since 1991 which have changed the macroeconomic environment for private sector firms. Far-reaching structural economic reforms were carried out during 1991-96. Industrial licensing has been abolished and private sector can now invest and produce many industrial products without getting license from the government.

Many industries, except a few industries of strategic importance, which were earlier reserved for the public sector have been thrown open for the private sector. Import duties have been greatly reduced due to which domestic industries face competition from the imported products. Incentives have been given to boost exports. Rupee has been made convertible into foreign currencies on current account. It is thus evident that new economic reforms carried out since 1991 has significantly changed the business environment.

2. Social and Cultural Environment

Members of a society wield important influence over business firms. People these days do not accept the activities of business firms without question. Activities of business firms may harm the physical environment and impose heavy social costs. Besides, business practices may violate cultural ethos of a society. For example, advertisement by business firms may be nasty and hurt the ethical sentiments of the people.

Businesses should consider the social implications of their decisions. This means that companies must seriously consider the impact of its actions on the society. When a business firm in their decision making take care of social interests, it is said to be socially responsible.

Social responsibility is the felt obligation or self-enforced duty of business firms to serve or protect social interests. By doing so, they promote social well-being. Good corporate governance should be judged not only by the productivity and profits earned by a business firm but also by its social-welfare promoting activities.

It is worth noting that in modern management science a new concept of social responsiveness has been developed. By social responsiveness we mean "the ability of a corporate firm to relate its operations and policies to social environment in way that are mutually beneficial to the company and society at large".

Every manager would like its performance to be positively appraised. Therefore, if the performance of managers of business firms are judged by the amount of profits they make for the owners of the firms, it is then not proper to expect socially responsible actions from them.

3. Political and Legal Environment:

Businesses are closely related to the government. The political philosophy of the government wields a great influence over business policies. For example, after independence under the leadership of Jawahar Lal Nehru India adopted 'democratic socialism as its goal.

In the economic sphere it implied that public sector was to play a vital role in India's economic development. Besides, it required that working of the private sector were to be controlled by a suitable industrial policy of the government. In this political framework provide business firms worked under various types of regulatory policies which sought to influence the directions in which private business enterprises had to function.

Thus, Industrial Regulation Act 1951, Industrial Policy Resolution 1956, Foreign Exchange Regulation Act (FERA), Monopolistic and Restrictive Practices (MRTP) Act were passed to control the business activities of the private sector. Besides, role of foreign direct investment was restricted to only few spheres.

However, since 1991 several structural economic reforms have been undertaken following a change in political philosophy in favour of a free market economy. The collapse of socialism in Soviet Russia, China and East European Countries has brought about a change in political thinking about the roles of public and private sectors in India's industrial development.

To encourage the growth of the private sector in India, licensing has now been abolished, role of public sector greatly reduced and foreign capital, both direct and portfolio, is being encouraged to raise the rate of capital formation in the Indian economy. FERA has been replaced by FEMA (Foreign Exchange Management Act) It is evident from above that with the change in the nature of political philosophy business environment for private firms has greatly changed.

Politico-legal environment

The politico-legal environment of business contains a number of critical elements such as the form of government, the ideology of the ruling party, the strength of the opposition, the role and responsibility of the bureaucracy, political stability, the velocity of government policies, plans and programmes, socio-economic legislations and politico-legal institutions. Business is no longer left alone. Government intervention to some extent in business activity all over the world is a rule than an exception. Therefore, the form and structure of the government is very important and decisive factor for the business sector.

Political Environment

This includes the political system, the government policies and attitude towards the business community and the unionism. All these aspects have a bearing on the strategies adopted by the business firms. The stability of the government also influences business and related activities to a great extent. It sends a signal of strength, confidence to various interest groups and investors. Further, ideology of the political party also influences the business organization and its operations. You may be aware that Coca-Cola, a cold drink widely used even now, had to wind up operations in India in late seventies. Again the trade union activities also influence the operation of business enterprises. Most of the labour unions in India are affiliated to various political parties. Strikes, lockouts and labour disputes etc. also adversely affect the business operations. However, with the competitive business environment, trade unions are now showing great maturity and started contributing positively to the success of the business organization and its operations through workers participation in management.

Legal Environment

Policies are statutorily decided through laws. Various socio-economic legislations subject to which business operates constitute the legal environment. This refers to set of laws, regulations, which influence the business organizations and their operations. Every business organization has to obey, and work within the framework of the law. The important legislations that concern the business enterprises include:

(i) Companies Act, 1956

(ii) Foreign Exchange Management Act, 1999

(iii) The Factories Act, 1948

(iv) Industrial Disputes Act, 1972

(v) Payment of Gratuity Act, 1972

(vi) Industries (Development and Regulation) Act, 1951

(vii) Prevention of Food Adulteration Act, 1954

(viii) Essential Commodities Act, 2002

(ix) The Standards of Weights and Measures Act, 1956

(x) Monopolies and Restrictive Trade Practices Act, 1969

(xi) Trade Marks Act, 1999

(xii) Bureau of Indian Standards Act, 1986

(xiii) Consumer Protection Act, 2019

(xiv) Environment Protection Act

(xv) Competition Act, 2002 etc.

Besides, the above legislations, the following are also form part of the legal environment of business.

Provisions of the Constitution: The provisions of the Articles of the Indian Constitution, particularly directive principles, rights and duties of citizens, legislative powers of the central and state government also influence the operation of business enterprises.

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

The various elements of non-economic environment are as follow:

Social Environment:

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

Cultural environment

Culture is the characteristics and knowledge of a particular group of people, encompassing language, religion, cuisine, social habits, music and arts. Culture encompasses the set of beliefs, moral values, traditions, language, and laws (or rules of behaviour) held in common by a nation, a community, or other defined group of people. The cultural environment consists of the influence of religious, family, educational, and social systems in the marketing system. These include: (a) language, (b) colour, (c) customs and taboos, (d) values, (e) aesthetics, (f) time, (g) business norms, (h) religion, and (i) social structures. Culture elevates performance through shared energy, enthusiasm, commitment and collaboration; Culture delivers business strategy; Culture creates the environments, daily rituals and beliefs that connect people, with the company. Culture is the context in which leadership must operate, influence and inspire. Similarly, business culture refers to the beliefs and behaviours that determine how a company's employees and management interact and handle outside business transactions. Often, business culture is implied, not expressly defined, and develops organically over time from the cumulative traits of the people the company hires.

Technological Environment:

The nature of technology used for production of goods and services is an important factor responsible for the success of a business firm. Technology consists of the type of machines and processes available for use by a firm and the way of doing things. The improvement in technology raises total factor productivity of a firm and reduces unit cost of output.

The use of a superior technology by a firm gives it a competitive advantage over its rival firms. The use of a particular technology by a firm for its transformation process determines its competitive strength. In this age of globalisation the firms have to compete in the international markets for sales of their products. The firms which use out-dated technologies cannot compete globally. Therefore, technological development plays a vital role in enhancing the competitive strength of business firms.

It has been generally observed that the competition between firms in the domestic economy and in international markets ensures that the firms will try to improve the technology they use because failure to do so would pose a threat to their survival. In the protected markets, technological improvements are slow and firms are able to survive for a long period without making technological changes.

It is when Maruti Udyog Ltd. was started in India using superior technology and introducing more attractive models that there has been a significant improvement in car manufacturing. With liberalisation of the Indian economy new car manufacturing firms have entered the industry and are producing different verities and models of cars with improved technology.

Besides, the cotton textile industry is another important example of an industry, which due to protection provided to it by imposing high tariffs on imports of cotton textiles survived. Following trade liberalisation many cotton textile firms have been closed down because they could not withstand competition. Technological environment affects the success of firms and the need for technological advancement cannot be ignored.

Demographic Environment:

Demographic environment includes the size and growth of population, life expectancy of the people, rural-urban distribution of population, the technological skills and educational levels of labour force. All these demographic features have an important bearing on the functioning of business firms. Since new workers are recruited from outside the firm, demographic factors are considered as parts of external environment.

The skills and ability of a firm's workers determine to a large extent how well the organisation can achieve its mission. The labour force in a country is always changing. This will cause changes in the work force of a firm. The business firms have to adjust to the requirements of their employees. They have also to adapt themselves to their child care services, labour welfare programmes etc.

The demographic environment affects both the supply and demand sides of business organisations. Firms obtain their working force from the outside labour force. The technical and education skills of the workers of a firm are determined mostly by human resources available in the economy which are a part of demographic environment.

On the other hand, the size of population and its rural-urban distribution determine the demand for the products of industrial firms. For example, when there is good monsoon in India causing increase in incomes of rural population dependent on agriculture, demand for industrial products greatly increases.

In the wake of economic reforms initiated in the early nineties when foreign investors were allowed to make investment in India, they were prompted to invest in India by pointing out that the size of Indian market was quite large. They were told that 200 million Indian people could afford to buy the industrial products and this constituted quite a large market which could be profitably exploited.

Besides, the growth rate of population and age composition of population determine the demand pattern of goods. When the population of a country is growing at a high rate, its child population will be relatively large. This means demand for products such as baby food which cater to the needs of children will be relatively high.

On the other hand, if population of a country is stable and life expectancy of the people is high, this will cause greater proportion of elderly aged people in the population of a country. This means different demand pattern of goods. Thus business firms have to consider all these demographic factors in their planning for production of goods and services and formulation of marketing strategies for sale of their products.

Demographic environment is also important for business firms as it determines the choice of technology by them. Other things being equal, if labour is abundant and relatively cheaper than capital business firms will prefer relatively labour-intensive techniques for production of goods.

However, for various reasons such as rigid labour laws and low productivity of labour, various tax concessions on investment in capital equipment and machinery, business firms in India are generally seem to be using capital-intensive technologies imported from abroad.

This has resulted in the increase in unemployment of labour, especially among the young workers.

Therefore, social and government pressure is increasing on the business firms to create more employment opportunities for labour so as to render help in solving the problem of unemployment. It is quite interesting to note here that to take advantages of relatively cheap labour in India and China that foreign MNCs are setting up manufacturing plants in these countries. It is evident from above that demographic factors play a crucial role in determining the productive activity of business firms.

Natural Environment:

Natural environment gives many inputs such as raw materials, energy which business firms use in their productive activity. Natural environment also includes geographical and ecological factors such as minerals and oil reserves, water and forest resources, weather and climatic conditions, port facilities are all highly significant for various business activities. Natural environment determines the business activity of a country.

For example, the availability of minerals such as iron, coal etc. in a region influence the location of certain industries in that region. Thus, the industries with high material contents tend to be located near the raw material sources. For example, steel producing industrial units are set up near coal mines to save cost of transporting coal to distant locations.

Besides, certain weather and climatic conditions also affect the location of certain business units. For example, in India the firms producing cotton textiles are mostly located in Bombay, Madras, and West Bengal where weather and climatic conditions are conducive to the production of cotton textiles.

Natural environment also affects the demand for goods. For example, in regions where there is high temperature in summer there is a good deal of demand for dessert coolers, air conditioners, business firms set up industrial units producing these products. Similarly, weather and climatic conditions influence the demand pattern for clothing, building materials for housing etc. Furthermore, weather and climatic conditions require changes in design of products, the type of packaging and storage facilities.

It may however be noted that resource availability is not a sufficient condition for the growth of production and business activities. For instance, India through rich in natural resources re-mained poor and underdeveloped because available resources had not been put to use due to lack of adequate capabilities of Indian business class. Thus, it is not the availability of natural resources alone but also the technology and ability to bring them into use that determines the growth of business and the economy.

Changing role of government

The role of governments differs from country to country. Particularly the role of government in capitalist economy and the role of government in communist economies vastly differ. For instance, when we compare the role played by the governments in two Asian countries Japan and China, these countries differ from each other totally in terms of their political and economic ideologies. The tiny Japanese nation is considered to be a capitalist giant. Chinese nation is one of the very few countries, which still, by and large, practice communism. Both in Japan and China, though justice, police and defence are part of the responsibilities of the government the economic role of the government, the situations in the two countries are strikingly different. In Japan, there are hardly any government enterprises and the means of production are almost entirely in private hands. The government at present has a very negligible role in the Japanese economy. In China the situation is almost exactly the opposite. The means of production are almost entirely in government hands and he government plays a very prominent economic even these days.

The Indian economy has also witnessed a big change in the role of the government over time. Right from independence till 1960s, the nation's objective was to have planned economic development without adopting extreme forms of capitalism or communism. Heavy industry and infrastructure were left in the hands of the government to develop. Priority sectors were decided upon by the government. While we had some success in increasing agricultural production, the level of our per capita consumption of food was woefully low. Government owned enterprises in basic and heavy industries were functioning far from efficiency and mostly using out dated technology. The Indian economy faced unprecedented crisis in 1990-91 because of fall of foreign currency and had $ 2.2.billion. Inflation had already crossed double digit figure and was actually at 14%. Fiscal deficit had risen to 8.4% of the Gross Domestic Product. The current account deficit on balance of payments was as high as $ 9.9.billion. International Credit Rating agencies went on to considerably downgrade India's credit worthiness.

In capitalist economy, the economic role of government had increased overtime. This is attributed to market failure on two counts. Firstly, the assumptions of perfect competition, absence of externalities and non-existence of public goods have been found to be not based on realities. Secondly, there have been lacunae in the performance of these economies in terms of cyclic fluctuations on income, employment and prices, existence of inequalities, poverty and inadequate provision for future.

In order to overcome the pitfalls in communist economy, the private ownership in means of production and market mechanism are being introduced gradually. Communist countries are similarly waking up to the fact that everything about the economy cannot be left to the state. To overcome these difficulties the governments of these countries are getting slowly out of the responsibility of running productive enterprises. They are also gradually introducing market forces and adopting more decentralised planning techniques. This is how the governments' roles are changing.

Many roles of Government

1. Government: Regulator of Business:

The entire regulatory legislation and policies stand covered under this segment. On the one hand, there is a very large indirect area of government control over the functioning of private sector business through budgetary and monetary policies. But against this there is also a fast expanding area of direct administrative or physical controls through which the government seeks to ensure that private investment and production in industry and the use of scarce resources conform to government's basic socio-economic objectives. They have become necessary tools in a system which seeks to avoid total nationalisation of resources.

Government's regulatory functions with regard to trade, business and industry aim at laying down the limits for the private enterprise. The regulatory functions of the Government include (i) restraints on private activities, (ii) control of monopoly and big business, (iii) development of public enterprises as an alternative to private enterprises to ensure competitive dualism, (iv) maintenance of a proper socio-economic infrastructure.

2. Government: Promoter of Business:

The promotional role of the government in relation to industries can be seen as providing finance to industry, in granting various incentives and in creating infrastructure facilities for industrial growth and investment.

For example, our government has identified certain backward areas as 'No Industry Districts'. To promote development of such areas, Government provides subsidies and tax holiday to attract investment in backward areas.

In this way the government will help the process of balanced development and thereby remove regional disparities. The government is assisting the development of small scale industries.

The District Industries Centers are assisting the development of small industries. The government is actively helping the industrial development of the country by providing finance to them through the development banks.

3. Government as an Entrepreneur:

The impressive growth of the public sector in India from a small beginning bears testimony to the role of the government as an entrepreneur. Private investors are solely guided by private profit motive and hence they are not interested in developing products of common public use and social services which yield relatively lower returns. But as a "social entrepreneur" the government does not hesitate to take them up.

4. Government as the Planner:

In its role as a planner, the government indicates various priorities in the Five Year Plans and also the sectoral allocation of resources. Mixed economies are democratically planned economies.

The government tries to manage the economy and its business activities through the exercise of planning. Planning is the most important activity in a modern mixed economy. The idea of economic planning can be traced to three different sources: Rationalism, Socialism and Nationalism.

Economists advocate a planned economy on the ground that it can be a rational economy which can utilize the available resources in an optimal manner.

In other words, the planned economy is a rational economy which attempts to secure the maximum return with minimum wastage of productive resources.

The socialists advocate a planned economy because it helps to achieve some desirable social ends like economic equality. An unplanned economy, left to it, is incapable of attaining the social ends.

The nationalists advocate a planned economy because a planned economy is a powerful economy.

The nationalists want to use planning as a weapon to strengthen the military power of the country. Hitler in Germany and Mussolini in Italy resorted to planning to achieve political motive.

Planning operation involves a number of steps.

The first stage in planning is the formulation of socio-economic objectives of the plan and their definition in quantitative terms.

Such objectives include growth, justice, eradication of poverty, price stability etc. In the second stage, the plan lays down the physical and financial targets.

The third stage is concerned with execution. The Planning Commission is only an advisory body and it has no power to execute the plan.

The various government departments take necessary measures to execute the plan. Executing a plan is more difficult than making it.

The execution of our Five Year Plans is not satisfactory. Prof. Lewis has observed that Indians are better planners than doers. The gap between promise and performance has got to be narrowed down.

Typically, businessmen have held that national planning is incompatible with free enterprise and that a “free economy” is the antithesis of a planned economy.

Planning by business is good but planning by government for the whole society is, in the eyes of most businessmen, ‘bad’ (perhaps because government planning has come to be identified with communist countries).

Case study

Disney World in Paris

When Euro Disney opened outside Paris in 1992, French attendance at the theme park was disappointing. Park attendance was around 25,000 instead of the predicted 60,000. Analysts attributed different factors for the poor show. Some attributed low ticket sales to a cultural snub of this American icon (cultural). Others noted a particularly wet and cold season (weather). Still, others blamed the strength of the franc against the U.S. dollar due to European recession (economic).

Some critics, prominent French intellectuals, denounced what they considered to be the cultural imperialism of Euro Disney and felt it would encourage an unhealthy American type of consumerism in France. In May 1992, entertainment magazine *The Hollywood Reporter* reported that about 25% of Euro Disney's workforce – approximately 3,000 people – had resigned from their jobs because of unacceptable working conditions and dress code. In fact, there were only 1000 that left the jobs.

The above facts would clearly indicate the impact of environmental factors on international marketing.

Self-assessment Questions

1. How would you classify business environment and criteria for such classification?
2. What are the basic propositions about business
3. How are economic and non-economic environment interrelated?
4. What is micro and macro environment in relation to external and internal environment?
5. Explain the changing role of government.
6. What do you understand by socio-cultural environment of business and how it is important for business?
7. Which are the legislations that impact legal environment of business?

LESSON – 2
STRUCTURE OF INDIAN ECONOMY

Introduction

Economic environment of business is all the external economic factors that influence buying habits of consumers and businesses and hence affect the performance of the organisation. These factors are often beyond a company's control, and may be either large-scale (macro) or small-scale (micro). While companies often can't control their economic environment, knowledge of economic environment may be useful to evaluate economic conditions before entering in to a particular market or industry or pursue other strategies.

Critical elements of the economic environment

The critical elements of macro-economic environment are

1. Economic system
2. Nature of the economy
3. Anatomy of the economy
4. Functioning of the economy
5. Economic planning and programmes
6. Economic policy statements and proposal
7. Economic controls and regulations
8. Economic legislations
9. Economic trends and structure and
10. Economic problems and prospects

The economic environment of a business determines the success or failure of a business..

Let us discuss some macroeconomic factors. If interest rates are too high, the cost of borrowing may not permit a business to expand. On the other hand, if the unemployment rate is high, businesses can obtain labour at cheaper costs. However, if unemployment is too high, this may result in a recession and less discretionary consumer spending resulting in insufficient sales to keep the business going. Tax rates will take a chunk of your income and currency exchange rates can either help or hurt the exporting of your products to specific foreign markets.

As regards microeconomic factors market size may determine the viability of entering into a new market. If a market is too small, there may not be sufficient demand and profit potential. This leads to the concept of demand and supply. If the product is in high demand but there is a low supply of it, e profit will be low, but if the product is in low demand and the market is flooded with similar products, the organisation may be in difficulties. The quality and quantity of the competition will also affect no matter how well the organisation does in winning customers in the marketplace. Suppliers are the arteries pumping vital supplies and resources to the organisation for production. If the organisation has problems with suppliers, it can clog up those arteries and cause serious problems. Likewise, the type of relationship the business organisation has with distributors, such as retail stores, may influence how quickly the products leave their shelves.

Economic and non-economic environment

The economic environment of business exercises a strong influence on the non-economic environment of business just as the non-economic environment influences the economic environment. Now let us discuss separately economic and non-economic environment.

Economic environment

The economic environment consists of external factors in a business and the broader economy that can influence a business. Economic environment can be divided into the microeconomic environment, which affects business decision making - such as individual actions of firms and consumers - and the macroeconomic environment, which affects an entire economy and all of its participants. Many economic factors act as external constraints on your business, which means that you have little, if any, control over them. Let's take a look at both of these broad factors in more detail.

Microeconomic factors influence how your business will make decisions. Unlike macroeconomic factors, these factors are far less broad in scope and do not necessarily affect the entire economy as a whole. Microeconomic factors influencing a business include:

- Market size
- Demand
- Supply
- Competitors
- Suppliers
- Distribution chain

Macroeconomic influences are broad economic factors that either directly or indirectly affect the entire economy and all of its participants, including your business. These factors include such things as:

- Interest rates
- Taxes
- Inflation
- Currency exchange rates
- Consumer discretionary income
- Savings rates
- Consumer confidence levels
- Unemployment rate
- Recession
- Depression

Structure of Indian Economy

The socio-economic environment of any country can be explained in terms of an institutional framework and a physical framework or the economic policy statements of the government, economic plan documents, the political constitution, economic regulations and control; among others which define the role and status of private sector, public sector, multinationals, corporations, small business etc. The physical framework comprises of the trends in economic variables such as income, price, output, investment, foreign trade, labour supply etc.

The economy of India is characterised as a developing market economy. It is the world's sixth-largest economy by nominal GDP and the third-largest by purchasing power parity (PPP). According to the IMF, on a per capita income basis, India ranked 142nd by GDP (nominal) and 124th by GDP (PPP) in 2020.

Features of Indian Economy

1. Since independence India has been a 'mixed economy'. India's large public sectors were responsible for providing employment and revenue to the economy.

2. India's share in global exports and imports increased from 0.7% and 0.8% respectively in 2000 to 1.7% and 2.5% in 2012 as per the WTO estimates.

1. Indian economy overview was highly inspired by Soviet Union's practices post-independence. It had been recording growth rate not greater than five jumped till 1980s. This stagnant growth was termed by many economists as 'Hindu Growth Rate'.

2. In 1992, the country ushered into liberalization regime. Thereafter, the economy started scaling upward. This new trend in growth was called 'New Hindu Growth Rate'.

3. India's diverse economy encompasses traditional village farming, modern agriculture, handicrafts, a wide range of modern industries and a multitude of services.

4. Services are the major source of economic growth, accounting for more than half of India's output with less than one third of its labour force.

Current Analysis

1. The current GDP factor cost is (at 2004-05 prices) Rs. 5748564 cr (2013-14)
2. Per capita Income (at current prices) Rs. 74920 (2013-14)
3. Gross domestic saving rate (at current market price as % of GDP) for 2-11-12 is 30.8%
4. Tertiary sector contributes 56% of GDP (2012-13).
5. Total food grain production is 265 million tone (2013-14).
6. India's share in world export is 1.8% of total trade.
7. India's share in total world import is 2.5%.

8. Total size of Indian population is 1.26 bn (2014).
9. Beating America and China, India saw the highest FDI inflow for new projects among all nations in the first half of calendar 2015. To boot, India attracted $31 billion against $12 billion in the first half of last year in capital expenditure (Capex) from foreign companies, while China and the US attracted $28 billion and $27 billion, respectively, in the same period.
10. Total size of foreign exchange reserve of India is $ 330 bn. in 2015.
11. Exports of top five sectors — engineering, petroleum, gems and jewellery, textiles and pharmaceuticals - fell by about 25% to $13.33 billion in August 2015 due to global demand slowdown. These five sectors accounted for about 65% of the country's total merchandise exports in 2014-15. In August last year, exports of these sectors stood at $17.79 billion.
12. Poverty Estimation - The Rangarajan panel's recommendation (those who spends Rs 32 in a day in rural areas and Rs 47 in towns and cities should not be considered poor), results in an increase in the below poverty line population, which is estimated at 363 million in 2011-12, compared to the 270 million estimate based on the Tendulkar formula — an increase of almost 35%.

Structural Dimensions of Indian Economy

The **economy** of **India** is characterised as a developing market economy. It is the world's sixth-largest **economy** by nominal GDP and the third-largest by purchasing power parity (PPP). According to the IMF, on a per capita income basis, **India** ranked 142nd by GDP (nominal) and 124th by GDP (PPP) in 2020.

At independence the economy was predominantly agrarian. Most of the population was employed in agriculture, and most of those people were very poor, existing by cropping their own small plots or supplying labour to other farms. Landownership, land rental, and sharecropping rights were complex, involving layers of intermediaries. Moreover, the structural economic problems inherited at independence were exacerbated by the costs associated with the partition of British India, which had resulted in about 12 million to 14 million refugees fleeing past each other across the new borders between India and Pakistan. The settlement of refugees was a considerable financial strain. Partition also divided complementary economic zones. Under the British, jute and cotton were grown in the eastern part of Bengal, the area that became East Pakistan (after 1971, Bangladesh), but processing took place mostly in the western part of Bengal, which became the Indian state of West Bengal in 1947. As a result, after independence India had to employ land previously used for food production to cultivate cotton and jute for its mills.

The structural change of an economy takes place mainly along two dimensions: one is the changing sector-wise shares in GDP and the second is the changing share of the labour force, engaged in each sector. Modern economic development cannot be explained satisfactorily in terms of labour and capital alone. The modern economists emphasise the catalytic role the technological changes paly in the growth of an economy. The technological changes bring about an increase in per capita income, either by reducing the amount of inputs per unit of output or by yielding more output for a given amount of input. Technological change of an economy, therefore, refers to changes in input-output relations of production activities. The process of development requires structural change.

Structural changes do not only characterise economic development, they are also necessary for sustaining economic growth. Economic growth requires structural change in the economy, for example, a movement of workers from low value added agriculture sector to higher value added manufacturing and service sectors leads to structural change.

Trends in Distribution of National Income Trends in the distribution of Gross Domestic Product (GDP) by industrial origin show that the Indian economy has undergone a vast structural change over the last few decades.

During 1950-51, Indian economy was predominantly an agricultural economy with 56.70 per cent share of the GDP originating from primary sector. The share of the secondary sector being 13.66 per cent in the same year is indicative of the fact that manufacturing and allied activities were just in the developing stage. The share of tertiary sector, almost the double of secondary, stood at 29.64 per cent.

The primary sector includes activities like agriculture, forestry and fishing, mining and quarrying etc. The share of primary sector that was 56.70 per cent of GDP in the year 1950-51, came down to 52.48 per cent in 19601-61; to 46.00 in 1970-71; to 39.93 in 1980-81; further to 34.05 in 1990-91; 26.18 per cent in 2000-01; and finally to 16.93 in the year 2009-10. Thus over a span of past 60 years, the share of primary sector related activities, in general, and the agriculture, in particular, in the GDP has come down to one third of what it was initially. The decline of primary sector share with every increase in the GDP is indicator of a healthy economic development. It shows that a raw materials producing/supplying economy is gradually shifting to a manufacturing and rigorous processing economy that has a higher value added generation.

The secondary sector of the economy has shown a change at the snail's pace. The share of secondary sector that was 13.66 per cent of GDP in the year 1950-51 took a long span of 60 years to grow to 25.77 per cent. The share of secondary sector during the decades of 1970s and 1980s remained in the range of 20 to 22 per cent of GDP. The decade of 1990s shows that the pace of change in the share of secondary sector in the GDP was very negligible and just near stagnation. The structural change in India, during the last half-century, is characterized by a shrinking share of agriculture coupled with slow paced industrial development. Decade of 1990s and the last few years are indicative of the fact that the share of secondary sector as a percentage of GDP has stagnated around 25 per cent.

Tertiary sector consists of trade and commerce, transport and other such activities. The percentage share of tertiary sector in the GDP has almost doubled as compared to what it was in the year1950-51. It has grown to 57.30 per cent in 2009-10 as compared to mere 29.64 per cent in 1950-51. In the initial years, i.e., during the decades of 1950s, 60s and 70s there was an overall rise of not more 5 per cent in this share. Most of the change in tertiary sector is during the last two decades. This implies that the tertiary sector has been the major beneficiary from the change. Instead of percentage sectoral shares, the growth profile of the three sectors may display the underlying structural dynamics more clearly. On the whole the gross domestic product has grown at the rate of 4.46 per cent per annum during the last half century under consideration. During this period the primary sector has grown at the rate of 2.74 per cent per annum against the growth of secondary and tertiary sector at a more than 5 per cent per annum. That is to say the rate of growth of secondary and tertiary sector has been almost the double that of the primary sector. Further periodic breakup according to decades underscores some interesting facets of the underlying dynamics.

The growth of GDP that was 3.79 per cent per annum in the decade of fifties and 3.55 in the sixties came down to 3.42 per cent per annum in the seventies. The average annual growth rate of GDP picked up in the eighties and ninety onwards. The growth rate of GDP was 5.29 per cent per annum during the eighties and it was 6.01 per cent per annum during the period of nineties and it went to 7.80 per cent per annum during 2000-01 to 2009-10. Primary sector that grew at a rate of 2.87 per annum in the fifties and at 2.10 per cent per annum in the sixties came down to 1.94 per cent per annum during the seventies. During the eighties the primary sector grew at the rate of 3.41 per cent per annum. On the other hand, secondary sector has shown consistently a good performance, i.e., with an exception of decade of seventies, the rate of growth has always been above 5.50 percent per annum. The growth rate of secondary sector is slightly lower in the seventies as compared to that of the other decades. The tertiary sector which grew at 4.00 to 4.75 per cent during the first three decades achieved the growth rate of 6.76 per cent per annum in the eighties; 7.67 per cent per annum in the nineties and an ever time high growth rate of 9.31 per cent per annum during 2000-01 to 2009-10. This implies that tertiary sector has responded positively; the primary sector has responded adversely to the economic reforms process of the nineties and the secondary sector is in its transitional phase of making adjustment of capital, labour and technology.

Growth of economy since 1980

The rate of growth improved in the 1980s. From FY 1980 to FY 1989, the economy grew at an annual rate of 5.5 per cent, or 3.3 per cent on a per capita basis. Industry grew at an annual rate of 6.6 per cent and agriculture at a rate of 3.6 per cent. A high rate of investment was a major factor in improved economic growth. Investment went from about 19 per cent of GDP in the early 1970s to nearly 25 per cent in the early 1980s. India, however, required a higher rate of investment to attain comparable economic growth than did most other low-income developing countries, indicating a lower rate of return on investments. Part of the adverse Indian experience was explained by investment in large, long-gestating, capital-intensive projects, such as electric power, irrigation, and infrastructure. However, delayed completions, cost overruns, and under-use of capacity were contributing factors.

Private savings financed most of India's investment, but by the mid-1980s further growth in private savings was difficult because they were already at quite a high level. As a result, during the late 1980s India relied increasingly on borrowing from foreign sources. This trend led to a balance of payments crisis in 1990; in order to receive new loans, the government had no choice but to agree to further measures of economic liberalization. This commitment to economic reform was reaffirmed by the government that came to power in June 1991.

India's primary sector, including agriculture, forestry, fishing, mining, and quarrying, accounted for 32.8 per cent of GDP in FY 1991. The size of the agricultural sector and its vulnerability to the vagaries of the monsoon cause relatively large fluctuations in the sector's contribution to GDP from one year to another.

In FY 1991, the contribution of industry to GDP including manufacturing, construction, and utilities, was 27.4 per cent; services, including trade, transportation, communications, real estate and finance, and public- and private-sector services, contributed 39.8 per cent. The steady increase in the proportion of services in the national economy reflects increased market-determined processes, such as the spread of rural banking, and government activities, such as defence spending.

By the early 1990s, economic changes led to the growth in the number of Indians with significant economic resources. About 10 million Indians are considered upper class, and roughly 300 million are part of the rapidly increasing middle class. Typical middle-class occupations include owning a small business or being a corporate executive, lawyer, physician, white-collar worker, or land-owning farmer. In the 1980s, the growth of the middle class was reflected in the increased consumption of consumer durables, such as televisions, refrigerators, motorcycles, and automobiles. In the early 1990s, domestic and foreign businesses hoped to take advantage of India's economic liberalization to increase the range of consumer products offered to this market.

The structural change of an economy takes place mainly along two dimensions: one is the changing sector-wise shares in GDP and the second is the changing share of the labour force, engaged in each sector.

Structural change represents the fundamental changes that occurring in the basic features of the economy over a long period. Structure of the economy thus means the occupational structure, sectoral distribution of income, industrial pattern, composition of exports, saving- GDP ratio etc.

As mentioned in the introduction, structural transformation is defined as the reallocation of economic activity across three broad sectors agriculture, manufacturing, and services.

Economic structure is a term that describes the changing balance of output, trade, incomes and employment drawn from different economic sectors – ranging from primary (farming, fishing, mining etc) to secondary (manufacturing and construction industries) to tertiary and quaternary sectors (tourism, banking, software.

In economics, structural change is a shift or change in the basic ways a market or economy functions or operates. ... For example, a subsistence economy may be transformed into a manufacturing economy, or a regulated mixed economy may be liberalized.

Structure of Indian Industry

Before the rise of the modern industrial system in the world economy, Indian producers, largely artisans, had a world-wide market. Indian muslin and calicos were in great demand world over. Indian industries not only supplied local needs but also enabled India to export its finished products. Indian exports consisted chiefly of manufacturers like cotton and silk fabrics, calicos, artistic ware, silk and woollen clothing.

The impact of British rule and the industrial revolution that took place in Britain led to the decay of the Indian handicrafts. Instead, machine-made goods started coming to India. The gap created by the decay of Indian handicrafts was not filled by the rise of modern industry in India because of the British policy of encouraging the imports of manufacturers manufactured product in to and export of new material from India.

The British government in India provided discriminatory protection to some selected industries since 1923. The protection was accompanied by the most "most favoured nation" clause for British goods. Despite this factor, because of the pioneering zeal and fostering care of the early Indian entrepreneurs, some industries such as cotton textiles, sugar, paper, matches, and to some extent, iron and steel did develop in the country. But capital goods industries were not fostered during the British period. The industrial pattern of India on the eve of planning (1950) was marked by low capital intensity, predominance of small enterprises, limited development of factories and imbalance between consumer goods and capital goods industry. This lop-sided pattern of industry with the predominance of consumer goods had to be corrected through economic planning in the post-independence period.

The process of industrialisation, initiated as conscious and deliberate policy under industry policy resolution of 1948 and 1956 involved heavy investments in basic and heavy industries. As a result of efforts for rapid industrialisation, a firm industrial base has been achieved. Industrial production grew by about 5 times and India now is the tenth most industrially developed country in the world. The progress, the country has made in respect of industrial sector is clearly reflected in the commodity's composition of India's foreign trade. The share of imports of manufactured goods in foreign trade has steadily declined, while industrial products, particularly engineering goods have become a growing component of India's exports. Further the rapid progress in industrialisation has been accompanied by a corresponding growth in technological and managerial know-how for efficient operation of the most modern and sophisticated industries and also for planning, designing, and construction of such industries.

India could achieve self-sufficiency in consumer goods. Growth of basic and capital goods industries has been particularly impressive. India can now sustain the future growth of key sectors of the economy primarily through domestic efforts production, with only marginal imports. Further, the infrastructure including research and development capability, consultancy and design engineering services, project organisation services and innovative capability to impro9ve and adapt technologies to suit the domestic factor endowment have shown an impressive record of progress. Now we turn to industrial growth rates.

During the third plan period, but for the concluding year of the plan period, the annual growth rate exceeded 8 per cent. The average annual growth rate during the period was 8.22 per cent. During the subsequent three annual plans the growth rates fell significantly. Except during 1968-69 when growth rate was 6.7 per cent.

Changing industry in India

There are four main types of jobs or industries in India. These are:

- primary, which involves getting raw materials from the land, eg farming or forestry
- secondary, which is making products out of raw materials, eg food processing and car manufacturing
- tertiary, which is providing a service, eg doctors and teachers
- quaternary, which means ICT and research, e.g. computer software designers and scientists

A country's industrial structure is the percentage of people working in each job type. Changing the balance between these four sectors of industry can help a country to develop.

Up until the 1980s, India's main type of industry was primary. Many people were subsistence farmers, which is not very profitable. From the late 1980s, the Indian government encouraged foreign transnational corporations (TNCs) to set up within the country. Factories were built and secondary jobs in manufacturing were created. Factory workers earn more money, which means that they can afford to pay people for services, such as entertainment and healthcare. Workers in the tertiary (service) sector are paid more than in primary and secondary.

The additional wealth generated from the changing industrial structure in India has created a multiplier effect - as one thing improves, it allows other things to improve too.

The role of transnational corporations (TNCs)

Many transnational corporations (TNCs) have set up factories and offices in India. The country is an attractive location to TNCs because the population speak good English, they have strong IT skills and they work for lower wages than people in many other countries. Companies like Toyota, Volvo and Hyundai manufacture cars in India. Companies like ASDA, BT and Virgin Media have call centres in India.

Advantages of TNCs in India

There are many advantages of TNCs. India has benefited in many ways:

- TNCs have created jobs and offered education and training to employees
- the additional wealth has led to the multiplier effect
- some TNCs have set up schemes to provide new facilities for local communities
- the infrastructure of the country has been improved, with new roads and internet cabling
- TNCs pay tax to the government, which can be spent on development projects

Disadvantages of TNCs in India

There have also been some disadvantages of TNCs in India:

- some corporation leaders have taken advantage of the relaxed environmental laws in the country by creating lots of pollution
- the conditions for workers in factories can be very harsh
- many TNCs are owned by foreign countries so economic leakage occurs, where profit is sent abroad
- the best jobs are often given to foreign workers from the TNC's country of origin
- TNCs use many of the country's natural resources - a soft drink bottling plant in Kerala, India, was shut down due to its impact on local water supplies.

Small Scale Industries in India

Essentially small scale industries comprise of small enterprises who manufacture goods or services with the help of relatively smaller machines and a few workers and employees. Some examples of small scale industries are agarbatti making, chalk making, biodiesel production, sugar candy manufacturing, wood works, rice milling, potato chips making, toys making, liquid soap making, honey processing, slippers making, detergent powder making, fruit juice production plant, spices, bakeries, manufacturing of candles, school stationeries, water bottles, leather belts, paper bags, Xerox and printing, T-shirt printing, photography, beauty parlours etc. Basically, the enterprise must fall under the guidelines set by the Government of India. At the time being such limits are as follows;

Essentially small scale industries comprise of small enterprises who manufacture goods or services with the help of relatively smaller machines and a few workers and employees. Basically, the enterprise must fall under the guidelines set by the Government of India. At the time being such limits are as follows:

1. For Manufacturing Units for Goods: Investment in plant and machinery must be between 25 lakhs and five crores.
2. For Service Providers: Investment in machinery must be between 10 lakhs and two crores.

In developing countries like India, these small scale industries are the lifeline of the economy. These are generally labour-intensive industries, so they create much employment. They also help with per capita income and resource utilization in the economy. They are a very important sector of the economy from a financial and social point of view.

The importance of Small Scale industries is increasing because it helps in increasing employment and economic development of India. Further, It improves the growth of the country by increasing urban and rural growth. Role of Small and medium scale enterprises are to help the government in increasing infrastructures and manufacturing industries, reducing issues like pollution, slums, poverty, and many development acts. Small scale manufacturing industries and cottage industries play a very important role in the economic development of India. If any amount of capital is invested in small scale industries it will help in reducing unemployment in India and increasing self-employment. The industry is a sector in which the production of goods is a segment of the economy.

Characteristics of Small-Scale Industries:

(i) Ownership: Ownership of small scale unit is with one individual in sole-proprietorship or it can be with a few individuals in partnership.

(ii) Management and control:

A small-scale unit is normally a one man show and even in case of partnership the activities are mainly carried out by the active partner and the rest are generally sleeping partners. These units are managed in a personalised fashion. The owner is activity involved in all the decisions concerning business.

(iii) Area of operation: The area of operation of small units is generally localised catering to the local or regional demand. The overall resources at the disposal of small scale units are limited and as a result of this, it is forced to confine its activities to the local level.

(iv) Technology: Small industries are fairly labour intensive with comparatively smaller capital investment than the larger units. Therefore, these units are more suited for economics where capital is scarce and there is abundant supply of labour.

(v) Gestation period: Gestation period is that period after which teething problems are over and return on investment starts. Gestation period of small scale unit is less as compared to large scale unit.

(vi) Flexibility: Small scale units as compared to large scale units are more change susceptible and highly reactive and responsive to socio-economic conditions.

They are more flexible to adopt changes like new method of production, introduction of new products etc.

(vii) Resources: Small scale units use local or indigenous resources and as such can be located anywhere subject to the availability of these resources like labour and raw materials.

(viii) Dispersal of units: Small scale units use local resources and can be dispersed over a wide territory. The development of small scale units in rural and backward areas promotes more balanced regional development and can prevent the influx of job seekers from rural areas to cities.

Role of Small Scale Industries in the Indian Economy

Total Production

These enterprises account for almost 40% of the total goods and services produced in the Indian economy. They are one of the main reasons for the growth and strengthening of the economy.

Employment

These small scale industries are a major source of employment in the country. The whole labour force cannot find work in the formal sector of the economy. So these labour-intensive industries provide a livelihood to a large portion of the workforce.

Contribution to Export

Nearly half of the goods (45-55%) of the goods that are exported from India are produced by these small enterprises. About 35% of direct exports and 15% of the indirect exports are from the small scale industries. So India’s export industry majorly relies on these small industries for their growth and development.

Welfare of the Public

Other than economic reasons, these industries are also important for the social growth and development of our country. These industries are usually started by the lower or middle-class public. They have an opportunity to earn wealth and employee other people. It helps with income distribution and contributes to social progress.

Tips to keep in mind to avoid problems in handling small scale enterprise

- Shortage of funds and raw materials – The most severe problem and money management should be done at all levels
- Marketing problems – Proper advertisement to run the show every time
- Quality – To fulfil the demand, one should not compromise with the condition.
- Technology – Be in par with the latest technology. It helps to reduce the cost of investment and increases the quality
- Managerial skills – To handle the labour class and get the work done from them.

Sickness in Indian Industry

Industrial sickness is defined all over the world[1] as "an industrial company (being a company registered for not less than five years) which has, at the end of any financial year, accumulated losses equal to, or exceeding, its entire net worth and has also suffered cash losses in such financial year and the financial year immediately preceding such financial year"

Industrial sickness specially, in small-scale Industry has been always a demerit for the Indian economy, because more and more industries like – cotton, Jute, Sugar, Textiles small steel and engineering industries are being affected by this sickness problem.

As per an estimate 300 units in the medium and large scale sector were either closed or were on the stage of closing in the year 1976. About 10% of 4 lakhs unit were also reported to be ailing. And this position also remains same in the next decades. At the end of year 1986, the member of sick units in the portfolio of scheduled commercial banks stood at 1,47,740 involving an outstanding bank credit of Rs. 4874 crores.

- Where the total number of large Industries which are sick were 637 units at the end of year 1985 increased to 714 units in the end of next year 1986.
- Likewise on the other hand the number of sick small scale units was also increased 1.18 lakhs at the end of 1985 to 1.46 lakhs at the end of 1986.
- The bank amount which was outstanding in case of large industries for the same period also increased from Rs.2,900 crores to Rs. 3287 crores at the end of year 1986
- Dues of Small Scale sector also increased from Rs.1071 crores to Rs.1306 crores at the end of the year 1986.
- Of the 147, 740 sick industrial units which contains large medium as well as small scale involving the total bank loan (credit) of Rs. 4874 at the end of the year 1986.

Industrial sickness specially, in small-scale Industry has been always a demerit for the Indian economy, because more and more industries like – cotton, Jute, Sugar, Textiles small steel and engineering industries are being affected by this sickness problem. Industrial Sickness is a major emerging problem in the country right now.

The causes of the sickness of different types of industrial units are not always similar. Different industries may become sick under different circumstances. Numerous factors acting simultaneously push a unit to sickness. The causes of Industrial sickness can be divided into two categories, first Internal Causes and second the External Causes.

Internal causes are those which emerge from the internal disorders in the major functional areas. They generally begin within the first two to three years from the start of the operation.

External Causes are those which originate outside the operational framework of the unit such as Political, Environmental and Social.

Internal Causes of Industrial Sickness

The major causes of internal industrial sickness are as follows.

Improper Site Selection: Several factors should be taken into account in selecting the site of an industrial unit which in future determine its healthy functioning. The availability of infrastructural facilities like power, transport etc., the nearness of the sources of raw materials and the markets of finished goods, the availability of skilled labour etc. are some of the relevant considerations should be taken. Improper selection of site, therefore, adversely affects the functioning of a unit and can cause sickness.

Improper Utilization of Assets: The health of an industrial unit depends on the proper utilization of assets held by it. Improper utilization implies that the concern is not achieving the maximum turnover with its existing assets. This leads to unused installed capacity and eventually to the sickness of the unit.

Inappropriate Technology Used: Inappropriate technology can also cause sickness to an industry. If the plant and equipment are uneconomical, obsolete and inefficient, both the quality and quantity of output of the unit will decline, and the cost will go up.

Faulty Financial Planning: It is also one of the major Financial planning helps an industrial unit in getting available resources at every stage of production and thus ensures full utilization of plant, equipment and labour. In a faulty production programme, the unit has to stop its production operations because of the non-availability of essential materials and components at the right time.

Bad Industrial Relations: A good relationship between labour and management is very necessary for the working environment of the industrial unit. Poor labour-management relations and labour disputes cause low productivity, poor quality of products, inadequate maintenance of plant and machinery, increase in wastage and often lead to demonstrations, strikes, lock-outs etc.

External Causes of Industrial Sickness: The major external causes of industrial sickness are as follows.

Unfavourable Investment Conditions

When the investment climate in the country is not favourable, a unit will not be able to raise funds by floating shares and debentures in the market as people may not like to invest in the companies in such a period.

Unavailability of Working Capital: Non-availability of adequate credit due to depressed conditions in the capital also causes industrial sickness. This may upset the working of an industrial unit, making it sick.

Shortage of Raw Material: The shortage of raw material can affect the health of industrial enterprises. If an industrial unit is unable to obtain the essential inputs like power, fuel, raw materials, etc., it reduces the capacity utilization and may be a major reason for hold up of its production. When this situation continues for years, the unit may turn sick. Non-availability of inputs, particularly power, has been a major factor hampering the progress of many Indian industries.

Political Scenario of the Country: If the political scenario of the country is not stable, it may also cause the industrial sickness. If the government is not stable, it may fear to take a strong economic decision.

The industrial sickness is not only damaging the industry but also ruining our economy. Our economy is already in a slowdown mode and needs a immediate treatment. Government has to look into both the matters quickly so that its effect cannot go worse.

Structural changes in the Indian Industry

As industrial development proceeds in an economy, several structural changes take place in the industrial sector. Historically, industrial development has proceeded in three stages. In the first stage, industry was concerned with the processing of primary products like milling grains, extracting oil, tanning leather, spinning fibres, preparing timber, smelting ores. In the second stage, baking, confectionary, foot ware, metal goods, cloth, furniture and paper were produced. The third stage consists of the manufacture of machines and other capital equipment to be used not for immediate use but for the future need.

In the post-independence period economic planning for overall development succeeded in laying firm foundation for future economic development. The heavy industry strategy formulated and implemented from beginning from the second Five Year Plan helped in creating a strong industrial base. Capacities in substantial quantities have been created in basic, key and heavy industries.

Size of Industrial Units

Size of industrial unit is another structural dimension. The size of the industrial unit can be measured using different criteria. Output total assets, fixed capital, and employment are some of the major criteria to measure size of the industrial units represent an important structural change of the industrial-sector in an economy. It is very much needed to understand the importance of dimension of the structure of industry. We may list the circumstances under which a large firm or a small one would be more efficient. Such synthesis provides guidance for making the proper choice of the optimum size for the firm. A large firm would be more efficient in situations where;

a. The product is standardised and can be produced on mass scale with longer production runs such as iron and steel, sugar, industrial chemicals and ferilizers;
b. The product/machine used in its production are large in size such as automobiles, ships and electricity generation;
c. The economies of linked process are significant as in the case of pulp and paper industry and steel among others;
d. The markets for the product are concentrated and for transport costs are considerably low in comparison to the price of the product;
e. Research activities are essential to compete in the market such as chemical industry.

A small firm would be more efficient if all these above conditions are not satisfied, that is, where;

1. The production factors, e.g. men and machines are divisible or adaptable;
2. The product is to be made an individual specification or where varieties or product differentiation are required in the market for existence, i.e., sandardisation and mass production is economical;
3. The raw materials and markets for the products are geographically dispersed and transport costs are quite significant;
4. The demand conditions change frequently as a result of which quichk adjustments are needed to adapt to such changes;
5. The nature of work done changes frequently due to technical condition.

Complete separation of situation for large scale units is not possible. There are many industries where small scale and large scale production is carried on side by side. Examples are engineering industries, cloth making, shoe making and several consumer products. In fact if we go through the industrial structure of a country, we will find such situations in most of the industries. Small units in an industry exist along with bigger ones mainly because 1) they may be relatively new and it is normal to grow large form small beginning in due course of time, (2) thye may be supplying finished products to the larger units under some type

They may be producing a highly specific variety of products in a differentiated product industry. All such small units may be equally efficient as the bigger units.

Ownership pattern of the industrial sector

After independence India wanted to adopt planned economic development. We have gone through several Five Year Plans. We opted for a mixed economy with both private and public sectors, complementing each other rather than competing. The scope of each sector was sell defined in the industrial policies announced from time to time by the government. Industrial policy Resolution of 1956 was a major policy announcement. Now let us understand the structure of industries in India on the basis of ownership.

The public sector accounted for 6.1 per cent of total number of industries. Public sector includes enterprises of the central government, state governments and local governments. The private sector including cooperative sector accounted for 92.3 per cent of total number of industries. This sector has four components namely, 1. Corporate enterprises, 2.Partnerships, 3.Inidviudal proprietorships, and 4.Cooperative enterprises.

Regional distribution of industrial activity and industrial cooperation are two more dimensions of the structure of India's industrial sector.

Public Sector in India

Public sector policy: In 1991, New Economic Policy (NEP) was announced to reform the defects of the public sector. These are as follow:

(i) Reduction of Reservations: In 1991, NEP decreased the reservations of public sector units from 1 7 to 8. These eight units are:

(a) Atomic Energy,

(b) Coal and Lignite

(c) Mineral oils

(d) Arm and Ammunition

(e) Mining of ores (iron, manganese, gold, diamond etc.)

(f) Mining of copper, lead, zinc etc.

(g) Minerals for atomic energy

(h) Rail transport. But from 1993 to 2001 the government further reduced the list of reserved PSUs from 8 to 3. Hence, the new reserved lists included Atomic energy, Rail transport and Minerals for atomic energy.

(ii) Policy of Disinvestment:

The government of India had adopted the policy of privatisation in the year 1991. The industries which are sick and weak and have a very high operation cost must be sold to the private sector. Hence, the selling of shares of the PSEs to the hand of private sector for the fulfilment of privatisation policy is known as Disinvestment. C.P. Chandra Shekhar and Jayanti Ghosh had correctly said that the main reason of adopting disinvestment policy is to meet the excessive budget deficits of India.

(iii) Weak Public Sector Units:

The government of India has given responsibility to Board for Industrial and Financial Reconstruction (BIFR) to decide which PSUs have any future hope and which are to be shut down immediately. According to BIFR, up to August, 2004, 286 PSUs were in the list, out of which 203 (85 central and 118 state) were registered. The government also set-up National Renewal Fund (NRF) to tackle the financial problems,

(iv) Memorandum of Understanding (MoU):

To raise the productivity and performances of PSUs, MoU system had introduced in 1991. It strengthens the relationship between PSUs and administrative departments. This system has started in 1987-88 with 4 PSUs and now it has gone up to 112 for 2005-07. The main work of MoU to judge the PSUs and leveled their perform,

(v) Navaratnas:

The government of India has identified 11 PSUs, in 1997 as under ‘Navaratnas’. These units are BHEL, GAIL, MTNL, NTPC, BPCL, IOC, ONGC, HPCL, SAIL, JPCL and VSNL. The government has given huge power to the Board of Directors of these units to spread their activities through the world. In July 2003, both IPCL and VSNL were privatised and thus the number had now reduced to 9. These 9 Navaratnas earned a net profit of Rs. 13,585 crores during 2002-03. To give more functional autonomy to other PSUs, the government identified another 97 units are under ‘Miniratnas’, in October 1997.

Here we detail about the following nine important roles played by public sector in Indian economy, i.e., (1) Generation of Income, (2) Capital Formation, (3) Employment, (4) Infrastructure, (5) Strong Industrial Base, (6) Export Promotion and Import Substitution, (7) Contribution to Central Exchequer, (8) Checking Concentration of Income and Wealth, and (9) Removal of Regional Disparities.

1. Generation of Income:
Public sector in India has been playing a definite positive role in generating income in the economy. The share of public sector in net domestic product (NDP) at current prices has increased from 7.5 per cent in 1950-51 to 21.7 per cent in 2003-04. Again the share of public sector enterprises only (excluding public administration and defence) in NDP was also increased from 3.5 per cent in 1950-51 to 11.12 per cent in 2005-06.

2. Capital Formation:

Public sector has been playing an important role in the gross domestic capital formation of the country. The share of public sector in gross domestic capital formation has increased from 3.5 per cent during the First Plan to 9.2 per cent during the Eighth Plan. The comparative shares of public sector in the gross capital formation of the country also recorded a change from 33.67 per cent during the First Plan to 50 per cent during the, Sixth Plan and then declined to 21.9 per cent in 2005-06.

But the Public sector is not playing a significant role in respect of mobilization of savings. The share of public sector in gross domestic savings increased from 1.7 per cent of GNP during 1951-56 to only 3.6 per cent during 1980-85. During 1980s, the share of public sector in gross domestic savings declined from 16.2 per cent in 1980-81 to 7.7 per cent in 1988-89.

In this connection Narottam Shah observed, “The failure of the public sector contributes only 21 per cent of the nation’s savings; that also in part, through heavy taxation and semi-fictitious profits of the Reserve Bank. The remaining 79 per cent of the nation’s savings came from the private sector.” Again the share of public sector in gross domestic savings increased from 4.78 per cent in 1990-91 to 6.61 per cent in 2005-06.

3. Employment:
Public sector is playing an important role in generating employment in the country. Public sector employments are of two categories, i.e:

(a) Public sector employment in government administration, defence and other government services and

(b) Employment in public sector economic enterprises of both Centre, State and Local bodies. In 1971, the public sector offered employment opportunities to about 11 million persons but in 2003 their number rose to 18.6 million showing about 69 per cent increase during this period.

Again in 2003, the public sector offered employment opportunities to 18.6 million persons which was 69 per cent of the total employment generated in the country as compared to 71 per cent employment generated in 1991. However, there is considerable decline in the annual growth rate of employment in the public sector from 1.53 per cent during 1983-1994 to 0.80 per cent during 1994- 2004.

Moreover, about 69.0 per cent of the total employments are generated in the public sector. Moreover, at the end of March 2004, about 51.7 per cent of the total employment (i.e. about 96 lakh) generated in public sector is from Government administration, community, social and personal services and the remaining 48.3 per cent (i.e., nearly 89.7 lakh) of the employment in public sector is generated by economic enterprises run by the Centre, State and Local Governments.

The maximum number of employment is derived from transport, storage and communications (28.1 lakh). The public sector manufacturing is the next industry which generated employment to the extent of 11.1 lakh persons.

4. Infrastructure:

Without the development of infrastructural facilities, economic development is impossible. Public sector investment on infrastructure sector like power, transportation, communication, basic and heavy industries, irrigation, education and technical training etc. has paved the way for agricultural and industrial development of the country leading to the overall development of the economy as a whole. Private sector investments are also depending on these infrastructural facilities developed by the public sector of the country.

5. Strong Industrial base:

Another important role of the public sector is that it has successfully build the strong industrial base in the country. The industrial base of the economy is now considerably strengthened with the development of public sector industries in various fields like—iron and steel, coal, heavy engineering, heavy electrical machinery, petroleum and natural gas, fertilizers, chemicals, drugs etc.

The development of private sector industries is also solely depending on these industries. Thus by developing a strong industrial base, the public sector has developed a suitable base for rapid industrialization in the country. Moreover, public sector has also been dominating in critical areas such as petroleum products, coal, copper, lead, hydro and steam turbines etc.

6. Export Promotion and Import Substitution:

Public sector enterprises have been contributing a lot for the promotion of India's exports. The foreign exchange earning of the public enterprises rose from Rs. 35 crore in 1965-66 to Rs. 5,831 crore in 1984-85 and then to Rs. 34,893 crore in 2003- 04. Thus, the export performance of the public sector enterprises in India is quite satisfactory.

The public sector enterprises which played an important role in this regard include—Hindustan Steel Limited, Hindustan Machine Tools (HMT) Limited, Bharat Electronics Ltd., State Trading Corporation (STC) and Metals and Minerals Trading Corporation.

Some public sector enterprises have shown creditable records in achieving import substitution and thereby saved precious foreign exchange of the country. In this regard mention may be made of Bharat Heavy Electricals Limited (BHEL), Bharat Electronics Ltd., Indian Oil Corporations, Oil and Natural Gas Commission (ONGC). Hindustan Antibiotics Ltd. (HAL) etc. which have paved a successful way tor import substitution in the country.

7. Contribution to Central Exchequer:

The public sector enterprises are contributing a good amount of resources to the central exchequer regularly in the form of dividend, excise duty, custom duty, corporate taxes etc. During the Sixth Plan, the contribution of public enterprises to the central exchequer was to the tune of Rs. 27,570 crore. Again this contribution has increased from Rs. 7,610 crore in 1980-81 to Rs. 18,264 crore in 1989-90 and then to Rs. 85,445 crore in 2003-04. Out of this total contribution, the amount of dividend contributed only 2 to 3 per cent of it.

8. Checking Concentration of Income and Wealth:

Expansion of public sector enterprises in India has been successfully checking the concentration of economic power into the hands of a few and thus is redressing the problem of inequalities of income and-wealth of the economy. Thus, the public sector can reduce this problem of inequalities through diversion of profits for the welfare of the poor people, undertaking measures for labour welfare and also by producing commodities for mass consumption.

9. Removal of Regional Disparities:

From the very beginning industrial development in India was very much skewed towards certain big port cities like Mumbai, Kolkata and Chennai. In order to remove regional disparities, the public sector tried to disperse various units towards the backward states like Bihar, Orissa, and Madhya Pradesh. Thus, considering all these foregoing aspects it can be observed that in-spite of showing poor performance, the public sector is playing dominant role in all-round development of the economy of the country.

Net Profit for Financial Year 2018–19

Sr No	**CPSE Name**	**Net Profit (In cr. INR)**
1	Indian Oil Corporation Ltd.	16,894
2	NTPC Ltd.	11,750
3	Coal India Ltd	10,470
4	Power Grid Corporation of India Ltd	9,939
5	Bharat Petroleum Corporation Ltd	7,132

Net Profit for Financial Year 2018–19		
Sr No	**CPSE Name**	**Net Profit (In cr. INR)**
6	Power Finance Corporation Ltd.	6,953
7	Bharat Sanchar Nigam Ltd.	6,040
8	Hindustan Petroleum Corporation Ltd	6,029
9	Gail (India) Ltd	6,029

Top 10 Loss Making CPSEs for 2018–19 [16]		
Sr No	**CPSE Name**	**Net Loss (In INR cr)**
1	Indian Post	14,904
2	Air India Ltd.	8,475
3	Mahanagar Telephone Nigam ltd.	3,390
4	State Trading Corporation of India	881
5	PEC Ltd.	500
6	Orissa Mineral Development Company Ltd.	452
7	MSTC Ltd	324

8	National Textile Corporation Ltd	315
9	Airline Allied Services Ltd	297
10	Chennai Petroleum Corporation Ltd.	213

List of Maharatnas

- National Thermal Power Corporation (NTPC)
- Oil and Natural Gas Corporation (ONGC)
- Steel Authority of India Limited (SAIL)
- Bharat Heavy Electricals Limited (BHEL)
- Indian Oil Corporation Limited (IOCL)
- Hindustan Petroleum Corporation Limited (HPCL)
- Coal India Limited (CIL)
- Gas Authority of India Limited (GAIL)
- Bharat Petroleum Corporation Limited (BPCL)
- Power Grid Corporation of India (POWERGRID)

Private Sector in India

Private sector includes all different types of individual or corporate enterprises, both domestic and foreign, engaged in different fields of productive activity. Private sector enterprises are owned and managed by the private sector. These private sector enterprises are mostly characterized by certain common characteristics like private initiative, profit motive and ownership and management in private hands.

In 18th and 19th century, most of the countries of the world adopted the policy of laissez faire where the Governments followed a policy of non-interference in economic activity by the State. This had led to huge expansion of private sector in almost all the countries of the world. In recent times, the private sector has changed its character and is now quite different from the private enterprises of the past.

Now-a-days, the private sector in the form of corporate industrial units are normally owned by the shareholders and managed by professional managers, where they are not only guided by profit motive but also by expansion, consolidation, arousing social consciousness, social responsibilities, social welfare etc.

Now-a-days, the scope of private enterprises is very much restricted due to the expansion of public sector in different countries of the world. Even the capitalist countries like USA, Japan, Western European countries etc. have developed public sector in some strategic areas like defence production, aircraft production, atomic energy, multi-purpose projects etc.

In a developing country like India, with the continuous expansion of the public sector, the productive areas open for the private sector has gradually squeezed. It is only during the post-

1991 period of economic liberalisation, more and more areas are being made open for the private sector and the industrial activities in this sector gained its momentum both through participation of domestic and foreign, private companies.

In India, the distinction between the private sector and the public sector gained its importance, particularly after the introduction of Industrial Policy Resolutions 1948 and 1956, paving the way for the adoption of mixed economy in India.

Growth of Private Sector in India:

At the dawn of independence, almost the entire productive activities and trade were owned and managed by the private sector. At that time, the role of public sector was insignificant, and its activity was very much confined to irrigation, power, railways, ports, ordinance, posts and telegraphs etc. But the activity of the public sector was gradually expanded in different new fields by both the Centre and the States.

Accordingly, the public sector started to play a significant role in different areas; in terms of investment, turnover, capital formation, import substitution, contribution to export etc. Even after the huge expansion of the public sector, the private sector still continued to play a dominant role in all spheres and thereby accounting nearly 80 per cent of the gross domestic product and about 90 per cent of the total employment. In a narrow sense, private corporate sector provides a picture about the private sector. Thus, it is quite important to study the growth of private corporate sector in comparison to that of public sector.

G35The Government Support and Control and the Private Sector*:*

In order to provide necessary support and finance to the private sector, the Government of India has set up a huge network of development banking and financial institution since independence. These institutions include Industrial Finance Corporation of India (IFCI), the State Financial Corporation's (SFCs), the Industrial Development Bank of India (IDBI), the Industrial Credit and Investment Corporation of India (ICICI), the EXIM Bank, the National Bank for Agricultural and Rural Development (NABARD) etc.

These institutions are providing adequate financial support to different large, medium and small scale industries, agricultural sector, traders, export oriented units etc. In addition to these institutions, the Government has set up some other institutions to assist the private sector in the form of infrastructure, technological development, raw material supply, marketing arrangements etc.

With such intention both the Centre and the State Governments have developed industrial estates, growth centres, industrial parks, technological parks for the development of the industrial centres. Moreover, the Government has been providing necessary fiscal incentives in the form of tax holiday or tax concessions etc. to various new industrial and export oriented units.

Thus, on many occasions the Government claim that the expansion and development of the private sector have been mostly due to active support and incentives offered by the Government under necessary situations.

Besides, the Government has set up an extensive control and regulatory structure for the private sector under which it has to work. The Planning Commission has been entrusted with the fixation of level of investment, overall targets etc. for the private sector for each Five-Year Plan.

Prospects of the Private Sector:

Since independence, the private sector was assigned with a secondary role to participate in the industrial activity of the country by the Government. It was only since the Sixth Plan, the Government started to assign much responsibility to the private sector by allocating about 47 per cent of the total planned investment in the private sector.

Side by side, the private sector has also improved its condition, showing sufficient buoyancy and registering higher rate of growth by raising higher volume of funds from the capital market and also by setting up many joint ventures in some other countries. In spite of that, the private sector of India was about 20 years behind the schedule as compared to that of other developing countries.

In order to overcome such gap, a series of measures has been taken by the Government so as to improve the conditions of the private sector. These measures include permitting automatic expansion of capacity to a good number of industries, providing special incentive to export oriented units, exemption from MRTP restrictions on industrial units producing export goods, granting licenses easily to industrial units located in "zero industry" districts, fastening the licensing procedures, liberalization of import and pricing policies etc. All these measures which were introduced during the Sixth Plan, were further liberalized and strengthened during the Seventh Plan.

Moreover, the Government has announced the New Industrial Policy, 1991, which has liberalized the private sector considerably. The main changes brought by this new policy include abolishing the system of industrial licensing for all industrial undertaking except for a short list of 18 industries, reducing the list of industries under public sector to 8 as against the 17 industries reserved earlier, inviting private sector participation in PSUs earning higher profit, abolishing, the system of pre-entry scrutiny of investment decisions of the MRTP companies, removing the asset limit of the MRTP companies, providing automatic permission for foreign technology agreement, removal of mandatory convertibility clause etc.

Self-assessment questions

1. After carefully going through this unit, give a brief account of economic environment

2. What are the critical elements of economic environment?

3. Give a brief account of economic environment of business in India.

4. Explain the major structuring characteristics of India's industrial sector.

5. State and explain the major objectives of the public sector.

6. Explain the growth of rivae sector in India.
7. Discuss he role and importance of small scale industry in India.
8. Explain industrial sickness and reasons for sickness.

LESSON 3
PLANNING AND POLICIES

Created by a 15 March 1950 Resolution, the Planning Commission became the centre of Independent India's economic policy universe, and its Five Year Plans the effective economic direction of the country. Its mandate included assessing the resources of the country and formulating plans.

After the adoption of a new constitution, the government of India set up the Planning Commission in March 1950 to assess the country's material, capital and human resources and to formulate a plan for the most effective and balanced utilization.

Some of the objectives outlined in these plans were maximization of national income, rapid industrialization, providing full employment and most importantly achieving self-sufficiency. The central purpose identified with the process of development was to raise the standard of living and opening out more opportunities to people.

Planning goals and strategies

Planning in India needed proper channelling of resources into different developmental activities in accordance with accepted national priorities. While short-term developmental objectives have varied from plan to plan, the planning process was in some ways inspired by certain long-term goals. These are:

(a) High growth rate with a view to improve the standard of living. Due to the oppressive policies of the British, the country in the colonial period witnessed a retarded development. The standard of living of the people was very low. The general objectives of all the Five year plans have been to raise the standard of living and achieve a much higher growth rate of national income.

(b) Achieving social justice. As per the Directive Principles of State Policy laid down in the Constitution, achievement of justice- social, economic and political were proclaimed as a national commitment. The Five Year Plans being an inherent part of state policy, social justice figured as the most important objective in them.

Its purview covered the achievement of economic and social equality and regional balance in development and avoidance of concentration of economic power. Special care for the backward classes of the population is one of the targets for attaining social justice.

(c) Economic self-reliance. Political independence is never complete without economic independence. Self-reliance in this regard came as a natural objective of the successive Five Year Plans.

The emphasis was on achieving financial self-reliance. Its essence lay in the fact that the economy should be able to finance its continued growth at a satisfactory rate largely from domestic resources. Foreign and external help should be kept at minimum level.

However, a major policy change occurred in this regard from 1991 when the Government at the Centre liberalized the economy and went all the way to attract foreign investments in order to modernize the economy faster.

The strategy for development included a comprehensive planning for all round development; a mixed economy approach to keep up the socialistic pattern of development; achieve a balanced development that would develop both agriculture and industry; provide maximum employment; cater to the development of backward areas; to uplift the backward classes and achieve overall social welfare.

First Five-Year Plan (1951-52 to 1955-56): The first five-year plan had a two-fold objective:

1. To correct the disequilibrium in the economy caused by the Second World War and the partition of the country.

2. To initiate simultaneously a process of all round development, that would ensure rise in national income, and a steady improvement in the living standards of the people.

The plan accorded the highest priority to agriculture, including irrigation and power projects. The plan also aimed at increasing the rate of investment from 5% to 7% of the national income. The growth rate achieved in this plan was 3.6%.

Second Five-Year Plan (1956-57 to 1960-61):

In December 1954, the Parliament declared the objective of the Second Plan to achieve the Socialistic Pattern of Society. The basic aim under this was to attain greater equality of income and wealth and not private profit.

It promoted a pattern of development that would lead to the establishment of a socialistic society in India. The benefits of the plan were directed towards the betterment of the less privileged than the progressive sections. The main objectives of the second plan were:

a. to increase of 25% in the national income.

b. rapid industrialization with special emphasis on the development of basic and heavy industries.

c. large expansion of employment opportunities.

d. reduction of the inequalities in income and wealth and a more even distribution of economic power.

The Plan aimed at increasing the rate of investment from 7% to 11 % of the national income by 1960-61. This plan increased the scope of industrialization by increasing the production of iron and steel, heavy chemicals, development of heavy engineering and machine building industries.

Third Five-Year Plan (1961-62 to 1965-66):

The third Five Year Plan aimed at securing a marked advance towards self-sustaining growth. Its objectives were:

(a) Increase in the national income of over 5% per annum and at the same time ensure a pattern of investment that would sustain this rate of growth during subsequent plan periods.

(b) Achieve self-sufficiency in food grains and increase agricultural production to meet the requirements of the industry and exports.

(c) Expand the basic industries like steel, chemicals, fuel and power and to establish machine building ability so that requirement of further industrialization could be met within a period of ten years and that too from the country's own resources.

(d) Utilize fully the manpower resources of the country and ensure a substantial expansion in employment opportunities.

(e)Bring down disparities of income and wealth and get a more equitable distribution of economic power.

The national income in this plan was to increase by about 30% by 1965-66 and per capita income by about 17% during the period. The growth rate stipulated at 2.2%. The Programmes of the second plan were carried over in the third plan too. The development of basic industries remained a fundamental concern to growth.

Annual Plans (1967, 1968, 1969):

The situation created by the Indo-Pak conflict, two successive years of severe drought, 1965-66 and 1966-67, devaluation of the currency in 1966, general rise in prices and erosion of resources available for plan purpose delayed the finalization of the fourth five year plan.

Instead three annual plans were formulated within the framework of the draft outline of the fourth plan. The main aim of this plan was to restore normalcy in the economy. The emphasis of these plans was to adopt irrigation projects along with the use of high yielding variety crops in the agricultural sector. In the industrial sector the stress was on the utilization of the existing capacity and on consumer goods industry.

Fourth Five-Year Plan (1969-70 to 1973-74):

The Fourth plan aimed at raising the standard of living of the people through programmes that would promote social justice and equality at the same time. The concentration of the plan was the welfare of the weaker sections of the society especially through employment and education. The rate of growth in national income was 3.3% per annum and the per capita income was 1.2% per annum. The performance in industry as well as agriculture was not satisfactory.

Fifth Five-Year Plan (1974-79): The following objectives were stated under the fifth five-year plan:

a. Removal of poverty.

b. Achievement of economic self-reliance.

To achieve these objectives the procedure thought was to get a 5.5% overall rate of growth; expansion of productive employment; extended programmes of social welfare; emphasis on agriculture and basic industry with special attention to production for mass consumption; export promotion and substitution of imports.

The Fifth plan that was to be completed in March 1979 was completed earlier; by March 1978.This was the golden period for rural development as the largest funds were diversified for rural development. The rate of growth achieved was 5.2%.

Sixth Five-Year Plan (1980-85):

This plan accelerated the work for the removal of poverty, generation of gainful employment and technological and economic self-reliance. The plan targeted a growth rate of 5.2% and achieved it. It was successful in achieving the required industrial development and agricultural growth. It also achieved aims of social justice.

The plan undertook the development of underdeveloped areas of the country. It also concentrated on the refinement of technology. It was the first perspective plan of the country slated for a long term of fifteen years. It also saw a rapid growth in the service sector. About 94% of the cost of investments was met from the domestic resources projecting the self-reliance of the country.

Seventh Five-Year Plan (1985-90):

The sixth five-year plan provided the background for the next plan. The guiding principles of the plan continued to be growth, equity and social justice, self-reliance, improved efficiency and productivity. The policies to accelerate growth in food grains production, increase employment opportunities and raise productivity were pursued in this plan.

The rate of growth of 5.6% was kept for this plan. The strategy in the seventh plan to generate productive employment was to increase cropping intensities and extension of agriculture through use of new technologies. Emphasis was also given on various rural schemes for development.

Eighth Five-Year Plan (1992-97): The Eighth plan had the following objectives:

a. Generating adequate employment to achieve near full employment level by the turn of the century.

b. Containing population growth through active scheme of incentives.

c. Eradication of illiteracy in the age group of 15 to 35 years.

d. Provision for health and availability of safe drinking water especially in villages.

e. Self-sufficiency in food and generation of agricultural surplus.

f. Strengthening the infrastructure in order to support growth process on a sustained basis.

The strategy for achieving the above mentioned goals was to be a mixture of new investments and correction of imbalances in different sectors and increasing investment efficiency. This plan also aimed at a 5.6% growth per annum. Much of the investments were to be met by capital inflow from abroad in the form of loans.

Ninth Five-Year Plan (1997-2002):

The Ninth plan proposed to achieve a 7% growth rate during the plan period. It introduced fiscal discipline and aimed to control rise in prices through controlling money supply. It aimed at resource mobilization and attract foreign direct investment. The thrust of the plan was to achieve agricultural growth. The proposition was to broaden the direct tax base for raising resources at the centre. Some of the objectives outlined in this plan were:

a. Priority to agriculture and rural development and generate productive employment and eradication of poverty.

b. Accelerating the growth rate of the economy and keeping the prices stable.

c. Containing the growth rate of population.

d. Promoting and developing people’s participatory institutions like the Panchayati Raj and Cooperatives.

e. Strengthening efforts of building self-reliance.

Evolution of Industrial policy

Industrial Policy during the British period was motivated by the supreme consideration of using India as a colony for British Empire. With the installation of national government in 1947, it was imperative that the perspective should change in favour of industrial development of India. In the initial years Indian government had several problems and was focussing on those problems like food shortage, integration of states, rehabilitation of refugees etc. With the apprehension of the government that initiation of industrial policy might be opposed either by the industries or working of 1948 to give stability to the industrial sector. Therefore the government decided to go slow and adopted industrial policy In 1956 giving a big push to the development of basic and heavy industries.

The Industrial Policy Resolution of April 1948 envisaged a mixed economy for India in which the existence of the public sector and he private sector was accepted as the hallmark of policy. The government classified industries in four categories as follows;

Exclusive monopoly of the state is the manufacture of arms and ammunition, production and control of atomic energy, Railway transport.

New undertakings by state: The industries included in this category were coal, iron and steel, aircraft manufacture, shipbuilding, manufacture of telephones, telegraph and wireless apparatus and mineral oils.

Industries of such basic importance that the central government would feel it necessary to plan and regulate such as automobiles, tractors, prime movers, electric engineering, heavy machinery, machine tools, heavy chemicals, fertilisers, non-ferrous metals, cotton and woollen textiles, cement, sugar and newsprint, air and sea transport. Reminder of industrial field was left open to the private sector, individual and cooperatives.

Industrial Policy of 1956

After the successful operation of the First Five Year Plan, the Indian Parliament felt that that a stage has been set for a take-off towards the rapid industrialisation. Under the new policy, industries were classified into three categories;

1. Schedule A: industries which were to be the exclusive monopolies of the state which are 17 in number.
2. Schedule B: New industries to be gradually set up by the state
3. All other remaining industries and their development wese left to the private sector.

In this policy, the state provided for the encouragement and rapid growth of village and small industries. This was essential because these industries promised to provide employment to the vase sections of the poor. Support to small and villge industries was to be provided by restricting the share of the large sector in production, by differential taxation or by direct subsidies. The state would concentrate on measures designed to improve the competitive strength of the small producer by constantly improving and modernising the technique of production.

This policy also intended to improve the working and living conditions for labour and living conditions for labour as a partner in production and thus it was expected to participate in the task of national development so that the country could build a socialist democracy. It also emphasised the need for foreign capital.

The long-term goals of planning as enunciated by the planning commission are:

1. To increase production to the maximum possible extent so as to achieve higher level of national and per capita income;
2. To achieve full employment;
3. To reduce inequalities of income and wealth; and
4. To establish a socialist society based on equality and social justice and absence of exploitation.

To achieve these objectives, mixed economy framework was accepted in preference to either he command model of the soviet society or the pure capitalist model of th private enterprise. The distinguishing feature of the Indian model was that it deliberately pushed the expansion of the public sector to build infrastructure and heavy industry and it subordinated the private sector to reconcile the element of self-interest.

Regulatory and Promotional Policy framework

The industrial policy pursued in India for the first four decades after independence was based on the socialist school of thought that India embraced, partly to alienate itself from the colonial past and more so owing to the obvious achievements of the socialist movement in the post-world war II period. Thus, through a Resolution dated April 6, 1948 the government set out the policy to be pursued in the Industrial field, wherein to secure continuous increase in production and equitable distribution, the country opted for a centrally planned development strategy, with the state playing a major role. For this purpose, the National Planning Commission was established for planning, co-ordination, integration of national economic activity and to formulate programmes of development and to secure their execution.

On October 30, 1956, at the beginning of the Second Five Year Plan, the Government adopted a New Industrial Policy Resolution, which reiterated the above objective and classified industries into three categories as follows:

Schedule A were those industries whose future development was the exclusive responsibility of the state. Schedule B consisted of industries which would be progressively state-owned, wherein the state would take initiative in establishing new undertakings and private enterprise would be expected to supplement the effort of the state. Schedule C included all remaining industries whose further development was left to the initiative and enterprise of the private sector. This led to the expansion of the public sector in India, whose share in GDP increased from 9.91% in 1960-61 to 27.12% in 1988-89. However, the cause of concern was that a large number of public sector enterprises – particularly the Non-departmental non-financial enterprises were making losses and had to be subsidized.

Industrial undertakings in the private sector were subject to control and regulation like the Industries Development and Regulation (IDR) Act (1951) and were expected to align their business strategy and goals with the broad economic and social objectives of the State. The IDR vested with the government necessary powers to regulate and control existing and future undertakings in a number of specified industries. A license was necessary for establishing a new undertaking, taking up the manufacture of a new article in an existing unit, effecting substantial expansion, carrying on the business of an existing undertaking and changing the location of an existing unit. A Letter of Intent (LOI) was issued for sectors/activities under compulsory license under the IDR Act, 1951. The LOI was converted into Industrial License on completion of specified formalities.

Further, to prevent monopolies and concentration of economic power in the hands of private sector, in 1969, the Monopoly and Restrictive Trade Practices Act (MRTP) was enacted. All these regulations and controls led to increase in bureaucracy, inhibiting enterprise and industry.

Also, given the state of the economy with limited resources, scarce capital and vast population base, the development ideology revolved around the notion of conservation and optimum utilization of capital so as to maximize 'employment' (and not necessarily output). Deployment of new capital was strictly controlled and regulated so as to meet social needs and maximize employment. Further, once the capital was committed to any activity and a certain employment was created, it was protected at any cost – even if it was non-viable in the face of market forces.

Labour intensive technology and employment generation were also the rationale behind the initial advocacy of small-scale industry. However, later, when it was realized that modern small scale industry was not necessarily labour intensive, the argument turned to encouraging the entry of new entrepreneurs in industry. A range of products were reserved for exclusive production in the small-scale sector, eliminating potential competition from medium and large firms. There were no pressures on the smaller firms to improve technology, update production techniques or reduce cost modernize or specialize. There was an inherent disincentive to grow beyond a certain size, if they had to continue production of a reserved product. Thus economies of scale could not be leveraged and market distortions were widespread.

Until 1991, the guiding principle of India’s industrial policy was self-reliance, which focused on indigenous production and reduced dependence on foreign capital and foreign technology – irrespective of the cost and/or quality. This did lead to the creation of a large industrial base, diversification of products, ownership and location. But in the absence of domestic competition, export rivalry and competition of imports, industry grew with a lack of cost and quality consciousness, leading to slow growth, increasing deficits and debt and finally the crisis in 1991 which paved the way for economic reforms in India. Some of the components of the reform package include:

- Reforms in Industrial Policies in terms of delicensing of most industries and deregulation of industries earlier monopolized by the public sector
- Liberalisation of foreign trade through steady reduction in tariffs and freeing up of the foreign investment limits in most industries combined with measures to attract FDI into the country
- Macroeconomic stabilization through substantial reduction in fiscal deficits and government’s draft on the private sector’s savings
- Other reforms including those in taxation, financial sector, insurance sector, public sector, etc.

During the last decade and half, these reforms have reoriented India from a slow-paced, centrally directed and highly controlled economy to a strong, vibrant, fast-growing and ‘market-friendly’ one. There now exists an internationally competitive private sector with varied scope for collaborations and joint ventures and a facilitating regulatory framework that is evolving to match the international standards.

This Chapter seeks to give an overview of the broad framework of regulations governing business in India particularly in the context of:

- Industrial Policy
- Foreign Investment Policy
- Anti-Trust Regulations
- Labour Laws
- Protection of Intellectual Property Rights
- Other Economic Laws & Procedures

Industrial policy

The Industrial Policy Resolution 1956, substantially augmented through the Statement of Industrial Policy 1991 and subsequent announcements – which liberalized the economy – provides the basic framework for the overall industrial policy of the Government of India.

Industrial Licensing

The requirement of obtaining an industrial license for manufacturing has been abolished for all projects except for a short list of industries connected with security and strategic concerns (reserved for public sector), social reasons, hazardous chemicals and overriding environmental concerns. The list of items requiring compulsory licensing is reviewed on an on-going basis. The stage of LOI has been dispensed with for all sectors/activities except for items reserved for SSI sector and an Industrial License is now issued without going through the stage of LOI. The following industries require compulsory license:-

1. Alcoholics drinks
2. Cigarettes and tobacco products
3. Electronic, aerospace and defense equipment
4. Explosives
5. Hazardous chemicals such as hydrocyanic acid, phosgene, isocynates and di-isocynates of hydro carbon and derivatives, etc.

Non-small-scale industrial units or units in which foreign equity is more than 24% require license to manufacture items reserved from small scale sector. All other industries are exempt from licensing and no industrial approval is required. Entrepreneurs are only required to file an Industrial Entrepreneurs' Memorandum (IEM) with the Secretariat for Industrial Assistance (SIA), providing information on new projects and substantial expansions.

There are however, certain *locational restrictions* in metropolitan areas. No industrial approval is required from the Government for locations outside 25 kms of the periphery of cities having a population of more than one million except for those industries where industrial licensing is compulsory. Non-polluting industries such as electronics, computer software and printing can be located within 25 kms of the periphery of cities with more than one million population. Permission to other industries is granted in such locations only if they are located in an industrial area so designated prior to 1991. Zoning and Land Use Regulations as well as Environmental Legislations have to be followed.

Appropriate incentives and investments in enabling infrastructure are provided to promote *dispersal of industry* particularly to the rural and backward areas and to reduce congestion in cities. Recently, the Government approved a package of fiscal incentives and other concessions for the North East Region namely the 'North East Industrial and Investment Promotion Policy (NEIIPP), 2007', effective from 1.4.2007.

Also, under the broad framework of the national industrial policy, different Indian States announce their respective Industrial Policies periodically, which highlight the areas in which the State would focus on and provide incentives to attract investment, the various sector & location specific schemes offered to private investors, the plans for development of enabling infrastructure, opportunities for public-private-partnership, etc.

Policies for Privatisation

The post 1991 liberalisation process brought with it deregulation of trade and industry, dismantling of bureaucratic controls, technological development and financial sector reforms. Privatising some of the activities which heretofore were the exclusive domain of public sector also became part of this initiative to boost enterprise and professional management of resources to enhance economic growth and competitiveness. Revolutionary policy measures were undertaken to encourage private participation in sectors like telecom, information & broadcasting, power, ports, airports, banking, etc. Over the years, the government has reduced the number of industries reserved for the public sector to the two which are deemed significant from security and strategic perspective, viz., Atomic energy and Railways.

However, in the last few years the railways announced opening up of its containerized operations to other private and public sector companies, thereby ending the monopoly enjoyed by the Container Corporation of India (CONCOR). Interested companies could avail of the route-specific or all-India permission by paying a registration fee which is valid for an operation period of 20 years (further extendable by 10 years). There is freedom to decide the tariffs to be charged to the customers for various services and also the exit norms involve transfer of the operational writes to another eligible operator with the railway approval.

Policies for Small Scale Sector

The provisions in the Industrial Policy Statement of 1991 and the subsequent policies are aimed at supporting the Small Scale Industries (SSI) sector though various measures and packages focusing – not only on policy of reservation – but also on price and purchase preference policy for marketing SSI products, credit and fiscal support to SSIs, support for cluster based development, technology upgrading, etc.

The IDR Act 1951 provided for the reservation of items for exclusive manufacture in SSI sector primarily with the objectives of increasing production of consumer goods in the small scale sector and widening of employment opportunities. In 1967, 47 items were reserved for exclusive manufacture in the small scale sector. This number was increased to 836 items in 1989. However, since 1997, a large number of items were de-reserved from the list in the phased manner. As of March 2007, only 114 items are reserved for exclusive manufacture in the small scale sector.

In addition to the policy of reservation, the Government has initiated various measures offering support for Cluster based Development, Technologies and Quality Upgradation, Marketing, Entrepreneurial and Managerial Development and Schemes for Empowerment of Women Owned Enterprises.

Further, with a view to facilitate the development of micro, small and medium enterprises (MSME), the Micro, Small and Medium Enterprises Act 2006, was implemented. The Act provides the new classification of each category of enterprises. As per the Act, MSME are defined as follows:

- *in the case of the enterprise engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the IDR Act 1951 –*
- a micro enterprise is the one where the investment in plant and machinery does not exceed twenty five lakh rupees.

- a small enterprise is one where the investment in plant and machinery is more than twenty five lakh rupees but does not exceed five crore rupees; or
- a medium enterprise is one in which the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees;
- *in the case of enterprises engaged in providing or rendering of services –*
- a micro enterprise is one where the investment in equipment does not exceed ten lakh rupees;
- a small enterprise is one in which the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees; or
- a medium enterprise is where the investment in equipment is more than two crore rupees but does not exceed five crore rupees

In February 2007, the Government announced a package for promotion of the SSI sector as follows:

- *Credit Support:* The package aims at increasing the number of beneficiaries of the credit provided by the Small Industries Development Bank of India (SIDBI) by 50 lakhs, over five years beginning from 2006-07. For this purpose, the Government has provided grant to SIDBI to augment its Portfolio Risk Fund. Besides, in an attempt to increase demand-based small loans to micro enterprise, the Government announced a provision of grant to SIDBI to create a Risk Capital Fund (as a pilot scheme in 2006-07). The eligible loan limit under the Credit Guarantee Fund Scheme has been raised to Rs. 50 lakh. The credit guarantee cover has also been raised from 75% to 80% for micro enterprises for loans up to Rs. 5 lakhs.
- *Fiscal support:* The Government has increased the General Excise Exemption (GEE) limit from Rs. 100 lakh to Rs. 150 lakhs since April 2007. It further proposes to examine the eligibility of extending the time limit for payment of excise duty by micro and small enterprises; and extending the GEE benefits to small enterprises on their graduation to medium enterprises for a limited period.

Foreign Investment Policy

In recognition of the importance of of foreign direct investment as an instrument of technology transfer, augmentation of foreign exchange reserves and globalization of the Indian economy, the Government of India revamped its foreign investment policy as part of the reform process.

Foreign Direct Investment

Foreign Direct Investment (FDI) regime in India was increasingly liberalized during 1990s (more particularly post 1996) and today India has the most liberal and transparent policies on FDI among the emerging economies, with restrictions on foreign investments being removed and procedures simplified. Some of the prominent features of the FDI policy in India are elucidated below:

- The approval mechanism for FDI has a two tier system.

    - Under the automatic approval route, companies can issue shares and receive inward remittances for investment in areas identified and upto the limits of foreign equity prescribed, with a reporting requirement, within a period of 30 days. In these sectors, investment could be made without prior approval of the central government.

- Although, in case of the automatic route, it is no longer necessary to obtain the ‘in principle’ permission from Reserve bank of India (RBI) before receiving overseas investment or for issuing shares to foreign investors, the company, would, however, have to make a report to the RBI within 30 days after issue of shares to the foreign investors.

- Proposals for investment in public sector units and also for Special Economic Zones (SEZs) / Export Oriented Units (EOUs)/ Export Processing Zones (EPZs) qualify for automatic approval subject to satisfaction of certain prescribed sector specific parameters.

- FDI up to 100% is permitted under the automatic route for setting up Industrial Parks. Proposals for FDI/NRI investment in Electronic Hardware Technology Park (EHTP) and Software Technology Park (STP) Units are eligible for approval under the automatic route, except for those requiring prior approval of the Central Government (as discussed below).

- FDI in sectors that are not covered under the automatic route requires prior approval of the Central Government. Activities/sectors require prior approval of the Government for FDI in the following circumstances:-

- Activities/items that require an industrial license
- Proposals in which the foreign collaborator has an existing financial/technical collaboration in India in the same field (except in IT and mining sector)
- All proposals falling outside notified sectoral policy/CAPS
- Proposals in which more than 24% foreign equity is proposed to be inducted for manufacture of items reserved for the Small Scale Sector

➢ The approval is granted by Foreign Investment Promotion Board (FIPB), which is a specially empowered board set up for the purpose, chaired by the Secretary, Union Ministry of Finance.

➢ Proposals for FDI could be sent to the FIPB Unit, Department of Economic Affairs, Ministry of Finance or through any of India’s diplomatic missions abroad. FIPB has the flexibility to examine all proposals in totality, free from predetermined parameters.

➢ Recommendations of FIPB regarding all proposals falling in the non-automatic route and involving an investment of Rs.6 billion or less are considered and approved by the Finance Minister. Projects with investment greater than this value are submitted by the FIPB to the Cabinet Committee on Economic Affairs for approval.

➢ Necessary regulatory approvals from the state governments and local authorities for construction of building, water, environmental clearance, etc. need to be acquired after the grant of approval for FDI by FIPB or for the sectors falling under automatic route. 'Single window' clearance facilities and 'investor escort services' are available in various states to simplify the approval process for new ventures.

- Decisions on all foreign investments are usually taken within 30 days of submitting the application.

- In cases where original investment is made in convertible foreign exchange, free repatriation of capital investment and profits thereon is permitted.

Sectors prohibited for FDI include:

- Retail trading (except Single Brand Product retailing)
- Atomic Energy
- Lottery Business
- Gambling and Betting

Investment in SEZs

In order to enhance competitiveness of Indian exports and attract investment in these sectors, India's Foreign Trade Policy promotes the setting up of SEZs and thus provides for a hassle-free environment with world-class institutional and physical infrastructure and supporting logistics. Some of the existing EPZs/FTZs have also been converted into SEZs. All the State Governments have been advised to give priority to waste and barren land for acquisition purposes. According to the total Waste Land area surveyed by the Ministry of Forest, 5,52,692.26 hectares was available for such purpose.

FDI up to 100% is permitted under the automatic route for setting up of SEZ. Proposals not covered under automatic route require approval from FIPB. The policy provides for setting up of SEZ in the public, private or joint sectors or by state governments. These could be product specific or multi-product SEZs. Designated duty-free enclaves are treated as foreign territory for trade operations and duties and tariffs, and duty-free goods need to be utilised within the approved period. The permitted activities cover an array of manufacturing and services like production, processing, assembling, reconditioning, re-engineering, packaging, trading, etc.

Proposals for setting up units in SEZ, other than those requiring industrial license are approved by the Development Commissioner (DC). The approval for those requiring industrial license is granted by the DC after receiving clearance from the Board of Approval. The Letter of Permission (LOP)/Letter of Intent (LOI) issued by the DC is construed as a license for all purposes, including procurement of raw material and consumables either directly or through a canalising agency. The LOP/LOI needs to specify the items of manufacture/service activity, annual capacity, projected annual export for the first year in dollar terms, Net Foreign Exchange Earnings (NFE), limitations, if any, regarding sale of finished goods, by products and rejects in the DTA and such other matter as may be necessary and also impose such conditions as may be required.

According to the policy, SEZ units have to be positive net foreign exchange earners and the performance of these units would be monitored by a unit approval committee consisting of the DC and the Customs Authority.

Entry Options for Foreign Investors

A foreign company has the option to set up business operations in India as an *Incorporated Entity* or as an Unincorporated Entity.

An Incorporated Entity would be a company registered under Companies Act, 1956, through *joint ventures* or *wholly owned subsidiaries*. Foreign equity in such Indian companies can be up to 100% depending on the requirements of the investor, subject to any equity caps prescribed in respect of area of activities under the FDI policy. Funding could be via equity, debt (both foreign and local) and internal accruals.

For registration and incorporation, an application has to be filed with the Registrar of Companies (ROC). Once a company has been duly registered and incorporated as an Indian company, it is subject to Indian laws and regulations as applicable to other domestic Indian companies. Companies in India can be incorporated as a private company or a public company.

In comparison with branch and liaison offices (discussed subsequently), a subsidiary company provides maximum flexibility for conducting business in India. However, the exit procedure norms of such companies are relatively more cumbersome.

An Unincorporated Entity could be Liaison Office/Representative Office or Project Office or Branch Office. Such offices can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office of other place of business) Regulations, 2000. They are also governed by the Companies Act 1956, which contains special provisions for regulating such entities.

Liaison Office/Representative Office

The role of a liaison office is primarily to:

- Collect information about the market
- Disseminate information about the company and its products to prospective Indian customers
- Promote exports/imports from/to India
- Facilitate technical collaboration between parent company and companies in India

A liaison office cannot undertake any commercial activity directly or indirectly and cannot, therefore, earn any income in India. Approval for establishing a liaison office in India is granted by the RBI.

Project Office

Foreign Companies planning to execute specific projects in India can set up temporary project/site offices in India. RBI has granted general permission to foreign entities to establish Project Offices subject to specified conditions. Such offices cannot undertake or carry on any activity other than the activity relating and incidental to execution of the project. Project Offices may remit outside India the surplus of the project on its completion, general permission for which has been granted by the RBI. Since a Project Office is an extension of the foreign incorporation in India, it is taxed at the rate applicable to foreign corporations.

Branch Office

Foreign companies engaged in manufacturing and trading activities abroad are allowed to set up Branch Offices in India for the following purposes :

- Export/Import of goods
- Rendering professional or consultancy services
- Carrying out research work, in which the parent company is engaged.
- Promoting technical or financial collaborations between Indian companies and parent or overseas group company
- Representing the parent company in India and acting as buying/ selling agents in India
- Rendering services in Information Technology and development of software in India
- Rendering technical support to the products supplied by the parent/ group companies
- Foreign airline/shipping company

Branch Offices established with the approval of RBI, are allowed to remit outside India profit of the branch – net of applicable taxes (which are at rates applicable to foreign companies) – however, subject to RBI guidelines. Permission for setting up branch offices is granted by the RBI.

Branch Offices could also be on *stand alone basis* in *SEZ*. Such Branch Offices would be isolated and restricted to the SEZ alone and no business activity/transaction would be allowed outside the SEZs in India, which include branches/subsidiaries of its parent office in India. No approval shall be necessary from RBI for a company to establish a branch/unit in SEZs to undertake manufacturing and service activities, subject to the conditions that:

- they function in sectors in which 100% FDI is permitted
- they comply with part XI of the Company's Act (Section 592 to 602)
- function on a standalone basis
- in the event of winding up of business and for remittance of winding-up proceeds, the branch should approach an authorized dealer in foreign exchange in the with documents required as per FEMA.

Financing Options for Corporates

Companies registered in India can raise finances through *Share Capital* or *Debentures* and *Borrowings*.

Share Capital

The Companies Act, 1956 allows for two kinds of share capital, viz., Preference share capital (preferred stock) and Equity share capital (with/without voting rights). Apart from this, private companies which are not subsidiaries of public company have the option of raising funds through Venture Capital.

The issue of shares to the public is governed by the guidelines issued by the Securities & Exchange Board of India (SEBI) – the body that regulates and oversees the functioning of Indian Stock markets and the RBI.

A company issuing shares or debentures has to comply with SEBI disclosure requirements with regards to its prospectus. The prospectus has to be approved by the stock exchange and scrutinized by SEBI and then filed with the Registrar of Companies.

Indian companies having foreign investment approval through FIPB route do not require any further clearance from RBI for receiving inward remittance and issue of shares to the foreign investors. The companies are required to notify the concerned Regional office of the RBI of receipt of inward remittances within 30 days of such receipt and within 30 days of issue of shares to the foreign investors or NRIs.

Equity participation by international financial institutions such as ADB, IFC, CDC, DEG, etc., in domestic companies is permitted through automatic route, subject to SEBI/RBI regulations and sector specific cap on FDI.

In all other cases a company may issue shares as per the RBI regulations. Other relevant guidelines of SEBI and RBI, including the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, wherever applicable, would need to be followed.

The Companies Act does not specify the nominal value of shares.

Self- Assessment Questions

1. Give the long-term objectives of planning in India

2. Discuss the planning strategies in different Five Year Plans

3. Compare different industrial polices announced by government of India from time to time.

4. Describe the salient features of the protective policy adopted by the government for small scale industries.

5. Foreign investment is a panacea for the economic ills of a developing country. Critically evaluate this statement.

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LESSON 4
EXTERNAL SECTOR

Indian Foreign Trade

Foreign trade or international trade refers to the trading of goods between countries. Thus, international trade is an extension of internal trade i.e. trade between two different regions within a country. Just like as single region within a country cannot produce everything it needs by itself, one single economy cannot produce every commodity all be itself. This could be due to differences in the availability of natural resources, skills of people etc. Therefore, it would be advantageous for a country to indulge in trade with other countries by exporting those commodities which it produces cheaper for what others can produce at a lower cost.

Foreign trade also facilitates the dissemination of technology transmission of ideas, and import of know-how, skills, managerial talents and entrepreneurship. In addition, foreign trade encourages movement of foreign capital. In totality, foreign trade can have a profound impact on the growth of an economy in terms of production, employment, technology, resource utilisation and so on.

In India foreign trade gained momentum during the British rule when India was a supplier of food stuffs and raw materials to England and an importer of manufactured goods. India's foreign trade has come a long way since 1950-51. The values of both exports and imports have increased several times over the period. The value of exports rose to Rs.606 crores in 1950-51 to Rs.1,06,465 croresin 1995-96. The value of imports during the same period increased from Rs. 606 crores to Rs. 1,21,647 crores. The value of India's imports has always been higher than that of exports except in 1971-72 and 1976-77. But exports grew significantly during the early '90s due to devaluation of currency in 1991 and the subsequent liberalisation of export-import regime particularly full convertibility of rupee on current account.

The composition of foreign trade refers to the kinds of goods imported and exported by a country. It is essential to understand the composition of imports and exports as it reveals the economic status of a country. The changes that may occur in the composition of trade over a period of time reflect the economic transformation of a country.

In general, a developing countries imports comprise mainly heavy manufacturing goods like machinery, transport equipment, iron and steel etc. whereas exports comprise mainly primary commodities like agricultural products, natural resources such as iron ore, and textiles, leather products, processed food etc. but in the process of industrialisation and economic development, the composition of trade undergoes transformation. As a consequence, a developed countries imports would include mostly primary commodities and light manufacturing goods and exports would consist of mainly heavy manufactured goods.

India imports mainly petroleum products, oils and lubricants. The import list includes fertilisers and chemicals; pearls and precious and semi-precious stones; iron and steel; non-ferrous metals. Whereas India's exports include agricultural and allied products like coffee, tea, oil cakes, tobacco, cashew, spices, sugar raw cotton, rice, fruits and vegetables etc., ores and minerals which include mica and iron ore, manufactured goods consisting of gems and jewellery, readymade garments, engineering goods, chemicals , leather products, jute manufactures etc., mineral fuels and lubricants etc.

India's export partners in 2019 are;

Below is a list highlighting 15 of India's top trading partners in terms of countries that imported the most Indian shipments by dollar value during 2019. Also shown is each import country's percentage of total Indian exports.

1. United States: US$54.2 billion (16.8% of India's total exports)
2. United Arab Emirates: $29.7 billion (9.2%)
3. China: $17 billion (5.3%)
4. Hong Kong: $11.5 billion (3.5%)
5. Singapore: $10.7 billion (3.3%)
6. United Kingdom: $8.82 billion (2.7%)
7. Netherlands: $8.75 billion (2.7%)
8. Germany: $8.6 billion (2.7%)
9. Bangladesh: $8.3 billion (2.6%)
10. Nepal: $7 billion (2.2%)
11. Belgium: $6.3 billion (2%)
12. Malaysia: $6.14 billion (1.9%)
13. Saudi Arabia: $6.05 billion (1.9%)
14. Vietnam: $5.49 billion (1.7%)
15. France: $5.45 billion (1.7%)

About three-fifths (60.1%) of Indian exports in 2019 were delivered to the above 15 trade partners.Saudi Arabia increased its import purchases from India from 2018 to 2019 by the most at 10%. In second place was the United States via a 4.7% gain in value. France boosted its imports from India by 3%, trailed by a 2.8% improvement for China.

In case of India's foreign trade, there is always a deficit which reached 184 billion dollars deficit by 2019. The highest trade deficit is recorded in 2012. Table furnished below gives insight into India's foreign trade in the past 20 years.

Summary table of recent India foreign trade (in billion $)

Year	Export	Import	Trade Deficit
1999	36.3	50.2	-13.9
2000	43.1	60.8	-17.7
2001	42.5	54.5	-12.0

2002	44.5	53.8	-9.3
2003	48.3	61.6	-13.3
2004	57.24	74.15	-16.91
2005	69.18	89.33	-20.15
2006	76.23	113.1	-36.87
2007	112.0	100.9	-11.1
2008	176.4	305.5	-129.1
2009	168.2	274.3	-106.1
2010	201.1	327.0	-125.9
2011	299.4	461.4	-162.0
2012	298.4	500.4	-202.0
2013	313.2	467.5	-154.3
2014	318.2	462.9	-144.7
2015[18]	310.3	447.9	-137.6
2016	262.3	381	-118.7
2017	275.8	384.3	-108.5

2018	303.52	465.58	-162.05
2019	330.07	514.07	-184
2020	314.31	467.19	-152.88

India's Balance of Payment

The balance of payment of a country is a systematic record of all economic transactions between the residents of a country and the rest of the world. It is composed of all receipts on account of goods exported, services rendered and capital received by residents and payments made by them on account of goods imported, services received and capital transferred to non-residents or foreigners. The balance of payments of a country consists of current account, capital account, and cash account/official reserve assets account.

The current account component portrays the flow of goods and services in the form of exports and imports for country during a given year. The capital account shows the volume of private foreign investment and public grants and loans from individual nations and multilateral donor agency such as the IMF, World Bank etc. the official reserve assets accounts comprise its gold stock, holding of its convertible foreign currencies and special drawing rights. The account is the balancing item response to current and capital accounts transactions. If the balance on current and capital accounts is negative it represents deficit balance of payment. But if the balance on current and capital accounts is positive, it would be called a surplus balance of payments.

Importance of balance of payments reveals various aspects of a country's internal economic position. It presents the international financial position of the country. It helps the government in taking decisions on monetary and fiscal policies on the one hand and on eternal trade and payments issues on the other. In the case of a developing country, the balance of payments shows the extent of dependence of the country's economic development on the financial assistance by the developed countries. The greatest importance lies in its serving as an indicator of changing international economic position of a country. The balance of payments is the economic barometer which can be used to appraise a nation's short-term international economic prospects to evaluate the degree of its international solvency and to determine the appropriateness of the exchange rate of countr's currency.

However, a country's favourable balance of payments cannot be taken as an indicator of economic prosperity nor its adverse or unfavourable balance of payments is a reflection of bankruptcy. A balance of payments deficit per se is not the proof of competitive weakness of a nation in foreign markets. However the longer the balance of payments deficit continues, the more it would imply some fundamental problems in that economy. Similarly, a favourable balance of payments should not always make a country complacent. A poor country may have a favourable balance of payments due to large inflow of inflow of foreign loans and equity capital. A developed country may have adverse balance of payments due to massive assistance given to developing countries.

Thus, a deficit or surplus of balance of payments of a country per se should not be taken as an index of economic bankruptcy of prosperity of the country. The balance of payments deals only with the transactions of the period under review. It does not provide data about assets and liabilities that relate one country to others. However, despite all these shortcomings, the significance of balance of payments lies in the fact that it provides vital information to understand a country's economic dealings with other countries.

Export and Import Policy

Export-import (EXIM) policy popularly known as Trade Policy refers to policies adopted by a country with reference to exports- and imports. Trade policy can be free trade policy or protective trade policy. A free trade policy is one which does not impose any restriction on the exchange of goods and services between different countries. A free trade policy involves complete absence of tariffs, quotas, exchange restrictions, taxes and subsidies on production. Though free trade, theoretically, offers several advantages, in reality, particularly underdeveloped countries were at a disadvantage in such a system of international trade. As a result the early 20^{th} century experienced the emergence of protective trade policies. Developing country may adopt commodity specific trade policies such as the following;

1. Primary outward looking policies aimed at encouraging agricultural and raw material exports.
2. Secondary outward looking policies aimed at promoting exports
3. Primary inward looking policies objective is to achieve agricultural self sufficiency
4. Secondary inward looking policies objective is attaining manufactured commodity self-sufficiency through import substitution.

Trade policy will strongly influence the direction, trend and growth of foreign trade of a country. This, in turn, will have a bearing on the economic development process. Therefore, trade policy is an important economic instrument which can be used by a country, with suitable modifications from time to time to achieve its long-term objectives.

Indian Policy incentives to promote exports can be broadly classified as under;

1. Special facilities to make the material inputs needed by exporters available at reduced costs.
2. Free trade zones and export oriented units
3. Facilities for making capital equipment available at reduced rate
4. Incentives for and assistance with export marketing
5. Profit tax and credit subsidies and
6. Subsidies on domestic raw materials

Over a period of time, the government has steadily increased and extended these incentives.

EXIM Policy changes in 1981 are initiated due to the balance of payment crisis, and India launched a programme of economic reforms in June 1991. The economic reforms comprised wide ranging changes in trade policies, apart from industrial policies etc. These policy changes aimed at strengthening export incentives, eliminating a substantial volume of import licencing and optimal import compression. Essential imports of sensitive items were fully protected., but other imports of raw materials and components were linked to export performance through enlargement and restructuring of the replenishment licensing system. The system of cash compensatory support was abolished consequent upon the change in exchange rates and other measures of reform which provided substantial incentivesfor exports across the board.

Foreign capital and collaborations

Economic development necessitates, availability of natural resources like land, water etc., adequate levels of savings and its transformation into investment, skilled labour force and entrepreneurship; technical knowledge etc., a developing economy may have a relatively low level of savings, an unskilled labour force, limited entrepreneurship and lack of technical kno9wledge to exploit its natural resources, for economic development in terms of technology, labour skills, entrepreneurship, savings and investment. Assistance from other countries might flow in the firm of investment or technical collaboration. It may be from foreign governments, foreign private companies or international financial institutions.

In India, private foreign investment and technical collaboration have been predominant. Though government of India has always welcomed foreign investment with certain restrictions, the government policy towards foreign investment has undergone remarkable changes, since independence, from time to time. the foreign investment policy, among other things, had a major influence on the direction and flow of foreign investment and technology into the country.

Merits of foreign capital

An industrialising economy like India can greatly benefit in different ways by welcoming foreign capital into the country.

1. India can have better technology to exploit the utilised and underutilised national resources.

2. Foreign investment and technology will enable technology upgradation and modernisation of industry to improve quality and productivity.

3. Foreign investment will supplement domestic savings and capital formation and towards accelerating the rate of investment for economic development.

4. Foreign investment and technology will help to build up the much needed infrastructure for the development of agriculture and industry.

5. Foreign investment will bring marketing expertise which would enable Indian goods to penetrate the international market on a larger scale.

6. Foreign investment will promote employment generation by absorbing the relatively economical, particularly skilled labour force.

India's foreign investment policy can be classified under two periods;

1948-1990 Period: By and large during this period we find restrictive policies and regulated inflow of foreign capital and technology. In 1973 India enacted Foreign exchange Regulation Act. This legislation consolidates regulation of certain payments, dealing in foreign exchange and securities, transactions indirectly affecting foreign exchange and the import of currency, for the conservation of foreign exchange resources of the country and the proper utilisation thereof in the interest of the economic development of the country. It also put a general ceiling of 40 per cent on foreign equity participation in the country. During 1964-1990 manufacturing sector had about 40 per cent of the stock of foreign investment. Government of India nationalised foreign business organisations in banking, insurance and petroleum sectors. Even foreign enterprises engaged in plantation were nationalised but foreign investment in manufacturing sector was encouraged.

1991 later Period: This period has been characterised by remarkable liberalisation of foreign investment laws resulting in increase in foreign investment flows. In order to achieve larger role of foreign investment and technology the Foreign Exchange Regulation 1(Amendment) Act, 1993 was brought into force. In 35 groups of high priority industries, foreign investment up to 51 per cent would be approved automatically. Foreign equity participation to the extent of 24 per cent is allowed in small scale industries. The portion of equity not proposed to be held by the foreign investor can be offered to the Indian public for subscription. To facilitate foreign investments Indian government established a Foreign Investment Promotion Board.

In India there are basically two forms of foreign collaboration. The collaboration may be either financial collaboration or it may be technical. In case of financial collaboration the approving authority is the Reserve Bank of India and in the case of technical collaboration the approving authority is department of Industrial Development in the Ministry of Industry, Government of India.

By the term foreign collaboration we mean an agreement for setting up of an enterprise jointly by the foreign and native enterprises.

Foreign collaboration may take place mainly in three for7ms:

(i) Collaboration between Indian and foreign private companies;

(ii) Collaboration between Indian government companies and foreign private companies; and

(iii) Collaboration between Indian Government and foreign government.

Foreign collaboration may be of two different types:

(a) Financial Collaboration (foreign equity participation) where foreign equity alone is involved;

(b) Technical Collaboration (technology transfer) involving licensing technology by the foreign collaborator on due compensation.

Procedure for Setting up Foreign Collaboration:

As per the Government Policy and Foreign Exchange Laws prevailing in India, proposals for foreign investment and technical collaborations would require Government approval. Later on, with adoption on New Industrial Policy, 1991 and subsequent amendments of laws regulating foreign collaborations and industry, this procedure has been simplified further.

With the enactment of FEMA, foreign collaborations and investments have become much easier.

Types of collaborative arrangements

While *collaborative arrangements* allow for a greater spreading of assets across countries, the various types of arrangements necessitate trade-offs among objectives. Finding a desirable partner can be problematic. A firm has a wider choice of operating forms and partners when there is less likelihood of competition and when it has a desired, unique, difficult-to-duplicate resource.

A. Some Considerations in Collaborative Arrangements

Two critical variables that influence the choice of *collaborative arrangement* are a firm's desire for control over its foreign operations and its prior expansion into foreign ventures.

1. Control. The loss of control over flexibility, revenues and competition is a critical variable in the selection of forms of foreign operation. The more a firm depends on *collaborative arrangements*, the more likely its control will be lessened over decisions regarding quality, new product directions and production expansion.

2. Prior Expansion of the Company. If a firm already owns and controls operations in a foreign country, the advantages of *collaboration* may not be as attractive as otherwise.

B. Licensing

Under a *licensing agreement,* a firm (the *licensor*) grants rights to *intangible property* to another company (the *licensee*) to use in a specified geographic area for a specified period of time; in exchange, the *licensee* ordinarily pays a royalty to the *licensor*. Such rights may be exclusive or nonexclusive. Usually the *licensor* is obliged to furnish technical information and assistance, while the *licensee* is obliged to exploit the rights effectively and pay compensation to the *licensor*. *Intangible property* may be classified as:

- 1. patents, inventions, formulas, processes, designs, patterns;
- 2. copy rights for literary, musical, or artistic compositions;
- 3. trademarks, trade names, brand names;
- 4. franchises, licenses, contracts;
- 5, methods, programs, procedures, systems.

1. Major Motives for Licensing. Licensing often has an economic motive, such as the desire for faster start-up, lower costs, or access to additional property rights (e.g., technology). For the licensor, the risks and costs of a given venture are lessened; for the licensee, costs are less than if it had to develop a product or process on its own. **Cross-licensing** represents the situation in which companies in various countries exchange technology rather than compete with each other with every product in every market.

2. Payment. The amount and type of payment for licensing arrangements may vary. Each contract tends to be negotiated on its own merits; the bargaining range is based on dual

expectations. Both agreement-specific and environment-specific factors may affect the value of a license.

3. Sales to Controlled Entities. Many licenses are given to firms owned in part or in whole by the licensor. From a legal standpoint, subsidiaries are separate companies; thus, a license may be required in order to transfer intangible property.

C. Franchising

Franchising represents a specialized form of licensing in which the franchisor not only sells an independent franchisee the use of the intangible property essential to the franchisee's business, but also operationally assists the business on a continuing basis. In a sense, the two partners act like a vertically integrated firm because they are interdependent and each produces a part of the product that ultimately reaches the customer.

1. Organization of Franchising. A franchisor may penetrate a foreign country by dealing directly with its foreign franchisees, or by setting up a master franchise and giving that organization the right to open outlets on its own or to develop sub-franchises in the country or region.

2. Operational Modifications. Franchise success is derived from three factors: product standardization, effective cost control and high recognition. Nonetheless, franchisors face a classic dilemma: the more they standardize on a global basis, the lower the potential for product acceptance in a given country; the more they permit adaptation to local conditions, the less the franchisor can offer the franchisee, the higher the costs and the less the control by the franchisor.

D. Management Contracts

Management contract represents an arrangement in which one firm provides management personnel to perform general or specialized functions to another firm for a fee. A firm usually pursues such contracts when it believes a partner can manage certain operations more efficiently and effectively than it can itself.

E. Turnkey Operations

Turnkey operations represent a type of collaborative arrangement in which one firm contracts with another to build complete, ready-to-operate facilities. Usually, suppliers of turnkey facilities are industrial-equipment and construction companies; projects may cost billions of dollars; customers most often are government agencies or large MNEs.

F. Joint Ventures

A joint venture represents a direct investment in which two or more partners share ownership. As a firm's share of the equity declines, its ability to control a given operation also declines. A **consortium** represents the joining together of several entities (e.g., companies and governments) to combine resources and/or to strengthen the possibility of pursuing a major undertaking. Other forms of joint ventures include:

- two firms from the same country joining together in a foreign market
- a foreign firm joining with a local firm
- firms from two or more countries establishing an operation in a third country
- a private firm and a local government
- a private firm joining a government-owned firm in a third country.

G. Equity Alliances

An equity alliance represents a collaborative arrangement in which at least one of the collaborating firms takes an ownership position (usually a minority) in the other(s). The purpose of an equity alliance is to solidify a collaborating contract, thus making it more difficult to break.

There has been a remarkable upsurge in the magnitude of foreign collaboration approvals. Total number of collaborations approved during 91-91 were 9319 with a total investment of Rs.81,680 crores.

India's External Debt

The economic development of a country may be financed either by domestic savings or by allowing and encouraging foreign investment. If domestic savings are inadequate or direct foreign investments are not forth coming then the country may go for borrowing from internal or external sources. Particularly, when a country runs a current account deficit on its balance of payments and to finance the deficit it may borrow from external sources apart from encouraging foreign investments. It is normal for developing countries to run current account deficit which lead to ecternal borrowings.

India had been borrowing both from internal and external sources. The borrowing of the government is called public debt. Borrowing from internal sources is called internal debt whereas borrowing from external sources is called external debt. The growth of external debt has more serious implications that the growth of internal debt.

- Internal debt may be deferred or even annulled. The same for external debt would not only affect country's international relations but may upset further inflow of capital and disturb trade flows.

- International debt can be monetised i.e., repaid by printing money but external debt cannot be paid that way.

- Internal debt can be repaid by privatisation. But selling of assets of foreigners to repay external debt may seriously harm a country's sovereignty.

- Internal debt can be serviced if the return on capital invested more than the cost of borrowing and amortisation. In the case of external debt, however, this will not be adequate. In addition, the foreign exchange earnings of the country through exports or otherwise must rise in relation to external debt servicing.

Thus, the complexities of issues involved in external debt are different from that of internal debt. In fact the level of India's external debt and debt servicing burden have steadily gone up since independence. Simultaneously, the composition and sources of India's external debt have undergone significant changes.

India's external debt may be broadly classified under eight categories. These include multinational, bilateral, and commercial loans and cover both the government and non-government sectors. These also comprise highly concessional loans as well as loans on market terms.

1. Multilateral debt: This refers to loans and credits extended by multilateral organisations to the government or in some cases, with government guarantee to public and private sector corporate bodies. This includes long-term credits (40 years) of International Development Association and long-term loans from the World Bank or the Asian Development Bank which have market interest rates and long repayment periods (15-20 years).

2. Bilateral loans: This refers to borrowing on varying degrees of concessions from other governments. Such loans are given to the government and in some cases to public sector organisations.

3. Loans from International Monetary Fund (IMF): the IMF debt assumed significance in the early 1980s, when India started withdrawals under the Extended Fund Facility; Supplementary /financing /facility to ease out the balance of payment difficulties.

4. Export credit: this comprises buyers' credit, suppliers and export credit for defence purchases. Buyers credit and suppliers credit are treated as forms of commercial borrowings.

5. Commercial borrowings: this includes commercial borrowings abroad by corporate entities and public sector undertakings (including India Development Bonds) and loans and securitised borrowings with multilateral or bilateral guarantees. Commercial borrowing also include loans form International Finance Corporation and self-liquidating loans.

6. Non-Resident Deposits: This refers to various types of Non-Resident Deposits and Foreign Currency (Banks & others) Deposits with maturities over one year.

7. Rupee Debt: This refers to debt denomination in rupees owed to other countries and paid through exports. Rupee debt is broken up into a defence and civilian component. Since March 1990, the civilian component of rupee debt has also included rupee supplier's credit.

8. Short-term debt: this refers to debt with a maturity period of up to one year. This is usually trade related debt.

India's total external debt rose 2.8% year-on-year to $558.5 billion as on March 31, 2020, mainly due to a rise in commercial borrowings, according to a finance ministry report. The external debt stood at $543 billion at the end of March 2019. The ratio of foreign currency reserves to external debt stood at 85.5% in FY2020. At end-June 2020, India's external debt was placed at US$ 554.5 billion, recording a decrease of US$ 3.9 billion over its level at end-

March 2020. The external debt to GDP ratio increased to 21.8 per cent at end-June 2020 from 20.6 per cent at end-March 2020.
Total liabilities of the government increased to Rs 101.3 lakh crore at end-June 2020 from Rs 94.6 lakh crore at end-March 2020, according to the latest data on public debt. The total debt of the government stood at Rs 88.18 lakh crore at end-June 2019.

Self-Assessment Questions

1. Write an essay on why a developing country should engage in foreign trade.

2. Analyse major trends in the growth of India's foreign trade.

3. What is balance of payments, its significance and its composition?

4. Analyse the trade policy reforms implemented by India in the 90s and its implications.

5. In what way trade policy reforms will contribute to enhancing India's competitiveness in the international market?

6. Analyse the need for foreign capital for a developing country like India?

7. Enlist the advantages and disadvantages of foreign collaborations.

8. Describe the various kinds of external debt and the relative merits and demerits of each.

9. What are the different sources of external assistance for India?

LESSON 5

ECONOMIC REFORMS SINCE 1991

Industrial Policy of 1991

The New Industrial Policy established in 1991 sought substantially to deregulate industry so as to promote growth of a more efficient and competitive industrial economy. The central elements of industrial policy reforms were as follows: Industrial licensing was abolished for all projects except in 18 industries.

The Broad Feature of New Industrial Policy, 1991

1. The Government reduced the number of industries under compulsory licensing to six.
2. Many of the industries reserved for the public sector under the earlier policy, were de-reserved. The role of the public sector was limited only to four industries of strategic importance.
3. Disinvestment was carried out in case of many public sector industrial enterprises.
4. The share of foreign equity participation was increased and in many activities 100 per cent Foreign Direct Investment (FDI) was permitted.
5. Automatic permission was now granted for technology agreements with foreign companies.
6. Foreign Investment Promotion Board (FIPB) was set up to promote and channelise foreign investment in India.

Features of New Industrial Policy

- De-reservation of Public sector: Sectors that were earlier exclusively reserved for public sector were reduced. However, pre-eminent place of public sector in 5 core areas like arms and ammunition, atomic energy, mineral oils, rail transport and mining was continued.
    - Presently, only two sectors- Atomic Energy and Railway operations- are reserved exclusively for the public sector.
- De-licensing: Abolition of Industrial Licensing for all projects except for a short list of industries.
    - There are only 4 industries at present related to security, strategic and environmental concerns, where an industrial license is currently required-
        - Electronic aerospace and defence equipment
        - Specified hazardous chemicals
        - Industrial explosives
        - Cigars and cigarettes of tobacco and manufactured tobacco substitutes
- Disinvestment of Public Sector: Government stakes in Public Sector Enterprises were reduced to enhance their efficiency and competitiveness.

- Liberalisation of Foreign Investment: This was the first Industrial policy in which foreign companies were allowed to have majority stake in India. In 47 high priority industries, up to 51% FDI was allowed. For export trading houses, FDI up to 74% was allowed.

Today, there are numerous sectors in the economy where government allows 100% FDI.

- Foreign Technology Agreement: Automatic approvals for technology related agreements.
- MRTP Act was amended to remove the threshold limits of assets in respect of MRTP companies and dominant undertakings. MRTP Act was replaced by the Competition Act 2002.

Outcomes of New Industrial Policies

- The 1991 policy made 'Licence, Permit and Quota Raj' a thing of the past. It attempted to liberalise the economy by **removing bureaucratic hurdles** in industrial growth.
- Limited role of Public sector reduced the burden of the Government.
- The policy provided easier entry of multinational companies**,** privatisation, removal of asset limit on MRTP companies, liberal licensing.

  All this resulted in increased competition that led to lower prices in many goods such as electronics prices. This brought domestic as well as foreign investments in almost every sector opened to private sector.

- The policy was followed by special efforts to increase exports. Concepts like Export Oriented Units, Export Processing Zones, Agri-Export Zones, Special Economic Zones and lately National Investment and Manufacturing Zones emerged. All these have benefitted the export sector of the country.

Way ahead

- Industrial policies in India have taken a shift from predominantly Socialistic pattern in 1956 to Capitalistic since 1991.
- India now has a much liberalised industrial policy regime focusing on increased foreign investment and lesser regulations.
- India ranked 77th on World Bank's Doing Business Report 2018. Reforms related to insolvency resolution (Bankruptcy and Insolvency Act, 2017) and the Goods and Services Taxes (GST) are impressive and will result in long-term gains for the industrial sector.
- Campaigns such as Make in India and Start up India have helped to enhance the business ecosystem in the country.
- However, electricity shortages and high prices, credit constraints, high unit labour costs due to labour regulations, political interference and other regulatory burdens continue to remain challenges for firm growth of the industrial sector in India.
- There is a need for a new Industrial Policy to boost the manufacturing sector in the country. Government in December 2018 also felt the need to introduce a new Industrial Policy that would be a road map for all business enterprises in the country.

Constraints to Industrial Growth

- Inadequate infrastructure: Rapid growth of the economy has put further stress on infrastructure. Lack of quality industrial infrastructure has resulted in high logistics cost and has in turn affected cost competitiveness of Indian goods in global markets.
- Restrictive labour laws: The labour laws have been overly protective of the labour force in the formal sector. Though labour protection and security are required, the flipside is that it discourages employers from hiring workers on a regular basis. It has probably also led to entrepreneurs choosing to stay away from labour-intensive sectors.
- Complicated business environment: Complex and time taking business processes and clearances have been a disincentive for businesses.
- Slow technology adoption: Indian industry has been a slow adopter of new and advanced technologies. Inefficient technologies led to low productivity and higher costs adding to the disadvantage of Indian products in international markets.
- Low productivity: Workers in India are overwhelmingly employed in low productivity and low wage activities. Productivity as measured by value added per worker and average wages in manufacturing in India are only one-third of that in China.
- Challenges for trade: Manufacturing sector especially exporters are facing challenges of stagnant/shrinking global demand and rising protectionist tendencies around the world. Indian MSME sector is particularly facing tough competition from cheap imports from China and FTA countries.
- Inadequate expenditure on R&D and Innovation: Investments in these areas is essential to ensure growth in the industry. Public investments have been constrained and private investment is not forthcoming as these involve long gestation periods and uncertain returns.

Liberalisation, Globalisation and Privatisation

We need to discuss the topic basing on the economic situation that was prevailing before pre-economic crisis period i.e. between 1985 and 1990. Early 1991, India still had a fixed exchange rate system, where the rupee was pegged to the value of a basket of currencies of major trading partners. India started having balance of payments problems in 1985, and by the end of 1990, the state of India was in a serious economic crisis. The government was close to default, its central bank had refused new credit, and foreign exchange reserves had reduced to the point that India could barely finance three weeks' worth of imports.

India's New Economic Policy was announced on July 24, 1991 known as the LPG or Liberalisation, Privatisation and Globalisation model. India under its New Economic Policy approached International Banks for development of the country. These agencies asked Indian Government to open its restrictions on trade done by the private sector and between India and other countries.

These measures were undertaken to correct the inherent weakness that has developed in Balance of Payments and control the inflation. These measures were short-term in nature. Various Long-Term Structural Reforms were categorized as Liberalization, Privatization and Globalization.

The policy had three components, each impacting the economy in different ways. The main objective of the policy was to solve the problems of fiscal deficit, to liberalize foreign trade and to increase areas of operation of the private sector. The first component of the policy was liberalization i.e. removing controls and restrictions like permits, licenses, tariffs imposed by the government. It aimed at increasing internal competitiveness of industrial production, reduce debt burden and to get an opportunity to export to developed countries and import capital machinery from them. The second component of the policy was privatization which refers to the transfer of activity, function or organization from the public to the private sector. It was mainly carried out through disinvestment and the policy of the navratnas. It aimed at improving the government's financial composition, the performance of public sector undertakings and at reducing the burden on public administration. The third and final component of the model was globalization i.e. the growing economic interdependence among countries with respect to technology, capital, information, goods, services etc. Globalization aimed at enhancing integration and improving the quality of goods produced by adopting new and flexible production methods.

Liberalization

The basic aim of liberalization was to put an end to those restrictions which became hindrances in the development and growth of the nation. The loosening of government control in a country and when private sector companies' start working without or with fewer restrictions and government allow private players to expand for the growth of the country depicts liberalization in a country.

Objectives of Liberalization Policy

- To increase competition amongst domestic industries.
- To encourage foreign trade with other countries with regulated imports and exports.
- Enhancement of foreign capital and technology.
- To expand global market frontiers of the country.
- To diminish the debt burden of the country.

Privatization

This is the second of the three policies of LPG. It is the increment of the dominating role of private sector companies and the reduced role of public sector companies. In other words, it is the reduction of ownership of the management of a government-owned enterprise. Government companies can be converted into private companies in two ways:

- By disinvestment
- By withdrawal of governmental ownership and management of public sector companies.

Forms of Privatization

- *Denationalization or Strategic Sale*: When 100% government ownership of productive assets is transferred to the private sector players, the act is called denationalization.

- *Partial Privatization or Partial Sale*: When private sector owns more than 50% but less than 100% ownership in a previously construed public sector company by transfer of shares, it is called partial privatization. Here the private sector owns the majority of shares. Consequently, the private sector possesses substantial control in the functioning and autonomy of the company.

- *Deficit Privatization or Token Privatization:* When the government disinvests its share capital to an extent of 5-10% to meet the deficit in the budget is termed as deficit privatization.

Objectives of Privatization

- Improve the financial situation of the government.
- Reduce the workload of public sector companies.
- Raise funds from disinvestment.
- Increase the efficiency of government organizations.
- Provide better and improved goods and services to the consumer.
- Create healthy competition in the society.
- Encouraging foreign direct investments (FDI) in India.

Globalization

It means to integrate the economy of one country with the global economy. During Globalization the main focus is on foreign trade & private and institutional foreign investment. It is the last policy of LPG to be implemented.

Globalization as a term has a very complex phenomenon. The main aim is to transform the world towards independence and integration of the world as a whole by setting various strategic policies. Globalization is attempting to create a borderless world, wherein the need of one country can be driven from across the globe and turning into one large economy.

Outsourcing as an Outcome of Globalization

The most important outcome of the globalization process is Outsourcing. During the outsourcing model, a company of a country hires a professional from some other country to get their work done, which was earlier conducted by their internal resource of their own country.

The best part of outsourcing is that the work can be done at a lower rate and from the superior source available anywhere in the world. Services like legal advice, marketing, technical support, etc. As Information Technology has grown in the past few years, the outsourcing of contractual work from one country to another has grown tremendously. Because of communication's wider reach, all economic activities have expanded globally.

Various Business Process Outsourcing companies or call centres, which have their model of a voice-based business processes have developed in India. Activities like accounting and bookkeeping services, clinical advice, banking services or even education are been outsourced from developed countries to India.

The most important advantage of outsourcing is that big multi-national corporate or even small enterprises can avail good services at a cheaper rate as compared to their country's standards. The skill set in India is considered most dynamic and effective across the world. Indian professionals are best at their work. The low wage rate and specialized personnel with high skills have made India the most favourable destination for global outsourcing in the later stage of reformation.

Financial Sector Reforms

Financial sector reforms refer to the reforms in the banking system and capital market.

An efficient banking system and a well-functioning capital market are essential to mobilize savings of the households and channel them to productive uses. The high rate of saving and productive investment is essential for economic growth. Prior to 1991 while the banking system and the capital market had shown impressive growth in the volume of operations, they suffered from many deficiencies with regard to their efficiency and the quality of their operations.

Under these reforms, attempts have been made to make the Indian financial system more viable, operationally efficient, more responsive and improve their allocative efficiency. Financial reforms have been undertaken in all the three segments of the financial system, namely banking, capital market and Government securities market.

1. Reduction in Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR):

An important financial reform has been the reduction in Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) so that more bank credit is made available to the industry, trade and agriculture. The statutory liquidity ratio (SLR) which was as high as 39 per cent of deposits with the banks has been reduced in a phased manner to 25 per cent.

2. End of Administered Interest Rate Regime:

A basic weakness of the Indian financial system was that interest rates were administered by the Reserve Bank/Government. In the case of commercial banks, both deposit rates and lending rates were regulated by Reserve Bank of India. Before 1993, rate of interest on Government Securities could be maintained at low levels through the means of high Statutory Liquidity Ratio (SLR).

Under SLR regulation commercial banks and certain other financial institutions were required by law to invest a large proportion of their liabilities in Government securities. The purpose behind the administered interest-rate structure was to enable certain priority sectors to get funds at concessional rates of interest. Thus the system of administered interest rates involved cross subsidization; concessional rates charged from primary sectors were compensated by higher rates charged from other non-concessional borrowers.

Lending rates of interest for different categories which were earlier regulated have been gradually deregulated. However, RBI insists upon transparency in this regard. Each bank is required to announce prime lending rates (PLRs) and the maximum spread it charges. Maximum spread refers to the difference between the lending rate and bank's cost of funds.

Interest on smaller loans up to Rs. 2,00,000 are regulated at concessional rates of interest. At present, the interest rate on these smaller loans should not exceed the prime lending rates. Besides, lending interest rates for exports are also prescribed and are linked to the period of availment. Changes in prescribed interest rates for exports have been often used as an instrument to influence repatriation of export proceeds.

3. Prudential Norms: High Capital Adequacy Ratio:

In order to ensure that financial system operates on sound and competitive basis, prudential norms, especially with regard to capital-adequacy ratio, have been gradually introduced to meet the international standards. Capital adequacy norm refers to the ratio of paid-up capital and reserves to deposits of banks. The capital base of Indian banks has been very much lower by international standards and in fact declined over time.

4. Competitive Financial System:

After nationalization of 14 large banks in 1969, no bank had been allowed to be set up in the private sector. While the importance and role of public sector banks in Indian financial system continued to be emphasised, it was however recognized that there was urgent need for introducing greater competition in the Indian money market which could lead to higher efficiency of the financial system.

A foreign bank may operate in India through any one of three channels, namely:

(1) As branches of foreign banks,

(2) A wholly owned subsidiary of a foreign bank,

(3) A subsidiary with aggregate foreign investment up to the maximum of 74 per cent of the paid-up capital.

5. Non-Performing Assets (NPA) and Income Recognition Norm:

Non-performing assets of banks have been a big problem of commercial banks. Non-performing assets mean bad loans, that is, loans which are difficult to recover. A large quantity of non-performing assets also lowers the profitability of bank. In this regard, a norm of income recognition introduced by RBI is worth mentioning. According to this, income on assets of a bank is not recognized if it is not received within two quarters after the last date.

6. Elimination of Direct Credit Controls:

Another significant financial sector reform is the elimination of direct or selective credit controls. Selective credit controls have been done way with. Under selective credit controls RBI used to control through the system of changes in margin for provision of bank credit to traders against stocks of sensitive commodities and to stock brokers against shares. As a result, there is now greater freedom to both the banks and borrowers in respect of credit.

7. Promoting Micro-Finance to Increase Financial Inclusion:

To promote financial inclusion the government has started the scheme of micro finance. RBI provides guidelines to banks for mainstreaming micro-credit providers and enhancing the outreach of micro-credit providers inter alia stipulated that micro-credit extended by banks to individual borrowers directly or through any intermediary would henceforth 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 model(s) or choose any conduit/intermediary for extending micro-credit.

Extension of Swabhimaan Scheme: Under the Swabhimaan financial inclusion campaign, over 74,000 habitations with population in excess of 2,000 had been provided banking facilities by March 2012, using various models and technologies including branchless banking through business correspondents (BCs). The Finance Minister in his Budget Speech of 2012-13 had announced that Swabhimaan would be extended to habitations with population more than 1,000 in the north-eastern and hilly states and population more than 1,600 in the plains areas as per Census 2001.

8. Setting up of Rural Infrastructure Development Fund (RIDF):

The Government of India set up the RIDF in 1995 through contribution from commercial banks to the extent of their shortfall in priority sector lending by banks with the objective of giving low cost fund support to states and state-owned corporations for quick completion of ongoing projects relating to medium and minor irrigation, soil conservation, watershed management, and other forms of rural infrastructure.

Termination of Automatic Monetisation of Budget Deficits:

This is significant reforms measure to put a check on the growing fiscal deficit of the Central Government. Before 1997 whenever there was a deficit in Central Government budget this was financed by borrowing from RBI through issuing of ad hoc treasury bills. RBI issued new notes against these treasury bills and delivered them to the Central Government.

Fiscal sector reforms

The fundamental function of any monetary and financial system, no matter how simple or complex, is to promote efficiency in the processes of exchange of trade in real goods and services, and thus to contribute to economic welfare. This statement suggests several related questions. In what ways is the exchange of real goods and services beneficial? How does money and finance promote efficiency in trade? What is meant by efficiency in this context?

Let us take the efficiency part of the discussion first. There are two types of efficiency (a) transactions or operational efficiency, and (b) allocational efficiency. Transactional or operational efficiency refers to economising on the use of scarce resources in carrying out the exchange process. The exchange process is not costless in real terms. It requires the time and energy of traders themselves, the services of brokers and others, materials and and supplies, and the land and equipment to perform the required functions of gathering and analysing information concerning trading opportunities, consummating trade transactions and settling trade accounts. Obviously, scarce resources used to effect transactions are not available to satisfy other wants. Also, high costs reflecting inefficiencies in transactions usually lead to a sacrifice of some allocational efficiency. Allocational efficiency is the degree to which potential gains from trade are exploited. Complete allocational efficiency would mean that all opportunities for potential gains from trade are exploited; and no opportunities remain unexploited so that at least one party feels “better off” without making the other feel “worse off”. In economics this is known as pareto efficiency.

Basic functions of money

Primary functions

Money as a Unit of Value: The money unit serves as the unit in terms of which the value of all goods and services is measured and expressed (i.e. as rupee, or dollar, or mark, or pound etc.) the value of goods and services can be expressed as a price which implies the number of monetary units for which it will exchange. The real value of the money unit is subject to fluctuation.

Money as a medium of exchange: Money is generally referred to as the generalised purchasing power or as bearer of options (since there is a choice in the use of money) this function of money is served by anything which is generally accepted by people exchange for goods and services. In earlier days copper or gold coins served as money. In modern days, however, paper currency, and cheques against commercial banks, current and savings deposits function as the major forms of money. In the well-developed financial system credit cards have become a very important form of payment.

Derivative functions

Money as a standard of differed payments: Modern economic systems require the existence of a large volume of contracts where payment of principal and interest on debt as future payments are in terms of monetary units.

Monetary as a store of value: the holding of money is, in effect, the holding of generalised purchasing power. The holder of money is aware of its universal acceptance any time. Also the value of money remains constant in itself over time. Money is thereby an ideal store of value with which contingencies as well as speculative motives may be satisfied.

Indian Financial System

The Indian financial system may be divided in to organised and unorganised segments. The organised market consists of commercial banks, development banks, co-operative banks, post office savings bank operations, stock markets etc. Unorganised financial market operations consist of hundis, money lending, chit funds etc. they operate mainly in the rural areas. However in the urban areas also unorganised money market activities are quite significant. There is no precise estimate of the size of the unorganised money market. It is generally expected that the relative size of the unorganised money market transactions would decline over time.
Banking operations in India are controlled by the Reserve Bank of India. The primary role of the RBI is to maintain a monetary equilibrium and balance in the economy by formulating various policies form time to time and controlling the financial instruments of the economy. The monetary liabilities of RBI consist of currency in circulation and commercial banks’ deposits with the RBI.

1. Net RBI credit to the government

As banker to the government, RBI provides credit to the central government and the state governments. This is done by investing in government securities (including treasury bills of the central government) and through the short-term advances to state governments. Until recently the central government was empowered to borrow any amount from RBI through treasury bills and rupee securities. In recent years the government has made some restrictions on the amount of borrowing from RBI. In the case of state governments, RBI had put restrictions on borrowing even earlier.

2. RBI provides credit to commercial banks through loans and advances against government securities, use of bills or promissory notes as collateral and through purchase of rediscounting of internal commercial bills as well as treasury bills. However the RBI does not regard its purchase or rediscounting bills for banks as part of its credit to banks. Instead it classifies it as RBC to whatever sector or commercial or government, which issued the bills in the first instance.

3. RBI credit to Development Banks

A large number of development banks had been established in the country through the initiative and help of RBI for the provision of long and medium term finance to industry and agriculture. RBI provides them credit by investing in their securities and through loans. Prominent development banks created through RBI are, Industrial Bank of India (IDBI), Industrial Financial Corporation of India (IFCI) and National Bank for Rural Development (NABARD)

4. Net Foreign Assets of RBI

These assets constitute foreign currency reserves of RBI and therefore represent RBC to the foreign sector (because of the financial liabilities of the foreign governments). Most of these assets held abroad are in the form of foreign securities and cash balances. The RBI comes to acquire as the custodian of the country's foreign exchange reserves. As the controller of all foreign exchange transactions, whether on private or government account,. it regularly bu foreign exchangeys and sells foreign exchange against Indian currency.

5. The net RBC to the above four sectors namely, government, commercial banks, development banks and foreign sector, is financed by RBI partly creating its monetary liabilities and partly by its net non-monetary liabilities.

Development banks

As the name suggests, development banks are development oriented. Development banks are specialised financial institutions which perform the twin functions of providing medium and long term finance to private entrepreneurs and of performing various promotional roles conducive to economic development. They are different from commercial banks in three ways.

1. They do not seek or accept deposits form the public,

2. They specialise in providing medium and long-term finance,

3. Their functions are confined to providing long-term loans.

There are four main categories of development banking in India as stated hereunder;

1. Industrial Development Bank
2. EXIM (export-import) Bank
3. Agricultural Development Banks (NABARD)
4. Housing Development Banks (HDFC)

Development banks provide financial assistance to industry in the following forms;

i) Term loans and advances

ii) Subscription to shares and debentures

iii) Underwriting of new issues

iv) Guarantees for term loans and deferred payments.

Commercial Banks

Commercial banks are single most important source of institutional credit in india. There are two essential functions which make a financial institution a bank; accepting deposits and lending. Commercial banks are the single largest source of institutional credit in India. Public sector banks constitute the dominant part of commercial banking.

Economic Reforms and Social Justice

The growth should be accompanied by social justice. It would be in the fitness of things to make an assessment of economic reforms, especially its impact on the common man, in terms of more employment opportunities, stabilisation of prices of articles of essential consumption or control of inflation, a better spread of growth benefiting the weaker sections of the society, in other words, its effect on social justice.

It is stated that there existed deep-rooted inequalities in Indian society and the economic reform policies initiated by the government since 1991 further aggravated the inequalities. Reforms have led to an increase in the income of those who were already rich. Quality of consumption of only high income group increased, economic growth has not trickled down to the poorer sections of the society. Growth has been concentrated only in some selected areas in the service sector such as telecommunication, information technology, finance entertainment, travel, hospitality services, real estate and trade. Vital sectors such as agriculture and industry which provide livelihoods to millions of people in the country have not been benefited much from reforms thereby increasing income disparities. Besides, large scale production has been promoted under reforms at the cost of small scale industries again leading to concentration of economic power with large Industrial houses and MNCs. Reforms have led to an increase in the income of those who were already rich. Quality of consumption of only high income groups increased, **economic** growth has not trickled down to the poorer sections of the society. If the economic reforms have given us an opportunity in terms of greater access to global markets and high technology, it has also compromised the welfare of people belonging to poorer section.

In the economic survey conducted by government of India in 1995-96 it is stated that despite the deep economic crisis in 1991-92, average growth rate over the first four years of the Eighth Plan at 5.7 per cent is higher than the plan target of 5.6 per cent. This is remarkable post-crisis achievement by international standards. The average annual growth rate of GDP worked out to 4.7 per cent for the period 1990-91 to 1995-96 as against 6.4 per cent for the preceding five year period (1985-86 to 1989-90). Though the economy picked up, it cannot be stated with confidence that the economy would be able to achieve a growth rate of 7 per cent per annum in the ninth Plan (1997-2002).

It is more appropriate to discuss the impact of economic reforms on proverry in the context of social justice. It is claimed by the government at the proportion of population below the poverty line declined from 25.49 per cent in 1987-88 to 18.96 per cent in 1993-94. The lower incidence of poverty in 1993-94, despite the intervening crisis of 1991-92, suggests that the various policies and programmes adopted in the process of economic reforms have helped the poor in the country. However, Dr. S.P.Gupta, Director of ICRIER disputed the government figures and stated that the total number of poor increased from298 million in 1990-91 to 39 per cent 346 million in 1993-94.

As regards economic reforms and employment, the economic survey mentions that the government has accorded the highest priority to promoting sustainable employment intensive growth in its economic reform policies. As a result, the total employment growth in the economy is estimated to be about 7.2 million in 1994-95 as compared to only 3 million in the year of 1991-92. Eighth Plan envisaged the employment potential would grow about 2.6 per cent per annum. In absolute terms it implies about the generation of 8 million jobs per annum during the first couple of years of Eighth Plan, and about 9 million jobs per year during the latter years, and more than 10 million jobs per year in the post-Eighth Plan period.

Social security is another aspect to be discussed in the economic reforms. Social security has three aspects namely, food security, employment security and health security. Food security after economic reforms was stated to be poor because of continuous rise in prices of food grains, more especially of consumer price index of agricultural labourers, remaining above the double digit level also adversely affected food security. Lower level of employment and continuous rise in consumer price index made the agricultural labour suffer.

The new economic reforms encourage multinationals to enter into food processing industries which led to labour displacement. The entry of big business in agriculture has also led to displacement of labour engaged in the marketing of agricultural produce. The mechanise boats in fishing threatened the livelihood of fisherman.

Healthy security is another aspect that we have to discuss under social justice. As a result of the process of economic reform privatisation of health service is recommended. As a result the charges of private hospitals shoot up. The average payment for private hospitals in rural areas was Rs.735 as against Rs.304 for government hospitals i.e. 2.3 times more than the charges of government hospitals. In urban areas, the situation was even worse. Private hospitals charged Rs.1,206 as against the government hospitals charging Rs.365. In other words, chares in private hospitals in urban areas were 3.13 times more than the government hospitals. Privatisation is thus bound to affect adversely the maintenance cost of health services for the poor. This has been compounded by the fact that in view of the patent rights payments to be made to patent holders, viz, multinational corporations, the cost of medicines has been rising under the new economic reforms.

From the on-going analysis, it may be concluded that economic reforms seem to be better in terms of growth, but have failed on the front of social justice., since neither poverty nor employment situation has improved. Failure to control inflation in terms of the consumer price index rising on an average by over 10 per cent per annum during 1991-92 to 1995-96 has serious welfare implications. Moreover, economic reforms have a narrow focus since they are concerned with the corporate sector only and have neglected agriculture. Introduction of high capital technology to meet the global competitiveness and modernisation led to retrenchment of labour.

Self-Assessment questions

1. What are the functions of money?

2. Describe the present Indian financial system.

3. What are the basic objectives of fiscal policy

4. Discuss the impact of economic reforms on poverty and employment.

5. List three major achievements and four major failures of economic reforms.