BUSINESS ENVIRONMENT

M.Com. (Previous)

Paper-III

Directorate of Distance Education
Maharshi Dayanand University, Rohtak

Business Environment

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M.Com (P)

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Maharshi Dayanand University
ROHTAK – 124 001

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M. Marks : 100
Time : 3 Hrs.

Note: There will be three sections of the question paper. In section A there will be 10 short answer questions of 2 marks each. All questions of this section are compulsory. Section B will comprise of 10 questions of 5 marks each out of which candidates are required to attempt any seven questions. Section C will be having 5 questions of 15 marks each out of which candidates are required to attempt any three question. The examiner will set the questions in all the three sections by covering the entire syllabus of the concerned subject.

Course Inputs

UNIT–I Theoretical Framework of Business Environment Concept, Significance and nature of business environment; Elements of environments internal and external; Changing dimensions of business environment, Techniques of environmental scanning and monitoring. Dualism in Indian Society and problem of uneven distribution of income; Emerging rural sector in India; Social responsibilities of Business; Consumerism in India; Consumer Protection Act.

UNIT–II Economic System and Business Environment, Economic Planning in India–Types of Economic Plan; Prerequisties of Successful economic planning; Latest Five Year Plan; Economic Reforms in India; Industrial Policy–policy of pre and post liberalization era; Industries (Development and Regulation) Act; Competition Policy and Competition Acts.

UNIT–III Public Sector-Objectives, pattern of growth; Changing role of public sector, Priviatization and Disinvestments of public enterprises; Pricing policies in public enterpirises; Fiscal policy, Monetary policy, Problem of NPA in the Banking sector; SEBI-functions, objectives; SEBI guidelines for fresh issue of shares, debentures and bonus shares.

UNIT–IV Government Business Relationship-Roles of government in business, Economic Implications of Indian Constitution- Preamble, Directive Principles of State Policy, Fundamental Rights, Centre-state relationship;

Small Scale Industries-Importance, Problems and Policies; Industrial Sickness-problem, magnitude and remedies.

UNIT–V Foreign Investment Policy; FEMA; Multinational Corporations and its role; EXIM Policy (Latest): An overview of International Economic Institutions and their working-WTO, IMF, Workd Bank.

UNIT-I

CHAPTER-1:
CONCEPT OF BUSINESS ENVIRONMENT

Environment literally means the surroundings, external objects, influences or circumstances under which someone or something exists. The environment of any organisation is "the aggregate of all conditions, events and influences that surround and affect it".1 Since the environment influences an organisation in multitudinous ways, it is of crucial importance to understand it. The concept of environment can be understood by looking at some of its characteristics. But before we do that, let us recount ten events and influences, in Exhibit 1.1 that have shaped business and industry in post-independence India.

Business World has recounted 25 events that shaped business, out of which we have picked up ten that happened after India attained independence. These events offer an interesting insight into how the business environment has been formed.

Independence and partition (1947). Muslim businessmen migrate to Pakistan; most jute mills are lost to East Pakistan and the fertile wheat and cotton fields of Punjab to West Pakistan; the merchant city of Karachi is lost forever; most British firms quit India

Establishment of Industrial Finance Corporation of India (IFCI) (1948). IFCI is set up to provide state funds for industrialisation. Starting a long chain of state intervention in business and industry

First five-year plan (1951). State-directed planning commences in the form of five-year plans with the state taking p entrepreneurial functions based on the ideology of what has come to be known as 'Nehruvian socialism.

The Mundhra scandal (1957). India's first major scam created public outcry when a businessman rigged the share prices of his company; the finance minister owned responsibility for the systemic lapse.

First Indian heads an MNC(1961). Prakash Tandon becomes the chairman of Hindustan Lever indicating the growing importance of the Indian managerial class.

Brain drain (1965 onwards). Indian scientists and technologists start migrating to the western countries in search of opportunity and earnings.

Licensing era (1965-73). The license raj, started in 1956, resulted in severe restrictions on industry, private investments, and managerial action

First Reliance public issue (1977). The first public issue for the shares of Reliance Industries heralds the equity culture in India.

Telecom revolution (1986). Sam Pitroda, the technology advisor to the youthful prime minister Rajiv Gandhi, leads the transition to the digital switching system which started the telecom revolution in India.

Liberalisation (1991 onwards). Manmohan singh, as the finance minister in Narasimha Rao's ministry, starts the process of liberalisation and globalisation marting a sharp turn of events in the course of India's industrial history.

Source: Based on "25 events that shaped business", Business World, Jan,3, 2000, pp 10-12.

Significance of Business Environment

Business environment is playing a very important role to boost up the economy of the country. Therefore, role of Business environment cannot be avoid to build a prosperous and progressive business structure. Business environment are directly or indirectly affect the business due to change in economic, political, socio-culture and natural factor. Some important point are given below which shows the significance of business environment

1. **Dynamic nature of Environment**

   Everyday environment is changing for business purposes due to change in either central government or state government which result amendment in economic policy and introducing new policy.

2. **Business threats and solution**

   Threats directly affect the business which indicates the success or failure of business. Before starting the business to find out the solution of business threats for a successful entrepreneurs.

3. **Structure of Economy**

   A large portion of business depends upon the structure of economy. A capitalism economy are in favour of capitalistic and maximum business are concentrated in the hands of capitalistic. A mixed economy supports the both type of business i.e capital intensive and labour intensive techniques.

4. **To Know the internal knowledge of business**

   Knowledge of internal environment like labour, raw material organization etc. is a essential qualification of a businessman.

5. **Govt. Policies**

   Govt. policies are directly affect the business environment. It means that before starting the business every type of policy like Industrial policy, licensing policy fiscal policy, foreign investment policy etc. must examined and take decision as per policies.

6. ***Optimum Utilisation of resources***

   Optimum Utilisation of resources can not be possible without favourable business environment.

7. **Change in Technology and Technique**

   A business should take decision regarding the future plans in the light of change in business environment due to change in technology and techniques.

8. **Conditions of market**

   Business environment provides us information regarding the condition of market either favourable or unfavourable. A new business should not start if condition of market is not favourable for a particular business.

9. **Attitude of customer**

   Business environment decides the changing attitudes of customer for a particular or general demand and supply. Business produce the product as per the demand and supply.

10. **Foreign countries policies**

    Foreign policies and organization also change the business environment of a country. Consequently, India liberalized also type of policies which totally change the Indian business.

Nature of Environment

Business environment (or simply environment) exhibits many characteristics. Some of the important, and obvious, characteristics are briefly described here.

1. **Environment is complex.** The environment consists of a number of factors, events, conditions, and influences arising from different sources. All these do not exist in isolation but interact with each other to create entirely new sets of influence. It is difficult to comprehend at once what factors constitute a given environment. All in all, environment is a complex phenomenon relatively easier to understand in parts but difficult to grasp in its totality.
2. **Environment is dynamic.** The environment is constantly changing in nature. Due to the many and varied influences operating, there is dynamism in the environment, causing it to change its shape and character continuously.
3. **Environment is multi-faceted.** What shape and character an environment will assume depends on the perception of the observer. A particular change in the environment, or a new development, may be viewed differently by different observers. This is seen frequently when the same development is welcomed as an opportunity by one company while another company perceives it as a threat.
4. **Environment has a far-reaching impact.** The environment has a far-reaching impact on organisations. The growth and profitability of an organisation depends critically on the environment in which it exists. Any environmental change has an impact on the organisation in several different ways.

Since the environment is complex, dynamic, multi-faceted, and has a far-reaching impact, dividing it into external and internal components enables un to understand it better. But before we do that it is important to understand that strategic management is becoming increasingly conscious of the nature that affects organisations and environment.

Types of Environment

On the basis of the intimacy with the firm, the environmental factors may be classified in to different types or levels. An indicated above, there are, broadly, two types of environment, the internal, environment, i.e., factors internal to the firm and external environment, i.e., factors external to the firm which have relevance to it.

The internal factors are generally regarded as controllable factors because the company has control over these factors; it can alter or modify such factors as its personnel, physical facilities, organisation and functional means, such as marketing mix, to suit the environment.

The external factors, on the other hand, are by and large, beyond the control of a company. The external or environmental factors such as the economic factors, socio-cultural factors, government and legal factors, demographic factors, geo-physical factors etc., are, therefore, generally regarded as uncontrollable factors.

It may, however, be noted that a firm may not sometimes have complete control over all the internal factors. Also, it is some times possible to change certain external factors.

Some of the external factors have a direct and intimate impact on the firm (like the suppliers and distributors of the firm). These factors are classified as micro environment, also known as task environment and operating environment. These are other external factors which affect an industry very generally (such as industrial policy, demographic factors etc.). They constitute what is called macro environment, general environment or remote environment.

We may, therefore consider the business environment at three levels.

- Internal environment
- Micro environment/task environment/operating environment.
- Macro environment/general environment/remote environment.

Although business environment consists of both the internal and external environments, many people often confine the term to the external environment of business. In this book too, in the subsequent chapters, the term refers mostly to external environment of business.

Internal Environment

The important internal factors which have a bearing on the strategy and other decisions are outlined below.

Value System

The value system of the founders and those at the helm of affairs has important bearing on the choice of business, the mission and objectives of the organisation, business policies and practices. It is a widely acknowledged fact that the extent to which the value system is shared by all in the organization is an important factor contributing to success.

The value system of JRD Tata and the acceptance of it by others who matter were responsible for the voluntary incorporation in the Articles of Association of TISCO its social and moral responsibilities to consumers, employees, shareholders, society and the people.

After the EID Parry group was taken over by the Murugappa group, one of the most profitable businesses (liquor) of the ailing Parry group was sold off as the liquor business did not fit into the value system of the Murugappa group.

The value system and ethical standards are also among the factors evaluated by many companies in the selection of suppliers, distributors, collaborators etc.

Mission and Objectives

The business domain of the company, priorities, direction of development, business philosophy, business policy etc., are guided by the mission and objectives of the company. Ranbaxy's thrust in to the foreign markets and development have been driven by its mission "to become a research based international pharmaceutical company". Arvind Mills' mission – "To achieve global dominance in select businesses built around our core competencies through continuous product and technical innovation, customer orientation and focus on cost effectiveness", - has driven its future development strategy including the portfolio strategy, and indicated the thrusts required in the functional areas to help achieve the mission.

Management Structure and Nature

The organisational; structure, the composition of the Board of Directors, extent of professionalisation of management structures and styles delay decision making while some others facilitate quick decision making.

The Board of Directors being the highest decision making body which sets the direction for the development of the organisation and which overseas the performance of the organisation, the quality of the Board is a very critical factor for the development and performance of company. The private sector in India presents extreme cases in this respect. At one end there are companies with highly qualified and responsible Board and at the other end there are companies which do not possess these qualities.

The share-holding pattern could have important managerial implication. There are very large companies where majority of the share is held by the promoters (like Wipro) and there are large firms where the promoters' position is very vulnerable (like the Tata group of companies).

Financial institutions have large share holding in many Indian companies. The stand of nominees of financial institutions could be very decisive in several critical instances.

Internal Power Relationship

Factors like the amount of support the top management enjoys from different levels of employees, shareholders and Board of Directors have important influence on the decision and their implementation.

The relationship between the members of Board of Directors and between the chief executive and the Board are also a critical factors

Human Resources

The characteristics of the human resources like skill, quality, morale, commitment, attitude etc., could contribute to the strength and weakness of an organisation. Some organisation find it difficult to carry out restructuring or modernisation because of resistance by employees whereas they are smoothly done in some others.

The involvement, initiative etc., of people at different levels may very from organisation to organisation. The organisational culture and overall environment have bearing on them. John Towers, M.D.. Rover Group. observer that a Japanese company of 30,000 employees is 30,000 process improvers. In a Western company. it is 2,000 process improvers and 28,000 workers.1 And in an Indian company?

Company Image and Brand Equity

The image of the company matters while raising finance, forming joint ventures or other alliances, soliciting marketing intermediaries, entering purchase or sale contracts, launching new products etc. Brand equity is also relevant in several of these cases.

Miscellaneous Factors

There are a number of other internal factors which contribute to the business success/ failures or influence the decision-making. They include the following

1. Physical Assets and Facilities like the production capacity technology and efficiency of the productive apparatus, distribution logistics etc., are among the factors which influence the competitiveness of a firm. For example, as quality is very important in the pharmaceutical industry, particularly for a global player, in the case of Core Healthcare not only there is no compromise on quality but also the company made the quality norms stricter than international or other relevant standards and the quality mantra has been well imbibed throughout the organisation.
2. R & D and Technological Capabilities, among other things, determine a company's ability to innovate and compete.
3. Marketing Resources like the organinsation for marketing, quality of the marketing men, brand equity and distribution network have direct bearing on marketing efficiency. They Are important also for brand extension, new product introduction etc.
4. Financial Factors like financial policies, financial position. Capital structure are also important internal environment effecting business performances, strategies and decisions.

External Environment

As stated earlier, the external business environment consists of a micro environment and a macro environment.

Micro Environment

As indicted earlier, the micro environment is also known as the Task Environment and Operating Environment because the micro environmental forces have a direct bearing on the operations of the firm.

"The micro environment consists of the actors in the company's immediate environment that affect the performance of the company. These include the suppliers, marketing intermediaries, competitors, customers and the publics."2 The macro environment consists larger societal forces that affect all the actors in the company's micro environment – namely, the demographic, economic, natural, technical, political and cultural forces."3

It is quite obvious that the micro environmental factors are more intimately linked with the company than the macro factors. The micro forces need not necessarily affect all the firms in a particular industry in the same way. Some of the micro factors may be particular to a firm. For example, a firm which depends on a supplier may have a supplier environment which is entirely different from that of a firm whose supply source is different. When competing firms in an industry have the same micro elements, the relative success of the firms depends, inter alia, on their relative effectiveness in dealing with these elements.

Suppliers

An important force in the micro environment of a company is the suppliers, i.e., those who supply the inputs like raw materials and components to the company. The importance of reliable source/sources of supply to the smooth functioning of the business is obvious. Uncertainty regarding the supply or other supply constraints often compel companies to maintain high inventories causing cost increases. It had been pointed out that factories in India maintained indigenous stocks of 3-4 months and imported stocks of 9 months as against an average of a few hours to two weeks in Japan.4 The liberalization, however, has caused a significant change in the situation.

Because of the sensitivity of the supply, many companies give high importance to Vendor development. Vertical integration, where feasible, helps solve the supply problem. For example, Nirma has always been a believer of the logic that captive production plants for raw materials is the best way to production costs in check and it has gone for a mammoth backward integration. In many cases, however, outsourcing is more beneficial.

It is very risky to depend on a singly supplier because a strike, lock out or any other production problem with that supplier may seriously affect the company. Similarly, a change in the attitude or behaviour of the supplier may also affect the company. Hence, multiple sources of supply often help reduce such risks.

The supply management assumes more importance in a scarcity environment. "Company purchasing agents are learning how to "wine and dine" suppliers to obtain favourable treatment during periods of shortages. In other words, the purchasing department might have to "market" itself to suppliers."5

Recognising the critical importance of the supply factor, companies all around the world are increasingly resorting to partnering / relationship marketing. (For details see the author's Business Marketing (Himalaya Publishing House). Partnering is becoming more and more international and this provides a challenging opportunity for Indian suppliers to become international players.

Customers

As it is often exhorted, the major task of a business is to create and sustain customers. A business exists only because of its customers. Monitoring the customer sensitivity is, therefore, a prerequisite for the business success.

A company may have different categories of consumers like individuals, households, industries and other commercial establishments, and government and other institutions. For example, the customers of a tyre company may include individual automobile owners, automobile manufacturers, public sector transport undertakings and other transport operators.

Depending on a single customer is often too risky because it may place the company in a poor bargaining position, apart from the risks of losing business consequent to the winding up of business by the customer or due to the customer's – switching over to the competitors of the company.

The choice of the customer segments should be made by considering a number of factors including the relative profitability, dependability, stability of demand, growth prospects and the extent of competition.

With the growing globalisation, the customer environment is increasingly becoming global. Not only that the markets of other countries are becoming more open, the Indian market is becoming more exposed to the global competition and the Indian customer is becoming more "global" in his shopping.

Competitors

A firm's competitors include not only the other firms which market the same or similar products but also all those who compete for the discretionary income of the consumers. For example, the competition for a company's television may come not only from other T.V. manufacturers but also from two-wheelers, refrigerators, cooking ranges, stereo sets and so on and from Firms offering savings and investment schemes like banks, Unit Trust of India, companies accepting public deposits or issuing shares or debentures etc. This competition among these products may be described as desire competition as the primary task here is to influence the basic desire of the consumer. Such desire competition is generally very high in countries characterised by limited disposable incomes and many unsatisfied desires (and, of course, with many alternatives for spending/ investing the disposable income).

If the consumer decides to spend his discretionary income on recreation (or recreation cum education) he will still be confronted with a number of alternatives to choose from like T.V., stereo, two-in-one etc, three-in-one etc. The competition among such alternatives which satisfy a particular category of desire is called generic competition.

If the consumer decides to go in for a T.V., the next question is which form of the T.V.- black and white or colour with remote control or without it etc. In other words, there is a product form competition. Finally, the consumer encounters the brand competition i.e., the competition between the different brands of the same product form.

An implication of these different demands is that a marketer should strive to create primary and selective demand for his products.

Consequent to the liberalisation the competitive environment environment in India has been undergoing a sea change. Many companies restructured their business portfolio and strategies. In many industries where a seller's market existed a buyer's market has emerged.

The competitive environment is detailed in the section Competitive Structure of Industries later in this chapter.

Marketing Intermediaries

The immediate environment of a company may consist of a number of marketing intermediaries which are "firms that aid the company in promoting, selling distributing its goods to final buyers".[6]

The marketing intermediaries include middlemen such as agents and merchants who "help the company find customers or close sales with them"[7], physical distribution firms which "assist the company in stocking and moving goods from their origin to their destination"8 such as warehouses and transportation firms; marketing service agencies which "assist the company in targeting and promoting its products to the right markets"9 such as advertising agencies, marketing research firms, media firms and consulting firms; and financial intermediaries which finance marketing activities and insure business risks.

Marketing intermediaries are vital links between the company and the final consumers. A dislocation or disturbance of the link, or a wrong choice of the link, may cost the company very heavily. Retail chemists and druggists in India once decided to boycott the / products of a leading company on some issue such as poor retail margin. This move for collective boycott was, however, objected to by the MRTP Commission; but for this the company would, perhaps, have been in trouble. Hindustan Lever too faced major challenge when it faced a collective boycott in Kerala on the issue of trade margin.

Financiers

Another important micro environment factor is the financiers of the company. Besides the financing capabilities, their policies and strategies, attitudes (including attitude towards risk), ability to provide non-financial assistance etc. are very important.

Publics

A company may encounter certain publics in its environment. "A public is any group that has an actual or potential interest in or impact on an organisation's ability to achieve its interests. "10 Media publics, citizens action publics and local publics are some examples.

Some companies are seriously affected by such publics. For example, one of the leading companies in India was frequently under attack by the media public, particularly by a leading daily which was allegedly bent on bringing down the share prices of the company by tarnishing its image. Such exposures or campaigns by the media might even influence the governmental pollution is an issue often taken up by a number of local publics. Actions by local publics on this issue have caused some companies to suspend operations and / or take pollution abatement measures. Non-government organisations (NGOs), particularly in developed countries, have been mounting up protests against child labour, sweat labour, cruelty against animals, environmental problems, reindustrialization resulting firm imports and so on. Exports of developing countries, particularly, are affected by such developments.

Growth of consumer publics is an important development affecting business.

It is wrong to think that all publics are threats to business. Some of the actions of the publics may cause problems for companies. However, some publics are an opportunity for the business. Some businessmen, for example, regard consumerism as an opportunity for the business. The media public may be used to disseminate useful information. Similarly, fruitful co-operation between a company and the local publics may be established for the mutual benefit of the company and the local community.

Macro Environment

A company and the forces in its micro environment operate in a larger macro environment of forces that

shape opportunities and pose threats to the company. As stated earlier, the macro environment is also known as General Environment and Remote Environment.

The macro forces are, generally, more uncontrollable than the micro forces. When the macro environment is uncontrollable, the success of a company depends on its adaptability to the environment. For example, if the cost of the imported components increases substantially because of the depreciation of the domestic currency, a solution may be their domestic manufacture.

Important macro environment factors include economic environment, political and regulatory natural environment and global environment.

Technological Factor

The technological environment consists of those factors that are related to the knowledge applied and the materials and machines used in the production of goods and services which have an impact on the business of an organisation. Some of the important factors and influences operating in the technological are as follows:

1. Sources of technology, like company sources, external sources, and foreign sources; cost of technology acquisition; collaboration in and transfer of technology.
2. Technological development, stages of development, change and rate of change of technology, and research and development.
3. Impact of technology on human beings, the man-machine system, and the environmental effects of technology
4. Communication and infrastructural technology in management.

Strategists can ill afford to ignore the technological environment, as technology, besides customer functions defines the business of their organisations. According to Boris Petrov, there are three strategic implications of technological change: it can change relative competitive cost position within a business, it can create new markets and new business segments, and it can collapse or merge previously independent businesses reducing *or eliminating their segment cost barriers*.2

In the Indian context, we find that the state of technological development varies among different sectors of the industry. Generally, it is felt that the technology used depends on a number of factors such as cost and availability of technology, nature of competition, relevance to customer needs, and government policy. At the macro-level, foreign technical collaborations are popular in India but subjected to strict regulations regarding indigenisation, impact on local technological development and employment, export commitments and so on. Technology is often used as a strategic weapon by the companies operating in a highly competitive environment.

A few specific examples of the factors operating in the technological environment and their impact on business are provided here.

- Rising petrol prices have forced automobile manufacturers to emphasize fuel economy. Fuel economy is dependent on a variety of factors such as weight, aerodynamics, engine technology, and frictional losses. The technological environment currently offers a few solutions to support these factors. For instance, aerodynamically designed cars to minimise resistance to air, front wheel drive to reduce fuel consumption, ceramic component technology for engine construction, and alternative fuels like diesel, vegetable oils, and alcohol are some of the means to increase fuel economy.
- The harmful side- effects of allopathic drugs and the symptomatic relief that they offer have made many companies look towards alternative systems of medicine.

- There are several instances of Indian companies and also of subsidiaries of MNCs operating in India and abroad who are interested in exploiting the potential of ayurvedic technology to find herbal solutions to common chronic ailments.
- India has traditionally held three advantages in the pharmaceutical industry: high-quality scientists in synthetic chemistry for doing R&D; very low manufacturing costs owing to tough price controls; and experience in reverse engineering of drugs because of low patent protection. But with the impending WTO regulations requiring Indian pharmaceutical manufacturers to adopt product patenting these advantages will not mean much unless companies are farsighted enough to leverage them to compete in the global markets.

Economic Factor

The economic environment consists of macro-lever factors related to the means of production and distribution of wealth which have an impact on the business of an organisation. Some of the important factors and influences operating in the economic environment are:

1. The economic stage at which a country exists at a given point of time.
2. The economic structure adopted, such as, a capitalistic, socialistic or mixed economy.
3. Economic policies, such as, industrial, monetary and fiscal policies.
4. Economic planning, such as, five-years plans, annual budgets, and so on.
5. Economic indices like national income, distribution of income, rate and growth of GNP, per capita income, disposable personal income, rate of savings and investments, value of exports and imports, the balance of payments, etc. and so on.
6. Infrastructural factors, such as, financial institutions, banks, modes of transportation, communication facilities, and so on.

Strategists are acutely aware of the importance and impact of the economic environment on their organisations. Almost all annual company reports presented by the chairmen devote attention to the general economic environment prevailing in the country and an assessment of its impact of their companies.

Here we have provided several examples of the factors and influences that operate in the Indian economic environment and which have had a far-reaching impact on all business organisations.

- The export sector in India had experienced an uneven growth in the late 1990s. While 1993-94 and 1995-96 were good times, subsequent years' export figures have proved to be disappointing. Several negative global economic forces, such as a downturn in the Asian markets, collapse of the East Asian economies, problems

  In global currency markets, and so on, were held responsible for the sharp decline in Indian export policies, undue reservations of export items for the small-scale sector, high tariffs, and so on were some of the major factors. The limited role of the corporate sector-specially of the large companies-in export contribution has come in for severe criticism. In the freer trade regime, spearheaded by the WTO. quantitative restriction on imports and subsidies for exports will have to be phased out by 2004. Exports are very likely to become even more critical for business survival.
- Economic showdowns results in lesser spending by consumers. But is the converse also true? This question has confounded the corporate sector and marketers more than the economists. Surveys of consumer behaviour are unambiguous on one point: Indian consumers are discerning spenders and try to maximise value for spending money. They are not swayed by hard-sell and do not rely excessively

on brand image alone. Companies, specially in the FMCG sector, have realised this and have been responding with alacrity. Colour TVs, cell phones, personal computers, airlines, hotels and several other industries have faced the onslaught of liberalisation and the ensuing competition with a range of innovative marketing strategies.

- The banking sector in India has been the focus of much reform. Though some observers comment cynically by saying that this sector has been overanalysed by a series of committees. The Narasimhan Committees (1991 and 1998) had laid down the basic parameters of reforms, several of which have remained on paper. Meanwhile, the banking industry in India is faced with a plethora of problems. The corporate sector basically needs attractive deposit avenues, easier credit terms, better service, and above all, a sound, effective and reliable banking system. This does not seem to be happening.
- Public saving in India have been traditionally invested in fixed assets and precious metals. The share of a saving entrusted to the government has been channeled through post offices and banks. However, after the seventies, the investors have increasingly turned to other avenues like stock markets and company deposits. Recent changes in economic and fiscal policies have led to many developments. Leasing and financing companies, public sector bonds, mutual funds, venture capital business, new financial instruments, and the entry of banks and financial institutions in stock trading are some of these developments which provide resources for capita markets and project financing,

Political Factor

The political environment consists of factors related to the management of public affairs and their impact on the business of an organisation. Some of the important factors and influences operating in the political environment are:

1. The political system and its features, like the nature of the political system, ideological forces, political parties and centres of power.
2. The political structure, its goals and stability.
3. Political processes, like the operation of the party system, elections, funding of elections, and legislation with respect to economic and industrial promotion, and regulation.
4. Political philosophy, government's role in business, and its policies and inter venations in economic and business development.

India is a democratic country with a stable political system where the government plays an active role as the planner, promoter, and regulator of economic activity. Businessmen, therefore, are conscious of the political environment that their organisations face. Most governmental decisions related to business are based on political considerations in line with the political philosophy followed by the ruling party at the centre and the state levels.

Here are two examples of the impact of the political environment on business.

- Indian industrialist evincea healthy and keen interest in the country's politics for several reasons. Political parties set the agenda for legislation affecting business. The government, despite liberalisation measures, wields enormous regulatory powers that could make or mar an industry. Political funding of elections is widespread among industrialists. In fact several of them openly

come out in favour of a particular political party while a few have also joined politics. There is a genuine concern about the stability of coalition governments, a common feature of the political system for the last several years, as the stability of a government bodes well for business and industry.

- IT companies have found Hyderabad, approvingly nicknamed by the media as Hyberabad, to be the most hospitable location primarily due to the supportive political climate. The chief minister of Andhra Pradesh, Chandrababu Naidu, had been personally interested in IT and had encouraged its use in the governance of the state. An IT-friendly environment was sought to be built by the state government by providing concessions, simplification of rules and procedures, and the building up of a good-quality infrastructure.

Socio-cultural Environment

The socio cultural environment consists of factors related to human relationships with in a society; the development, forms and functions of such a relationship; and the learnt and shared behaviour of groups of human beings which have a bearing on the business of an organisation. Some of the important factors and influences operating in the social environment are:

1. Demographic characteristics, such as, a population, its density and distribution, changes in population and age composition, inter-state migration and rural-urban mobility, and income distribution.
2. Socio-cultural concerns such as environmental pollution, consumerism, corruption use of mass media, the role of business in society, and consumerism.
3. Socio-culture attitudes and values, such as, expectation of society from business, social customs, beliefs, rituals and practices, changing lifestyle patterns and materialism.
4. Family structure and changes in it, attitude towards and within the family, and family values.
5. The role and position of men, women, children, adolescents, and the aged in family and society.
6. Educational levels, awareness and consciousness of rights, the work ethic of the members of society, and the attitude towards minority and disadvantaged groups.

The Rise of the Indian Middle Class

India is home to the largest socioeconomic group of population know as the middle class. As the term indicates, it is a group which is above the poorer masses but has yet to attain the affluence of the richer class. Owing to the black money economy which largely benefits this class and the repatriation of money from abroad by non-resident Indians (NRIs) who mainly belong to this class, the rising Indian middle-class is believed to possess a high-potential purchasing power. In 2000, this class was expected to attain a size of 30 crores or 300 million.

The social phenomenon most often attributed to the middle class is that of upward mobility- the propensity to seek a better quality of life by either working hard, or seeking the benefits accruing out of economic development through fair or foul means. Pavan Verma, author of The Great Indian Middle Class, who has made an incisive analysis of the phenomenon, comments acidly by drawing attention to the "insensitivity (of the middle class) to other's welfare' and its being "obsessed with status and consumerist objects of desire".

Through most of the 1990s, there had been a raging controversy about the size, content, pr[illegible] purchasing power of the middle class. The estimates of the size are hotly debated. Th[illegible] several MNCs and domestic companies have proved to be bitter as their demand projections [illegible] to be way off the mark. There seems to be an emerging consensus that the phenonmenon of the rising [illegible] class has been misjudged. The MNCs particularly are attributed with confusing the Indian middle [illegible] its counterpart in developed countries.

The National Council for Applied Economic Research (NCAER), which publishes the [illegible] Demographic Report, classifies the Indian market into five categories, not on the basis of [illegible] ownership of consumer durables: very rich, consuming class, climbers, aspirants, and destitute. [illegible] class clearly belongs to the middle class, while climbers and aspirants are really those who could b[illegible] to the category of the rising middle class. For them, wealth does not automatically translate into a d[illegible] purchase and there is a high propensity for saving for the future, owning to the absence of a social [illegible] net in India.

There are important implications of the changing socioeconomic structure which is taking shape [illegible] the economy in general, and industry and business in particular. Much of the macro-level sectoral [illegible] from agriculture to manufacturing and services could be attributed directly to middle class affluence [illegible] corporate sector, the middle class constitutes the investing public and a continuing demand potential [illegible] variety of consumer items, ranging from detergents to refrigerators, and a number of services like [illegible] leisure, and advertising. New lifestyles and images have appeared due to the consumerist and materialistic ethos prevailing in the middle class society. The urban middle class spends time and money on [illegible] activities like amusement parks, while the rural middle class takes pride in wearing readymade garments and driving motorcycles.

In sum, the social environment facing Indian business is radically changing and these changes have to be taken into consideration for strategic management. The corporate sector could seek to capitalise on the aspir[illegible] of the rising middle class not in the short run but in the long run.

The socio cultural environment primarily affects the strategic management process within the organisation [illegible] in the areas of mission and objective-setting, and decisions related to products and markets. Strategists in the Indian context, do not seem to be fully aware of the impact of the socio cultural environment on business or they are so preoccupied with other environment influences that they do not give a high priority to [illegible] cultural factors. One reason for such a lack of interest could be the nature of socio cultural influences. [illegible] cultural changes take place very showly and do not seem to have an immediate and direct impact on [illegible] term strategic decisions. Nevertheless, some socio cultural changes are too prominent to be ignored. [illegible] such change in the Indian context is the emergence of the middle class as a powerful socioeconomic [illegible] with a considerable influence and purchasing Power. Exhibit 4.9 provides some understanding of the phenomenon of the emergence of the middle class in India.

Here are a few examples of the impact of socio cultural environment on business.

- India is a diverse civilisation with a large variety of castes. The Anthropological Survey of India [illegible] identified more than 4600 jatis or castes that make up the Indian society. Identity [illegible] social mobilisation, politicisation of caste, and inter-caste tensions are some of the domin[illegible] cultural features of Indian society. Business and industry is affected as the corporate culture within is largely a microcosm of the wider socio cultural features of Indian society. Business and [illegible] is affected as the corporate culture within is largely a microcosm of the wider socio cultural environment outside.

- Indian seem to be averse to contracting debt of any kind. This could be one of the possible reasons why the credit card business has not picked up in India. Retail bankers have been aggressively targeting the salaried class to sell credit cards. But the idea of 'spend now and pay later' does not seem to appeal to them. The average Indian would rather save and buy things he or she needs, except a house possibly, for which a loan could be sought.
- Branded garments seem to have been a greater success till now with men than with women in India. Ethnic wear remains popular across the country. Most women prefer to wear traditional clothes such as salwar-kameez or saree even at the workplace. There is a potential segment, of course, comprising of school and college girls who have grown up comfortably wearing branded jeans, skirts, and trousers. The branded women's apparel industry believes that opportunities exist in the not-too-a-distant future.

CHAPTER-2:
CHANGING DIMENSIONS OF BUSINESS ENVIRONMENT

Business environment of a country in never constant or static. It is always in a dynamic state and is affected by a number of factors as discussed in the following sections. The various factors that affect or constitute business environment keep interacting with one another. Except in the case of emergency or crisis, changes in business environment are not sudden but gradual. Many business organisations are able to predict or forecast the changes on the basis of their wisdom and experience with which they can analyse the existing configuration of variables affecting the environment. Such organisations are able to reposition themselves and exploit the opportunities unfolded by changing environment. Those who are not able to understand the present environment and anticipate future changes face the danger of being marginalised in competition.

Understanding a changing business business environment and predicting it atleast in near future is not an easy task. The task requires a cadre of professional business economists and mangers who have through knowledge of the behaviour of macroeconomic variables and can estimate the impact of their changes on business environment conditions. Not only that, an appropriate understanding of the interaction between the different layers of business environment (as discussed in Chapter 1) is also essential. There is a deep relationship between economic and not-economic environment, local, regional, national and international environment and past, present and future environment. The various facts, data and trends have to be carefully studied and analysed and researched to scan and assess business environment over a particular period of time Unfortunately most of the firms don't have adequate resources and the expertise in this regard and depend upon the reports of the rating agencies, consultants, newspapers and journals, economic research institutions or even on the intuitive understanding of a few top-level managers in their organisation.

Factors producing changes in Business Environment

The dynamics of business environment can be understood in terms of the following important factors that trigger changes in business environment. At a particular time, some or all of the factors could be at work but their impact on the environment would depend on the extent of change and intensity of impact.

Changes in Government Policies

Government affects business environment in various roles as regulator, promoter, entrepreneur, planner and consumer. Changes in government policy in each of these roles have a profound impact on the macroeconomic as well as sectoral business environment. Change in fiscal policy affect expenditure levels and the structure of taxation, which affects costs and prices. Monetary policy changes impact the cost (rate of interest) and availability of credit (liquidity), which influence the cost of capital of business firms. Monetary policy changes influence the financial

Environment in general which impacts economic growth. Public debt policy affects the supply of savings and the aggregate level of demand for the private sector. Often, government has a coordinated approach in designing monetary, fiscal and public debt policy in terms of a set of pre-determined objectives like spurting growth, controlling inflation, promoting environment or correcting regional disparities. Similary changes in

policy towards foreign investment and export-import policy affect competitiveness, foreign exchange position and balance of payments. These variables, in turn, affect the demand for and supply of foreign exchange, which, within the parameters of exchange rate policy, affect the rate of exchange. Changes in rate of exchange themselves affect imports, exports and prices.

Government policies are also designed to impact specific sectors. Government undertakes investment and disinvestment programmes in specific industrial segments affecting their growth and competitive conditions. For example, under the present policy of the Indian government towards public sector undertakings, it has been decided to reduce government equity to 26 percent in all non-strategic undertakings and in a number of sectors including telecommunications, transport, metallurgy, petroleums automobiles, tourism and hotels, privatisation is in progress. Government also adopt policies for specific sectors like infrastructure, agriculture, small-scale industries, core-industries, exports, textiles and the like. Reserve Bank of India, in consultation with the government, decides qualitative credit controls under which it changes the flow of credit to specific industrial sectors according to national priorities or their specific financial problems and requirements. In agriculture, government policies affect agricultural costs and prices as well as infrastructure and the operation of agricultural markets. These, in turn, affect food prices and prices of agro-industrial inputs. The effectiveness of government policies depends greatly on the clarity and consistency of objectives, implementation design and sufficiency of funds.

Variations in Growth Performance

Performance of the various sectors determines the growth environment. A growth rate of about 7 pr cent or more causes appreciable increase in national income and aggregate demand, assuming saving behaviour to be constant . Variations in growth rate from year to year being about corresponding change in the business environment and business firms adjust to the changing scenario. Along with the overall growth rate, the sectoral contributions from different segments of agriculture, industry, infrastructure and services also change depending upon sectorsal environments of agriculture, industry, infrastructure and services also change depending upon sectoral environment conditions. The different sectors of the economy are, however, not segmented or independent. Each sector has both forward and backward linkages. Changing economic conditions in one sector tend to affect conditions in related sectors. For example, a slump in the automobile industry will reduce demand for steel. The excess of demand over the supply of electricity will increase the demand for power generators and batteries. These interrelations are complex and widely networked. Where forward and backward linkages are weak or non existent, different business situations can persist in different sectors. Inter-sectoral variations in performance are caused both by supply-side and demand-side factors.

Corrective Policy Actions

Corrective actions are taken when actual performance deviates from intended or planned performance. Governments as well as individual business firms take corrective action when progress or performance does not proceed according to the objectives and the time and expenditure schedules. Government often makes fiscal correction to keep revenue and expenditure growth on budgeted lines. Central banking authorities undertake monetary correction under which they readjust money supply and credit growth rates according to the output performance and liquidity conditions in the market as well as in terms of the objectives of macroeconomic policy. Countries like India, which have a formal system of planning, undertake mid- plan reviews and appraisals and make necessary corrections. Corrective actions are relatively less smooth and sometimes are one-time decisions as compare to policy actions though these can be taken on a number of occasions. Corrective actions are based on performance feedback and are an important part of the overall

control system. An untimely, irrelevant or ill-found corrective action can frustrate policy objectives.

Changes in Market Structure and Competition

In an economy, different product and industry groups face different market structures depending upon the state of competition. The market structure basically depends upon such factors as the number of buyers and sellers in the market, freedom of entry and exit, independence between firms, mobility of the factors of production and availability of market information to the various participants. At one end, the market for ... or for wheat at the time of harvest is highly competitive whereas the government has monopoly in ... transport. Markets for such products as detergents and readymade garments are monopolistically competitive. Oligopolistic conditions prevail in markets for automobiles, refrigerators, air conditioners and automatic washing machines. The determinants of market structure and constantly changing and so is the state of competition. For example, the number of firms in aerated (soft) drinks in India has considerably gone down after the entry of multinationals. Trade liberalisation and import competition are further impacting the market structures. Similarly, policy of the government towards foreign direct investment and multinational corporations, public sector disinvestments and privatisation are making the economy more competitive forcing the firms to become more efficient or pack up.

Future Expectations and Business Speculation

Constantly changing variables of business environment generate future expectations and speculation. Both individuals and business firms, on the basis of past trends and current scenario anticipate future changes in a number of variables such as rate of interest, rate of inflation, exchange rate, taxes, government borrowings, advertisement expenditure, production in the various sectors and market demand and these changes guide their current economic behaviour which produces changes in the present business environment. When there are future expectations about inflation, economic units tend to prepone their purchase to save money. This tends bring inflation form future to the present. Similarly an expected increase in the rate of interest will weaken the current demand for fixed-interest bearing financial assets or investments. Firms that are able to foresee substantial increase in government borrowings can anticipate liquidity shortages and a rise in the rate of interest in future. This can spur them to borrow a head of their requirements so that additional cost and scarcity of capital could be avoided. Current changes and future expectations lead to the establishment of markets for futures and forwards in respect of commodities and financial investments. Now, the markets for derivatives are emerging fast in a number of developing countries like India adding new dimensions to business environment.

Change in Consumer Attitudes, Tastes and Preferences

Consumer attitudes and tastes play a major role in product designing, delivery and accompanying services. In competitive markets, professionally managed firms are customer focused and closely monitor any changes that take place in consumer perception attitude towards their products. Such consumer related factors are subject to shoe change over time. The main factors that bring about changes are education, geographical mobility, fashion trends and compulsions of seasonal factors. Consumer tastes also change as his age advances but among younger age groups even major changes over relatively shorter period of time may be expected. Among these groups, tastes and preferences quickly change over to jeans, entertainment parks, sunglasses, horse races, sleek mobiles and exercising equipments. A large number of persons quickly get initiated into smoking and drinking. Consumer perceptions, attitude and lifestyle are greatly influenced by advertising and result in changing tastes ad preferences. The changes on the side of consumer induce

changes in product content and presentation (including packaging and delivery) making the environment more competitive.

Imports and Foreign Investment Changes

Exposure to foreign products and foreign business firms can cause a sea change in the nature of business environment. Present age is the age of globalisation and interdependence between countries. With in the framework of the World Trade Organisation, most economies of the world are opening their borders for imports and paying special attention to export development. As explained earlier, imports not only add to competition but also create an environment in which domestic firms learn about new products and the technologies on which they are based. Differences in the prices of imported and domestically produced goods pose challenges to the domestic firms to become lean and efficient so that they can stay in competition. With the progress of import liberalisaton, the environment gets more vibrant and dynamic. Similar effect is produced when multinational firms enter with their own range of products and brand names. Foreign firms only bring in investment but also new management philosophies, cultures, work ethos and performance standards. Multinational companies compete with domestic enterprises both in home and foreign markets and establish new benchmarks. Domestic enterprises which are fat and lazy, are either taken over or driven out of the market.

External Economic Shocks

Between economies with high degree of global linkages, international economic changes get transmitted easily. Conditions of recession in industrial market economies mean reduced markets to a large number of countries, which export to them. Globally inter-dependent economies freely transmit, like infectious diseases, such problems like inflation, stagnation, unemployment and slump. The greater the degree of international economic linkage of a country, the greater is its vulnerability to external economic shocks. The cases like collapse of a number of East-Asian economies in the late nineties and the September 11, 2001 terrorist attacks on the US caused economic disruption in a number of countries. Similarly, international wars, civil strife, international economic sanctions affect international trade, tourism, foreign investment and international remittances of the countries which have good international economic relations. The countries whose trade and investment are concentrated in a few narrow geographic locations are more likely to be adversely and severely affected.

Non-economic Factors

There is a wide variety of non-economic factors, which can destabilise the business environment. Business firms can do very little with these factors. The best they can do is to adjust to such changes. Social and cultural environment of business by itself is slow changing but social tensions, communal violence and religious fanaticism can trigger disturbances in internal law and order situation and can disrupt smooth flow of business. Similarly, political changes, existing or anticipated, have the potential to disturb the business environment. Major industrial accidents and natural calamities like earthquakes and floods, outbreak of epidemics or a spurt in crime rate over a wide region can have a destabilising effect on the business environment, which can be felt over a considerable period of time. An earthquake in an urban location, for example, can halt infrastructure projects and can make a number of insurance companies go bankrupt. Recent earthquake and communal violence in Gujarat have caused tremendous damage to the economy of the state. Such factors are least predictable and prudent business firms seek insurance against the most likely factors in this group.

Corporate Response and Adjustment

The above factors are capable of bringing changes in the macroeconomic as well as sectoral environment for business firms, depending upon the magnitude, direction and duration of impact. These factors impact the different macroeconomic variables ands the interrelationship between them making the business environment volatile, less comprehensible and unpredictable. A large number of firms, unable to understand the current state and dynamics of business environment, consider it as black box and attempt to wriggle out of a particular set of circumstances through strategic or tactical postures. Rational and professional firms always seek to build projections, at least in the short run, basing their predictions on past experience and current trends. Determining the right quantum and direction of adjustment is not an easy task. Over-reaction and under-reaction both can be expensive and painful and deviate the firms from their planned goals. Before deciding a particular response action, it is necessary to find out which causative factors will affect which component of business environment. Table 1 gives as illustrative list areas of corporate adjustment corresponding to specific changes in business environment.

Table 1: An illustrate List of Areas of Corporate Adjustment Corresponding to Specific Changes in Business Environment.

Areas of environment change	Areas of corporate response
Technological environment	R&D, foreign technical collaborations, choice of technology, labour-capital ratio.
Labour environment	Employee motivation, productivity, employees' turnover rate, working *conditions, labour relations, compensation, capital labour ratio, nature of* employment, job description and specification.
Competitive environment	Pricing, merger, acquisition or amalgamation, sub-contracting, horizontal, vertical, backward or forward integration, marketing strategy, new product development, cost cutting, measures for realisation of economies of *scale and scope.*
Monetary environment	Working capital financing, liquidity restructuring.
Fiscal environment	Dividend policy, sub-contracting, transfer pricing, product mix, industrial location, sourcing.
Trading environment	*Foreign collaboration, input mix, export orientation, import intensity,* product mix.
Financial environment	Project development, overhead financing, financing mix, capital structure, rate of return, external financing, risk management.
Legal environment	Procedures and documentation, credibility, conformity and ethical practices, intellectual property protection.
Social environment	Social responsibility, local and regional relationships, welfare expenditure.

Firms that are able to make appropriate adjustment to business environment changes reduce risk and uncertainty and gain competitive edge over the rivals. Failure to make timely adjustment may seriously erode profitability, competitiveness and market share or may even trigger industrial sickness putting the clock of corporate development several years in the back. Therefore, it is sickness putting the clock of corporate development several years in the back. Therefore, it is necessary to monitor the environment closely and visualise the future at least in the short run.

Environment monitoring and forecasting require appropriate database, market intelligence and analytical skills for corporate managers. Environment-savvy firms are often able to perceive the foreshows of environment

changes and listen to early warning signals. Such firms have sufficient leeway and lead-time to readjust and re-orient their operations well in advance and are able to exploit the new opportunities and meet the challenge that a change in business environment may toss up. The foreshadows or early warning signals are contained in the movements of the business environment. The corporate policies must have sufficient flexibility to enable the firm to adjust to the changing environment. Business environment changes are sometimes like stormy currents. Firms that bend and give way survive those that stand erect and are razed to the ground.

Unfortunately, a large number of firms are either unwilling or unable to make adjustments to business environment changes. There are a number of reasons. First, the momentum and flow of business along a pre-set business plan and within a particular strategic perspective doesn't permit interruption by way if adjustment. Secondly, the current state of business environment and the anticipated changes are subject to varying and even conflicting interpretations and no conclusive response action is possible to arrive at. Thirdly, a possible wrong adjustment can be fatal and generally no individual or group of individuals in the top management is willing to volunteer for a risky initiative. The adjustment could mean alteration in the debt-equity ratio, readjustment of inventory size, and introduction of a new or redesigned product, staff rationalisation or changes in compensation structure. There are financial, physical or even psychological costs associated with adjustment. Finally, many business environment changes are considered to be minor or temporary and reversible so that no response in required.

Nevertheless, firms prefer to restrategise or restructure when changes in business environment are clear, dominant and durable. They may have to readjust their goals, business plans and policies and implementation designs. On e of the basic decisions is whether to diversify or stick to core competency in the new business environment. They may have to plan changes in their liquidity use asset, capital and investment-return ratios. A change in their planned return ma be required as business environment changes cause variations in the competitive environment and vary the relative strengths of market entry and exit barriers. When the environment changes take place at the sectoral level, the changes in relative market growth rate and market shares may affect the profitability and cash generation potential of products. These factors require to be scanned carefully so that the adjustment and response of the firms is appropriate.

Role of the Business Economist

Large and professionally managed companies maintain a distinct cadre of business economists who provide valuable support tot eh top management. The primary job of a business economist it to provide the economic logic and perspective for managerial decision-making. The ability of a business economist lies in integrating economic theory with practical business situations so that economically sound and logical solutions could be provided to the issues related to business planning, strategy and policy. Monitoring and scanning the different components and layers of business environment requires careful analysis and interpretations and a business economist performs this task and advises the top management on the kind of adjustment and market response to be made. Large and diversified organisations maintain separate economic research divisions to provide inputs for managerial decision-making. At the micro level, business economists study the industry level trends and advise the managements abut the specific actions to be taken. These professionals also perform the predictive function. On the basis of past and current trends, they are involved in exercises of making short, medium and long run projections to guide future planning and strategy of business. These professionals generally have good level of skills in the applications of managerial economics, business econometrics and forecasting. The firms, which are unable or unwilling to employ such cadres, have to depend upon outside economic consultancy and research services or on the economic wisdom of their own top managers.

Environmental Scanning

In the two preceding sections, we have seen how organisations can comprehend the environment in which they exist, identify their environment, and classify it into different sectors. In this section, we turn to the methods and techniques employed by the organisations to monitor their environment and to gather data to derive information about the opportunities and threats that affect their business. The process by which organisations monitor their relevant environment to identify opportunities and threats affecting their business is known as environmental scanning.

Factors to be considered for Environmental Scanning:-

The external environment in which an organisation exists consists of a be wildering variety of factors. These factors (may also be termed as influences) are events, trends, issues and expectations of different interested groups. These factors are explained below.

- Events are important and specific occurrences taking place in different environmental sectors
- Trends are the general tendencies or the courses of action along which events take place
- Issues are the current concerns that arise in response to events and trends
- Expectations are the demands made by interested groups in the light of their concern for issues.

Take the example of the gas-leakage accident at the Union Carbide factory at Bhopal in December 1984 That accident and the resulting holocaust was an 'event'. The 'trend' that arose is a general tendency on the part of the regulatory authorities and organisations to be conscious about safety from hazardous exposure to chemicals. The 'issue; is a rising concern about environmental pollution. The 'expectation' of the general public from the government is to legislate changes in rules and regulations pertaining to safety measures and stricter enforcement through various mechanisms.

Approaches to Environmental Scanning

Kubr has suggested three approaches which could be adopted for sorting out information for environmental scanning. We could call these approaches the systematic, ad hoc and processed-form approaches.

1. **Systematic approach.** Under this approach, information for environmental scanning is collected systematically. Information related to markets and customers, the changes in legislation and regulations which have a direct impact on an organisation's activities, government policy statements pertaining to an organisation's business and industry, and so on, could be collected continuously updating such information is necessary not only for strategic management but also for operational activities.

2. **Ad hoc approach.** Using this approach, an organisation may conduct special surveys and studies to deal with specific environmental issues from time to time. Such studies may be conducted, for instance, when an organisation has to undertake special projects, evaluate existing strategies, or devise new strategies. Changes and unforeseen developments may also be investigated with regard to their impact on the organisation.

3. **Processes –form approach.** To adopt this approach, an organisation uses information in a processed form, available from different sources both inside and outside the organisation. When an organisation uses information supplied by government agencies or private institutions, it uses secondary sources of data and the information is available in a processed form.

Since environmental scanning is absolutely necessary for strategy formulation, organisations use different

practical combinations or approaches to monitor their relevant environments. These approaches may range from an informal assessment of environmental factors to a highly systematic and formal procedure. Informal assessment may be adopted as a reactive measure to a crisis and ad hoc studies may be undertaken occasionally. A highly systematic and formal procedure may be used as a proactive measure for the anticipation of changes in environmental factors, and structured data collection and processing systems may be used continuously.[4]

Between the two extremes of the informal and formal approaches ma lie different stances adopted by organisations depending on varying-related decision has to be taken, approaches can be used for the relevant environment may be done. Systematic and ad hoc approaches can be used for the relevant environment of the organsation while the processed-form approach could be used to appraise both the relevant as well as the general environment. Whatever approach is adopted for environmental scanning, data collection is necessary for deriving information about environmental factors.

Sources of Information for Environment Scanning

The various sources of information which are tapped for collecting data for environmental scanning could be classified different ways. There could be formal and informal sources. Then there could be written as well as verbal sources. In terms of origin, data sources could be external and internal. Given below are some of the important types of sources of information.

1. Documentary or secondary sources of information, like, different types of publications. These could be newspapers, magazines, journals, books, trade and industry association newsletters, government publications, annual reports of competitors, companies, and so on
2. Mass media such as radio, television and the internet
3. Internal sources, like, company files and documents, management information systems, databases, company employees, and so on
4. External agencies, like, customers, marketing intermediaries, suppliers, trade associations, government agencies, and so on
5. Formal studies conducted by employees, market research agencies, consultants and educational institutions
6. Spying and surveillance through ex-employees of competitors, industrial espionage agencies, or by planting 'moles' in rival companies

Strategists use different information sources depending on their needs for environmental scanning. Government publications- though a rich and comprehensive source of information – are usually available after a considerable time lag. Private sources, though relevant and timely, are quite expensive to tap. Therefore, whenever a particular information source is used, it should be checked for its reliability, time frame, methods of data collection and analysis used, form of presentation, and so forth.

Following are a few selected and important sources which can be used in the Indian context for collecting information for environmental scanning.

1. International publications

(a) Intergovernmental and international agencies like UN, UNESCO, ILO, WHO, UNDP, FAO, World

Bank, OECD and others are a rich source of international statistical data. World Development Report, World Economic Survey, Statistical Yearbook of UN, International Trade Statistics Yearbook of UN, among others are some examples of major international publications.

(b) International private data agencies such as country-rating agencies like Standard & Poor, Moody's, and others provide ranking of countries with regard to their attractiveness for foreign investments

2. Government Publications

(a) Governmental information sources such as the Census of India reports, five-year plan reports, statistical abstracts of Indian Union, and others provide valuable macro-level data useful for planning purposes. Statistical abstracts and statistical handbooks are published by several central and state government agencies. The main drawbacks are the delay in availability of the data and the fact that the data available has to be adapted for its particular use.

(b) Periodic reports like economic surveys, annual surveys of industries, annual reports of ministries, and so on, which provide current data and reflect governmental thinking and priorities.

(c) Occasional reports brought out by arouse statutory agencies, such as, guidelines to industries, policies related to specific industry, export-import policies, and so on, which are relevant for business and industry. RBI's Department of Statistics also publishes valuable occasional papers related to different aspects of the economy and industry.

(d) References, such as, India- A Reference Annual published by the Ministry of Information, contains comprehensive information on the geographic and demographic features of India, its political and social institutions, economy and culture, plans, programmes, and so on.

3. Institutional publications

(a) The Bombay Stock Exchange Directory contains valuable and timely statistical and financial data related to public limited companies (PLCs), besides latest information on statutory and other regulations.

(b) The Centre for Monitoring India Economy (CMIE), which is a private institution, provides publications which contain comprehensive and timely information on economic indices.

(c) An example of one of the several industrial directories brought out in India is Kothari's Industrial Directory of India, published by Kothari Enterprises, Chennai. It contains analyses of several industries and companies, besides general information on the economy and industry.

(d) Publications of market research agencies such as the National Council for Applied Economic Research (NCAER), a statutory agency, provide extensive contemporary data on the demographic profile of customers that can be used for strategic and market planning. The Operations Research Group (ORG) is an example of a private agency that provides similar information.

(e) Publications of trade and industry federations such as CII, federation of Indian Chambers of Commerce & Industry (FICCI), Association of Chambers of Commerce & Industry (ASSOCHAM), and industry associations like ATMA.

(f) Annual company reports, which contain data related to the balance sheet and profit and loss account apart form information on plans and programmes, are an important source for the study of industry and for competitor analysis. Company in-house journals are also a source of rich information, though their circulation is limited to the members of the company.

4. Periodicals and newspapers

Magazines (Business India, Business World, Business Today, etc.) ; and newspapers (Economic Times, Financial Express, Business Standard, Business Line, etc.) are the most timely sources of information related to a wide variety of issues. Private agencies also exist which provide information services based on classified magazine and paper cuttings.

5. Online databases and systems

(a) Online databases are a rich source of statistical and other types of data regarding the economy, industry, and the corporate sector. Several online databases are available worldwide covering a vast range of subjects.

(b) With the emergence of the internet, the availability of data has increased manifold. The internet is a convenient way to access online databases of several types of organisations. Government agencies, private data agencies, federations of trade and industry, individual companies, and other types of institutions maintain websites that provide access to information.

6. Industrial espionage agencies

Private agencies provide information and reports on competitor plans and activities which are essential for strategic planning.

Methods and Techniques used for Environmental Scanning:

There is a wide range of methods and techniques available for environmental scanning. There are formal and systematic techniques as well as intuitive methods available. Strategists may choose those methods and techniques from among these which suit their needs in terms of the quantity, quality, availability, timeliness, relevance and cost of environmental information.

Various authors have mentioned the methods and techniques used for environmental scanning. LeBell and Krasner have outlined nine groups of techniques: single-variable extrapolation, theoretical-limit envelopes, dynamic modes, mapping, multivariable interaction analysis, unstructured expert opinion, structured expert opinion structured inexpert opinion, and unstructured inexpert speculation.5

Fahey, king and Narayanan have included 10 techniques in their survey of environmental scanning and forecasting in strategic planning. These are: scenario-writing, simulation, morphological analysis, PPBS, game theory, cross-impact analysis, field anomaly relation, multiechelon coordination, and other forecasting techniques.6 Of particular interest are the emerging set of techniques based on complexity theory, which is a group of mathematical techniques designed to deal with the dynamic nature of real-world problems. Among the techniques are the application of the mathematical concepts of fractals, fuzzy logic, genetic algorithms, swarm stimulation, the Monte Carlo method, and, the most popular of these the chaos theory. Exhibit 4.2 attempted an understanding of chaos theory and its relevance to strategic management.

While many of these techniques are based on the statistical methods that are used for forecasting, some of these-like scenario-writing-may not use statistical information but employ informed judgment and intuition to predict what the future is most likely to be. This may be expressed in the form of a descriptive statement or report.

To provide an illustration of how environmental scanning can be done by strategists, we shall briefly explain a technique called QUEST (Quick environmental scanning technique), as proposed by B Nanus. QUEST is a four-step process which uses scenario-writing for scanning the environment and identifying strategic options. The four steps involved in applying this technique are:

1. Strategists make observation about the major events and trends in their industry.
2. Then they speculate on a wide range of important issues that might affect the future of their organisations by scanning the environment broadly and comprehensively
3. The QUEST director prepares a report summarising the major issues and their implications, and three to five scenarios incorporating the major themes of the discussion.
4. The report and scenarios are reviewed by a group of strategists who identify feasible strategic options to deal with the evolving environment. The options are ranked and teams are designated to develop strategies.

After the environmental scanning process is complete, the strategists are faced with the problem of structuring the mass of information available to them. The problem boils down to sifting the information in such a manner that a clear picture of the opportunities and threats operating in different sectors of the environment facing the organisation could emerge.

Monitoring

Monitoring involves tracking the environmental trends, sequences of events, or streams of activities. It frequently involves following signals or indicators unearthed during environmental scanning. The purpose of monitoring is to assemble sufficient data to discern whether certain trends and patterns are emerging. Thus, as monitoring progresses, the data turn frequently from imprecise to precise.

Three outcomes emerge out of monitoring: (a) a specific description of environmental trends and patterns to be forecast; (b) the identification of trends for further monitoring, and (c) the identification of areas for further scanning. These outputs (particularly the first) become inputs for forecasting. They will also cause for further scanning and monitoring.

Forecasting

Scanning and monitoring provide a picture of what has already taken place and what is happening. Strategic decision-making, however, requires a future orientation. Naturally, forecasting is an essential element in environmental analysis.

Forecasting is concerned with developing plausible projections of the direction, scope, and intensity of environmental change. It tries layout the evolutionary path of anticipated change. For example, how long will it take the new technology to reach the market place? Are current lifestyle trends likely to continue? These kinds of questions provide the grist for forecasting efforts.

Unlike scanning and monitoring, forecasting is well focused and is much more deductive and complex activity. This is so because the focus, scope and goals of forecasting are more specific than the earlier two stages of environmental analysis.

Assessment

Scanning, monitoring, and forecasting are not ends in themselves. Unless their outputs re assessed to determine implications for the organisation's current and potential strategies, scanning, monitoring and forecasting simply provide 'nice-to-know' information. Assessment involves identifying and evaluating how and why current and projected environmental changes affect or will effect strategic management of the organisation.

In assessment, the frame of reference moves from understanding the environment – the focus of scanning, monitoring and forecasting – to identifying what the understanding means for the organisation. Assessment, therefore, tries to answer questions such as what are the key issues presented by the environment, and what are the implications of such issues for the organisation?

CHAPTER-3:
DUALISM IN INDIAN SOCIETY

The Indian economy presently is characterised by a dualistic economic structure – a modern economy existing side by side with a traditional primitive economy. A dutch economist, J.H. Boeke has propounded a theory of social dualism which asserts that dualism implies the presence and conflict of an imported social system with an indigenous social system of another form. India's economic structure does not reveal any such clash However, there is a clear evidence of technological dualism in Indian society. Technological dualism implies the use of different production functions in the advanced sector and the traditional sector. In this form, dualism is "a situation in which productive employment opportunities are limited, not because of lack of effective demand, but because of resource and technological restraints in the two sectors."

Like in other less developed countries, the traditional rural sector in India possesses the following characterstics it is engaged in peasant agriculture and handicrafts or very small industries; it has variable technical co-efficient of production so that the commodities can be produced with a wide range of techniques and alternative combinations of labour and capital (which is so defined as to include improved land); and factor endowment is such that labour is the relatively abundant factor of production, so that techniques of production are labour intensive. In cortrast, the modern sector is composed of large scale industries, mines, coalfields and plantations. In this sector, there is very limited degree of substitutability of factors so that production is characterised by fixed technical co-efficients and the production processes are relatively capital- intensive

In India, since Independence there has been a significant decline in the mortality rates while birth rate has failed to decline correspondingly. As a result there is population explosion in the country. However, due to fixed technical co-efficient in the industrial sector, employment opportunities have failed to grow rapidly. This explains why the absorption of increased labour force in industries has been rather small. The increased population is forced to seek a livelihood in the agricultural sector, which because of variable technical co-efficients is able to absorb them. Until the mid-1960s this absorption could be facilitated by bringing additional land under cultivation and prevented ratio of labour to land becoming far more adverse. In course of time land became scarce and much scope was not left for bringing additional land under cultivation. In this situation the ratio of labour to both land and capital in agriculture showed a tendency to rise. This obviously did not allow introduction of capital technology on a big scale. Mechanisation thus could be possible only on a limited scale. In this country, it seems that we have now reached a stage that all available cultivable land is already cultivated by highly labour intensive techniques and the marginal productivity of labour has declined to zero. Under these circumstances any increase in population and its absorption in agriculture is bound to result in what is known as disguised unemployment. In this situation there is not incentive for farmers or small scale enterprises to make investment of capital in the labour intensive sector even if they have capital to invest. Nor will they be interested in introducing labour saving techniques even if they have capital to invest. Nor will they be interested in introducing labour saving techniques even if they know about them and could finance them. However, the fact stands that there is no technology designed as yet to raise output per man hour without also raising the ratio of capital to labour. Since labour supply is in excess, labour as a group is also not interested in increasing its efforts. Thus while methods of production remain labour intensive, levels of technology, man hour productivity and economic and social welfare remain low.

It seems that the problem of disguised unemployment in the rural sector has tended to become more and more serious in recent years because technological progress took a form favouring the capital intensive sector.

While technological progress was slow in peasant agriculture and handicrafts, the industrial sector including mining and petroleum registered a spectacular technological development. Further, since Independence trade union activity and direct government intervention in the labour market have increased and this has led to artificially high wage rates in the organised sector. However, these policies had no effect on real wages in the rural sector and contributed a great deal to the emergence of technological dualism.

The Indian economy presently faces the factor proportions problem as discussed by Richard Eckaus. Eckaus begins with a simple and abstract case where only one good is produced in the economy, national product, with the help of two factors, labour and capital. Assuming that the factors must be used in fixed proportions, Eckaus finds that the relatively abundant factor labour, is bound to face structural unemployment. Even on introducing a relatively more labour-intensive process of production, he observes that structural unemployment of labour still exists. Eckaus, however, does not consider this assumption as necessary for his conclusion.

In the next step, he divides national product into two goods – output of Western enterprises which are relatively capital- intensive and output of local enterprises which are relatively labour- intensive. Once again he argues that in spite of a very high labour- capital ratio, structural unemployment of labour will persist and this cannot be eliminated by price adjustments or by creation of increased effective demand. This general conclusion is unchanged even if variable coefficients replace the fixed coefficients in the more labour-intensive field of employment. Eckaus demonstrates that structural unemployment is aggravated under any of the following conditions:

1. If trade – union activity, or the government policy successfully pushes up the wages.
2. If technological progress takes a form that favours the capital- intensive sector.
3. If the rate of population growth is higher than the rate of capital accumulation in the labour – intensive sector.

India—A Mixed Economy

The Indian economy is a mixed economy. It has acquired this form with the growth of a large public sector since Independence. Bhabatosh Datta asserts, "In examining the Mixed Economy thus introduced, one has to remember that no economy has ever been completely unmixed. Even before Independence, India had a fairly important public sector, the most important component of which was the railway system. There may be various grades of mixture between the impracticable extremes of one hundred per cent laissez – faire and one hundred per cent socialist production." In India, the Second Five Year Plan summed up the objectives of the planned development in the phrase 'socialist pattern of society', implying that "the basic criterion for determining lines of advance must not be private profit, but social gain..." and yet the character of the economy that has emerged as a result of planned development does not resemble even remotely socialism.

Nationalisation of banks, setting up a number of enterprises in the public sector and such other measures may create an illusion that the economy has advanced towards socialism but in fact socioeconomic relations have not undergone any such change as to warrant the conclusion that the Indian economy has drifted away from its capitalist form. According to Sukhamoy Chakravarty,".....as of now, there is no evidence that despite the growth of a large public sector, India has mode to any significant extent closer to a 'socialist society', in any meaningful sense of the term. If the present trends are not going to be reversed, it is possible that India will witness in the closing decade of this century a considerably enlarged private sector with further erosion of

the role of planning in the traditional sense of the term." Sixteen years have passed since Sukamoy Chakravarty made these observations. In these years commitment to build a socialist economy has been completely abandoned. Even the policy measures adopted by the government have been such that they significantly undermine the role of economic planning. However, in many respects, the character of the Indian economy is different from that of the capitalist economies of the eighteenth century Europe. The two factors in the Indian economy, viz, the presence of the public sector and economic planning make it distinctly different from the capitalist economies of the West in the earlier phase of their development. Some economists taking note of the public sector and economic planning in India's economy have characterised it as state capitalism. In essence, however, state capitalism is the same thing as the mixed economy. We explain below some features of India's economy which determine its character as a mixed economy.

Private ownership of the means of production and profit-induced commodity production. Under Indian constitution private ownership of means of production has been allowed. Moreover, the capitalist class controls the State power whereby it influences the policies of the government. These factors adequately explain why the private sector in this country remains pervasive. (The share of the public sector in the total national output is less than 25 per cent). At present big segment of the industrial sector is in private hands. As a matter of fact, with the exception of some basic industries, all other industries including cotton textile, jute, sugar, cement, vegetable oil, leather, etc., are in the private sector. Lately with the adoption of neoliberal economic policy the government is hastily withdrawing from industrial sector so much so that even the profit making industrial enterprises are being handed over to private companies at prices which are far below their asset values. Though railways are still State owned, road transport is mostly in private hands. Agriculture, the principal economic activity in the country, is in the private sector as the ownership of agricultural land is entirely personal. These facts pointedly suggest that the production in such an economy will be done for the market and the activity of the producers will be motivated primarily by profit. In agriculture, no doubt, small farmers do not have marketable surplus and, therefore, their behaviour as producers is generally not responsive to market changes.

Decisive role of the market mechanism. Market mechanism has a predominant position in the Indian economy. At present this country has markets not only for various products, but also for productive factors such as labour and capital. In terms of organisation all the commodity and factor markets may not be equally integrated but there is no denying the fact that prices of most of the commodity and factors of production are determined by the interplay of demand and supply forces. Prices of various commodities and timely changes therein, along with future price expectations, influence the decisions of the producers. Factor prices, to a great extent, also determine the techniques of production. Money market in the country is also now better organised comprising diversified financial institutions. Though all major commercial banks still remain nationalised, their working as well as their business dealings with producers in the private sector are generally determined according to the laws of the market. Further, the amount of investment and its form is greatly influenced by the interest rates that prevail in the money market. In the stock market too, fluctuations in the share prices not only reflect the prospects of different companies, but they also determine whether particular companies can obtain equity capital for their expansion or not

However, the market mechanism in India has not been completely free state control. In 1951, Industries (Development and Regulation) Act was passed to provide system for industrial activity in the country. The State wanted to evolve a licensing system under the provisions of the Act, as an effective instrument of industrial planning. In practice, this objective could not be realised. Jagdish Bhagwati and Padma Desai have extensively analysed the working of the licensing system of India and have noted that the Licensing Committee did not follow any fixed criteria or principle for granting licenses either for establishing new industrial units

or for expanding the capacities for existing units. The approach of the Licensing Committee was generally ad hoc. Apart from the licensing system, the government also introduced certain other controls and incentive measures for influencing the decisions that were arrived at in the markets. These controls and incentive measures, however, did not alter the basic character of market mechanism. Their importance lay only in their capacity to rectify irrationality of certain market decisions by changing them for the better. G. Thimmaiah is, however, of the view that the license and control system in this country failed in this direction. Contrary to the expectations of the Indian planners, the private sector could not be made ineffective in its exploitative motive under the license and control system. Under the structural reforms which have been carried out in this country since 1991-92 various physical controls have been withdrawn. Thus the market now operates far more freely than in the past.

Monopoly trends. Since Independence, monopoly houses have grown rapidly and with it the concentration of economic power in the country has increased. This trend was first noted by the Committee on distribution of Income and Levels of Living chaired by P.C.Mahalanobis. The Committee stated in its report, "It is also evident that the working of planned economy has contributed to this growth of big companies in Indian industry." Rapid growth of monopolies in the country was later on confirmed by the Monopolies Enquiry Commission. According to the commission, there were 75 big business houses in 1963-64 controlling 44 per cent of the paid up capital of all non-government and non-banking companies of the country. In absolute terms they had control over capital worth Rs. 2,606 crore. Since then, monopoly trends appear to have become stronger and the grip of big business on the economy seems to have increased in spite of the governmental measures to control them. Each of the top 10 industrial houses had net sales of Rs. 4,700 crore or more in 2001 (ranking in terms of net sales). In terms of assets, the two largest private sector companies of the country in 2001 were Reliance Industries and Tata Steel with their assets amounting to Rs 29, 875 crore and Rs. 12,385 crore respectively. The phase of economic reforms initiated in 1991 has seen the emergence of some new business companies and the manifold increase in the assets of many old companies.

Public sector. Presence of a large public sector in India along with free enterprise makes the character of the economy as mixed. The public sector in India has not been developed for any ideological reasons. Its creation was a historical necessity. At the time of Independence the private enterprise had neither the resources nor the will to undertake the task of industrial development on a massive scale. Further more, country's transport system, energy sources and certain other components of the infrastructure were undeveloped. To be brief, though the economy emerging from its colonial past needed a 'big push', the conditions prevailing in the country were hardly conducive to development in general and industrialization in particular. At this juncture an effective intervention of the State in the economy was an imperative condition to break the low level equilibrium trap in which the economy was caught during the British period. The government recognising this need of the time decided to take upon itself the responsibility of developing strategic sectors so as to create conditions for the development of private economic activity. Hence during the earlier four decades of economic planning around 40 per cent investments were made in the Sate sector. This policy is sometimes wrongly construed as a step towards socialism. In fact, in a predominantly free enterprise economy, creation of a State sector (however large it may be) will not alter the basic character of alter the basic character of the economy and India is no exception to this rule.

In India's essentially capitalistic economy, creation of a large public sector is, by no means a novel experiment. In a number of Western capitalist countries, the State has not only intervened in their economies in a big way but has also engaged itself in various productive and distributive functions. The developmental role of the State has been more direct and pronounced particularly in those countries where industrialisation was somewhat delayed. Therefore, the presence of the public sector in some country or an active role played by the State

in promoting the development of the economy provides no guarantee that the character of the economy would not be capitalistic. At best these factors would make it a mixed economy which, in essence, is a variant of capitalism.

Economic planning. Another factor in the Indian economy that often creates confusion about its character is economic planning. Economic planning has been an integral part of the Indian economy for the past five decades. Because planning was first adopted in the erstwhile Soviet Union and thereafter other socialist countries also followed the path of planned economic development, planning got so much identified with socialism that many people now mistakenly characterise all planning is an essential ingredient of a socialist economy, but al planned economies are not necessarily socialist economies. A country can adopt planning while retaining its capitalistic structure, but in its form and range planning in a capitalistic economy would be different from the one in a socialist economy.

In India economic planning has been introduced in a basically capitalistic economic framework. It has nothing to do with socialism or an egalitarian order of society. Further, not only planning in this country in limited in its range, it also very much lacks the element of compulsion. In socialist countries every possible attempt is made to implement the plans and great seriousness is attached to the realisation of targets laid down in it. There are no such compulsions in the Indian planning. The Indian plans lay down targets even for sectors over which the State has little control. For example, the whole of agriculture is in the private sector and the government attempts to realise the targets laid down for this sector by providing certain incentives, which may not always work. Even for the sectors over which the government may have effective control, the measures adopted by the administration ma not always be in conformity with those stated in the plans. This is quite natural in the Indian economic planning which is indicative in its form. Commenting upon the character of the Indian plans, Charles Bettelheim has aptly remarked, " The main characteristic is that they state what is anticipated or expected. They are entirely different from socialist plans, which lay down imperative and compulsory conditions. The latter sort of plan, once adopted, has to be implemented by administrations and enterprises, whereas the Indian plans attempt to define as precisely as possible the government's economic and industrial policies for the following five years. The government and its administration naturally want to fulfill as much of the plan as possible, but they may adopt measures very different to those suggested by the original plan without violating any legal obligations."

The economic planning as practiced in India over the past five decades and the development of the public sector in this period were thus meant to move a standstill economy, their purpose was not to change the basic character of the country's economy. Therefore, the character of the Indian economy has not undergone any change since Independence. It still continues to be a mixed economy. The Indian experience shows that the mixed economy framework is a feasible proposition for a developing country as it allows for a modest rate of growth, which is both steady and less subject to fluctuations in the economic activity at the international level. This requires over time substantial growth of productive capacity in the key sectors of the economy. In the mixed economy framework this can be ensured by transferring commanding heights of the economy into the hands of the State. Such a system is also consistent with an increase in the rates of saving and capital formation. India's experience over the years proves this point. It may thus be argued that the mixed economy framework which India decided to pursue after getting Independence enabled it to overcome one of its major obstacles to economic growth. As stated earlier, the pursuit of a mixed economy framework does not transform a capitalist economy into a socialist economy. Sukhamoy Chakravarty rightly states that India's experience shows that "adherence to a mixed economy does not imply that it will grow into what many people once thought to be its rationale, i.e., a socialist pattern of society. In fact, a mixed economy is an unstable blend of different features, which is dynamically compatible with different outcomes. Which outcome finall

prevails depends on a changing balance of social forces and also on the ability of the political processes to find corridors of action."

The mixed economy framework in India has tended to favour relatively rich on account of their strong economic position. Suresh D. Tendulkar contends that when the feature of market based decentralised.

Problem of Unequal Distribution of Income

In India there is no official organisation to compile data on income distribution. In 1960 the Committee on Distribution of Income and Levels of Living under the Chairmanship of P.C. Mahalanobis was appointed to look into the question of distribution of income. Since then a similar attempt has not been made again. However, the National Council of Applied Economic Research (NCAER) and some individual researchers have examined the pattern of income distribution in India at different points of time. Their results are not strictly comparable on account of differences in their methodology and data sources. However, they are good enough to provide a reasonably clear picture of the income distribution during the past five decades. Moreover, India lacks data which may be used for estimating income distribution directly. This is perhaps the reason why in almost all studies the data on consumption expenditure obtained from the household surveys have been used along with the income tax data.

Income Inequalities during the First Three Decades of the Planning Period

Income distribution in different years/periods during the 1950s was estimated by F.H.lydall, 1 N.S. Iyengar and M. Mukherjee,2 the RBI3 and the NCAER. The broad picture that emerges from these estimates is as follows: It appears from the estimates of Lydall and the NCAER that the top 10 percent of the households had received about 35 percent of the income. According to the estimates of the Reserve bank and Iyengar and Mukherjee, the top 10 percent households accounted for about 25 per cent to 28 per cent of the income. All the estimates except the one made by the NCAER suggest that the bottom 20 per cent received about 8 to 9 percent of the income. While in terms of the NCAER estimates their share was about half of what was indicated by the other studies. Further, both the NCAER and the Reserve Bank studies suggest that into h 1950s the distribution of personal income in the urban sector was more unequal than in the rural sector.

The NCAER and P.D. Ojha and V.V. Bhatt estimated personal income distribution at different points of time during the second decide of the planning period. The NCAER carried out nationwide surveys during the 1960s to collect data on consumption expenditure in 1964-65. Its data on income distribution in 1964-65 are a by-product of this survey. Ojha and Bhatt in their study4 of income distribution in during 1963-64 and 1964-65 relied on all available data from various sources. They used the CSO data on national income, estimates of direct taxes paid by unincorporated business, and households saving data for estimating the aggregate consumption expenditure which they distributed among the docile expenditure groups of population on the basis of relevant NSS percentage distribution. On the assumption that savings in this country are done only by the richest, they were added to the consumption expenditure to the top most group. For all other group, income was taken as equivalent to their consumption expenditures.

Though the different estimates used for explaining at different points of time during the second decade of planning suffer from various data problems, yet their results are strikingly similar. Taking all the estimates together, it can be said that the bottom 20 per cent of the population had a share of about 7.5 per cent of total personal income; the top 20 per cent of the population had a share of about 47 per cent; and the Lorenz ratio was between 0.35 and 0.39. Further, the income share rose relatively showly on moving from lower deciles to upper deciles. Only when we go up from the seventh or eighth docile to the top most docile, we notice

a significant increase, that is, between 2 and 3 times that of the preceding decile [illegible] extreme concentration of income at the top which is typical of many underdeveloped [illegible]ntries. [illegible] was greater concentration of income in the urban sector than in the rural sector. [illegible] annual income of the topmost decile was about 18 times that of the lowest decile in urban [illegible] the rural sector it was about 10 times.

The Planning Commission in the Draft Five Year Plan 1978-83 observed, " Trends in the distribution [illegible] and wealth are difficult to discern, but the evidence of persistence of gross inequalities is clear. [illegible] consumption expenditure (data source : National Sample Survey---28th Round) shows that in [illegible] lowest 20percent accounted for 38 percent. For urban areas the corresponding figures were [illegible] and 40 per cent. The concentration ratios for two distributions were 0.27 and 0.30. The inequality [illegible] for both groups would be greater than consumption inequalities."

The planning commission's view that income inequalities are far greater than consumption [illegible] corroborated by the World Bank estimates of income inequalities. The World Bank estimates [illegible] are based on the results of a joint project of the World bank and the International Labour Organisation [illegible] estimates show that in 1975-76 the lowest 20 per cent households (rural and urban households [illegible]) accounted for 7 per cent of the household income while the highest 20 per cent accounted for [illegible]

N.S. Iyengar and P.R. Brahmananda have calculated Gini-Lorenz Ratios of the size distribution [illegible] per capita household private consumption expenditure.7 They have used the NSS data on consumer [illegible] expenditure for this purpose. Their results are given in

Table 2: Planwise Average Gini-Lorenz Ratio

Plan	Number of Observations	Rural	Urban
First (1951-56)	6	0.34	[illegible]
Second (1956-60)	6	0.33	[illegible]
Third (1961-65)	4	0.33	[illegible]
1966-68*	3	0.30	[illegible]
Fourth (1969-73)	4	0.29	[illegible]
Fifth (1974-79)	1	0.31	[illegible]
1979-1980*	NA	NA	[illegible]
Sixth (1980-84)	1	0.30	[illegible]

*Annual Plan Years

Source: N.S. Iyenger and P.R. Brahmananda, "Estimated Distribution Parameters and Their Behaviour" [illegible] Brahmananda and V.R. Panchamukhi (eds). The Development Process of the Indian Economy (Bombay [illegible]

From the results given in Table 1 one would be tempted to draw the following conclusions

1. Since during the 1950s the average Gini-Lorenz Ration for both rural and urban areas [illegible] than the Gini-Lorenz Rations for the subsequent decades, inequalities in the distribution of consumption expenditure have declined over time.
2. *From the 1960 onwards upto the end of the Sixth Plan, the Gibni-Lorenz Ratio of the rural areas* [illegible] stable at around 0.30. This implies that during this period spanning two and a half decades inequalities in the rural areas did not increase. The Gini-Lorenz Ratio for the urban areas was stable at [illegible] the two decades period form the mid- 1980s which means that there is no evidence in support [illegible] the commonly held notion that inequalities increased in urban areas.

3. The Gini-Lorenz Ration for the urban areas are about 10-12 per cent higher than the Gini lorenz Ratios for the rural areas. This clearly suggests that inequalities are higher in the urban areas than in the rural areas.

Iyengar and Brahmananda draw exactly these conclusions from the results provided in Table 1 and thus argue, "The hypothesis that growth and development in a poor economy tend to accentuate the skewness of the distribution is not supported by Indian data. In fact, if we take the entire period, we can argue that in a democratic country where political leadership is responsive to public opinion, the degree of skewness may actually get reduced through planning and associated market effects."

Suresh D. Tendulkar is more cautious in drawing conclusions from the Gini coefficients for per capita consumer expenditure over time. In his opinion, the observed reduction in inequality could be a purely monetary illusion. In order to know whether the reduction in inequalities holds good in real terms as well, it is necessary to estimate the relative shares of different groups at constant prices. However, on account of data constraints such an exercise is not possible. Tendulkar, therefore, makes use of the information in relative price movements for different (decile) groups of population to draw the following conclusions:

1. "While it is difficult to provide definitive quantifications", from whatever evidence is available it seems "that relative inequality in levels of living in real terms may possible have been lower towards the mid-1970s than in the early1970s."
2. For the post 1973-74 period "it is not possible to make any statement regarding the time-trends or movements in real terms of relative levels of living, " because of the non-availability of "the estimates regarding the relative rates of growth of prices faced by bottom and the top fractiles of the population corresponding to the pre-1973-74 period."

From the G.....-Lorenz Ratios now available it is not correct to conclude that inequalities of income distribution have also diminished. In the first place, the NSS data which Iyengar and Brahmannada and some other economists have used for calculating the Gini-coefficients are not wholly reliable inerspect of consumption expenditures of higher expenditure groups. The rich in India who have a natural tendency to evade taxes understate their consumption. Moreover, the value of the perquisites enjoyed by the business executives is not likely to be reflected in the NSS consumption expenditure data.10 Further, over time saving rate in India has risen. Iyengar-Brahmannanda study should have taken note of this fact before arriving at the conclusion that income inequalities have diminished merely on the basis of the private nominal consumption expenditure of the various groups. Saving are done mostly by the rich. Therefore, if the saving rate has risen over time, it implies that the income of the higher income groups has risen faster than their consumption expenditure. Under the circumstances it is thus quite likely that the income distribution has not improved though over time, according to Iyengar and Brahmananda's study, distribution of private consumption expenditure in money terms has undergone a change for the better.

The World Bank Estimates for the 1980s and 1990s

The World Bank estimates for 1983, 1989-90, 1994 and 1997 (provided in Table 2) related to distribution of household expenditure and are thus not comparable to its estimates for 1975-76 which relate to distribution of income. These estimates are based on household survey data presently available.

Table 2: Percentage Share of Household Expenditure by Percentile Groups of Households

Percentile groups of Households	1983	1989-90	1994	1997
Lowest 20 percent	8.1	8.8	9.2	8.1
Second quintile	12.3	12.5	13.0	11.0
Third quintile	16.3	16.2	16.8	15.0
Fourth quintile	22.0	21.3	21.7	19.3
Highest 20 percent	41.4	41.3	39.3	46.1
Highest 10 percent	26.7	27.1	25.0	33.5

Source : The World Bank, World Development Report 1992, Table 30, pp. 276-7; World Development 1993, Table 30, pp. 296-7, and World Development Report 1999/2000 Table 5, pp. 238.9.

According to the World Bank's estimates of household expenditure distribution, it is clear that between 1983 and 1989-90, there was very little change in the expenditure distribution. In 1983 the top 20 per cent households had accounted for 41.4 per cent of the expenditure. In 1989-90 also their share in household expenditure remained almost the same (41.3 per cent). However, the share of lowest 20 per cent of the households rose from 8.1 per cent in 11983 to 8.8 per cent on 1989-90. The gain of this group of households was at the cost of the fourth quintile group of households whose share in household expenditure declined from 22.0 percent to 21.3 per cent over the same period. Between 1989-90 and 1994 there seems to be some improvement in the distribution of household expenditure. In this period while the share of the lowest 40 per cent in household expenditure increased from 21.3 per cent, that of the highest 20 per cent decreased from 41.3 per cent to 39.3 per cent.

During three years from 1994 distribution of consumption expenditure became more inequitable. These were the years of liberalization policy. In these years the share of the highest 20 per cent population rose sharply from 39.3 per cent to 46.1 per cent. Rest of the population suffered a set back as the shares of population in other quintile groups registered a sharp decline. The inequality of incomes in 1983, 1980-90, 1994 and 1997 must have been far greater than expenditure inequalities because whereas the first and second quintile groups of households constituting the households below the poverty line could do no savings, the highest 20 per cent households did country's most of the savings. Further, there has been a significant increase in the savings of the household sector since 1983 which reflects a rapid increase in the income of the highest 20 per cent.

During the last two decades black income has increased substantially. It is supposed to have grown from 20 per cent of the GDP in 1981 to 40 per cent by 1995-96 This black income is obviously concentrated in the hands of the highest 20 per cent population. If these facts are taken into consideration then we will find that the inequality of incomes has increased significantly during the 1980s and 1990s.

Causes of Income Inequalities in India

The foregoing evidence candidly shows that there are glaring income income inequalities in India and that these income inequalities have tended to increase in recent years. Let us now examine why Unjustifiable inequalities exist in India and what prevents us from eliminating them. Protagonists of class societies have always argued that income inequalities arise from basic differences in the capabilities of the people. Though this argument apparently looks convincing, it is not correct. Natural differences among people can never explain the incomes of top elite on the one hand and blatant destitution of the mass of the population on the other. In India, there tow basic causes of income inequalities: (i) the existing economic system based on the institution of private property, and (ii) the law the inheritance. At a very high level of national income per capita these factors may not result in mass poverty but in a country like India where national income per capita is very low, they inevitably lead to denial of basic necessities to a very large section of population

Private Ownership of Property

India has a mixed capitalist economy. In this economic system people enjoy a right to property. Therefore, not only land, buildings, automobiles, etc., are owned by individuals, but the means of production like factories, buses, farm land, mines etc., are also possessed by private companies and persons. Broadly, people in the country are divided into two main classes. In the first category, we may include all those who own means of production and other property. Their main source of income is their property. In the second category we may include rest of the people. Since these persons have no property, they rely on their labour power for their subsistence. Except some professionals belonging to this class, all other people falling in this category are poor. Now we propose to explain how income inequalities have arisen in this country from private ownership of property.

1. ***Inequalities in land ownership and concentration of tangible wealth in the rural sector.*** There was concentration of landed property in India during the British period on account of the Zamibndari system. The zamindari system was abolished immediately after Independence, yet the concentration of land ownership could not be broken. According to NSS (26 th Round), in 1971-72 big and large farmers constituting 5.44 per cent of the peasant households possessed 39.43 per cent of the total agricultural land while the marginal farmers (below 1 acre) constituting 43.99 per cent of the peasant households owned only 1.58 per cent land. An examination of the concentration of land ownership also reveals that over time not only the absolute number of tiny holdings has increased, but the average size of the holding of marginal farmers had also registered a decline from 0.27 acre in 1953-54 to 0.14 acre in 1971-72. In contrast, small, medium and big farmers managed to prevent any decline in the average size of their holding. Even in the case of large farmers the average size of holding declined by only 16.8 per cent, and in 1971-72, it was as large as 73.8 acres. There is no evidence to suggest that since that since 1971-72 the pattern of distribution of land has changed.

   Sukhadeo Thorat has computed data on Gini ratio of landownership distribution for 1961-62, 1971-72, 1982 and 1992. Since the mean of Gini ratio for these years is as high as 0.710, there is clear evidence of a high concentration of landownership. Further, a low standard deviation of 0.003 suggests that over time landownship distribution has not changed.11 Further, the data for the size distribution of nominal value of assets for rural households suggest that over the years there has been no significant decline in concentration of wealth. The Gini coefficients for the years 1962, 1971 and 1981 are 0.652, 0.659 and 0.635 respectively.12 Almost all experts are of the view that the major cause of income inequalities in the rural sector is the concentrated ownership of land and other assets. In their attempt to identify rural poor Minhas, Dandekar and Rath and Bardhan have clearly stated that all agricultural workers and marginal and small farmers with less than 2 hectare holdings are poor. Incomes of big and large farmers may not be vary high, at the same time there is no denying the fact that they are certainly high by Indian standards and since the green revolution they have been steadily rising. Now big and large farmers not only have capacity to save, they also have an access to institutional finance. Naturally they are attempting to improve the farm techniques. These efforts over the years have not only raised the earning of these farmers, but have also accentuated income inequalities in the countryside.

2. ***Private ownership of industries, trade and buildings.*** India's social system permits private ownership of industries, business and buildings. Hence microscopic minority has acquired control over vast assets. Industrial and business houses easily obtain capital from banks and other financial institutions, besides equity capital which they raise from the market. This is the reason why even in the period of recession their assets continue to increase. The evidence on the concentration of assets in the private corporate sector indicates that in the two-decade period from 1951 to 1971 only between 1958 and 1964 share of certain (comparable) Monopoly groups in the total assets of the private sector did not rise. In the remaining fourteen years there was a clear trend of assets concentration. Between 1971 and 1975 it seems that the share of these monopoly groups remained constant. On the basis of this evidence, Tendulkar states, "The conclusion seems plausible that concentration of economic power in the private corporate sector at best remained unchanged during the growth oriented phase and possibly increased during the deceleration phase."13 The control measures of the government to prevent these monopoly trends have been found defective.

   A survey conducted by NCAER for the year 1975-76 indicated that the distribution of assets in urban areas was very much skewed. In this year the top10 per cent had accounted for 46.28 per cent of the total wealth in urban areas as against a mere 11.67 per cent wealth being in possession of the

bottom 60 per cent. A survey conducted by the National Sample Survey for the year 1981-82 also indicates a highly skewed distribution of tangible assets in urban areas. This pattern of assets distribution has enabled the industrialists, traders, transporters and owners of urban property to prosper over the years. In fact, they have been the real beneficiaries of growth. Most of these persons are men of average intelligence, and yet their incomes are very high because they have control over the means of production. In contrast, many intelligent and enterprising person never get any opportunity in their life time and live on moderate earnings merely because their only asset is their labour power. Workers employed in the unorganised sector and the unemployed persons belonging to the lower strata of the society generally constitute the class of poor in urban areas.

3. **Inequalities in professional training**. Incomes of business executives, engineers, information technologists, physicians, lawyers and other professionals are often high and from this fact emanates the false notion that income inequalities arise from professional competence or lack of it. On superficial consideration this may look convincing, but the truth is otherwise. In a class society like ours, training required for professional competence is not available to all. Only children belonging to elite families have workers and socially handicapped like tribal and dalits cannot hope to get this education. Therefore, even the education and training which perpetuate inequalities in income distribution in this country have their roots in unequal distribution of wealth and private property.

Inheritance Law

The existing inheritance law in India perpetuates income inequalities. This fact must be given a serious thought why son of a capitalist becomes a capitalist, while son of an agricultural labourer becomes an agricultural labourer or at best an industrial worker. The reason is obvious. According to India's inheritance law, property of the father is inherited by his children and hence sons and daughters of industrialists, traders, big farmers, transporters and other wealthy persons automatically get resources where by they easily manage large incomes. In contrast, children of workers rarely inherit any persons. Therefore, the law of inheritance is one such institution in the country, which besides accentuating income inequalities also provides legitimacy to them.

Other Causes

A part from the two basic causes of existing income inequalities discussed above, there are a few other factor which also have a bearing on inequalities. The most important of them are as follows:

1. **Inflation and the price rise**. Since the mid-1950s prices have been rising continuously eroding the real income of the working class, while the industrialists, traders, and farmers with large marketable surplus have benefited a great deal from this inflationary process. In India, very little has been done to offset this redistributive effect of inflation, and as a result it has greatly accentuated income inequalities.

2. **Inequity in credit facilities**. In India, there is inequity in credit facilities which accentuates the inequalities arising from an unequal distribution of wealth. Business firms and individuals having an access to the formal capital markets manage to obtain finance on very favorable terms, while vast mass of small and marginal farmers, agricultural labourers and artisans depend heavily on moneylenders who charge an exorbitant rate of interest and also exploit these poor people in a number of ways.

3. **Urban bias in private investment**, while 70 per cent of the population in this country lives in rural areas, about 70 per cent of private investment goes to industries in urban areas. Therefore, there is a distinct 'urban bias' in the pattern of private investment. This urban bias takes the form of highly mechanised projects in which the share of wages in value added is relatively low.14 Therefore, as

noted by Keith Griffin, "the rate of employment creation in the capital-intensive sector is slow, sometimes not even as fast as the rate of growth of the labour force."15 This naturally leads to inequality in income distribution.

4. ***The role of the government.*** Though the State is often proclaimed as a 'procures' and 'initiator' of economic change in India, the fact is that the State investment essentially plays a supportive role to private investment (especially the large and capital-intensive enterprises). This is due to the fact that the State depends for its support on the same social forces which own the wealth of the country and supply the technicians, administrators and the dominant political groups. In such an environment, the government merely guards the status quo and adopts policies which, on balance, are designed to perpetuate the hegemony f the propertied classes and those allied to them. Even the public expenditure policies in the field of social welfare, i.e., health, education, social security and public housing help the relatively better off people more than they help the wretched poor belonging to the lowest income groups.

Government Policy and Measures

In the earlier phase of economic planning, elimination of inequalities in income distribution was one of the proclaimed objectives of the government in this country. Plan documents and policy declarations of the State from time to time indicated various measures for reducing income inequalities. These measures can broadly be grouped into two categories: (i) those expected to affect income generation, and (ii) those expected to affect income accruing to individuals and /or households. In the first category we may include measures which affect the distribution of wealth and productive assets, investment and technological choices and returns to factor. Taxation policies, provision of commodities and or services at subsidized prices, social security and welfare measures, etc., belong to the second category.

The whole approach of the government towards redistribution of existing income and wealth is aptly summarised in Nehru's oft-quoted phrase, "in a poor country there is only poverty to redistribute". The government in this country never appreciated the idea of transfer of resources from the rich to the poor to ameliorate their condition.. In fact, it insisted that only through rapid overall growth of the economy a lasting impact could be made on the living standards of the poorer sections of the society. In order to achieve this objective whatever resources the State could mobilize were to be channeled into the most productive activities. This strategy was evolved under the ideological influence of the World Bank economists who had illusions in that period about the possibilities of the 'spread effects' of overall growth. However, by the end of the 1960s the myth of the 'spread effect' strategy was exploded as more and more information became available about the increasing concentration of wealth and income in underdeveloped countries. In a society with an unequal distribution of assets and power, growth often failed to redistribute income and to eradicate poverty.17 The Indian experience in this regard was not unique. In this country, economic growth had been slow and there is enough evidence to show that the most vulnerable sections of population had not benefited from it. In the light of this experience the government revised its policy towards the problem of poverty. In fact, on the distributional front, the focus shifted from relative inequality to absolute poverty.18 With this shift in the approach, the government did undertake certain measures to alleviate poverty. We shall now discuss them and also the measures to prevent concentration of economic power and try to assess if they made any impact on income inequalities.

Land Reforms and redistribution of agricultural land. It is a well-known fact that income inequalities in the rural sector emanate mainly from the concentration of agricultural land. Before the abolition of the Zamindari system most of the land belonged to the absentee landlords who appropriated a large portion of

the agricultural production while the tiller for the soil got hardly enough for subsistence. Thus legislative measures were undertaken to abolish landlords and other intermediaries and ceilings on holdings were fixed. Serious attempts to carry out these reforms would have broken the concentration of agricultural land. But unfortunately not only the legislative measures to carryout land reforms were inadequate and defective, their implementation was also scuttled at various levels. As a consequence, even now about 40 per cent of the agricultural land belongs to top 5.0 per cent of the rural household. Dandekar and Rath who have examined the issue at length are, however, of the opinion that redistribution of agricultural land has limited utility from the point of view of alleviating poverty. They observe: "However simple it may appear, it is futile to try to resolve the problem of rural poverty, in an overpopulated land, by redistribution of land which is in short supply ... (Further) any drastic lowering of the ceilings and redistribution of the surplus to the landless workers will serve no useful purpose. Firstly, it does not meet the problem of rural poverty. Secondly, it is not a feasible solution in the sense of one which can be maintained in the face of the economic forces operating in the economy ...Thirdly, it nullifies the major impetus which the recent technological advances have given to agricultural development." Minhas also concludes, "By itself, a radical distribution policy ... would not be able to solve the problem of adject poverty." The practical experience of land reforms in West Bengal, however, contradicts the arguments of Dandekar, Rath andMinhas. Abhijit V. Banerjee, Paul Gertler and Maireesh Ghatak state, "Land reform is a classic example of a redistributive policy. Operation Barga, a tenancy reform in the Indian State of West Bengal in the late 1970s and early 1980s, is one of the few examples of large-scale transfers of property rights not accompanied by major social upheaval..The operation was associated with an 18 per cent increase in agricultural output in the State." Obviously with so much increase in agricultural production as a result of land reform in West Bengal, inequalities in income in the rural sector must have been reduced.

Control over monopolies and restrictive trade practices. Control of monopoly tendencies is considered necessary for reducing income inequalities. However, for more than two decades since this country got Independence virtually nothing was done to prevent the growth of monopolies. The Monopolies and Restrictive Trade Practices Act was oassed as late as 1969. It was stated in the preamble of the Act that it would permit operation of the economic system only in the manner that the growth of monopolies resulting in concentration of economic power did not take place. The Act thus provided for control over monopolies and also for prohibiting restrictive trade practices. In case of business houses indulging in objectionable restrictive trade practices, their cases were to be handed over to the Monopolies and Restrictive Trade Practices Commission whose judgment would be binding on erring enterprises. In Practics, these measures were found rather inadequate and ineffective.. Not only this, the government further liberalised these measures on one pretext or the other.22 Even earlier the industrial licensing machinery which was expected to protect and encourage small industries had failed. Both the Hazari Committee of the Planning Commission (1967) and the Dutt Committee of the Government of India had noted that the bigger industrial houses had utilised the licensing system to the detriment of small enterprises. Now with the increasing stress on liberalisation in the industrial sector, it is very likely that monopoly trends are further strengthened and economic disparities increase

Employment and wage policies.:- until the Fourth Five Year Plan the employment objective was not taken seriously. T.N. Srinivasan has succinctly remarked that "employment schemes proposed in the plans were like frills added to their structure." However, since the beginning of the Fourth Plan some special programmes have been undertaken such as the Crash Scheme of Rural Employment, the Drought Prone Areas Programme, self employment schemes for engineers, employment schemes for educated unemployed, Food for Work Programme and so on. These programmes were short lived as they were undertaken in an ad hoc manner. The Intergrated Rural Development Programme (IRDP) was started in 1978-79 and extended to the entire during the Sixth Plan period. The Integrated Rural Development Programme, the National Rural Employment

Programme (NREP) and the Rural Landless Employment Guarantee Programme (RLEGP) aimed at providing employment to the rural poor with a view to eliminating poverty in the country side. On April 1,1989 and NREP and the RLEGP were merged into the Jawahar Rozgar Yojana. No doubt these attempts were in the right direction, but the experience at the implementation level in the past has been very disappointing. M.L.Dantwala has noted that in the past while some schemes could not be implemented because funds were not available, there were others in which funds sanctioned could not be spent for lack of suitable projects. The government is no longer committed to work for employment generation. Hence the existing employment programmes have been reduced to a ritualistic exercise devoid of any substance.

Role of statutory minimum wage un ameliorating the condition of the poor is limited in this country. In India, hardly 10 per cent of the working population is presently employed in the organised sector. The statutory wage provisions become unenforceable and ineffective, particularly in the countryside where agricultural labour is not only ignorant of law, but is also unorganised and oppressed. In contrast, the workers in the organised sector have been able to maintain, and in certain cases, even improve their incomes over the years.

Social security measures. Although the country does not have a comprehensive social security system, yet there are some social security provisions which are expected to help the workers I the orgainsed sector. For example, the Workmen's Compensation Act entitles industrial workers to compensation in case of injury resulting in death, disability or disease while on duty. Similarly the Maternity benefit Act regulars the employment of women workers for certain periods before and after child birth and the employees Provident Fund Act entitles workers employed in organised industries to the benefit of provident fund. The most comprehensive social security measure, however, is the employees State Insurance Act which entitles the insured workers to medical benefits, disability benefit, benefits for the period of sickness, maternity benefit and benefits to dependents. Undoubtedly, these social security measures are of great importance and their contribution in alleviating destitution in urban life is not small. Nonetheless, social scientists and other experts insist that unemployment dole and old age pension are the only measures which make a frontal attack on poverty. Unfortunately these measures have not been introduced in India as yet.

Minimum Needs Programme. Since the beginning of 970s a very influential section of development economists has started asking for the pursuit of the minimum needs programme in developing countries. They assert that the benefits of growth do not automatically percolate downwards and thus less developed countries have no choice except to pay direct attention to the basic needs of the people at the lowest strata of the society. They further argue that it would be wrong to believe that there is necessarily a conflict between the two objectives, viz, the basic needs and growth. Their assertion is that while ensuring of the fulfillment of the basic needs dopes not hinder economic growth, the reverse, as the experience in the various developing countries has proved, is not true.25 This approach influenced the planners in this country also. In the late 1970s and early 1980s the planners argued that the Minimum Needs Programme which was introduced in the Fifth Plan was not only directed towards the alleviation of poverty but also aimed at assisting economic growth. The Sixth Five Year Plan stated thus, "The Programme is essentially an investment in human resources development. The provision of free or subsidised services through public agencies is expected to improve the consumption levels of those living below the poverty line and thereby improve the productive efficiency of both the rural and urban workers. This integration of social consumption programmes with economic development programmes is necessary to accelerate growth and to ensure the achievement of plan objectives." With the introduction of liberalisation measures in the 1990s, the government has abandoned this approach.

Programmes for the uplift of the rural poor. The hard core of the poverty is to be found in the rural areas. The poorest sections belong to the families of landless agricultural labourers, small and marginal

farmers, rural artisans, Scheduled Castes and Scheduled Tribes. In order to raise income of these categories of people broadly the following three types of programmes have been undertaken : (i) Resource and income development programme for the rural poor, (ii) Special area development programme, and (iii) Works programme for creation of summplementary employment opportunities. A number of programmes falling in one category or the other have been in operation in the country for as much as the last two and a half decades and a few others were introduced under the Sixth Plan and Seventh Plan. The planning commission has noted that the earlier programmes were often overlapping. They not only faced difficulties in effective monitoring and accounting but also lacked a clear perspective. "In practice, therefore, these programmes were reduced to mere subsidy giving progammes shorn of any planned approach to the development of the rural poor as an in-built process in the development of the area and its resources. The Sixth Plan intended to overcome these problems by undertaking one single integrated programme known as the Integrated Rural Development Programme (IRDP). This programme aimed at helping the rural poor in more than one way. But its major thrust was on the creation of productive assets for the vulnerable sections of the rural population. Since seasonal unemployment and underemployment are the major factors in rural poverty, a special programme known as the National Rural Employment Programme was conceived to eliminate unemployment in the countryside. The Seventh Five Year Plan claimed that the two anti-poverty programmes started under the Sixth plan and considerably benefited the rural poor. On April 1, 1989 a comprehensive employment programme was adopted, and the NREP, the RLEGP and the Jawaharlal Nehru Rozgar Yojana were merged into it. The merged progamme was named Jawahar Rozgar Yojana (JRY). The JRY has been restructured with effect from April 1999 and has been renamed as Jawahar Gram Samridhi Yojana (JGSY).

Taxation. Looking at the taxation structure and the degree of progression in the rates of direct taxes one gets the impression that the Indian tax system is progressive and has been designed to prevent concentration of wealth in a few hands. Is it really so? This question is difficult to answer. It requires information about the actual and not disclosed incomes. There is large undisclosed income of the people in the topmost income brackets which no economist can hope to know. Amaresh Bagchi rightly asserts, "The sharpness of progression in the nominal rates is, however, no guarantee to the redistributive effect of tax. Much depends on the extent to which the tax base comprehends the various ingredients of ecnomic power. The base on which income tax is levied in India corresponds to what is called in the tax jargon a `realized income' and is arrieved at after allowing for all expenses of earning (subject to a few restrictions). In addition, the law allows numerous exemptions and deductions in order to promote various "non-tax" objectives. No systematic attempts has been made to examine how the Indian income tax base compares with a true index of the economic position of the tax payers such as the net accretion concept of income which is more relevant for judging the impact of taxes on the distribution of the command over goods and services in the community. Data required for such an enquiry are simply not available." Thus on the basis of superficial examination of the tax rates it would be wrong to claim that Indian tax system redistributes income in favour of the poorest sections of the society. Taxation of income on the basis of realization, as is the practice in this country, does not touch the major source of inequality.

To sum up, the various measures supposedly undertaken by the government have made little impact on poverty, and thus income inequalities perpectuate in their ugliest form. For the removal of inequalities of income two measures are most necessary. First, the private ownership of property must be abolished, and secondly, the unnatural and arbitrary law of inheritance should be diluted. But no government in a capitalist country will agree to adopt these measures. As a matter of fact, one should not except ruling classes to pursue a policy which goes against their own interests. In this country, although rich and poor, literate and illiterate, men and women, all participate in electing the government, yet the power always remains in the hands of capitalists, landlords and rich farmers. Under these circumstances one should not expect any positive approach

from the government for the elimination of economic disparities. Ashok Rudra asserts that "the government's price policy, investment policy and production policy all go to increase inequality among different sections of population in the matter of their standard of living. These different sections, affected by the government's economic policy, are defined by their production relations.

Lately in the liberalization decade the government has abandoned even the hypocritical commitment to reduce income inequalities and its results are there for everyone to see. Income inequalities have rapidly increased during the 1990s. The World Bank's estimates of consumption expenditure distribution to which we have referred to earlier in this chapter unequivocally substantiate this fact.

Earlier it was hoped that with increasing consciousness the poor and deprived would build pressure on the government for certain concessions and this could prevent widening of the gap between the rich and the poor. However, this possibility is now to be rules out. The correlation of forces at the moment is not in favour of the poor and the middle class and the partisan State ruthlessly intervenes all the time in favour of the rich. This process is likely to continue for some time and thus in coming years income inequalities would certainly continue to increase.

Rural Development

Majority of people in our country, as is well known, live in villages. The living conditions of villagers are far from satisfactory. Anything that is done in the direction of improving their living conditions is welcome. The Government of India is doing a yeoman service in this direction under its Integrated Rural Development Programme (IRDP). The efforts of the government need to be supplemented by business establishments, because the task of making living decent and comfortable for villagers is stupendous, considering the number of villages in our country and their geographical spread.

What specific activities can-business undertake in the name of rural development? There are many urgent and important facilities to be provided such as god roads, drinking water, employment, medical aid, family planning, housing, schools and nutrition programmes

Many progressive business houses have adopted certain villages for their all-round development. Particular mention may be made of the public sector giant Bharat Heavy Electrical Ltd. (BHEL) which has carved out a name for itself in this direction.

There are other instances also. An IMRB study conducted recently reveals that 83 percent of the 150 sample companies are active in rural development. On top are the Tates who had set up Tata Steel Rural Development Society, way back in 1979 itself. Mafalals were also one of the first industrialists to set up a rural development organisation, viz., Satguru Seva Sangh. Many companies are active in playing a facilitative role in implementing World Bank sponsored projects or the government's Integrated Rural Development projects. Mangalore Chemicals and Fertilizers(MCF), a UB group company, has been involved in socio-economic development work for several years now. In 1975, the United Kingdom, under what is known as the Colombo Plan, granted aid for the overall growth of villages in the developing countries. As part of the aid, 2,700 million tonnes of fertiliser was supplied to MCF by the UK government to undertake overall development activities in the under developed regions of Karnataka. MCF sold this and with the proceeds, created a corpus of Rs. 40 lakh.

MCF surveyed several villages in the districts of Bellary and Raichur, keeping in view the irrigation potential, agricultural practices followed, adequate representation of small and medium land holding farmers as also rural artisans and selected Sangankal village of Bellary district and Herur village of Gangavathi taluk of Raichur taluk of Raichur district for implementation of the project. The project name is rather a mouthful:

UK-MCF-TGB. Introduction of double cropping, use of balanced fertilisers, better water management etc. are a few of the achievements which have increased the income of farm families from Rs. 4,000 to Rs. 10,000 annually. From the interest accrual on the corpus fund of Rs. 40 lakh the trust has so far spent Rs.21.26 lakh towards various developmental activities.

Further down South, SPIC's agro-services centres (ASC) are yielding similar results. 10 ASCs were set up in Tamil Nadu. Toda there are 21 and extend to the neighbouring states of Andhra Pradesh, Karnataka and Pondicherry. Each ASC has 10 villages attached to it as satellite villages, located within a radius of 10-15 km from the main centre.

Apart from the ASCs, SPIC has rural development centres in Tamil Nadu and Andhra Pradesh for training in scientific farming and helping in integrated farming efforts, the agricultural and rural development programmes are conducted by technical assistants. Necessary tools like tractors with accessories, pre-fabricated buildings, agricultural implements and plant protection equipment are offered at subsidised rental rates.

Consumerism in India

An important socio-political environment confronting the business is the growth of consumerism and the legislative measures to protect the consumers. Consumer movement had its conspicuous beginning and development in the United States. There has been a growth of consumer awareness in most countries leading to growth of consumerism and growing demand for consumer protection.

Through consumerism is not well developed in India, there are several consumer organizations in India like the Consumer Guidance Society of India (CGSI), Mumbai, and the Consumer Education and Research Centre (CERC), Ahmedabad, which are doing commendable work. Some of these organizations are very active in conducting product testing and exposing substandard quality and adulteration. The demand for regulatory measures or effective implementation of available measures for consumer protection have been substantiated by the results of such tests. ISI certification of food colours, demanded by the C.G.S.I., is now mandatory. Consumer organizations also play an important role in redressing consumer grievances.

Since 1993, the Consumer Education and Research Society (CERS), sponsored by the CERC, has been performing a very bold and commendable task of comparative testing of consumer goods at their in – house laboratory, and since 1998 its publication INSIGHT – The Consumer Magazine has been carrying our test results far and near. The media have been publishing the test findings. These test results enable the consumers to evaluate and compare product of different companies. The manufacturers can, therefore, no longer be complacent.

Consumer movement is growing, albeit slowly, in India. It may gather momentum from the growing consumer awareness and the growing feeling that the consumer is ruthlessly exploited and taken for a ride. Many products fail to satisfy the quality requirements and many sellers do not favourably respond to the genuine grievances of consumers.

Many products tests conducted by some consumer organizations have brought to light alarming facts regarding product quality and safety and, they have, therefore, been very vehemently demanding governmental action ensuring equality standards. Consumers have been increasingly taking resort to redressal measures. In short, the business can no more taken the consumer for granted.

This does not, however, mean that consumerism is necessarily a problem for the business. Consumerism is, in fact, regarded as an opportunity by consumer oriented businessmen, as described later in this chapter.

Consumer Rights

Consumers in the advanced countries, obviously, are much more conscious of their rights than in countries like India. In 1962 President John F. Kennedy and in 1965 President Johnson emphasized the consumer rights and gave an impetus to consumerism in the U.S.A. and other countries.

Important consumer rights include :

1. Right against exploitation by unfair trade practices.
2. Right to protection of health and safety from the goods and services the consumers buy or are offered free.
3. Right to be informed of the quality and performance standards, ingredients of the product, operational requirements, freshness of the product, possible adverse side effects and other relevant facts concerning the product or service.
4. Right to be heard if there is any grievance or suggestions.
5. Right to get the genuine grievances redressed.
6. Right to choose the best from a variety of offers.
7. Right to a physical environment that will protect and enhance the quality of life.

The Consumer Protection Act, 1986, has listed the consumer right it seeks to protect in India. Details of the Act are given at the end of the Chapter.

Exploitation of Consumers

Consumers are, however, by and large, practically denied most of these rights. They are exploited by a large number of restrictive and unfair trade practices. A situation has developed in which the public have become victims of false claims for products blatantly advertised. Behavioural science is extensively applied to marketing to ruthlessly, exploit the consumers by stimulating the weak points and soft corners of their mind. Misleading, false or deceptive advertisements are quite common. Many a time the advertisements deliberately give only half truths so as to give a different impression than is the actual fact. Thus, advertisements may, be misleading because things that should be said have not been said, or because advertisements are composed or purposefully presented in such a way as to mislead. The situation is such that misrepresentations about the quality of a product or the potency of a drug or medicine can be projected without much risk.

As the High-Powered Expert Committee on Companies and MRTP Acts, popularly known as the Sachar Committee, points out, fictitious bargains are another common from of deception. Many devices are used to lure buyers into believing that they are getting something for nothing or at a nominal value for their money. Prices may be advertised as generally reduced and cut when in reality the goods may be sold at sellers' regular prices.

Thus, apart from the monopolistic and restrictive trade practices that have the effect of restricting competition and increasing the market imperfections to the common detriment, consumer exploitation through unfair trade practices that mislead or dupe the customers has become widespread. And it is this situation that has largely led to the growth of consumerism.

Consumerism

Philip Kotler defines Consumerism as "a social movement seeking to augment the rights and powers of the buyers in relation to sellers". Boyd and Allen state that "although often abused as a term, consumerism may be best defined as a dedication of those activities of both pubic and private organizations which are designed

to protect individuals from practices that impinge upon their rights as consumers."

In his speech delivered at the 44th Annual General Meeting of Hindustan Level Ltd., in 1977, the Chairman Mr. T. Thomas, rightly pointed out : "While the producer has the power or the right to design the product distribute, advertise and price it, the consumer has only the power of not buying it. One may argue that the producer runs the greater risk in spite of having several rights because the veto power remains with the consumer. However, the consumer often feels that while he has the power of veto, he is not always fully equipped to exercise that power in his best interests.

This situation may be the effect of lack of information, too much indigestible information or even misinformation from one or several producers. This problem facing the consumer has led to 'consumerism'. It is worthwhile to note that consumerism, like several other social movements, e.g., independence movement Civil Rights movement, etc., has been the result of a social conflict and cannot, therefore, be wished away. It will be with us till the conflict facing the consumer is resolved".

Consumerism, interpreted as a collective endeavour of the consumers to protect their interests, is a manifestation of the failure of the business, including that of the public sector, and the government to guarantee and ensure the legitimate rights of the consumers.

Consumer Protection

For effective consumer protection, a practical response on the part of three parties, for example, the business the government and the consumers, is essential.

Firstly, the business, comprising the producers and all the elements of the distribution channels, has to pay due regard to consumer rights. The producer has an inescapable responsibility to ensure efficiency in production and the quality of output. He should also resist the temptation to charge exorbitant prices in a seller's market. Many a time, the imperfections on the supply side, like hoarding and black-marketing, mercilessly gouge the consumer. Hence, a socially responsible producer should see to it that whatever is produced reaches the ultimate consumer in time and at reasonable prices.

As T. Thomas observes, "Restraint is best exercised voluntarily than through legislation which will otherwise become inevitable. Advertising agencies and marketing management have a very important role to play in this respect. By overplaying the claims, they will be cutting the very branch on which they are perched."

Secondly, the Government has to come to the rescue of the helpless consumer to prevent him from being mislead, duped, cheated and exploited. It should also take special care of the vulnerable sections.

The UN Guidelines for Consumer Protection points out that "the governmental role in consumer protection is vital and finds expression through policy-making, legislation and the development of institutional capacity for its enforcement. To provide a legal basis for enforcing basic consumer rights, every country needs to have an irreducible minimum of consumer protection legislation, covering physical safety, promotion and protection of consumers' economic interests, standards for the safety and quality of goods and services, distribution facilities, redress, and education and information programmes. Governments also require the necessary machinery to enforce such legislation." The Guidelines encourage Governments to develop, strengthen or maintain a strong consumer protection policy. In so doing, each Government must set its own priorities for the protection of consumers in accordance with its economic and social circumstances and the needs of its population.

The UN Guidelines also calls upon the Government to establish distribution facilities for essential consumer goods and services. It is suggested that Government should, where appropriate, consider; (a) Adopting or maintaining policies to ensure the efficient distribution of goods and services to consumer; where appropriate,

specific policies should be considered to ensure the distribution of essential goods and services where this distribution is endangered, as could be the case particularly in rural areas. Such policies could include assistance for the creation of adequate shortage and retail facilities in rural centres, incentives for consumer self-help and better control of the conditions under which essential goods and services are provided in rural areas; and (b) encouraging the establishment of consumer cooperatives and related trading activities, as well as information about them especially in rural areas.

Further, according to the Guidelines, Governments should establish or maintain legal and/or administrative measures to enable consumers or, as appropriate, relevant organizations to obtain redress through formal or informal procedures that are expeditious, fair, inexpensive and accessible. Such procedures should take particular amount of the need of low-income consumers. Governments should also encourage all enterprises to resolve consumer disputes in a fair, expeditious and informal manner, and to establish voluntary mechanisms, including advisory services and informal complaints procedures, which can provide assistance to consumers. Information on available redress and other dispute-resolving procedures should be made available to consumers.

The motive of private gain tempts business to maximize income by socially undesirable trade practices; and this calls for government intervention. Statutory action to protect the interests of consumers has become quite common. In the United Kingdom, for instance, the Trade Description Act, 1968, prohibits the use of misleading descriptions of goods or services or misleading representation of price reductions. In a number of countries, pro-consumer legislation contains provisions that enable an effected party to seek remedy for compensation for the loss or damage suffered by at the hands of a person who has indulged in prohibited practices. This is a true of the Sherman Act and the Clayton Act of the U.S.A.; Federal Act of Switzerland, the Act Against Restraint of Competition of Spain, the Act concerning Prohibition of Private Monopoly and Maintenance of Fair Trade of Japan, the Trade Practices Act of Australia, the Combines Investigation Act of Canada, etc.

In some countries, statutory bodies are empowered to require the advertiser to substantiate the claims made in the advertisements. For instance, the Federal Trade Commission (FTC) of the United States can seek affirmative disclosures. That is, if information in an advertisement is considered insufficient by the FTC, the Commission may require a company to disclose in its advertising some of the deficiencies or limitations of its product or service so that the consumer can judge its negative, as well as, positive attributes. The FTC can also require the advertisers to submit on demand by the Commission data to back-up advertising claims for a product's safety, performance, quality or price comparability. The intent of this substantiation is to help consumers make more reasoned choices by having information made available to them. Members of many industry groups, including automobiles, appliance, soaps and detergents, television sets. Dentistries, hearing aids, and all over-the counter drugs have been ordered to provide the Commission with documentation in support of their designated advertising claims. Corrective advertising requirements have increasingly been a part of many FTC consent orders. Corrective advertising doctrines are based upon the idea that inaccurate information has already been communicated by advertisers, and that corrective advertising in needed to eliminate the lingering effects of such information.

Thirdly, consumers should accept consumerism as a mean of asserting and enjoying their rights. Consumerism should succeed in making the business and the government more respective to the rights of the consumers. Consumerism is a social force to (i) make the business more honest, efficient, responsive and responsible, and (ii) pressurize the government to adopt the necessary measures to protect consumer interests by guaranteeing their legitimate rights.

Peter Drucker has remarked that "consumerism is the shame of the total marketing concept", implying that the concept it not widely implemented. Consumerism reflects not only the failure of the business to widely implement the marketing compete but also the need to give the business policies a social orientation so as to

enhance long – run social welfare. As Philip Kotler observes, "consumerism is a clarion call for a revised marketing concept". Hence, the original marketing concept has to be broadened to include the societal marketing concept.

"The societal marketing concept calls for customer orientation backed by integrated marketing aimed at generating customer satisfaction and long-run consumer welfare, as the key the attaining long run profitable volume."

As Kother points out, "the addition of long-run consumer welfare asks the businessman to include social and ecological consideration in his product and market planning. He is asked to do it not only to meet his social responsibilities but also because failure to do this may hurt his long run interests as producer. Thus, the message of consumerism is not a setback for marketing but rather points to the next stage in the evolution of enlightened marketing. Just as the sales concept said that sales were all important, and the original marketing concept said that consumer satisfaction as also important, the societal marketing concept has emerged to say that long-run consumer welfare is also important." Hence, he feels that consumerism will be enduring, beneficial, pro-marketing and ultimately profitable. "Consumerism mobilizes the energies of consumers, businessmen and government leaders to seek solutions to several complex problems in a technologically advanced society. One of these is the difference between serving consumer desires efficiently and serving their long-run interests. To marketers, it says that products and marketing practices must be found which combine short-run and long-run values for the consumer. It says that a societal marketing is an advance over the original marketing concept and a basis for earning increased consumer goodwill and profits. The enlightened marketer attempts to satisfy the consumer and hence his total well being on the theory that what is good in the long-run for consumer is good and business."

Non-governmental Organisations : NGOs or voluntary organizations have a very important role in consumer protection. Successful consumer movements almost everywhere owe a lot to the efforts of such consumer advocates.

It may be noted that one of the stated objectives of the U. N Guidelines for Consumer Protection is to facilitate the development of independent consumer groups which should have the freedom to present their views in decision-making processes affecting them. The Guidelines state that consumer organizations should be encouraged to monitor adverse practices, such as the adulteration of foods, false or misleading claims in marketing and service funds. Business and consumer groups should also be encouraged by Government to formulate codes of marketing and other business practices to ensure adequate consumer protection. Consumer groups have a role to a play as well in undertaking education and information programmes, particularly for low-income populations. Promoting the growth of a strong consumer movement and increasing protection for people in their role as consumers are central aims of Consumers International's work. To this end, it assists newly formed consumer groups in developing countries. Consumers International' independence is guaranteed by strict membership rules – organizations that join must be non-profit-making and non-commercial and must operate exclusively in the consumer's interest.

Utility of Consumerism

Well-organised and dynamic consumerism may be expected to produce the following results

1. Producers and sellers will not take the consumer for granted. When consumers are strong enough protect their rights, the business will be compelled to shun unfair trade practices.
2. Consumerism will provide feedback for the business. It will enable the producers to understand consumer grievances, needs and wants. This will assist in the more effective implementation of the marketing concept or the social marketing concept, depending upon the nature of consumerism.

3. Producers will be able to enlist the support of consumers to minimize the imperfections on the distribution front. Several times the supply position is made worse by hoarding and black-marketing by traders. Further, many sellers have a tendency to charge a price which is higher than the actual by giving one or other reason. There is no reason why the consumer and producer should not co-operate to get rid of the unscrupulous traders.

   (The above points indicate that consumerism is an opportunity for honest and dynamic firms. In fact, quite a few leading business view it so).

4. Consumerism will make the government more responsive to consumer interests, prompt it to take necessary. Statutory measures, and make the required institutional arrangements to safeguard consumer rights.

UN Guidelines for Consumer Protection

After many years of hard lobby by the International Organisation of Consumer Unions (later renamed as Consumers International), on 9th April, 1985, the United Nations adopted the Guidelines for Consumer Protection by the General Assembly which provide for enhanced protection of consumers by enunciating various steps and measures around seven themes : 1. Physical Safety, 2. Economic Interests 3. Standards 4. Essential Goods and Services, 5. Redress 6. Education and Information and 7. Health. The Guidelines also provide for international cooperation in the area of consumer protection. These Guidelines were reviewed from time to time by the Un and resolutions adopted to take the issues forward.

Objective : Taking into account the interests and needs of consumers in all countries, particularly those in developing countries; recognizing that consumers often face imbalances in economic terms, educational levels, and bargaining power; and bearing in mind that consumers should have the right of access to non-hazardous products, as well as the importance of promoting just, equitable and sustainable economic and social development, these guidelines for consumer protection have the following objectives :

1. To assist countries in achieving or maintaining adequate protection for their population as consumers.
2. To facilitate production and distribution patterns responsive to the needs and desires of consumers.
3. To encourage high levels of ethical conduct for those engaged in the production and distribution of goods and services to consumers.
4. To assist countries in curbing abusive business practices by all enterprises at the National and international levels which adversely affect consumers.
5. To facilitate the development of independent consumer groups.
6. To further international cooperation in the field of consumer protection.
7. To encourage the development of market conditions which provide consumers with greater choice at lower prices.

General Principles : Governments should develop, strengthen or maintain a strong consumer protection policy, taking into account the guidelines set out below. In so doing, each Government must set its own priorities for the protection of consumers in accordance with the economic and social circumstances of the country, and the need of its population, and bearing in mind the costs and benefits of proposed measures.

The legitimate needs which the guidelines are intended to meet are the following :

1. The protection of consumers from hazards to their health and safety.
2. The promotion and protection of the economic interests of consumers.

3. Access of consumers to adequate information to enable them to make informed choices according to individual wishes and needs.
4. Consumer education.
5. Availability of effective consumer redress.
6. Freedom to form consumer and other relevant groups or organizations and the opportunity of such organizations to present their view in decision-making processes affecting them.

Governments should provide or maintain adequate infrastructure to develop, implement and monitor consumer protection policies. Special are should be taken to ensure that measures for consumer protection are implemented for the benefit of all sectors of the population, particularly the rural population.

All enterprises should obey the relevant laws and regulations of the countries in which they do business. They should also conform to the appropriate provisions of international standards for consumer protection to which the competent authorities of the country in question have agreed.

Guidelines : The following guidelines should apply both to home – produced goods and services and to imports.

In applying any procedures or regulations for consumer protection, due regard should be given to ensuring that they do not become barriers to international trade and that they are consistent with international trade obligations.

Physical Safety : Governments should adopt or encourage the adoption of appropriate measures including legal systems, safety regulations, national or international standards, voluntary standards and the maintenance of safety records to ensure that products are safe for either intended or normally foreseeable use.

Promotion and Protection of Consumers' Economic Interests : Government policies should seek to enable consumers to obtain optimum benefit from their economic resources. They should also seek to achieve the goals to satisfactory production and performance standards, adequate distribution methods, fair business practices, informative marketing and effective protection against practices which could adversely affect the economic interests of consumers and the exercise of choice in the market-place.

Consumers should also be protected from such contractual abuses as one-sided standard contracts, exclusion of essential rights in contracts, and unconscionable conditions of credit by sellers.

Standards for the Safety and Quality of Consumer Goods and Services : Governments should be appropriate, formulate or promote the elaboration and implementation of standards, voluntary and other, at the national and international levels for the safety and quality of goods and services and give them appropriate publicity. National standards and regulations for product safety and quality should be reviewed from time to time, in order to ensure that they conform, where possible, to confirm generally accepted international standards. Where a standard lower than the generally accepted international standard is being applied because of local economic conditions, every effort should be made to raise that the standard as soon as possible.

Governments should encourage and ensure the availability of facilities to test and certify the safety, quality and performance of essential consumer goods and services.

Distribution Facilities for Essential Consumer Goods and Services : Governments should, where appropriate, consider : (a) Adopting or maintaining policies to ensure the efficient distribution of goods and services to consumers; where appropriate, specific policies should be considered to ensure the distribution of essential goods and services where this distribution is endangered, as could be the case particularly in rural

areas. Such policies could include assistance for the creation of adequate storage and retail facilities in rural centres, incentives for consumer self-help and better control of the conditions under which essential goods and services are provided in rural areas. (b) Encouraging the establishment of consumer cooperatives and related trading activities, as well as information about them especially in rural areas.

Measures Enabling Consumers to Obtain Redress : Government should establish or maintain legal and/or administrative measures to enable consumers or, as appropriate, relevant organizations to obtain redress through formal or informal procedures that are expeditious, fair, inexpensive and accessible. Such procedures should take particular account of the needs of low-income consumers.

Governments should encourage all enterprises to resolve consumer disputes in a fair, expeditious and informal manner, and to establish voluntary mechanisms, including advisory services and informal complaints procedures. which can provide assistance to consumers. Information on available redress and other dispute resolving procedures should be made available for consumers.

Education and Information Programmes : Governments should develop or encourage the development of general consumer education and information programes, bearing in mind the cultural traditions of the people concerned. The aim of such programmes should be to enable people to act as discriminating consumers, capable of making an informed choice of goods and services, and conscious of their rights and responsibilities. In developing such programmes, special attention should be given to the needs of disadvantaged consumers, in both rural and urban areas, including low-income consumers and those with low or non-existent literacy levels.

Consumer education should, where appropriate, become an integral part of the basic curriculum of the education system, preferably as a component of existing subjects.

Consumer education and information programmes should cover such important aspects of consumer protection as the following : (a) Health, nutrition, prevention of food-borne diseases and food adulteration; (b) Product hazards; (c) Product labeling; (d) Relevant legislation, how to obtain redress, and agencies and organizations for consumer protection; (e) information on weights and measures, prices, quality, credit conditions and availability of basic necessities; and (f) As appropriate, pollution and environment.

Government should encourage consumer organizations and other interested groups, including the media, to undertake education and information programmes, particularly for the benefit of low income consumer groups in rural and urban areas.

Business should, where appropriate, undertake or participate in factual and relevant consumer education and information progammes.

Consumer Protection and Consumerism in India

Plight of the Indian Consumer

An examination of the important problems facing the Indian consumer would make clear the need for more effective government intervention and consumer movement to safeguard consumer rights.

The following factors make the plight of the India consumer miserable.

1. Short supply of many goods and services, especially of essential items, is a very serious problem afflicting the Indian consumer. The demand –supply imbalance has produced all the associated evils of profiteering, hoarding and black-marketing, corruption, nepotism, irresponsiveness and arrogance towards consumers. Although the situation has improved as a result of the increase in competition due to liberalization, it is still for from satisfactory.

2. The Indian consumer is also the victim of lack of effective or workable competition [illegible] among sellers, even though imperfect, may be regarded as effective or workable [illegible] alternatives sufficient to enable them, by shifting their purchases from one seller to another [illegible] to influence quality, service, and price. Competition, to be effective, need not involve the [illegible] of commodities; it does, however, require the ready substitution of one product for another [illegible] manifest itself in differences in quality and service as well as in price. Effective competition [illegible] also upon the general availability of essential information; buyers cannot influence the behaviour [illegible] sellers unless alternatives are known. It requires the presence in the market of several [illegible] of them possessing the capacity to survive and grow, and the preservation of conditions [illegible] alive the threat of potential competition from others...... The test of effectiveness and [illegible] competition among sellers is thus to be found in the availability of buyers of genuine [illegible] policy among their sources of supply."

   (The above two points should not be confused as one and the same. Short supply refers to [illegible] insufficiency whereas lack of effective competition refers to dearth of enough alternatives [illegible]

3. Many products with which consumers in advanced countries are quite familiar are [illegible] segment of the Indian consumers. The unfamiliarity of the consumers with product features [illegible] sale of standard, inferior or even defective products easier in India than in advanced countries.

4. Due to low literacy levels and unsatisfactory information flows, the Indian consumers [illegible] are not conscious of all their rights. This encourages irresponsible and unscrupulous business attitudes and tactics.

5. It has been said that the legal process in India is comparatively time-consuming and cumbersome [illegible] discourages the consumers from seeking the redressal of their grievance by means of the [illegible] process.

6. Consumerism in India is not well organized and developed.

7. Though the public sector had been developed and expanded to serve the public interest by [illegible] effective competition to the private sector, increasing production, improving distribution, etc. [illegible] to produce benefits that were commensurate with the investment. It is an irony that though [illegible] welfare is an avowed objective of the public sector, in certain areas the poor performance [illegible] sector monopolies has made the plight of the consumer more miserable. Some of them have been charged with unfair trade practices.

8. Though there are a number of laws to safeguard the interests of consumers, they are not [illegible] implemented and enforced to achieve the objectives.

The above factors call for effective State intervention and consumerism to ensure the rights of [illegible]

Government Measures

In India, the Government has taken a number of measures to protect consumer interests. [illegible] Government measures may be classified into (i) statutory regulation of private business, and (ii) [illegible] of the public sector.

Statutory Regulation : Government of India has armed itself with a number of statutory weapons to [illegible] the production, supply, distribution, price and quality of a large number of goods and services. It is [illegible] to regulate the terms and conditions of sale, the nature of trade and commerce, etc. There is a [illegible] "unlike in the West, the Government in India has a large number of controls on industry and it, therefore, [illegible] a position to respond more swiftly and effectively than Western Governments. In some ways [illegible]

has perfected the are of assuming the guardianship of all interests of the consumers and the vulnerable sections."

Important legislations in this respect include the MRTP Act, Industries (Development and Regulation) Act, Essential Commodities Act, Prevention of Food Adulteration Act, Prevention of Blackmarketing and Maintenance of Supplies of Essential Commodities Act, Trade Marks and Merchandise Marks Act, Sale of Goods Act, Indian Patents and Designs Act, Agricultural Products Grading and Marketing Act, Indian Standard Institute's Certification Act, Standard Weights and Measures Act, Imports and Exports Control Act, Packaged Commodities Order, Price and Stock Display Order, Consumer Protection Act etc.

There are, thus, a good number of laws of protect consumer interests. But a common complaint is that these laws are not effectively implemented.

The Monopolies and Restrictive Trade Practices Act, 1969, contains provisions to deal with monopolistic, restrictive and unfair trade practices that are prejudicial to public interest.

Growth of Pubic Sector : There had been a significant growth and expansion of the public sector in India. One of the most important objectives of the public sector was the enhancement of consumer welfare by increasing production, improving efficiency in production and supply, making available goods and services at fair prices, curbing private monopolies and reducing market imperfections, improving the distribution system, and so on. The public sector, in fact, is expected to implement the societal marketing concept.

There is, however, a general feeling that the public sector in India has still a long way to go to realize these objectives. It has established monopolies or near-monopolies in public utilities, whose performance is far from satisfactory.

The irony, further is that certain laws like the MRTP Act are not applicable to the public sector. As the Sachar Committee was observed, "There is no justification for exempting Government and Government-controlled/ owned undertakings from the provisions relating to control and prohibition of monopolistic and restrictive trade practices and the .....provisions relating to unfair trade practices...... The beneficiary of monopoly legislation is the consumer and it is only fair and reasonable that undertakings owned or controlled by the Government should be subject to the same type of rigour and discipline as the private sector undertakings where the interests of consumers are involved."

The Government has developed the pubic distribution system to reduce the hardships of consumers, especially of the vulnerable sections, by making essential consumer goods available more equitably and at fair prices. There is, however, a common complaint that some of the items, especially the food grains supplied by the system, are of inferior quality.

Consumerism

Consumerism is still in its infancy in India. There have been occasional mass consumer demonstrations against market imperfections, mainly shortages and exorbitant prices. But several of these demonstrations have been organized with vested political interests and consumer involvement and dedication have been limited. Of course, a number of consumer organizations have been formed in different parts of the country. But with the exception of a very few, they are yet to demonstrate their practical utility. Further, whatever little organized consumer movement there is in India is almost confined to urban areas, leaving the large majority of the Indian consumers high and dry.

A well developed consumerism is essential for the protection of consumer rights. Consumerism has the following important roles to play :

1. **Consumer Education :** The consumer is given information about various consumer goods and services. This related to prices, what the consumer can expect, standard trade practices. etc. Consumers are also made aware of their rights and responsibilities and the ways of getting the grievances redressed.

2. **Product Rating :** In order to guide the consumer in his choice of products, some of the agencies (for example, CERS, Ahmedabad) carry out tests and reports the results of such tests.

3. **Liaison with Government and with Producers :** Another important role of consumer organizations is to maintain liaison with producers on the one hand and Government authorities on the other. As Government has a key role in protecting consumer rights, the consumer organizations have an important role to see that government plays its role.

Opportunity for Industry

T. Thomas (former Chairman, Hindustan Lever) observes that consumerism in India has not developed as a social reaction against overselling by industry, as happened in the west. On the contrary, it has been more a reaction to the evil effects of shortages and inflation. Therefore, the industry in India has a unique opportunity to respond to consumerism in a positive manner as outlined below.

1. First of all, marketing must be recongnised and practiced as something more than sales and distribution. It has to be considered as the company's relationship with the consumer. In the wider context, it can be extended to become a part of the organisation's total responsibility to society. When we talk of the social responsibility of industry, one of its prime social responsibilities is to the consumer through the adoption of sound marketing methods.

2. Yet we cannot be complacent even with good marketing because it is not possible that many manufacturers, including large ones, will always ask all the questions that are relevant to the consumer, particularly with regard to product safety, comparative cost effectiveness, etc. Consumer movements tend to focus on such questions and may well be seen as an extension of the marketing role. Therefore, industry should co-operate with consumer movements in terms of information on, and education in, the products. Conversely, such information may also educate the consumer in the issues facing the producers, viz., cost of capital, norms of profitability, impact of Government policies, etc.

3. Industry will have to invest increasingly in testing the safety of the products in use. It is far better to organize for this than to wait for nasty accidents which will make it all mandatory and exaggerated.

4. Dealing with consumer complaints satisfactorily is yet another responsibility of the industry. Promptness, courtesy and generosity are expected by the consumer with a genuine complaint. Apart from the loss and irritation caused to the consumer, persistent complaints, even if small in number, are often a good indicator of a necessary improvement.

5. Another important role of the industry is in relation to claims made on behalf of the products through advertising. Restraint is best exercised voluntarily than though legislation which will otherwise become inevitable. Advertising agencies and marketing managements have a very important role to play in the respect. By overplaying the claims, they will cut the very branch on which they are perched.

6. Lastly, if industry has to continue to cope with consumerism, it has to invert in R & D because consumer expectations and needs are constantly rising and the constraints on meeting them are changing. To cope with this effectively, industry has to find solution through R &D. It is when consumer needs exceed the industry's ability to meet them that consumerism lends to become menacing. With adequate anticipation by industry, such a situation need not arise.

The above facts indicate that co-operative efforts on the part of the consumers, business and the Government are very necessary to protect the rights of the consumers. A well-organised consumerism is needed to make the Government responsive and effective and the business responsible and obliging. To sincere the dynamic business enterprises, consumerism does not pose a threat but offer as opportunity.

Consumers Protection Act, 1986

An important landmark in consumer protection endeavours in India in the Consumer Protection Act, 1986, which provides for a system for the protection of consumer rights and the redressal of consumer disputes.

This Act extends to the whole of India except the State of Jammu and Kashmir, and save as otherwise expressly provided by the Central Government by notification, it applied to all goods and services.

The objective of the Act is to provide for the better protection of the interests of consumers and for that purpose to make provision for the establishment of consumer councils and authorities for the settlement of consumers disputes and the matters connected therewith.

Consumer Protection Councils

The Act provides for the establishment of a Central Consumer Protection Council by the Central Government and a State Consumer Protection Council in each State by a respective State Governments.

The Central Council shall consists of the Minister in charge of consumer affairs in the Central Government who shall be its Chairman and such number of other official or non-official members representing such interests as may be prescribed. The Council shall meet as and when necessary but at least one meeting of the Council shall be held every year.

The State Council shall consist of such members as may be specified by the State Government by notification from time to time.

Objects of Councils : The Objects of the Central Council are to promote and protect the rights of the consumers such as :

a) the right to be protected against marketing of goods and services which are hazardous to life and property;

b) the right to be informed about the quality, quantity, potency, standard and price of goods and services so as to protect the consumer against unfair trade practices;

c) the right to be assured, wherever possible, access to a variety of goods at competitive prices;

d) the right to be heard and assured that consumers' interests will receive due consideration at appropriate forums;

e) the right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers; and

f) the right to consumer education

The objects of every State Council are to protect within the State the rights of the customers listed above.

Consumer Disputes Redressal Agencies

The consumer protection act provides for a threes-tier consumer disputes redressal system encompassing the district, state and national levels. There are, thus, two levels of agencies in the State and one agency at the national level. In other words, the Act provides for the establishment of the following consumer disputes redressal agencies;

(i) A district Forum in each district of every State. If the State Government deems it fit, more than one District Forum may be established in a district.

(ii) A State Commission in each State.

(iii) A National Commission

The National Commission was established by the Central Government in August 1988. The responsibility for the establishment of the other two agencies, with the prior approval of the Central Government, rest with the respective State Government.

The District Forum shall consist of (a) a person who is, or has been, or is qualified to be a District Judge nominated by the State Government who shall be it President, (b) a person of eminence in the field of education, trade or commerce, and (c) a lady social worker.

Each State Commission shall consist of a person who is or has been a judge of a High Court, appointed by the State Government (who shall be its President) and two other members who shall be persons of ability, integrity and standing and have adequate knowledge or experience of or have shown capacity in dealing with problems relating to economics, law commerce, accountancy, industry, public affairs or administration, one of whom shall be a woman.

The National Commission shall consist of a person who is or who has been judge of the Supreme Court, appointed by the Central Government (who shall be its President) and two other members who shall be persons of ability, integrity and standing and have adequate knowledge or experience of or have shown capacity in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration, one of whom shall be a woman.

A complaint where the value of the goods or services and the compensation, if any, is less than rupees five lakhs is to be dealt with the District Forum; where such value exceeds rupees five lakhs but does not exceed rupees twenty lakhs it is to be dealt with the State Commission and cases involving more than rupees twenty lakhs fall within the jurisdiction of the National Commission.

The State Commission will also entertain appeals against the orders of any District Forum within the State. Appeals against the orders of the State Commission can be made to the National Commission. Appeals against the orders of the National Commission can be made to the Supreme Court.

The State Commission is empowered to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Forum within the State, where it appears to the State Commission that such District Forum has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested or has acted in exercise of its jurisdiction illegally or with material irregularity. The National Commission has similar jurisdiction over the State Commissions.

Consumer Complaints

A complaint, in relation to any goods sold or delivered or any service provided may be filed with the redressal agency by –

(a) the consumer to whom such goods are sold or delivered or such service provided;

(b) any recognized consumer association, whether the aggrieved consumer is a member of such association or not;

(c) one or more consumers, where there are numerous consumers having the same interest, or

(d) the Central or State Government

Remedial Action

If the consumer disputes redressal agency is satisfied that any of the allegations contained in the complaint is true, it shall issue an order to the opposite party directing him to take one or more of the following things, namely;

(i) to remove the defect pointed out by the appropriate laboratory from the goods in question;

(ii) to replace the goods with new goods of similar description which shall be free from all defects;

(iii) to return to the complainant the price, or, as the case may be, charges paid by the complainant;

(iv) to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to negligence of the opposite party;

(v) to remove the defects or deficiencies in the services in question;

(vi) to discontinue the unfair/restrictive trade practice or not to repeat them;

(vii) not to offer the hazardous goods for sale;

(viii) to withdraw the hazardous goods from being offered for sale;

(ix) to provide for adequate costs to parties.

Penalties

If a trader or person against whom a complaint is made or the complainant fails or omits to comply with any order made by a redressal agency, he shall be punishable with imprisonment for any term not exceeding three years or with fine not exceeding ten thousand rupees or with both.

Conclusion :

The Consumer Protection Act, 1986, which was modified by the Amendment Act of 1993, is a very important means to protect the consumer rights. However, the effective functioning of the consumer redressal agencies and, consequently, the achievement of its objectives, are hindered by several problems.

The posts of president and/or other members of the for a remaining vacant are not uncommon. Many redressal agencies are not adequately staffed. They also suffer from financial problems.

The Act has been hailed for the time frame set for the disposal of the cases. In fact, the Act envisages a simple, inexpensive and speedy redressal of consumer grievances related to defective goods. deficient services and unfair and restrictive trade practices. But the problems mentioned above come in the way of expeditious disposal of the cases.

Further, taking recourse to the law is affected by the lack of consumer awareness and education.

One redeeming feature of the Consumer Protection Act is that it applies not only to the private sector but also to the public sector and government agencies. As against this, it may be noted that, the undertakings in the public and cooperative sectors and those undertakings the management of which has been taken over by the Government are exempted even from the provisions dealing with unfair trade practices under the MRTP Act.

economic activity in the private sector in a mixed economy "is combined with a skew size distribution of private ownership of means of production, it implies a possible accentuation of economic inequalities." The deprived in the social system expect the government to counter this tendency by regulating the activities in the private sector and through direct participation in extensive areas of economic activities. However, in a class society like the one we have in this country the government has neither the ability nor the required will

to prevent the tendency of the concentration of economic power. In India the assumption that "the State in general and the government in particular can act as an agent of desirable socio-economic change independent of the various interest groups" does not hold good and thus accentuation of income inequalities and a rise in the absolute number of poor is inevitable.

Social Responsibilities of Buisiness

Introduction

Business is an integral part of society. Business affects and is affected by the society. The two-way relationship must be healthy and positive for the social and economic development of a country. For the business to contribute to the development of the society it is important that the business practices are honest, fair and transparent. These have to legally and socially conforming. Business is not merely a money-earning system; it educates the society, provides channels of income, establishes technology and product standards and satisfies human wants. It learns from the society and transmits its own knowledge to the society through its products, philosophy, management, human resource development, advertising and other marketing operations, technologies, publications and public relations. It has its own culture incorporating knowledge, beliefs, values, attitudes and preferences, which is an important determinant of its internal environment. According to Steiner and Steiner (1997), culture is 'a set of traditional values, rules or standards transmitted between generations and acted upon to produce behaviour that falls within acceptable limits'. In business environment, culture establishes an identity of business. It is a prominent reason that a number of Indian, Japanese and US firms are identified according to their historical and typical styles of management, which are products of their business culture.

The Concept of Business Ethics

The word 'ethics' is derived from the Greek word ethos that means 'custom'. Ethics denotes the relative concepts of right and wrong and refers to the distinction between good and bad, moral and immoral so that its practice can improve the quality of life and human conditions. Business ethics is the application of moral standards to managerial decision-making. It is the systematic application and study of customs, moral values and standards that guide behaviour in business environment. The ethical principles of a business manager are the guidelines and rules that enable him to make value-based judgements.

Descriptive and Normative Ethics

Like many concepts in the social system, business ethics can be descriptive or normative. Descriptive ethics is what is already being accepted as right or desirable or customary and the present working of an organisation is judged in terms of such prevailing ethical standards. Normative ethics disregards what at present is considered ethical and prescribe independently what the values or practices of an organisation should be. It is basically prescription as it lays down, on some logical basis, what the operative standards should be for an organisation. There can be a number of alternative normative ethical standard that a particular firm has before it to choose from. These could be the ones developed and advocated by management, owners, employees and media, public at large or the government. Nevertheless, the normative standards depict what the different segments of society expect from business. These expectations need not be the same; rather, there may be elements of conflict, which pose dilemmas for business decision-making. Similarly, business ethics may conflict with actual pecuniary business interests. An organisation may be committed to employee welfare but may be reluctant to part with a substantial amount of compensation in case of an industrial accident involving workers in times of recession and losses.

Most of the professionally organised firms maintain a code of ethics to be followed by different organisational units and members. A firm itself has a mission statement which spells out answers to two basic questions: Why does it exist and for whom does it exist? Then it has a vision which spells out the broad approach as to how its mission will be achieved. The two statements together provide the broad contours of business ethics which are further broken down into rules, guidelines, behaviour norms, conduct standards and conventions. Existence of mission and vision statements however, by themselves, doesn't ensure ethical conduct and performance of a firm. Creation and maintenance of an ethical environment require healthy practices supported by the top management and the culture of the organisation. Human resources are a key factor in this regard.

Traditional and Extended Views

Traditional view of business ethics is basically individualistic. It focuses individuals in the business organisation and for ethical lapses individuals are identified, held responsible and dealt with. The lapses could be in the form of embezzlement, dereliction of duty, misuse of official position, sexual harassment of another employee and the like. Individual lapses are identified in terms of established codes, rules, procedures and guidelines at the firm level and these norms, themselves, may not as such conform to ethical standards.

In the expanded or expansive view, ethical aspects of the proposed or planned actions at the firm level influence managerial decision-making. At the various levels of management hierarchy, employees are sensitised and motivated to take decisions keeping in view the ethical dimensions of the decisions. Thus, ethics become an integral part of the management strategy. The extent to which ethical considerations are involved in day-to-day managerial decision-making would be determined by the philosophy of the top management. Integration of ethics into managerial decision-making is termed as institutionalisation of ethics.

Three Basic Principles of Business Ethics

There are three basic principles of ethics which can be applied to business. These are utilitarianism, rights and justice. These are derived from the discipline of philosophy. These principles enable a business manager to develop a logical base in reaching ethically sound decisions, to identify ethical problems and to make decisions that conform to ethical standards.

Utilitarianism

Utilitarian is the philosophy which preaches maximum good for the maximum number of people as a result of an action. An action of a business causes both a benefit and a cost and an analysis of such an action is done in terms of a cost-benefit analysis. According to this analysis, a decision or action should be undertaken if the expected benefit exceeds the cost. The utilitarian theory focuses on the end result rather than the means that produce the result. Under this approach, a loss-making unit should be closed down if the resources so released are utilised in other plants or activities that cause net increase in employment, income or taxes to the government which are spent back to increase public welfare. There cannot be unanimity over the logic of such a philosophy. In this example, owners and managers of a firm may lend their support to such a decision but the workers would oppose it.

Principle of Rights

Another aspect of ethical principle is based on the principle of rights. Rights can be natural or legal. Natural rights come almost automatically as these can be considered as divine. Rights to life, freedom and happiness are, for example, natural rights. Some of these may even provided directly or indirectly in a country's constitution and to that extent the distinction between natural and legal rights could be blurred. *Legal rights* are provided by law, executive orders or court decisions and are enforceable by the government. In a number

of countries like India and the US there exist fundamental rights like freedom to speech and express religion, assembly and the right to vote.

In the world of business, various pieces of legislation provide certain rights to consumers, investors, ... owners, workers and suppliers. These rights protect the respective groups against unethical or unfair practices of others. Similarly there are rights for business property and environmental rights. In society there are certain preference or disadvantaged groups for which special rights are created. These rights generally exist for women, children, minority groups, physically handicapped, economically deprived or certain social classes that *are believed to have been deprived of equal opportunity for a considerable time in the past.* Most of the natural rights are contained in the present day concept of human rights.

The Universal Declaration of Human Rights by the UN

The Universal declaration of human rights by the United Nations provides a common standard of achievement for all people and all nations. The declaration includes:

The right to life, liberty and the security of persons.

- The right to equal protection against any discrimination. · The right to freedom of movement, thought and expression.
- The right of property alone as well as in association with others.
- The right to work to free choice of employment, to just and favourable conditions of work and to protection against unemployment.
- The right to just and favourable remuneration.Source: he Worldwide web home page of the UN <http: /www.leftjustified.com/leftjust/fount/wtp/un-decla.htm>

Principle of Justice

This principle seeks to provide fair or just treatment to individuals and organisations. It is very difficult to specify what is fair or just in a given situation as it depends upon the basic set of criteria on which the concept rests and the concepts themselves are highly subjective and debatable. In business environment, like in other non-business situations, there are basically three types of justice-distributive justice, compensatory justice and retributive justice. Distributive justice refers to equitable and just distribution of benefits, gains and burdens or costs of business. Main channels of distributive justice in business take place through dividend policies, remuneration systems and pricing practices. When business practices don't follow the principles of distributive justice; government intervention is called for to undertake corrective action.

Compensatory justice is concerned with paying fair amounts in compensation against losses incurred as a result of particular business decisions. The loss could arise to a worker by an individual accident or to a consumer by an unsafe product or to a supplier by way of a delayed payment. Damage could even be caused to society through pollution. Companies which don't adhere to the principle of compensatory justice are often challenged in courts of law. Retributive justice refers to the justice by way of punishment to the wrongdoer. A company could be punished for violating laws, tax evasion or misleading advertising and could be made to pay heavy damages to the victims. This can erode financial viability and reputation of the organisation. Punitive damages awarded to victims are often greater than the compensation values.

Developing an Internal Ethical Environment

Developing an internal ethical environment is a long-term process in business. An ethical environment is not only a social responsibility but also a requirement to generate goodwill assets which have their own returns in financial as well as non-financial forms. *A firm enjoying goodwill and reputation is able to attract*

talented human resources, borrow more cheaply and on good credit terms from the market and enter into business contracts more easily as compared to others. It even enjoys a better government, public and consumer support.

Developing an ethical environment requires a sustained effort and a key role of the top management in creating a suitable human resource environment. There are four major sources from where ethical values are derived-religion, philosophical systems, cultural experience and the legal system. These values are derived both at individual and corporate levels. Personal ethical values are a great contributor to the corporate ethical values. Nevertheless, most professionally managed organisations make efforts to preserve an ethical climate through long-term ethical programmes in order to maintain goodwill assets and protect them against avoidable litigations. These programmes are basically of two types:

a. Value based programmes which are designed to enable the employees to take decisions incorporating moral standards and integrity; and

b. Compliance based (or conforming) programmes, designed to conform to or comply with societal norms, codes of conduct, business laws or commonly accepted business principles.

These programmes communicate corporate values and lay ground rules for ethical behaviour.

Salient Features of a Corporate Ethical Programme

The main features of a business ethics programme are the following:

a. *Top Management Commitment.* This is an indispensable component of an ethical programme. As pointed out earlier, top management should not only have consistent commitment but it also has to provide continuous leadership in establishing and maintaining internal ethical environment. In such environment, members of the top management set examples of behaviour for managers and employees down the line. These practices, when followed by others, become a part of corporate culture. To encourage the adoption of ethical practices by others, top managements often institute a system of incentives and rewards.

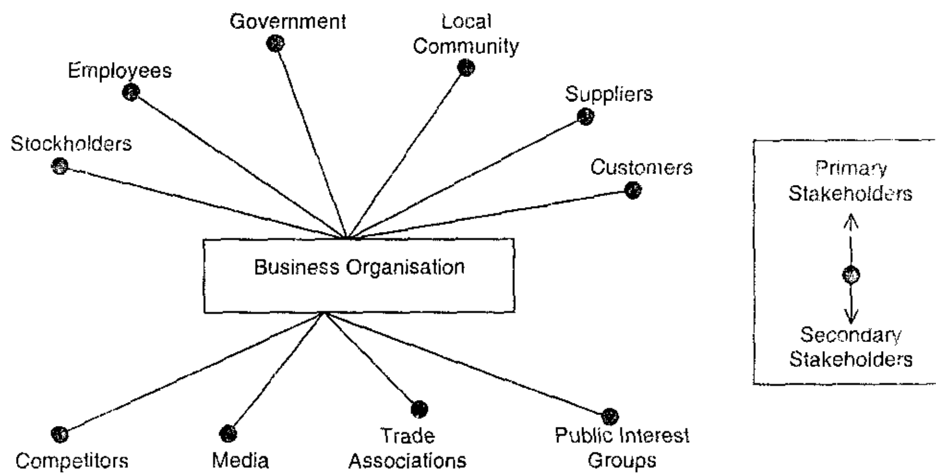
b. *Ethical Code.* Nearly all corporate organisations known for ethical practices have a well-publicised code of ethics. The code describes the principles and rules of conduct and behaviour and lists the practices that are desired and that are prohibited. These are essentially normative and qualitative. The codes themselves don't ensure ethical practices but these do provide valuable guidelines the deviation from which can be detected and dealt with.

c. *Communication System.* For the code of ethics to be followed by all the employees of an organisation, it is essential to have a good communication system between the management and other employees. Communication is both downstream (from management to employees) to communicate messages concerning ethical practices and upstream from employees to managers to provide feedback. The messages are both written and verbal. Some of the main communication channels include letters, meetings, newsletters, training videos, posters, e-mail, on-line systems and interactive training.

d. *Enforcement.* Enforcement of ethical standards is required as all the employees may not voluntarily adopt such standards. Corporation keen to maintain an internal ethical environment institute systems of both incentives and disincentives to encourage the employees to adopt recommended rules of conduct. These measures are designed both to prevent the malpractices and punish the wrongdoers. The extreme form of penalty could be dismissal or legal action.

Corporate Social Responsibility

There is a two-way relationship between business and society. Business affects the different segments of society and is affected by them. The different segments are also known as 'publics' or 'stakeholders' with which it deals directly or indirectly and which have direct or indirect stake in the business. The segments are both internal and external. Internal segments are the owners and the employees (including managers). External segments are the competitors, customers and suppliers with which the business organisation has direct and almost continuous interaction. Then, there are local communities, advocacy groups (including social, economic and political groups or coalitions with their own agenda who have intellectual base and a veto power) amidst which the organisation has to operate. Finally, and most importantly, the organisation deals with the government the relationship with which is a key factor for its survival and growth.



Primary Stakeholders are essential for survival of business.

Secondary Stakeholders are important but not essential for survival.

Box : Stakeholder Map of a Business Organisation

No business organisation can afford to be in conflict with any of these segments. Its wisdom lies in developing cordial and congenial relationship with these groups on the long-term. The organisation, therefore, has to rise above its profitability and bottom line considerations and take care of societal interests.

Social Responsibility Versus Social Responsiveness

Social responsibility highlights moral obligation of business towards social development and requires some resource spending for solution of social problems or on activities of socio-economic welfare. It emphasises social dimension of business activity in which it makes contribution towards improvements in the quality of life. The responsibility can be both obligatory (required by law) and voluntary (as a matter of social policy of the organisation).

Concept of social responsiveness emerged in the beginning of 1970s out of the arguments of the opponents of social responsibility. They believe that the managers of a firm are obliged to earn the highest possible rate of return on the owners' (stockholders) funds entrusted to them within the framework of the existing corporate legal system. They believe that any social responsibility devolved upon the business organisation undermines the spirit of free enterprise. The concept of social responsiveness makes a clear departure from the social responsibility concept and denotes responsiveness of a firm to changing social environment.

expectations and requirements. Socially responsive firm responds to social demands, needs and problems and has a system or mechanism (like social audit or environment scanning) for the same. The responsiveness is shown by its behavioural pattern. It emphasises managerial rather than ethical aspect of a firm's relation with society and signifies institutionalisation of social policy and actions.

In 1992. a number of leading companies including Coca Cola, Time Warner, AT&T, Ben & Jerry's, Motorola, Reebok and Levi-Strauss formed a business association called Business For Social Responsibility to spread and popularise the message of social responsibility. In India, business associations like CII and FICCI constantly strive to make business aware and responsive to the needs of the society. Almost all the countries of the world have corporate laws relating to the various aspects of the operation of business so that it could be made subservient to the needs of the society and the country. All business organisations have to conform to these laws as a mater of obligation; but the concept of social responsibility is basically voluntary in nature. It seeks to achieve societal concerns much beyond the requirements of corporate laws. Different organisations meet social responsibility standards in various forms and in various ways depending upon their own vision and resources.

Dimensions of Social Responsibility

The nature and extent of responsibility towards different stakeholder groups are discussed below:

Responsibility Towards Stockholders

Stockholders are the owners of a business firm who have a direct stake in it. This is the class of people who have risked their capital and it is the primary responsibility of a firm to protect the capital and provide a fair or reasonable return to the owners in the long run. Not only that, the firm should strive for a reasonable stability of the dividend income of the owners. This devolves upon the managers of the firm a responsibility of running the business in such a way that it remains viable and growing in the long run through optimal and strategic management of resources available to it. Shareholders have a right to know how their resources are being used and how the business of the firm is conducted. That means there has to be a reasonable degree of transparency in the business operations of the firm.

Responsibility Towards Employees

Employees including all categories of workers and managers are the human resources on the strength of whom a firm operates in the competitive environment of the market. Employees are the key resources of a firm and it has a major responsibility towards their well-being and growth. The firm must provide a fair compensation system including wages and salaries, facilities, amenities and perquisites commensurate with work requirements and status. It is the moral responsibility of the firm to set fair work standards and provide welfare facilities including healthcare, sanitation, education and basic facilities like housing and water supply. The firm must provide suitable training and development facilities so that employees can show increase in productivity and have opportunities for career growth. The firms must recognise, appreciate and support qualitative and creative work and should have a suitable reward and incentive system. Good organisations have a consistently maintained motivating environment, which keeps the workers loyal and satisfied. Such firms listen to the workers' suggestions and grievances and take appropriate actions when considered necessary.

The issues concerning job security are controversial but mindless retrenchments not consistent with business conditions must be avoided. Such practices can be counterproductive as organisations spend huge sums of money on recruitment, training and development of employees. Most of these aspects are dealt within the

various labour laws but a firm's responsibility towards employees extends much beyond legal provisions.

Responsibility Towards Consumers

Consumers are the foundation of business and all the operations of the firms are directed to meet consumer needs and problems. A dissatisfied customer is a warning signal to a firm. A business that thrives on consumer exploitation cannot survive in the long run. Many businesses have been able to make quick profits in situations of monopoly and consumer distress. Most of the countries have legislated consumer protection measures against business malpractices. Five Fundamental Consumer Rights.

- The basic rights of a consumer include:
- Right to safety
- Right to product knowledge and education
- Right to product choice
- Right to full value
- Right to justice (compensation against loss or damage)

However, socially responsible firms have good concern for consumers and their rights. The consumer has a right to safety respecting which the firm must provide safe products. Product safety is important in case of such products as automobiles, toys, pharmaceuticals and other chemicals. He has right to knowledge and education so that the firm is obliged to provide complete and reliable information about the product and such necessary information that enables him to take a decision. Consumer's right to choice provides that there should be no restriction on the choice of a product by a consumer and a firm should not deny particular categories of products to certain classes of consumers. Right to justice dictates that the firm must listen to consumer complaints and provide suitable compensation for loss or damage incurred due to the use or consumption of the product. The consumer has right to full value, which states that the product must perform according to the firm's declaration. The firm declares the utility, performance or life of the product in its advertisement, product labels or other promotional literatures. From the firm's end, the right implies that the firm must deliver the product precisely as per specifications, claims and declaration made by it. This is not merely a nature of responsibility; it is essential for a firm to maintain its credibility and goodwill in the market and to avoid consumer disputes. Some of the implications of the firms' concerns for consumer rights are that they should:

- Strive to improve product quality through research, development and innovation;
- Provide goods to consumers at fair or competitive prices;
- Ensure adequate availability of products in the market;
- Provide satisfactory after-sale and consumer-support services;
- Provide complete knowledge about the product, particularly its side or adverse effects;
- Ensure right product standards; and
- Avoid exaggerated or misleading claims.

Responsibility Towards Suppliers

A business firm procures a variety of materials including machinery, tools, spares, raw materials, intermediate goods, finished products and business services like consultancy, repair and maintenance etc. These supplies are known as industrial goods and services that are meant for further processing or resale. A good relation with suppliers is essential for lower cost and continuity of operations. In a situation of monopsony, the industrial

buyer commands a substantial market power and may tend to exploit the suppliers. However, good business organisations might use their bargaining power to their advantage but they don't resort to unfair or exploitative practices. An ethical business organisation does not break contracts, makes timely payments, does not seek legal loopholes in supply contracts to take advantage and encourages suppliers to build long-term business relationships. It even seeks to dovetail its sourcing or procurement network with the marketing channels of suppliers to reduce sourcing and marketing costs to the advantage of both the parties.

Responsibility Towards Competitors

A socially responsible firm plays a fair game in competition. It engages itself in healthy competition by learning the good business strategies and practices of its competitors. It does not indulge in brand assassination, which may be defined as the deliberate design of a firm to denigrate or tarnish the image of a competitor's brand through its misrepresentations or wrong comparison. Such a firm supports free and fair competition and does not indulge in monopolistic, restrictive or unfair trade practices. Monopolistic practices restrict competition, retard technological development and discourage new investment. Restrictive trade practices chiefly take place on the marketing side and include market collusions, price discrimination, predatory pricing, tie-up sales, exclusive dealerships and resale price maintenance. Unfair trade practices mainly include misleading advertisements, tricky prices, unreasonable product guarantees or second-hand goods posed as new. Such practices are unfair both to competitors and consumers.

Responsibility Towards Government

Business organisation, which are socially responsible, are good corporate citizens. Their business operations are legally conforming and contribute to the development of the industry and the economy. These units are fair and regular in the payment of various taxes and charges, provide data as may be required by the government from time to time, help in the implementation of various practices and schemes of the government and respond to the instructions and appeals issued from time to time. These organisations give preference (to the extent possible) to government companies in their purchase of industrial supplies and sell to the government at relatively lower or concessional rates. Good relations with the government have their own rewards. Such firms find it easier to obtain new licenses, credit from public sector banks and supply orders from government organisations. Firms that invite raids, enquiries, strictures, penalties or confiscation by government due to their suspicious or irresponsible actions find their market reputation eroded.

Responsibility Towards Local Community

It is both in the interest of business and the society that a business firm takes steps for the economic and social development of the local community. It serves to enhance the image and acceptance of the firm among the public. Local acceptance is very important as it ensures support from local masses. Local masses suffer many problems and disturbances caused by the firm such as land, water, air and noise pollution, decline in agricultural productivity and shortage of water and power and must be compensated, at least indirectly. The firm can compensate by way of developing local infrastructure like paved roads and water supply, providing civic facilities like parks and sanitation, establishing educational institutions and dispensaries and providing employment. It can also encourage local trade and sub-contracting wherever possible.

In addition to the above, the firm must show responsible behaviour towards the media, public interest groups and trade associations. Good relations with media are always rewarding. It should provide right and justified information to the media relating to developments in the industry and the impact of government policy. It should have a meaningful association with the trade bodies and help it in projecting the right image of the industry before the government, media, public interest groups and other agencies.

Strategic Management of Stakeholders

The survival, growth and image of a corporate organisation depends upon its relations with various stakeholders. The managers of the organisation must have a comprehensive understanding of the relative importance of each stakeholders group and constantly monitor changes in them. Not only that, the managers must understand how and to what extent the groups affect and are affected by the interests and operations of the organisation. These groups have to be managed strategically so that the gains from relationship with the stakeholders are maximised and constraints from the relationship minimised. Any strategic management of the stakeholders essentially rests on what may be called 'stakeholder analysis'. The analysis basically involves the following:

- Studying the relationship of each stakeholder group with the firm and finding out to what extent the stakeholder and its relationship is important to the firm.
- Finding out the coalitions or groupings among stakeholders, the basis of coalition and the objectives for which these are formed. Through this information, the firm can formulate a suitable response strategy.
- Understanding the nature of each stakeholder interest so that the firm is able to know what these groups expect from the firm.
- Assessing the strength of each stakeholder so that the firm understands which group and to what extent this group is capable of modifying the firm's business plans and operations to meet its objectives. Different groups have different types of powers. Stockholders have voting power, consumers the market power, suppliers the economic power, government the regulatory power and the local community the political power. The assessment of each stakeholder's strength is necessary for a firm to design its response and relationship strategy.

The firm equally has to be aware of the responsibility of each stakeholder.

The stakeholders' relationships, coalition, nature of interests, powers and responsibilities are subject to constant changes and the firm must monitor these changes closely and continuously. Managers must take cognisance of the stakeholders' interests and concern in their decision-making. They have to understand that these groups are not antagonist to the firm, though their interests sometimes may be opposite to that of the firm. Managers must work cooperatively with these groups and avoid conflicts through open communication, consultations and even third-party review.

Limits to Social Responsibility

Most of the large and professionally organised firms realise the economic logic behind social responsibility. In any case, they prefer to project their image as socially responsive organisations, alive to the needs and problems of society. As pointed out earlier, socially responsible behaviour is essential for the survival and growth of a firm. A major portion of the responsibility is met in the process of complying with corporate laws, business codes and government instructions issued from time to time with reference to social obligations of business. Modern firms often go beyond obligatory level and build goodwill assets.

Building goodwill and credibility assets through socially responsible activities makes sound business sense. Firms possessing such assets economise on advertisement expenditures as the consuming masses have faith in the utility of their products. The firms, on the strength of such assets, are able to raise resources and industrial supplies adequately, cheaply and on more favourable terms. They can establish distribution channels for their new products more easily and at lower costs, as they already possess a wide customer base. These factors contribute a lot towards keeping the firm competitive in the market through economies of scale and cost reduction.

Nevertheless, fulfillment of social responsibility involves commitment of financial and other resources, which impact negatively on the profits. It is obvious that the social commitment and responsibility of a firm cannot be limitless. It has to target a particular level of social responsibility to be discharged over a particular period of time. The target responsibility level involves a careful cost-benefit analysis of social responsibility expenditure. In a pure business sense, a firm can maximise its return of social expenditures as shown in the diagram below:

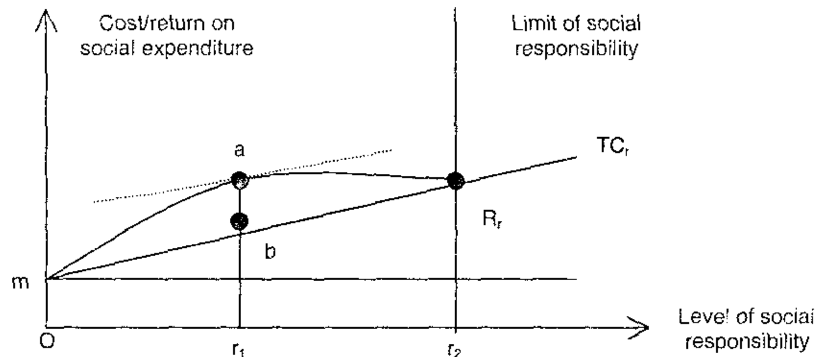


Figure : Determining Optimum Level of Social Responsibility

Om is the minimum social expenditure that a firm has to make to comply with the legal requirements. As the level of responsibility increases, total cost to the firm on this account also increases and is represented by the line TCr. Total return on responsibility (approximated in financial terms) is represented by Rr which increases initially and tends to peak off subsequently. Vertical distance between TCr and Rr shows return on social responsibility expenditure, which is maximised at ab corresponding to the responsibility level of Or1. This level of responsibility makes a perfect business sense. However, a firm may go beyond this level and attain Or2 level of social responsibility with no net cost or return to it. This can be a part of the firm's business strategy in which it seeks to reap its benefits in subsequent periods. The responsibility levels Or1 and Or2 show the two limits which a firm can choose as per its own objectives and strategy. Any responsibility level beyond Or2 will cause a net reduction in the firm's net return from social responsibility expenditure.

Conclusion

The actual ethical standards and social responsibility level of a corporate organisation depend a lot on the attitude of the top management and the overall human resource environment. The organisation must understand the significance of its contribution towards society both for its long-term survival and growth. Business ethics and social responsibility generate goodwill and other off-balance-sheet assets the monetary equivalents of which may far exceed their financial costs. Social responsibility expenditures are not philanthropic contributions; these are the expressions of positive commitments to society of which business organisations are an integral part.

CHAPTER-4:
ECONOMIC PLANNING IN INDIA

A completely laissez-faire economy has now become a relic of history. The socialist economies covering about one-fourth of the world population are wholly planned economies. Since economic planning without State ownership of means of production is inconceivable, planning does not exist in the capitalist countries. In this chapter, we shall explain what exactly economic planning means in India, what it its rationale, how planning works in practice, and what are its features and objective.

Meaning of Economic Planning

The term economic planning has been used in economic literature to describe widely different types of economic systems which in a way has now become a source of confusion. Today people rarely agree on the content of economic planning. Therefore, one always finds it difficult to understand as to which system one is referring to when one talks of economic planning unless one clearly spells out the nature of that system.

In India, development plans were formulated and carried out within the framework of the mixed economy. Mixed economics are characterised by the coexistence of private and public sectors. The private sector typically comprises four distinct productive activities: (1) Subsistence farming and handicrafts, (2) Small-scale individual and family owned commercial business and industry; (3) Medium sized commercial enterprises in industry, trade, transport and agriculture; (4(Large manufacturing enterprises, mining companies and plantations, producing for domestic and/or foreign markets. The public sector generally remains confined to infrastructure and basic and heavy industries. In India, now the State is retreating from both industrial sector and infrastructure. In such an institutional setting of the Indian economy, one can identify two principal components of economic planning:

1. The government mobilises domestic resources and also raises foreign finance to carry out such projects which are expected to induce productive activities in the private sector. From this point of view, development of infrastructure, particularly railways, hydroelectric projects and irrigation system received overriding priority. The other activity that invited government's direct involvement in the past is setting up of heavy industries involving large finance and long gestation period.

2. The government also adopted on the one hand certain economic policies (e.g. taxation, industrial licensing, tariffs, wages, prices and interest rates) which stimulated private economic activity, and on the other introduced restrictive physical controls in order to ensure a harmony between the social objectives of the government and the behaviour of the private producers and businessmen. Since the early 1990s, however, the physical controls have been withdrawn as pan of liberalisation measures and the government now chooses to be completely oblivious to the activities of the private business even if they are violative of social objectives.

The Rationale For Planning

From the above characterisation of planning in India, it is clear that economic planning in this country did not replace market. In fact, the market and economic planning have been complementary to one another.

Till recently economic planning was accepted in India as a development tool on account of various reasons. Of these, the following are the most important:

1. **Limitations of the market mechanism.** Need for economic planning has often been felt on account of the limitations of the market mechanism in respect of both efficiency and equity. Among the socialists the conviction that market system discriminates against the working class is quite strong. Therefore, when they capture state power, they attempt to abolish private ownership of the means of production and subordinate the role of the market to the planning authority. In market economies-both developed and underdeveloped -- planning has been adopted for overcoming the limitations of the market mechanism.

   The need for economic planning in India was felt particularly due to its economic backwardness. Having won Independence in 1947 this country realised that the path of economic development followed by England, the U.S.A. or Japan was no longer available to it. Relying entirely on market mechanism this country could not even hope to come out of the low level equilibrium trap in which it had fallen during the period of its colonial subjugation. In tile socialist path of development alone there was a ray of hope. The country, therefore, wanted to benefit from the Soviet Union's experience in economic planning.

2. **The need for social Justice.** India like many other Third World countries had earlier thought that economic growth will automatically solve its poverty problem. However, the experience of the past five decades clearly suggests that in a free enterprise economy gains of economic growth do not necessarily trickle down. In fact, market forces operate in such a manner that further concentration of economic power takes place and the growth bypasses those very people who deserve to be helped most. It is this reason why in this country need for undertaking poverty alleviation programmes in the overall frame work of development planning is felt. Moreover, India will find it increasingly difficult to tackle the unemployment problem if it relies entirely on market forces. Moreover, if human resources are to be used fruitfully, India must adopt scientific manpower planning.

3. **Resource mobllisation and allocation in the context of overall development programme.** India suffers from resource constraints and, therefore, it has to use the resources judiciously. Investment projects in this country should not be chosen entirely on the basis of private profitability. In case that is permitted, large investment will be made into socially low priority areas, such as consumption goods for the rich. In a society where income distribution is highly skewed, competitive markets will dictate a pattern of investment which will not be consistent with the overall long-term objectives of the country. In developing countries, the choice of development projects should rest on social benefits rather than private profitability. Hence the State's intervention in the economy with a view to optimise social gain from the utilisation of scarce resources becomes necessary. Even as a resource mobiliser the State has been far more effective in this country than any private institution. Hence, there is a strong case for adopting economic planning in this country in some form or the other.

The U.N. conference on planning held in 1965 recommended adoption of economic planning in underdeveloped countries on similar grounds. The U.N. report asserted, "It is an integral task of planning to achieve the best possible use of scarce resources for economic development... The need for using appropriate criteria for selecting projects arose because the market prices of such factors of production as labour, capital and foreign exchange deviated substantially from their social opportunity costs and were not, therefore, a correct measure of the relative scarcity or abundance of the factor in question."1

D.R.Gadgil has aptly summed up the reasons why economic planning was adopted in the developing countries like India. He wrote, "Planning for economic development is undertaken presumably because the pace of direction of development taking place in the absence of external intervention is not considered to be satisfactory and because it is further held that appropriate external intervention will result in increasing considerably the

pace of develop taking and directing it properly, planners seek to bring about a rationalisation, and if possible and necessary some reduction of consumption, to evolve and adopt a long-term plan or appropriate investment of capital resources with progressively improved techniques, a programme of training and education through which the competence of labour to make use of capital resources is increased, and a better distribution of the national product so as to attain social security and peace."2

Important Features of Indian Plans

Economic planning is mainly of three types-firstly, planning in developed capitalist countries where the main objective is preserving the level of full employment in the economy; secondly, economic planning resorted to in underdeveloped countries with the objective of translating development promises into practice and thirdly, planning in socialist countries. We in India are practising the second type of planning. Let us discuss the features of this planning as found in India:

Indicative economic planning. Indian plans do not carry an element of compulsion or inevitability as is the case in the planning of socialist countries. In socialist countries every effort is made by the administration to achieve the targets laid down in the plaits. This is not so in India. The plans generally lay down targets even for those sectors of the economy over which the government has no control. For instance, practically the whole agricultural sector in India is in private hands but the government lays down detailed targets for the sector. Undoubtedly the government can provide some incentives to increase agricultural production and productivity through distribution of high yielding varieties of seeds, fertilizers, pesticides, improved credit and irrigation facilities etc., and can also fix procurement and support prices to ensure satisfactory return to the farmers. However, since the management of farming and other agricultural activities rests in private hands, the government can never be too sure of achieving the targets laid down in the plans.

The main reason for this state of affairs is the presence of the mixed economy. Such a system gives adequate incentives to the private capital and uses few controls. There is no compulsion or inevitability in any work though there might be some regulation and regimentation of economic activities. As against the private sector it is indeed more essential to accomplish the targets laid down for the public sector. However, even here there is no compulsion as such. This shows that Indian planning is indicative economic planning or planning by inducement only.

Indian plans are comprehensive. The Indian plans are comprehensive and encompass all fields of economic activity. Viewed in this way, they are different from economic planning in West European countries where it is partial (touching a few sectors). The attempt in those countries is mostly directed towards maintaining a high level of employment through fiscal measures. When conditions of scarcity or shortages of certain commodities emerge plans are drawn for their judicious distribution through rationing and price control. As against this type of partial planning, Indian planning is comprehensive.

In this characteristic at least it follows the pattern of socialist countries. Targets me laid down separately for all the sectors of the economy like the agricultural sector, manufacturing industries, electricity generation, transport, communications, etc.

Physical planning. Economic planning can be Of two types-(i) physical planning, and (ii) financial planning. The former implies allocation of resources in terms of men, material and power to accomplish the targets laid down in the plan documents. The latter implies the provision of financial resources to make this possible. Both are complementary and proceed side by side in rational planning strategy. However, both P.C. Mahalanobis and Pitambar Pant who influenced the framing of the Second Plan most were physical planners. They believed that "provided the investments were technically feasible, savings ought to be forthcoming somehow." The obviously wrong assumption that "What is physically possible is financially possible too" led to complacence on the financial front and the neglect of financial planning to large scale deficit financing giving rise to inflationary conditions.

Indian planning is social planning. Indian planning is social planning rather pure economic planning. It is precisely on account of this factor that its economic character has become distorted. Because of its social nature, the impact of all those factors that affect political environment has been very much visible on Indian planning as well. As far as the political environment is concerned, the impact of the capitalist class, the zamindars and the prosperous large farmers is very much in evidence. The government policies have been formulated keeping the interests of these classes in view. How else can one account for the failure of land reforms, increase in the concentration of wealth and economic power, expansion in the activities of large business houses, etc.? The initial outline of the Mahalanobis strategy for the Second Plan was quite progressive. Accordingly, much was said on the expansion of the public sector, role of industrialization, lower ceilings on land holdings, inculcating a spirit of cooperation, etc. However, because of the political influence of the dominant classes, all this was considerably watered down in actual practice.

Unreliable data. Any planning, if it has to be purposeful, should be based on authentic data. Without reliable data, projections would be 3 mere guesswork and the analysis would lack the rigour of sound economic reasoning. However, the status of data in India is really very poor. There is no denying the fact that considerable progress has been registered since 1951 when the planning process was initiated in this country and the data now collected are of a much better quality. Nonetheless we have still a long way to go. Particular mention has to be made of the fact that data below the State level in this country are in a deplorable state. Either they are not available at all or are full of mistakes and gaps. Even data on major economic aggregates are not available on a continuous basis year after year. There is also a gnat time lag which considerably reduces the utility of the data for purposes of planning. Changes in the base year off and on renders the comparability of different series difficult.

Objectives of Economic Planning

The long-term objectives of economic planning in this country were spelt out in various plan documents. Upto the Seventh Five Year Plan broadly the main objectives were: (1) economic growth (approximately 5 per cent per annum increase in the net national product), (2) self-reliance, (3) removal of unemployment, (4) reduction of income inequalities, (5) elimination of poverty and (6) modernisation. Some of these objective a were elaborately discussed in the Second and Third Five Year plans. In the subsequent plans they were simply reiterated. Various plans, however, did not place equal emphasis on these objectives. Whereas earlier plans laid stress on rapid economic growth more than any other objective, the Fifth and Sixth Plans great importance, generation of employment and removal of poverty. In the Seventh Plan modernisation was stressed. The government which assumed office in June 1991 virtually abandoned these long term objectives of economic planning. Its entire concern was to implement B programme of macro-economic stabilisation through fiscal correction. Moreover, the trade, industrial and public Sector policies aimed at undermining the very system of economic planning. The government's lack of commitment towards economic planning can be appreciated from the remarks of the Deputy Chairmans of the Planning the preface to the Eighth Plan document that the Eight Plan document that the Eighth Plan is a Plan "for managing the transition from centrally planned ceonomy to market led economy".

Economic Growth

Economic growth has always remained in focus as the main objective or Indian Five Year Plans. Even when some other objectives were stated emphatically in some Five Year Plans, the objective of growth retained its preeminent position. This inference is not without basis. In the first place one would clearly notice in Indian plan documents that while stating various objectives the conflict that might exist between them has been generally ignored. It has often been assumed that the gains of economic growth would percolate downwards and thus inequalities would decline and poverty problem would automatically be solved. Th, growth of employment was also taken for granted. The connection between economic growth and other objectives is

not that Simple as is often considered to be in this country. It has been observed in a number of less developed countries that economic growth generally benefits the elite groups and, as a result, economic inequalities grow.5 India's experience over the planning period is precisely the same. Secondly, from the very character of Indian plans, the targets set out therein, and the allocation resources to various sectors, it becomes obvious that the major thrust of economic planning in India is economic growth. Finally, when the performance of a particular is plan is evaluated, the main thing that is investigated is the success on the growth front

High priority to economic growth in Indian plans looks very much justified, particularly when we view it in the context of long period of stagnation in the nineteenth and early twentieth century. The economy of the country had received servere jolt under the British on account Of massive drain of wealth from India. In this period while the European countries developed, India suffered underdevelopment. Therefore, once this country got Independence, the unequivocal choice of the decision makers was for economic growth

The Earlier Phase: 1951 to 1980 The era of economic planning ushered in 1951. The First Five Year Plan covering the period from 1951 to 191i6 had a target of 2.1 per cent per annum increase in national income. This target, in fact, war very modest and even with its realisation there could be, increase in per capita national income. The Performance of the plan, however, we, better and over the five-year period national income recorded a 3.6 Per cent per annum increase. The per capita income over 'he plan period increased at the rate of 1.8 per cent per annum. The Second Five Year Plan envisaged a target of 4.5 per cent per annum increase in national income. From a quantitative point of view this target was not significantly higher than the actual growth performance during the First Plan period. The Second Plan was, however, different from the First Plan in terms of its objectives. Its basic framework WBS based on the Mahalanobis strategy of development, which gave the highest priority to heavy industries. The implementation of this policy involved rapid development of the public sector. The actual growth rate during the Second Plan, however, turned out to be a little lower than the targeted rate. The national income rose at the rate of 4.2 per cent per annum and the rate of increase in per capita income turned out to be a mere 2.0 per cent per annum.

The Third Plan had aimed at securing an increase in national income of 5.6 per cent per annum. The planners had the confidence that the pattern of investment designed in the Third Plan could sustain this rate of growth during the subsequent plan periods a$ well. The highest priority in` this plan was accorded to agriculture. After the experiences of the first two plans, more particularly of the Second Plan, it had become evidently clear to the planners that among the factors determining the rate of economic growth in this country, agriculture had a unique place. Hence the Third Plan put special emphasis on raising the agricultural output. Further, like the Second Plan, from the point of view of overall economic development, it attached great importance to growth of steel, machine tools and heavy engineering industries on the one hand and energy sources on the other. Thus, in totality the development strategy of the Third Plan was basically the same as that of the Second Plan. During the Third Plan period the national income rose only at a modest rate of 2.7 per cent per annum and this there was only a marginal increase in national income per capita. In brief, from the point of view of economic growth, the Third Plan was a miserable flop, and as a consequence, the economy found itself stranded in deep waters. Only told and vigorous planning could have saved the country. However, contrary to tile need of the hour, long-term planning was suspended for full three years. The Fourth Plan thus started in 1369 instead of 1966 which was the scheduled year for its beginning.

The emphasis in the Fourth Plan was on growth with stability. In India's economy, two factors, viz., fluctuations in agricultural production and uncertainties about foreign assistance cause greater instabilities. Hence the Fourth Plan laid stress not only on various programmes for raising the agricultural output, but also on creating buffer stocks of foodgrains so as to ensure regular supply of food. The Planning Commission was convinced that it was a necessary measure for the stability in general price level. In order to eliminate uncertainties in respect of resources for the plan, it was also felt that the dependence on foreign aid was to be minimised. The Planning Commission had visualized the possibilities of accelerating the rate of growth in an atmosphere

free from instability and uncertainties. With this perspective the planners had contemplated a 5.7 per cent per annum increase in national income during the Fourth Plan period In reality nothing of the sort happened and the growth rate remained stuck at 2.1 per cent per annum. Instability could not be eliminated. In addition, some new bottlenecks developed-the most notable being in the field of energy and transport. These factors together prevented growth rate from picking up.

In the Draft Fifth Five Year Plan, the target laid down for the increase in GDP was 5.5 per cent per annum, which was considerably higher than what was achieved during the past two decades. The Fifth Five Year Plan in its final form was different from the Draft Plan in a number of respects. The Final Plan aimed at only 4.4 per ant per annum increase in GDP as against the target of 5.5 per cent per annum set in the Draft Plan. For the realisation of this objective, the principal emphasis was on raising the investment rate apart from pushing up the productivity level. During the Fifth Plan period the national income recorded a totally erratic growth. The large fluctuations in the rate of growth were mainly on account of the fluctuations in agricultural production. The rate of increase in GDP during the 1974-79 period was 4.8 per cent per annum which looks quite satisfactory when we compare it with the performance of the economy during the earlier plan periods. However, the Fifth Plan failed to create any solid foundation on the basis of which subsequent growth process could be sustained. Thus in 1979-80, the economy suffered a major setback and the GDP declined by 5.2 per cent.

When we consider the trend growth rate during the first three decades of economic planning, we note that at best it was extremely modest. In this period GDP had increased at the rate of 3.4 per cent per annum.

The Later Phase: 1981 to 2002. In the later phase four plans have been completed. The average GDP growth rate of about 5.7 per cent in this period is an improvement over the growth rate of 3.4 per cent per annum during the previous three decades. We shall now analyse the performance of the Indian economy on growth front plan-wise in the later phase.

The Sixth Five Year Plan registered 5.5 per cent per annum increase in GDP against the targeted GDP growth rate of 5.2 per cent per annum. The Plan had proposed to pay particular attention to certain aspects of the economy for achieving the growth target. These were: (1) improving the efficiency level of existing capital stock utilisation, (2) raising the investment rate, (3) changing the Investment pattern to make it more rational from the point of view of growth, and (4) keeping deficit in balance of payments within certain limits so as to prevent emergence Of foreign exchange crisis. The actual growth rate exceeded the target set for the Sixth Plan. This was mainly due to good agricultural performance and a rapid growth in the services sector. Agricultural output during the Plan period Increased at the rate of 4.3 per cent per annum against the target rate of agricultural growth of 3.8 per cent per annum. The level of investment is generally considered a major determinant of growth and, in this, the Sixth Plan expectations were fulfilled. However, the saving rate failed to reach the target. The shortfall in the saving was largely due to the failure of the public sector to generate the desired surplus.

The Seventh Plan aimed at 5.0 per cent per annum increase in GDP. This rate was a little higher than the rare of growth realised during the past decade. According to the Planning Commission, this rate was also in line with the growth rate achieved in the Sixth Plan. However, considering the resource constraint and the actual performance of the economy during the first three years of the plan, realisation of this target did not look very easy. In the first three Years of the Seventh plan GDP had increased "' a modest rate of 3.8 per ant per annum. However, during 1988-89 and 1989-90 due to bumper harvests the growth rate picked up sharply and the average annual increase in GDP during the whole of the Seventh Plan period turned out to be 6.0 percent per annum against the target of 5.0 per cent per annum. Thus the overall rate of growth exceeded the target. In isolation this may look quite impressive. However, when we examine as to how the overall rate of growth of 6.0 per cent per annum was realised during the Seventh plan period, the situation

appears to be less encouraging. The country did not register a steady rate of growth during ... period. There were marked variations in the rate of growth registered in different years ...

The growth process of the 1980s, in spite of an improvement in the average GDP growth rate has been criticised. One major criticism of this growth process which involved high fiscal deficit was that it was unsustainable as it put pressure on balance Of payments and also led to inflation. Another major ... was that involved a inefficient utilisation of resource.

The year of 1990-91 was not bad in terms of growth though in this year the economic crisis which ... in 1991-92 had already begun. In 1990-91: CDP registered 5.4 per cent increase. This could not ... in 1991-92 as in this year adverse effects of the economic crisis arrested the overall growth ... rate of growth of GDP in this year was only 0.8 per cent and both agricultural and industrial sectors ... negative growth rates of 2.8 and 0.1 per cent respectively.

The Eighth Plan began in a difficult situation. In the first two years of this Plan the rate of ... was rather modest-5.5 per cent per annum. However, in the remaining three years annual rate ... in GDP was 7.0 percent or more with the result that the Plan turned out to be 6.7 per cent per annum ... than the target of 5.6 per cent per annum. This average rate of increase in the Eighth ... satisfactory ... On the growth front made proponents of economic liberalsation in the country unduly optimistic. In ... circles also the decision makers contended that the liberalisation package had put the Indian economy ... high growth path.

However, the Performance of the economy during the Ninth Plan turned out to be poor and ... prophets of liberalisation wrong. As against the target of 6.5 per cent per annum increase in GDP the ... increase turned out to be only 5.4 per cent per annum. The Planning Commission has put the blame ... poor performance on low agricultural growth in three out of five years, reduced demand for industrial ... and the consequent reduction in the growth rate of the industrial sector, and slowdown in within ... the world economy that adversely affected the level of exports. If one views the rate of increase ... during the liberalisation phase of L990s as a whole, if turns out to be merely 5.8 per cent per annum which is definitely low and not at all impressive. It also exposes the misplaced confidence in the capacity of ... free enterprise economy to take the country on a higher growth path.

Self-Reliance

About five decades ago on the eve of the First Plan, India was dependent on foreign countries at ... respects. First, despite the fact that Indian economy is essentially agrarian, the output of foodgrains ... adequate and the country imported big quantities of foodgrains from the U.S.A. and some other ... Second, on account of virtual non-existence of basic industries, transport equipment, machine tools ... engineering goods, electrical plant and machines and many other capital goods had to be acquired ... developed countries. Third, saving rate being very low, foreign aid had to be obtained in order to ... investment rate in the country.

No one disputes that trade between two equal partners on purely commercial terms is beneficial ... may not. however, be correct in respect of underdeveloped countries trading with developed countries ... an unequal bargaining position. It has been observed in many cases that developed countries while ... essential commodities like foodgrains, machinery and other capital equipment to underdeveloped ... attempt to take full advantage of their strong bargaining position and extort exorbitant prices for their ... Often exports of these and other essential goods are used as political weapons to blackmail the Third World countries. Therefore, if some underdeveloped country seriously desires to keep its growth activity free ... political pressures of other countries, it has no choice but to become completely self-reliant in food and ... equipment. Further, it has also to minimize its dependence in respect of aid from other countries ... institutions like the IMF and the World Bank.

Broadly these are the reasons why self-reliance was adopted as a major objective of economic planning in this country. The emphasis on self-reliance was not much in the first two plans. In the Third Plan for the first time it was stated that the country would endeavour to become self-reliant over a decade or so. The concept of self-reliance adopted in the Plan was, however, narrow. Self-reliance was defined merely as overcoming the need far external assistance. In the Fourth Plan, the objective of self-relianace was stated in a concrete form. The Plan not only reiterated the government's commitment to reduce its dependence on'foreign aid but also decided to do away with concessional imports of foodgrains from the USA under PL 480. The country made progress along the expected lines during the first three years of the Plan. However, in the fourth year of the Plan, the country faced a deterioration in its balance of payments position mainly due to large imports of foodgrains n ecessitated by the drought and sharp rise in the international prices of imports.

Under the Fifth Plan for tackling the balance Of payments problem, two pronged strategy was adopted in the form of export promotion and import squeze. This policy and unexpectedly large private remittances considerably improved the balance of payments position. However, during the 1980s liberalisation in the foreign sector led to severe strains on the balance of payments and the country's foreign exchange reserves declined to $ 2, 236 million. The government thus resorted to economic reforms. It is now hoped in the official circles that with the correction of macro-economic imbalances and structural reforms, the economy in the future would tread O" a high growth path and would ultimately realise the goal of self- reliance. But some independent analysts have serious doubts about the claims of the government.

It is now generally agreed that in the field of self-reliance, India has two achievements to its credit. First, the country is now almost self-sufficient in food. Second, with the growth of iron and steel, machine tools and heavy engineering industries, this country has made considerable advancement towards self-reliance in equipment. In totality, however, the goal of self-reliance has proved to be elusive. International prices of petroleum products are highly volatile and any unexpected spurt in them can cause severe strain on the country's balance of payments. Also, because of the hot money inflows the country ha snow become extremely vulnerable to the designs of global finance capital.

Removal of Unemployment

Unemployment problem requires an immediate solution for the elimination of poverty. It is observed that with the rising number of unemployed, poverty expands. Removal of unemployment has thus been mentioned as one of the objectives of economic planing in all the Five Year Plans, but it never got a high priority. Ashok Rudra asserts that the government never had an employment policy. It also did not set a target date "by when any able bodied person who wants to work and make an honest living can be assured Of a job that would offer him at least a minimum subsistence." This explains why unemployment has not decreased over the years. However, the Planning Commission stated in the Eighth Plan documents that employment is to be treated as a direct focal point of Policy. "The government at the Centre, it seems, does not share this perception of the Planning Commission.

The approach of the Planning Commission till recently has been of nor seeing the question of employment generation separately from investment programmes. It was believed that as investment increased employment would also grow. In the Third Plan document while discussing the objectives of economic planning The, Planning Commission had argued that as national Income grows in response to increased investment and development outlay, the demand for labour rises and employment expands. This is a very simplistic view. The main weakness of this approach is that it ignores the fact that an increase in investment does not automatically create larger employment or the growth of employment besides an increase in investment the choice of techniques should also be correct. This is possible only if before finalising each investment project. its employment potential is carefully studied from a technical point of view. Decisions taken in purely macroeconomic framework will be of little avail. Keeping in view the requirements of different regions, sectors and economic classes, separate employment plans have to be framed for each one of them.

Creation or Fresh Jobs in an Inadequate Number. How incorrect we, the approach of the [illegible] in respect of employment in the earlier phase of economic planning is, evidently clear from [illegible] did not even attempt to create as many jobs as were required by the fresh labour force coming [illegible] market. Consequently, at the end of each plan period the unemployment backlog was greater than [illegible] beginning of the plan. For example, the backlog of usual status unemployment on the eve of the Sixth [illegible] was estimated around 12 million (based on 32nd Pound of the NSS). The net addition to the labour [illegible] the age group 5+ during 1980-85 was estimated to be around 34 million. These two together indicate [illegible] overall magnitude of employment to be generated during the Sixth pi, period. It is clear that employment [illegible] not be generated w, this scale during 1980-85, and as a consequence the backlog of usual status unemployment on the eve of the Seventh Plan was around 13.9 million (based on 32nd round of the NSS). According [illegible] Seventh Plan, net addition to the labour force in the age group 5+ during 1986-90 was expected to be [illegible] 39.38 million. This along with the unemployment backlog indicated the magnitude of employment [illegible] to be generated in the Seventh Plan for wiping out unemployment. However, employment could [illegible] generated on this scale, and unemployment in April 1990 was 13 million in terms of usual status and 20 [illegible] in terms of daily stuatus. According to the Planning Commission, the proportion of unemployed and [illegible] employed to labour force was 2.02 per cent and 8.43 per cent respectively in 1993-94

Lack of Compatibility between Employment and Output. AS already stated, the main focus of Indian [illegible] has been on production targets. The problem of unemployment is generally discussed separately [illegible] reference. The objective of employment is often presented as if employment would rise automatically [illegible] the growth targets are achieved. Pramit Chaudhuri has aptly remarked, "Although full employment [illegible] regarded as a desirable objective, its achievement was seen to depend on the fulfilmet of achieving a [illegible] stock objective and that in the long run. There was no serious concern in the formulation of the strate[illegible] the compatibility of the employment targets with the various output and investment targets." 11 The [illegible] in unemployment over the years in the country is generally attributed to the basic weakness in the [illegible] of the government. As noted by Arun Ghosh, to increase employment opportunities at a minimum [illegible] per cent per annum that is required to wipe out unemployment in this country, it is necessary to restructure the pattern of investment and output in favour of areas, sectors and production proceses with greater employment potential. 12 However since the introduction of liberalisation measures, this no longer [illegible] the government and the planners.

Reduction in Income Inequalities

Reduction in income inequalities has been mentioned as one of the objectives of economic planning in India. However, in terms of priority it always got a very low place. It is probably on account of this [illegible] neither the plan documents, nor any other publications of the Planning Commission ever provided [illegible] of the inequalities in income and wealth distribution. Pramit Chaudhuri is perhaps right in his assertion that Indian plans have never made any serious attempt to redistribute income and wealth. 13

The Planning Commission had spelt out its approach in respect of income inequalities in the Fourth Plan. In its opinion, fiscal measures at best can reduce disposable income at the top and thus their importance [illegible] eliminating income inequalities is limited. It stressed the need for raising the living standards of the [illegible] accelerating the pace of growth on the assumption that the gains of development will percolate downward. Interestingly in the Fifth Plan though removal of poverty was mentioned as a major objective, only a passing reference was made to the problem of income inequalities. No doubt presence of widespread poverty [illegible] stigma an Indian society and no possible effort should be spared to remove it. But it is difficult to follow [illegible] only a passing reference was made to the problem of income inequalities since they are too Large to [illegible] overlooked. The Sixth Plan reiterated the need for removal of poverty, but did not spell out concrete measures to be followed for eliminating income inequalities, The Pian document simply hoped that fiscal policy, industrial licensing, monopoly control measures and additional employment opportunities to be created during the Plan

period should be able to reduce disparities in income distribution. The Seventh Plan did not make even a passing reference to this objective. All this shows that the objective of reduction in income inequalities was accorded a very low priority in economic planning. The neglect of this objective arose out of the conviction of the planners that economic growth will automatically reduce income inequalities. Since the Eighth Plan like the Seventh Plan made no reference to the objective of reduction in income inequalities, it would not be wrong to infer that it has now been completely abandoned by the government. It seems that with the onslaught of liberalisation ideology, egalitarianism has been put into cold storage and growing income inequalities are no longer viewed as a social evil in the government circles.

From rapid growing assets of the big business houses, it is obvious that income inequalities have been increasing in urban areas as well. Anti-monopoly measures can reduce inequalities in income and wealth, but from this point of view, the Monopolies and Restrictive Trade Practice (MRTP Act) has always been found rather ineffective. Lately the government has considerably liberalised the statutory provisions of the MRTP Act which will further induce economic concentration. The Dutt Committee in its report had noted that the lending Policies of the State-owned financial institutions have discriminated against small industrial units and thereby encouraged growth of monopolies. The phenomenal growth of big business over the Years has accentuated income inequalities in the country. The role of fiscal policy from the point of view of redistribution of income is not very clear. Contrary to the general belief that India's tax structure is progressive, Amaresh Bagchi has argued that tax structure in India is regressive and it has encouraged concentration of economic power.

Elimination of Poverty

The removal of poverty as an objective of economic planning was mentioned explicitly for the first time in the Draft Fifth Five Year Plan. During the first two decades of planned development, that is, until the completion of the Fourth Plan the poor had hardly benefited from the Plans and their life was as wretched in the early seventies as at the time of Independence. This happened largely due to the defective approach of economic planning which on the one hand encouraged concentration of economic power, and on the other resulted in inflation which had serious repercussions on poor.

Strategy to Tackle Poverty Problem. We have presented estimates of poverty provided by different economists and the Planning Commission in the Chapter on "Poverty of India". As can be seen from these estimates, a little less than half of the population has remained below the poverty line (defined as the bare minimum subsistence level) for a major part of the planning period. However, until the late 1970s decision-makers in the government and the Planning Commission were of the view that the trickel down effects of growth could alleviate poverty in the country in the coming years. It was thus stated in Draft Five Year Plan 1978-834, "Without any redistribution the poverty percentage should fall from 46 per cent at present to 27 per cent after 10 years if the assumed rates of growth materialised."15 This was certainly an unwarranted optimism, as the past record of growth in this country did not lend support to it. The government soon recognised this fact. The Planning Commission in the Sixth Plan document thus stated. "The incidence of poverty in the country is still very high. Thus determined measures are necessary to combat poverty. A substantial increase in the overall rate of growth of the economy will no doubt create favourable conditions for a reduction in poverty and unemployment. However, in the light of past experience it will not be realistic to rely solely on the growth process to find a solution to the problem. Specific policy measures will be Deeded not only to influence compa4tjon of output in favour of mass consumption goods, but also to ensure a more even regional and class distribution of output, paying special attention to stimulating growth in more backward region.. In addition., the ongoing poverty eradication probrammes aimed at the specified groups of population will have to be improved and enlarged with regard to both content and coverage."16

According to the government, this strategy has worked in the past. The Planning Commission had also claimed that the process of economic growth and anti-poverty programmes had brought down the proportion of the population below the poverty line from 48.3 percent in 1977-78 to 29.9 percent in 1987-88. The Planning Commission nonetheless asserted, "It is, however, necessary to emphasis that these anti-poverty programmes cannot by themselves be expected to remove poverty on, sustainable basis. It is only in the framework of an expanding economy and dynamic agricultural sector that we can hope to make a lasting impact on the problems of poverty and underdevleopment." The government's claim with regard to success on the poverty front was, however, questioned by the various economists. Minhas, Jain and Tendulkar pointed our that the Planning Commission had followed a wrong methodology and, as a result, it arrived at erroneous estimates of the population below the poverty line in 1983-84 and 1987-88. According to the estimates of Minhas, Jain and Tendulkar, the proportion of Population below the poverty line was as high as 45.85 per cent in 1987-88.18 Comparing it with the planning Commission's estimates of the population below the poverty line in 1977-78, it becomes evidently clear that in the ten year period from 1977-78 to 1987-88 there was only a marginal decline in the incidence of poverty in the country. In the mid-nineties, the Planning Commission adopted the Expert Group Methodology to present the estimates of poverty in India. According to these estimates, the proportion of population below the poverty line was 40.7 per cent in 1992-93 and 36.0 per cent in 1993-94.

Recently, in its eagerness to prove that the liberalisation measures have significantly reduced the incidence of poverty in the country, the Planning Commission g, made estimates of poverty on the basis Of questionable results of the 55th Pound of the NSSO. These estimates show that there has been a steep Fall in the incidence of poverty since 1993-94, " on the basis of 30day recall only 27.1 per cent of the rural population and [illegible] per cent of the urban Population was below me poverty line in 1999-2000. The overall incidence poverty was 26.1 per cent. The merit of these estimates has been rightly questioned by Abhijit Sen Jayati Ghosh. We thus ignore the Planning Commissions estimates of poverty and consider relatively reliable poverty estimates of S.P. Gupta which show that 45.3 per cent of the rural population and 34.6 per cent of the urban Population WBS below the poverty line in January-June 1998." Estimates of poverty by Sundaram and Tendulkar show that 44.9 per cent of the rural population and 31.6 per cent of the urban Population was below the Poverty line in January-June 1998. These poverty estimates of both S.P. Gupta and K. Sundaram and S.D Tendulkar clearly suggest that neither economic planning nor liberalisation policy made any dent in the poverty during the 1990s.

In the Sixth Plan for the first time the objective of modermisation was explicitly mentioned. While spelling out the concept of modernisation the planners gave it a very wide meaning. The Plan document stated, "The term modernisation conotes a variety of structural and institutional changes in the framework of economic activity." It thus implied a "shift in the sectoral composition of production diversification of activities, and advancement of technology and institutional innovations" so as to transform "a feudal and colonial economy into a modern and independent economy."21 If one accepts this concept of modernisation then this is also to be admitted that during the whole of the planning period. India did make advance on the modernisation path though the process might not have been spectacular. Over the five decades of planning, the composition of national income has changed steadily. The share of manufacturing, mining, construction and productive infrastructure has increased from about 20 per cent in the early fifties to about 3d per cent in the late 1980s. In the industrial sector considerable success has been achieved from the point of view of diversification. Today India's capabilities in technical know-how are far greater than those in the early 1950s. Even in the institutional framework this country's achievements are not small. For example, setting up of development hanks for industry and agriculture, innovation of Regional Rural Banks and extension of co-operative credit to the remotest interiors of the country have radically changed the institutional framework of credit.

In the Seventh Plan the concept of modernisation was narrowed down. For the planners now modernisation refers primarily to technological advances. In agriculture it implies increased use of fertilizers and HYV seeds

extension of irrigation facilities, improvement in water management change in the pattern of energy use and greater mechanisation. It is hoped that all these measures in course of time will spread green revolution to new Press. In industry several major technological advances have taken place in the world "of which the more important flow from three sources: (a) the application of computers and electronics to production process: (b) improvements in fuel efficiency of prime movers and other industrial equipment; and (c) the use of new materials."22 During the Sixth Plan period a beginning was made to introduce these changes in the economy. No one will dispute that these measures will improve efficiency and thereby accelerate economic growth. But there is a risk in indiscriminate modernisation. In a labour surplus economy like the one we have in this country a steadily automation in industries can force lots of industrial workers to lose their jobs. Similarly, m the countryside, mechanised farm operations can worsen employment situation among the agricultural workers. Unfortunately, the planners have refused to recognise that at this juncture India a real conflict exists between the objective of modernisation and the objectives of unemployment and poverty removal.

Evaluation of The Objectives of Economic Planning

The main objectives of economic planning as they have been spelt out in various plans cannot be realised simultaneously. Often ignoring the incompatibility between various objectives it is expected that the success will be achieved in all the directions. The experience in the past, however. has belied these expectations. In India's mixed-economy. the objectives of rapid economic growth and reduction in income inequalities seem to be in conflict and the planners Clearly betray awareness of trade-off between them. India's underdeveloped economy is basically different from the Keynesian world. In the developed West, recourse to various redistributive measures will raise the marginal propensity to consume, which in turn wilt induce investment. Obviously with m increase in investment not only employment level will rise, but overall development will also take place. However, this policy will not work in India with the same effectiveness. Shortage of capital is the major obstacle to development in this country. Most of the unemployment in this country is structural in character and differs from unemployment of the Keynesian world. The saving rate is not high enough to match the investment rate required for providing employment to everyone. The techniques which can generate adequate surplus for rapid economic growth are such that they will hamper creation of new jobs and will thereby accentuate inequalities in income and wealth. If, on the contrary, labour-intensive techniques are adopted so as to create employment opportunities on an extensive scale, adequate surplus required for realising warranted rate of growth may not be generated. This, as a matter of fact, is a major problem to which in the past Indian plans have not paid sufficient attention. Ignoring the incompatibility between growth and other objectives. Indian plans have accorded the highest priority to growth and, in practice, whenever other objectives have come in conflict with the objective of growth, they have been given up in favour of the latter. There is ample evidence in support or this contention.

While spelling out the objectives of the Fourth Plan, reference in most unequivocal terms was made to reduction of inequalities in income and wealth. However, the indifference of the Planning Commission towards this objective was unconcealed. One can easily judge this from its broad approach defined in the Fourth Plan document itself which states, "To some extent income disparities can he reduced through fiscal measures aiming at reduction of income at tile top levels. but for us it is important to lay far greater stress on positive steps for ameliorating tile conditions of poorer people through planned economic development. In a rich country greater equality could be achieved ill pal by transfer of income through fiscal, pricing and other policies. No significant results can be achieved through such measures in a poor country, where whatever surplus can be mobilised from the higher incomes of richer classes an needed for investment in the economy to lay the basis for larger consumption in the future." 23 This approach of the Plan was criticised by Dandekar and Rath who wrote : "But a plan of development, which accepts a national minimum and aims at assuring the same to all within the shortest possible lime, cannot depend entirely on a high rate of economic growth.

Without a deliberate policy to ensure an equitable distribution of the gains of development, the processes development benefit the upper middle and richer sections of the population much more than they do the lower middle and the poorer sections. As a result even a high rate of growth, probably beyond the range of feasibility cannot lift the bottom of the society to the desirable minimum within the foreseeable future. This is not a plea fore lower it a of growth but a warning that a his rate of Growth is not a substitute for deliberate policy to ensure suitable distribution of the gains of development.'"24 Mahbub-ul Haq seems to speak on behalf of a great number of economists when he succinctly remarks that "we were taught to take care of our GNP Is this will take care of poverty. Let us reverse this and take care of poverty as this will take care of the GNP."25 The Fifth Plan also referred to The necessity of eliminating poverty. But how superficial was the commitment of the planners is explained by Suresh D. Tendulkar thus, "It is round that the basic statement of the social objective is a non-statement. The discussion of The 'policy-frame' exhibits a penchant for abstract logic without being operational. The programmes For the removal of poverty are vague in terms of their quantitative effects on the attainment of the social objective. The discussion of the changes in the institutional framework is similarly couched in non-operational terms such as 'attitude transformation' and 'structural reformation'. The credibility of the Planning Commission even in terms of its own statements appears to be poor indeed with reference to the avowedly basic social objective of the plan "

Tenth Five Year Plan

The Tenth Five Year Plan officially commenced on April 1, 2002 and covers the period 2002-03 to 2006-07 However, the Plan document was released almost one year of the commencement of the Plan.

Objective and Monitorable Targets

The Tenth Five Year plan has kept an 'ambitious' objective of achieving 8 per cent per annum growth over the plan period. The Plan itself admits that achieving this objective is bound to be a daunting task as the medium term performance of the economy " the past several years suggests that the 'demonstrated growth potential' is only about 6.5 per cent.

In addition to the 8 per cent growth target, the Tenth Plan also aims at enhancement of human well being and identifies the following Specific and monitorable targets for this purpose:

1. Reduction of poverty ratio by 5 percentage points by 2007 and by 15 percentage points by 2012.
2. Providing gainful and high-quality employment at least to addition to the labour force over the Tenth Plan period;
3. All children in school by 2003; all children to complete 5 years of schooling by 200i;
4. Reduction in gender gaps in literacy and wage rates by at least 50 per cent by 2007;
5. Reduction in the decadal rate of population growth between 2001 and 2011 to 16.2 per cent;
6. Increase in literacy rate to 75 per cent within the Plan period;
7. 'Reduction of infant mortality rate to 45 per 1000 live births by 2007 and to 28 by 2012;
8. Reduction of maternal mortality ratio to 2 per 1090 live births by 2007 and-to 1 by 2012
9. Increase in forest and tree cover to 25 per cent by 2007 and 33 per cent by 2012.
10. All villages to have sustained access to potable drinking water within the Plan period;.
11. Cleaning of all major polluted rivers by 2007 and other notified stretches by 2012.

According to the Tenth Plan, while earlier plans also had many of the above mentioned issues as objectives,

in no case were specific targets set. "As a result, these were viewed in terms of being desirabl but not essential. Thus a 'best endeavour' approach was usually adopted in this regard. In the Tenth Plan, however, these target: are considered to be as central to the planning framework as the growth objective".'

The Development Strategy

The development strategy as envisaged in the Tenth Plan has the following elements:

Redefining the Role of Government

According to the Plan, it is necessary to redefine the role of the government in the new emerging economic scenario. In the part, the government took on too many responsibilities, imposing severe strain on, its limited financial and administrative capabilities and also stifling individual initiative. An all pervasive government role may have been necessary at a stage where private sector capabilities were undeveloped, but the situation has changed considerably over the years with a strong and vibrant private sector now emerging in the economy. Therefore, the focus of government policies should now shift to providing an environment which is conducive to the growth of the private sector.

The Plan. however, specifically mentions two areas wherein the role of government will continue to be important: (1) the social sectors, where its role Will clearly have to expand: and (2) infrastructure development, where gaps are large and the private sector cannot be expected to step in significantly. The Plan divides infrastructure into two categories: telecommunications, power, pens etc. where the private Sector should be allowed to play a greater role; by Providing an appropriate policy framework: and rural infrastructure and road development etc. where the government will have to take the lead.

Reappraisal of Macro-Economic Management System

With the growing importance of the private sector in economic matters, and the consequent increase in the sensitivity of the economy to business cycle fluctuations, both the role and the manner of macroeconomic management require reappraisal. Greater flexibility in fiscal and monetary policies has now become necessary to ensure that the economy is consistently maintained on the feasible growth path. According to the Plan, while there has been considerable improvement in the flexibility and sophistication of monetary and exchange rate management in the country, the fiscal policies remain rooted in outmoded budgetary procedures. It is imperative that a reformulation of the fiscal management system be undertaken expenditiously to make it more appropriate for the changed context.

Laying Down State Level Targets

The Indian plans have traditionally focused on setting only national targets. However, the performance of different States has varied significantly-while some States have registered fast growth, some poor States have seen a deceleration in growth. According to the Tenth Plan, it is important to recognize that the sharp increase in the growth rate and Signi6cant improvement in the social indicators that are being contemplated in the Plan will be possible only if there is corresponding improvement in the performance of the laggard States. In order to emphasise this fact, the Tenth Plan lays down State-specific targets for different development goals consistent with the national plan. This is expected to reinvigorate planning at the State level on account of the following reasons: First, the very recognition of the diversities that exist in the country should lead to a similar recognition at the sub-Slate level. Different districts within a State are at different levels of development and have different capabilities. Specification of State level targets should help in the preparation of better sub-State Plans. Secondly, a statement of the comparative position of the various Stales in different dimension;

of development is, in itself, an important method for encouraging introspection, leading hopefully to effective benchmarking of future progress."

Strategy for Equity and Social Justice

According to the Tenth Plan, although growth has strong direct poverty reducing effects, the frictions and rigidities in the Indian economy can make these processes less effective. Accordingly, it is necessary to explicitly address the need to ensure equity and social justice. The Plan proposes the following three pronged strategy for attaining equity and social justice along with high rates of growth:'

1. Agricultural development must be viewed as a core element of the Plan, since growth in this sector is likely to lead to the widest spread of benefits especially to the rural poor. The first generation of reforms concentrated on the industrial economy and reforms in the agricultural sector were neglected. This must change in the Tenth Plan.

2. The growth strategy of the Tenth Plan must ensure rapid growth of those sectors which are most likely to create gainful employment opportunities and deal with the policy constraints which discourage growth of employment. Particular attention must be paid to the policy environment influencing a wide range of sectors which have a large employment potential. These include sectors such as agriculture in its extended sense, construction, tourism, transport, small-scale industries, retailing, IT and communication-enabled services, and a range of other new services which also need to be promoted through supportive policies.

3. There will be a continuing need to supplement the impact of growth with special programmes aimed at special target groups which may not benefit sufficiently from the normal growth process. Such programmes have long been part of our development strategy and they will have to continue in the Tenth Plan as well. However, it is important to ensure that they are effective in achieving their objectives.

Growth Rate and Plan Size

The Tenth Plan aims at a growth rate of 8 per cent per annum. The parametric requirements of the economy required to achieve this growth rate are presented in Table I.

Table 1: Macro Parameters for the Tenth Plan (2002-2007)

	Ninth Plan	Tenth Plan	Post Plan
1. Domestic Savings Rate (% of GDP at market price)	23.3	26.8	33.0
2. Current Account Deficit (% of GDP at market price)	0.9	1.6	3.1
3. Investment Rate (a of GDP at market price)	24.2	28.4	36.1
4. ICOR	4.53	3.58	3.84
5. GDP Growth Rate (per cent per annum)	5.4	7.93*	9.4
6. Export Growth Rate (per cent per annum)	-	12.4	-
7. Import Growth Rate (per cent per annum)	-	17.1	-

*GDP growth rate target for Tenth Plan was later revised from 7.93 per cent per annum to 8 per cent annum.

Source: Government of India Planning Commission, Tenth Five Year Plan, 2002-2007, Volume I, (Delhi, 2003), Table 2.7. p.30.

Achievement of the targeted growth rate in the Tenth Plan is crucially dependent on an expected reduction in the incremental capital output ratio (ICOR) from 4.53 during the Ninth Plan to 358 in the Tenth Plan. However, as can be seen from the Table, even with this reduction in the ICOR, the investment rate will have to be stepped up by more than 4 percentage points of GDP during the Tenth Plan period, and also conditions will have to be created for further increase of nearly 8 percentage points during the Eleventh Plan. In order to finance the increased investment requirement, the domestic savings rate is targeted to increase by 3.5 percentage points of GDP, and external savings, in the form of the current account deficit, to make up the rest. It is further expected that the rate of growth of imports will average more than 17 per cent per annum during the Tenth Plan, which arises partly out of +the increased demand generated by the higher growth and partly from the planned reduction in the average level of tariffs. The exports are expected to increase by 12.4 per cent per annum over the Tenth Plan period.

The pubic sector outlay for the Tenth Plan has been kept at Rs. 15,92,300 crore at 2001-02 prices comprising the Centre 's share at Rs. 9,21,291 crore and States and Union Territories share at Rs, 6,71,009 crore. The resources for the Central Plan include gross budgetary resources support of Rs. 4,05,735 crore and the internal and external budgetary resources (IEBR) of Rs, 5,15,556 crore. The IEBR component as currently assessed by the Central Ministries is Rs. 4,87,448 crore, which is Rs. 28,108 crore lower than the level consistent with the 8 per cent growth target of the Tenth Plan. Thus the resource allocation in the Central Plan amounts to Rs. 8,93,183 crore. As far as the States and Union Territories' Plan is concerned, while resources are projected al Rs. 6,7 1.009 crore, the core plan estimates arrive at a resource figure of Rs. 5,90,918 crore, leaving a balance of Rs. 80,061 crore. Accounting for tile Central Assistance of Rs. 41,508 crore, the balance that remains is Rs. 38,553 crore. Allocation of this component will have to await its actual mobilisation by the States and Union Territories. Consequently, sectoral allocation in the State and Union. Territories sector is arrived at Rs. 6,32,156 crore. The total for Centre and State sector thus Comes to Rs. 15,25,639 crore. Allocation of this amount as among different sectors is presented in Table 2.

Table 2 : Public Sector Outlay by Major Heads of Development in Tenth Plan (2002-2007)

(Rs. Crore at 2001-02 prices)

Sector	Ninth Plan Realisation	Percentage to Total	Tenth Plan Outlay	Percentage to Total	Percentage increase in (4) over (2)
(1)	(2)	(3)	(4)	(5)	(6)
1. Agriculture and Allied Activities	37,239	4.0	58,993	3.9	58.3
2. Irrigation and Flood Control	69,830	7.4	1,03,315	6.8	48.0
3. Rural Development	88,965	9.4	1,21,928	8.0	37.1
4. Special Area Programmes	5,408	0.6	20,879	1.4	286.1
5. Energy	2,19,243	23.3	4,03,927	26.5	84.2
6. Industry and Minerals	44,695	4.7	`58,939	3.9	31.9
7. Transport	1,43,249	15.2	2,25,977	14.8	57.8
8. Communications	92,836	9.9	98,968	6.5	6.6
9. Science, Technology and Environment	15,667	1.7	30,424	2.0	94.2
10. General Economic Services	13,734	1.4	38,630	2.5	181.3
II. Social Services	1,94,529	20.7	3,47,391	22.8	78.6
12. General Service	15,646	1.7	16,328	1.1	4.4
Total	941,041	100.0	15,25,639	100.	62.1

Source: Tenth Five Year Plan, 2002-07. Volume I, Annexture 3-A, p. 87.

As is clear from this Table, the largest allocation of Rs, 4,03,927 crore (which is [illegible] per cent [illegible] outlay) has been kept for the energy sector in the Tenth Plan. This is in accordance with the [illegible] pattern in earlier plans. Social services sector comes second with allocation to this sector amounting [illegible] 3,47,391 crore (2.8. per cent of the total outlay). Allocations for transport and communications sectors [illegible] are Rs. 3,24,945 crore (21.3 per cent of the total outlay). The agricultural sector (defined to include agriculture and allied activities, irrigation and flood control, and rural development) has been allocated Rs [illegible] (18.7 per cent of the total outlay). In contrast; industry and minerals have been allocated only Rs. 58[illegible] (which is just 3.9 per cent of the total outlay) This is due to the reason that the State is withdrawing [illegible] from the industrial sector giving more space to the private sector to expand its activities.

A comparison Of column (3) and column (5) shows that in percentage terms, the order of priorities [illegible] sectors in the Tenth Plan has been almost the same as in the Ninth Plan. [illegible] study of the last column [illegible] Table (column 6) shows that in real terms, the public sector allocations in the Tenth Plan are higher [illegible] actual expenditure under the Ninth Plan by 62.1 per cent: Maximum increase much as 286-percent [illegible] planned for special, area programmes as the government feels that these programmes have a special [illegible] tackling the problems of unemployment and poverty.

Financing Pattern of The Tenth Plan

The overall pattern of finance of the public sector outlay during the Tenth Plan is presented in Table [illegible]

Table 3: Financing Pattern of the Tenth Plan

(Rs. crore at 2001-02 prices)

Resources	Centre	States and UTs	Total
1. Balance from current revenues (RCR)	-6.85	26,578	[illegible]
2. Resources of public sector enterprises	5,15,556	82,684	[illegible]
3. Borrowings (including net MCR* and other liabilities)	6,85,185	2,61,482	[illegible]
4. Net inflow from abroad	27,200		[illegible]
5. Aggregate resources (1 to 4)	12,21,556	3,70,744	[illegible]
6. Assistance to States and UTs	-3,00,265	3,00,265	
7. Resources for public sector plan (5+6)	9,21,291	6,71,009	[illegible]

*MCR: miscellaneous capital receipts

Source: Tenth Five Year Plan, Volume I, Table 3.10, p. 85. -

As far as the Central Plan is concerned, the aggregate resources required have been put at R[illegible] crore. Taking into account the assistance of Rs. 3100,265 crore to be provided to the States and Union Territories, the Central government would be required to raise resources worth Rs. 12,21,556 crore. The Tenth Plan proposes to raise Rs 6,85,185 crore worth of resources through borrowings (56.1 per cent of the total) and RS, 5,15,,556 crore through public sector enterprises (42.2 per cent of the total). The balance from current revenue (BCR) is expected to be.(-) Rs. 6,385 crore. However, if previous experience is any guide, the position on the BCR front is likely to be much more worse than this. For instance, while the Ninth Plan had estimated RCR for the Central Plan at (-) Rs. 2,778 crore, the actual BCR was (-) Rs [illegible] - a deterioration of 5,544 per cent. This was primarily due to a stagnant level of revenue receipts (particularly tax receipts) on the one hand, and rapid increase in non-plan revenue expenditure (NPRE) on the other hand. To achieve a BCR of (-) Rs. 6,385 crore, the Central revenues (net) must grow from 8.80 per cent of GDP in 2001-02 to 9.98 per cent in 2006-07, an increase or 1.18 percentage points. NPRE must come down from 10.60 per cent of GDP in 2001-02 to 9.06 per cent, a decrease of 1.54 percentage points 5.3 Both these targets are difficult to achieve. To raise revenue receipts, the Tenth Plan proposes a number of steps [illegible]

extending the he coverage of service tax, computerization of the income tax system to ensure better compliance, removing unnecessary exemptions under corporate tax, moving progressively to a truly single rate extension of VAT, levying of user charges to raise cost recovery levels etc. To reduce NPRE, the Plan proposes progressive reduction in fertilizer, subsidy, eliminating petroleum subsidy, reducing as well as effectively directing food subsidy, curtailment in pat and allowances of the government by downsizing etc.6

As far as the State level Plan is concerned, BCR has been estimated at Rs. 26,578 crore. If one were to consider the realisation in the Ninth Plan, one would see how difficult it would be to achieve this target. The Ninth Plan had projected BCR for States' Plan at Rs. 1,372 core. As against this, the actual BCR was (-) Rs. 1,06,962 crore-a deterioration of 7,896 per cent This sharp deterioration was a result or both revenue and expenditure related slippages. To achieve BCR of Rs. 26,578 crore at the State level, the Tenth Plan advocates a number of revenue increasing and NPRE curtailing measures like inclusion of services in the tax base, removal of tax exemptions and concessions, harmonisation of tax rates, tightening of tax administration, adopting an integrated VAT regime, reduction of budget based subsidies by raising user charges of departmental services, reducing expenditure by cutting administrative cost and privatization, reducing staff strength, restricting borrowings to attain a "on-rising debt to GDP ratio from current levels in order to reduce the burden of interest, improving internal resources of State public sector enterprises by implementing power reforms, etc.7

However, all this easier said than done. Increasing tax revenue both at the Central level and State level is a stupendous task keeping in view the low income levels of a vast majority of the population loopholes in the tax laws, widespread tax evasion and avoidance, rampant corruption in tax administration etc. Reducing NPRE is also very difficult as political compulsions often come in the way of cutting down subsidies and levying of user charges on various services provided by the government at the level of Centre and the States, In all probability, the government will restore to cutting down staff strength and downsizing with the objective of reducing NPRE with all its adverse effect on labour welfare and social security. Even then, the target of generating Rs. 20,193 crore through BCR (both Centre and states combined) is nothing but just wishful thinking keeping in view the fact that BCR in the Ninth Plan stood at (-) Rs. 263,752 crore. Resources provided by the public sector enterprises are also likely to be lower than those excepted. As a result, the dependence on borrowing in likely to continue raising the interest burden to still higher levels.

The Employment Perspective

The employment scenario presented by the Tenth Plan document during the pried of the Tenth Plan and beyond assuming 8 per cent per annum growth and extrapolated industrial structure Is given as in Table 4.

Table 4: Employment Scenario In Tenth Plan Period and Beyond

(Based on actual elasticity and 1.8 pr cent per annum growth in force)

	Unit	1999-2000	2001	2002**	2007	2012	Employment growth over Tenth Plan Per annum
Labour force (1.8% p.a. growth)	million	363.33	37152	378.21	413.50	451.53	1.8%
Employment*	million	336.75	340.82	343.36	373.03	403.52	1.7%
Unemployment rate	%	7.32	8.26	9.21	9.79	10.63	-
No. of unemployment	million	26.58	30.70	34.85	40.47	48.01	3.0%

Note: * Based on 8 per cent per annum growth in GDP during 2000-07.

** based on 5.2 per cent GDP growth during 2000-01 and 2001-02

Source: Government of India, Planning Commission. Tenth Five Plan, 2002-2007, Volume 1 (Delhi, 2003). Annexure 5.14, p. 170.

According to Table 4, the estimates of unemployed were around 34.85 million person years (defined on current daily status (CDS) bais) when the unemployment rate went up to around 9.21 per cent. The estimates of addition to labour force over the Tenth Plan period are 35.29 million person years (=413.50 minus 378.[illegible]). Thus, the Tenth Plan faces 'he daunting task of creating job opportunities against a potential job demand of more than 70.14 million person years (34.85 million base period unempl oyment and 35.29 million new labour entry net of exits). The Plan aims at creating employment opportunities of around 29.67 million person years (i.e. an increase from the base figure of 343.36 million to 373.03 million) with the help of a 8 per cent per annum growth over the next five-year period. Assuming 'business as usual' scenario (i.e. an employment growth of 1.7 per cent per annum as against a labour force growth of 1.8 per cent per annum). the Plan notes that even with as high a growth as 8 per cent, the objective of providing employment opportunities to all additions to labour force will not be achieved; an additional 5.62 million employment opportunities will have to be created. This, added to the base period stock unemployment of33.85 million. will give an unemployment rate of 9.79 per cent as at the end of the Tenth Plan, an increase of 9.21 per cent at tile base. According to the Tenth Plan, "this arises largely due to the near jobless growth character in many sectors of the economy especially in the organized sector, and even in some of the unorganized sectors including some over al scale industries. The Plan cautions that the unemployment rate at the end of the Tenth Plan may even go up by minimum one-percentage point (adding 4 million more unemployment) if the labour force growth increases to 2.0 per cent per annum.

In addition to the above, it is necessary to point out that the grim scenario on the employment front that emerges from the above discussion is based on the assumption of a 8 per cent per annum growth in GDP. No serious economist hopes the rate of growth to touch this high level as in recent years, the rate of growth has hovered around 5 to 6 per cent. In fact, CSO estimates the rate of growth at only 4.4 percent in the first year of the Tenth Plan i.e. 2002-03. This shows that the rate of growth in the remaining years of the Plan would have to around 10 per cent per annum if the overall average growth rate target of 8 per cent per annum is to be achieved - a highly improbable occurrence. Accordingly, The unemployment Situation is likely to be much more serious than what the Plan document postulates. In fact, the Plan itself estimates that if the rate of growth of GDP is 6.5 per cent then on the 'business as usual basis' (i.e. with the present employment elasticity), the percentage of unemployed will grow up to 11.0 at the end of the Tenth Plan, giving a total unemployed labour force of 45.56 million person years."

Keeping the above facts in view, the Tenth Plan advocates the adoption of a development strategy which will revamp the activities in those sectors where the comparative advantage lies in a labour intensive nature of production. The Plan specifies the following labour intensive sectors which would require policy intervention:(1) Agriculture and allied activities (programmes include diversion of land from cereals to pulse and oilseeds, regeneration of degraded forests and watershed development, wasteland development, development of medicinal plants and energy plantation, minor irrigation and cultivation of bamboo and manufacturing of bamboo based products); (2) Food processing, (3) Rural non-farm activities/industries including Khadi and Village Industries);(4) Small and medium enterprises, and (5) Services sector (specific areas include helth, nutrition, education, and information technology and communication).

Sectoral Issues

The Tenth Plan document discusses the approach to development in different sectors of the economy in a very detailed and elaborate way. We, however, intend to focus on a few main programmes in some sectors only due to space constraints.

Agriculture and Irrigation

In line with the New Agriculture Policy 2000 which envisaged B growth rate exceeding 4 percent per annum in the agricultural sector, the Tenth Plan aims at a 4 per cent per annum growth. The demand for foodgrains estimated on the behaviouristic approach is 236 million tonnes by the end of the Plan, i.e. 2006 -07, white the supply projection for foodgrains in that year ranges from 22J million tonnes to 243 million tonnes. The Plan emphasizes that an adequate thrust on maize cultivation could help in achieving a production level of foodgrains of about 245-?48 million tonnes by the end of the Tenth Plan. As far as the strategy for agricultural growth is concerned, the Tenth Plan endorsed the regionally differentiated strategy based on agro-climatic conditions and natural resources envisaged for the Ninth Plan, for increasing the pace of growth in every region of the county · The three pronged strategy envisaged for the Ninth Plan to meet the basic food requirements for all will be continued. This strategy involves: (i) increase In overall employment and incomes by raising farm productivity and the growth of other economic activities in the rural areas; (ii) provision of gainful supplementary employment through poverty alleviation schemes; and (iii) distribution of foodgrains through the public distribution system at subsidised prices to those living below the poverty line.

Thrust areas for the Tenth Plan are defines as follows: (i) utilistion and un-utilised/under-utilised lands; (ii) reclamation/development of problem soils/lands; (iii) rainwater harvesting and conservation far the development of rainfed areas; (iv) development of irrigation/especially minor irrigation; (v) Conservation and utilisation, of biological resources; (vi) diversification of high value crops/activities; (vii) increasing cropping intensity; (viii) timely and adequate availability of inputs; (ix) strengthening of marketing Processing/ value addition infrastructure; (x) revamping and modernising the extension systems and encouraging private sector to take up extension services; (xi) bridging the gap between research and farmers' fields; (xii) cost-effectiveness while increasing productivity; (xiii) promotion of farming systems approach; (xiv) promotion of organic farming and utilisation of organic waste; (xv) development of eastern and north-eastern regions, hills and coastal areas and (xvi) reforms to introduce proactive policies for the farm sector.11

The Tenth Plan also places due emphasis on horticulture and planation crops as they can help in diversification of agriculture. It notes that the target of 4 per cent per annum growth; in agriculture can be achieved if the annual growth rate of horticulture maintained at 6-8 per cent. The thrust areas for Providing boost to the horticulture sector have been defined by the Tenth Plan as follows: (i) area expansion; (ii) improving production; (iii) improving productivity; (iv) reducing cost of production; (v) Improving quality of products; (vi) value addition; (vii) promotion of marketing and exports; (viii) strengthening of credit and organizational support; (ix) human resource development; (x) addressing relevant policy issues; and (xi) cold chains.12

In addition to the above, the Tenth Plan lays down a number of policy recommendations pertaining to practically each and every facet of agriculture and rural development like agricultural inputs (seeds fertilisers, farm Implements, pesticides, credit, insurance etc.), agricultural extension, agricultural research and training,

land reforms, agricultural infrastructure, warehousing, godowns and cold storage, agriculture marketing, agricultural exports, agricultural statistics, etc.

As far as irrigation is concerned, the Tenth Plan document has estimated that a total of 159 major, 242 medium and 89 ERM (Extension Renovation and Moderniztion) Projects will spillover into the Tenth Plan. A further 67 major, 130 medium and 34 ERM projects are likely to be taken up under the Tenth Plan. During the plan 11.14 million hectares of irrigation potential through the major and medium sector is likely to be created In the field of micro irrigation the Plan targets a creation of g million hectares of potential (3 million hectares from surface water and 5 million hectares from ground water).

Industry and Minerals

The target for industrial growth in the Tenth Plan has been kept at 10 per cent annum. Keeping in view the fact that industrial growth rate in recent years has hovered in the range of 5-7 per cent (with that industrial growth rate in 2002-03 is likely to remain below 6 per cent, achievement of an average annual growth rate of 10 per cent will require a growth rate much higher than 10 per cent annum in the remaining four years of the Tenth Plan. The main focus of the, Tenth Plan is the industrial sector is to be on providing, more conducive atmosphere to the private sector by pulling down restrictions and barriers, and disinvestment of government equity in pubic sector enterprises. As far as the former issue is connected, the following comment in the Tenth Plan document lays down the approach of the Planning Commission: "Unless the economic environments is conducive to high level of private sector participation, there can be little progress in accelerating industrial development and growth. An inward-looking policy environment in the past promoted import substitution with artificial props such as high tariff protection. quota restructions, entry barriers etc In order to ensure that the transition from a closed to an outward-looking economy is smooth and non-disruptive, well conceived government interventions to dismantle existing barriers to industrial growth and accelerating new initiatives to create an enabling environment at par with the rest of the world are needed." To promote private initiative in industrial development, the Plan recommends 'a considerable widening and deepening of economic reforms cutting across the Centre and states and local bodies.. As far as the latter issue (the issue or disinvestment) is concerned, the Government Intends to phase itself OU' BS a producer of non-strategic goods and services in the Tenth Plan According to the Plan document, the closure of non-variable public sector undertakings (PSUs) and expeditious disinvestment of others will release unproductive assets and direct them into more efficient sectors with higher priority where they are likely to leverage economic growth.

The different element, of industrial development strategy as laid down in the Tenth Plan are as follows: (I) Providing conducive policy environment (this would involve labour and fiscal reforms. streamlining of procedures, legal and procedural reforms, bankruptcy foreclosure; (2) Providing world class infrastructure; (3) Augmenting source base by strengthening capital and financial markets and attracting higher level of foreign direct investment;(4) Optimizing resource allocation by increasing flows into high growth areas and releasing unproductive resources by releasing unproductive resources by closing down non revivable PSUs and disinvestment in non-strategic PSUs; (5) Introducing efficiency enhancing policies (6) Providing export thrust through the setting up of Special Economic Zones, providing Market Access Initiatives, updating export infrastructure etc.; and (7) Providing level playing field through rationalisation of taxes and duties, building up world class infrastructure intellectual property rights regime modernising patent offices etc.

Power and Energy

Power is one of the prime movers of economic development. The Tenth Plan targets capacity addition of 41,110 MW. Of this, 22,832 MW (55.6 per cent) is accounted for by the Central sector and 11,157 MW (27.1 per cent) by the State sector. The balance of 7.121 MW (17.3 per cent) is expected to be added by the private sector. The government proposes to enhance public funding for the power sector as well as encourage the public sector unertakings to lake up projects in joint ventures with private investors and State governments during the Tenth Plan period. As part of these efforts, the Accelerated Generation and Supply Programme (AG & SP) in proposed to be extended during the Tenth Plan to provide funds to critical on-going schemes subsidised interest rates. There is also a focus on initiating suitable policy measures to accelerate the pace of hydro-power development as well as to make nuclear power generation an competitive as power genertion from other fues. Adequate investment is also to be channelised to ensure the completion of the National Grid by the end of the Eleventh Plan. This would enhance the inter-regional transfer of power and facilitate the optimum utilisation of existing assets. Other reform objectives for the Tenth Plan are follows: (i) rationalising power tariffs and making the tariff setting process transparent; (ii) reflecting cost of service in the tariff and transferring all subsidies explicity to State budgets; (iii) improving efficiency in a!! the three segments, viz, generation, transmission and distribution, either by creating separate profit centres with full accountability within the vertically integrated structure, or unbundling SEBs (State Electricity Boards) into generation, transmission and distribution entities or through other models of reform depending on the choice of the State government; and (iv) encouraging competition and private participation in each element of the electricity value chain.

With a GDP growth target of 8 per cent per annum in the Tenth Plan, the energy demand is expected to grow at 5.2 per cent per annum. The Tenth Plan strategy for the sector includes increasing the production of coal and electricity, accelerated exploration for hydrocarbons, equity oil abroad. introduction of reforms through restructuring/deregulation of the energy sector to Increase efficiency, demand management through introduction of energy efficient technologies/ processes and appliances.

Transport

An efficient transport system is a prerequisite for sustained economic development. It is a key infrastructural input for the growth process. The Indian transport scector has expanded manifold in the first 50 years of planned development and several qualitative improvements have also taken place. However, capacity shortages on both the main road and rail links continue to be a serious constraint to overall growth. Even the existing infrastructure continues to be inefficiently used.

The Tenth Plan has addressed a number of issues related to the transport sector. As far as railways are concerned, the Tenth Plan lays down the following tasks; (i) rebalancing tariff to make Indian railways competitive, market sensitive and a user-friendly organisation; (ii) augmenting capacity through technological upgradation and modernisation; (iii) reorienting investment strategy focussing on projects that aim at improving capacity in high density corridors; (iv) spinning off non-core activities as separate entities: (V) constituting a Railway Regulatory Authority to de-politicise fixation of rail tariffs and also regulate rail activities; (vi) determining and identifying the social and commercial roles of Indian railways; (vii) altering accounting practices of Indian railways into company format; and (viii) restructuring the core business of Indian railways on sound commercial lines.

As far as the road sector is concerned, the Tenth Plan lays down the following broad goals and objectives:

(i) balanced development of the total road network comprising three functional groups. viz the primary system (National Highways and expressways), secondary system (State Highways and Major district roads) and rural roads; (ii) *integrating the development plans of roads with railways and other modes of transport*; (iii) completion of the National Highways Development Project (NHDP) comprising the Golden Quadrilateral and the North-South and East-West corridors; (iv) four laning of high density corridors: (v) rehabilitation and reconstruction of weak/dilapidated bridges for traffic safety; (vi) special attention to development of roads in the North-Eastern region; (vii) encouraging participation of the private sector in the highways sector; (viii) levying user charges on the National Highways and State Highways for sustainable financing of the road sector; (ix) providing connectivity through all weather roads to all habitations with a population of over 500 persons (as per the 2001 census) etc. Top priority in the Tenth Plan is to be accorded to the completion of the NHDP.

As in the case of Ninth Plan, the Tenth Plan also seeks to encourage private sector participation in the development of ports. The Plan also recognises the role of the shipping sector in promoting trade and economic development as it accounts for over 90 per cent of the country's overseas trade in terms of volume and 68 per cent in terms of value. *The Plan also emphasizes the development of inland water transport* as it can play an important role in the movement of passengers and freight in regions with a considerable length of navigable waterways. Tenth Plan has also proposed a number of steps for the development of the civil aviation sector. The main objective in this field is to provide world class infrastructure facilities and efficient, safe and reliable air services to meet the requirements of domestic and foreign trade and tourism. The plan advocates much larger private sector participation in the civil aviation sector than before.

Poverty Alleviation in Rural India

According to the Tenth Plan, poverty alleviation has been one of the guiding principles of the planning process in India. Yet, the incidence of poverty continues to be very high. Its eradication is integral to humanity's quest for sustainable development. According to the Tenth Plan, "Effective implementation of anti-poverty programmes would be central to achieving the planned reduction in poverty. The challenge before the State is to provide employment opportunities which provide enhanced incomes. This becomes more important in view of the fact that substantial additions to lahour force are expected in the next five years. *Enlargement of self and wage-employment programmes and their effective delivery becomes an imperative* in such a scenario."15

As far as providing self employment to rural poor is concerned, Tenth Plan will focus on the Swarnajayanti Gram Swarozgar Yojana (SGSY) which was launched in April, 1999. The Tenth Plan aims to shift the programme to a 'process oriented approach' in five stages (i) social mobilisation for formation of self help groups; (ii) savings among the group and internal lending among its members; (iii) provision of a revolving fund; (iv) micro finance: and (v) micro-enterprise development. Network of institutions that promote the self-help movement would be created during the Plan period. Partnership would be forged between NGOs and other community-based organisations, government agencies and other financial institutions. As far as wage employment is concerned, Sampoorna Grameen Rozgar Yojana (SGRY) launched in September 2001 would be the single programme. The programme would have three streams which would seek to address the need of rural infrastructure at the village level, ensure guaranteed employment of at last 100 days in areas facing chronic unemployment/migration and provide relief in natural calamities such as floods, droughts, earthquakes and other contingencies. The projects under SGRY would be chosen with a view to taking up schemes that enlarge the scope for increased economic activity.

Access to land will be an important element in the poverty alleviation strategy. Tenancy reforms, record of rights of land owners and tenants, computerisation of land records, prevention of alienation of tribal lands, and issue of land rights for women will be the major tenets of the land reform agenda.

A Critical Appraisal

Reduced role of planning in a liberalised economic scenario. Ever since the adoption of new economic policy in 1991, the State has been increasingly withdrawing from the production field leaving more and more economic space to the private sector to expand its activities. All the three plan documents (the Eighth Plan, the Ninth Plan and the Tenth Plan) released during the period of the last decade or so have emphasised the role of the private sector in future economic development of the country. The State is now required to play only a 'facilitatory role' so that a proper economic and business environment can be provided to the private sector to expand its activities. In particular, the State is required to invest in infrastructure and social sectors only. In such a 'liberalised economic scenario', planning loses much of its meaning as State no longer has the required control on economic variables. Accordingly, laying down of specific targets for each and every sector of the economy (as the Tenth Plan does) makes no sense. In any case, it is difficult to visualise how the State would ensure the accomplishment of these targets when it is the private sector that will call the shots.

CHAPTER-5:
ECONOMIC REFORMS IN INDIA

In early 1991, a major economic crisis surfaced in India. Most economists are now convinced that this crisis in the economy was the worst that this country had experienced since Independence. For all the bold claims, this crisis is, as yet not over. The economy is slowing down with no signs of recovery. The fiscal imbalances persist. The balance of payments situation remains precarious. Inflation which is presently dormant can trigger off anytime. Nonetheless, the situation is much less unstable than it was eleven years ago. Over the past eleven years the government has followed a policy of macroeconomic stabilisation and has introduced certain structural reforms. So far these policy measures have not shown any encouraging results and whether in future they will ensure economic growth with equity cannot be said a priori.

The Origin of Economic Crisis

The problems of the economy in this country which assumed crisis proportions in 1991 did not develop suddenly. They had accumulated over several years. In fact the origin of the costs Is directly attributable to the cavalier macro management of the economy during the 1980s which led to large and persistent macroeconomic imbalances. The strategy Of development, notwithstanding its limitations, cannot be blamed for this crisis. The widening gap between the revenue and expenditure of the government resulted in growing fiscal deficits which had to be met by borrowing at home. Further. the steadily growing difference between the income and expenditure of the economy as a whole resulted in large curret account deficits in the balance of payments which were financed by borrowing from abroad. According to Deepak Nayyar, "The internal imbalance in the fiscal situation and the external imbalance in the payments situation were closely related through the absence of prudence in the macro management of the economy. The macroeconomics of this relationship can be reduced to a simple proposition ex post, the current account deficit in an economy is the sum of (a) the difference between investment and saving in the private sector and (b) the difference between expenditure and income of the government sector."' This was, however, not appreciated particularly during the 1980s and in an attempt to live beyond means, the economy was pushed into a deep economic crisis.

The Gulf crisis in the late 1990 Sharply accentuated macroeconomic problems. There was also political instability in the country at this juncture, All these developments together eroded international confidence in the Indian economy and as a result, this country's credit rating in the international capital market declined steeply. However, it has to be recognised that the problems of the economy did not assume crisis proportions abruptly. These problems, in fact, Wen very much there for years destroying the capacity of the economy to dope with any internal or external shocks. In the 1970s, the Indian economy was strong enough to bear much larger and more sustained oil shocks. But by 1990 the situation had changed so much that the minor oil shock made disproportionately large impact on the economy and a macroeconomic crisis erupted in the form of unsustainable fiscal and current account deficits and accelerating inflation.

The Fiscal Imbalance

The fiscal crisis in 1990 was not a coincidence. The fiscal situation had deteriorated throughout the 1980s due to growing burden of non-development expenditure. All the indicators of fiscal imbalance reflect that throughout the 1980s it was on the rise. The indicators which are normally used to measure fiscal imbalance are the budgetary deficit, the revenue deficit, the monetised deficit and the gross fiscal deficit. Of these first

three known as conventional measures of fiscal imbalance indicate only a pan of the resource gap which is mainly financed by the issue of treasury bills. A large portion of the gap in the resources of the government is financed by market borrowings, small savings, provident funds, external borrowings etc. and this does not get reflected in the conventional measures of fiscal imbalance. In contrast, the concept of gross fiscal deficit is a complete measure of fiscal imbalance. It equals the excess of total government expenditure over government revenue and grants. In 1990-91 all the measures of fiscal imbalance indicated that there was a serious fiscal crisis. The budgetary deficit of the Central government was 2.1 per cent of GDP in 1990-91 as against 0.9 per cent in 1981-82. Similarly the revenue deficit had risen from 0.2 per cent of GDP in 1981-82 to 3.3 per cent in 1990-91. However, the moat disquieting development was a steep rise in the gross fiscal deficit. From 4.1 per cent of GDP in 1975-76, it rose to 6.6 per cent in 1990-91. Since this fiscal deficit had to be met by recourse to borrowings, the internal debt of the Central government increased rapidly, rising from 3~ per cent of GDP at the end of 1980-81 to 49.8 per cent of GDP at the end of 1990-91. This naturally made burden of servicing the debt onerous. Interest payments which were 2 per cent of GDP and 10 per cent of total Central government expenditure in 1980-81, rose to 3.8 per cent of GDP and 22 per cent of total Ceneral government expenditure in 1980 How alarming this fiscal situation was can be realised from the fact that in 1990-91 interest payments had eaten up 39.1 percent of the total revenue collections of the Central government. This obviously was an unsustainable situation. The danger of the government falling into debt-trap was real. The government thus could not persist with its cavalier Policy of growing reliance on borrowings to meet steadily increasing fiscal deficit to which unchecked growth of non-plan revenue expenditure was the major contributing factor.

Fragile Balance of Payments Situation

The balance of payments situation was highly precarious in 1991, but this was not unexpected. The current account deficit which was $ 2.1 billion or 1.35 per cent of GDP in 1980-81 rose to % 4.9 billion or 2.56 per cent of GDP in 1985-86 and further to $ 9.7 billion or 3.69 per cent of GDP in 1990-91. These continuously growing deficits had to be financed by borrowing from abroad and as a consequence India's external debt rose from 12 per cent of GDP at the end of 1980-81 to 23 per cent of GDP at the end of 1990-91. This steadily growing external debt led to an increase in debt service burden from 10 per cent of current account receipts and 15 per cent of export earnings in 1980~81 t0 22 per cent of current account receipts and 30 per cent of export earnings in 1990-91. These mounting strains during the 1980s stretched to the breaking point in 1991 due to the Gulf crisis. The balance of payments position was on the brink of disaster as in mid-January 1991 and again in late June 1991 the level of foreign exchange reserves dropped to levels which were not sufficient to finance imports of even ten days.

No doubt this was a very difficult situation from India's point of view, as default in terms of financing imports and meeting debt service obligations looked imminent. The country's balance of payments position was extremely vulnerable on account of two factors which were greatly influenced by Perceptions and expectations. First, it was exceedingly difficult to prevent flight of short-term debt on account of adverse international perception of the situation. Second, the net outflow of non-resident deposits which added up to $ 1.64 billion in the period October 1990 - September 1991 could further increase if the perceptions had worsened. In this extremely precarious situation, default could be averted only by recourse to last-resort measures, such as using stocks of gold to obtain foreign exchange, seeking emergency bilateral assistance from donor countries and borrowing under special facilities from the IMF. Thus soft options which the government adopted during the 1980s had such repercussions that in 1991-92, it was left with no options but to resort to measures which, although helping the country to avert default in meeting payments obligations, pushed it Into a recessionary situation.

Mounting Inflationary Pressures

The price situation Was apparently not alarming during the second half of rile 1980s as tire average rate of inflation was 6.7 per cent per annum in terms of the wholesale price index. However, the rate of inflation rose to 10.3 per cent per annum in terms of the wholesale price index. However, the rate of inflation climbed to 11.2 per cent per annum which was certainly a cause for concern. However, the most disquieting feature of this inflationary situation was that the prices of food rose substantially in spite of three good monsoons in a row. According to Deepak Nayyar, these "inflationary pressures in the economy did not surface out of the blue. The build-up was attributable to the large deficits, which were inevitably associated with a monetisation of budget deficits and an excessive growth of money supply This liquidity overhang, in conjunction with real disproportionalities and underlying supply demand imbalances was bound to fuel inflation."

In response to the crisis situation of 1990-91 the government decided to introduce economic policy reforms which consisted of two distinct Strands - macroeconomic stabilisation and structural reforms. While stabilisation deals with demand management, structural reforms deal with structural adjustments designed to tackle the problems on the supply side of the economy.

Macroeconomic Stabilisation

Macroeconomic stabilisation (often called just stabilisation) involves returning to low and stable inflation and a sustainable fiscal and balance of payments position. Stabilisation is necessary to Overcome a crisis but it assumes a special importance if structural reforms are also introduced together with stabilisation. This is because structural reforms often add to macroeconomic pressures. For example, in the short run, trade liberalisation may increase deficits in the balance of payments and financial sector reforms may worsen fiscal position by raising the cost of public borrowing. Therefore, stabilisation must accompany structural reforms and stabilisation policies have to be bold and effective, otherwise extra macroeconomic strains generated in the reforms process can disrupt the latter completely. Vijay Joshi and I.M.D. Little have argued, "In the longer run, structural reform is as helpful for stabilisation as stabilisation is for structural reform. In the absence of reform, losses of public enterprises would continue to burden the budget; trade restructions would the growth of exports; and compulsory government capture of private savings would hamper fiscal discipline."

The Congress government which assumed office at the end of June 1991 responded quickly to the economic crisis. Besides committing itself to a comprehensive programme of structural reform, it accorded an overriding priority to the stabilisation of the economy. To this end, a policy to control inflation was adopted measures for fiscal correction and improving the balance of payments position were undertaken.

Control of Inflation

Tile rate of inflation in 1990-91 was well above 10 per cent per annum. This could be brought down on the one hand by introducing fiscal and monetary discipline in the economy and on the other by improving output and supply position. It seems that the government's achievements are modest on both the fronts. in 1991-92, while output failed to increase over the 1990-91 level, the money supply rose by 20.6 per cent as a result of large accretion of foreign exchange reserves which were not sterilised. This naturally fuelled inflation and the wholesale price index rose by 13.7 per cent. In 1992-93, however, agricultural growth was satisfactory and industrial production also increased though rather al a modest rate. As a result, net national product rose by 5·0 per cent. On the demand side the government followed a cautious approach and thus the supply of money (M,) rose by only 14.8 per cent. The fiscal deficit of the Central government was also brought down to 4.8 per cent of GDP. These disinflationary measures did make some impact on the price, situation and the rate of inflation declined to around 7.0 per cent at the beginning of 1993. However, even in 1992-93, the wholesale price index rose by 10.1 per cent which indicates that respite from inflation was only for a very short period. In the next two years-1993-94 and 1994-95, it seems that the Central government did not attempt

to enforce much fiscal and monetary discipline. The fiscal deficit thus rose to 6.4 per cent of GDP in 1993-94 and remained as much as 4.7 per cent of GDP in 1994-95. Money supply (M,) growth accelerated to 18.4 per cent in 1993-94 on account of sharp increase in the amount of both demand deposits and currency. This situation did not change in 1994-95 and as a consequence, the supply of money increased at the rate of 22.4 per cent per annum. These facts clearly reflect casualness in the fiscal and monetary policies of the government. Under the circumstances, the inflation rate which persisted over 10 per cent per annum in 1993-94 and 1994-95 should not surprise anybody. The situation, however, changed in 1995-96 due to moderated money supply growth. The inflation came down sharply and in January 19% was running at a rate of around 5 per cent This was mainly the result of slower monetary growth, faster growth of output a freeze on fuel prices and non-revision of administered prices despite cost increases. During 1996-97 the expansion of broad money (M3) by 16.2 per cent was marginally above the target of 15.5 - 16.0 per cent stipulated for the year. The fuel prices also remained frozen on account of political considerations. Hence, the average annual inflation rate remained at a modest level of 6.4 per cent. In 1997-98, the supply of M3 increased by 18.0 per cent. Fuel prices rose by around 10 per cent. However, prices of food articles recorded only a modest increase of 3.2 per cent. As a result, the inflation rate remained at 5.3 per cent on point to point basis. The point to point annual rate of inflation rose during 1998-99 to a peak of 8.8 per cent on September 26,1998. It decelerated thereafter to 4.6 per cent on January 30,1999. The annual rate of inflation for 1999-2000 on point to point basis was 6.5 per cent. It, however, declined to 5.5 per cent in 2000-01 and further to 1.6 per cent in 2001-02. The annual point to point inflation rate for the week ended January 18, 2003 was 4.4 per cent. A low trend rate of inflation in Indian context requires firm control of the rate of monetary expansion. Joshi and Little argue that if the controlled expansion of money supply is accompanied by a high rate of fiscal deficit, "real interest rates are driven up and private investment is squeezed. If high rates of private investment are necessary for rapid growth, this in effect means that low inflation becomes incompatible with high

Fiscal Adjustment

Fiscal adjustment is necessary for dealing with the twin problems of high domestic inflation and large deficits in the balance of payments. Fiscal deficit of the government (Centre, States and Union Territories together) was less than 6 per cent of GDP at the beginning of the 1970s. It, however, rose to about 8.5 per cent of GDP by the beginning of the 1980s and was as large as 11.2 per cent of GDP in, 1990-91. The factor which contributed most to the growing fiscal deficit was sharp deterioration of balance on revenue account. In 1970-71, the government has a revenue surplus of about 0.3:per cent of GDP, but the situation drastically changed during the 1980s, as by 1985-86 there was a revenue deficit of about 2 per cent of GDP which rose to 4.2 per cent in 1990-91. The government having recognised that suck high levels of fiscal deficits. both overall and on revenue account were not sustainable, committed itself to a policy of fiscal adjustment.

The Central government initiated a programme of fiscal adjustment under which its fiscal deficit which was around 6.6per cent of GDPin 199~91~ Was reduced to 4.7 percent in 1991-92 and stood at 4.8 per cent in 1992-93. The Central government also announced its fiscal adjustment programme for the medium term according to which is fiscal deficit was expected to he brought down to about 3 to 4 per cent by the 1990s. However, the Central government once again rose to 6.4 per cent of GDP. The States never committed themselves to any fiscal adjustment programme. Indulging in populism they are neither inclined to current non-plan revenue expenditure, nor willing to optimise resource mobilisation through tax and non-tax sources. Under these circumstances the fiscal deficit of the Centre and the States taken together did not roll back from about 11.2 per cent in 1990-91 to an average of 7 per cent during the Eighth Plan period as stipulated. The combined fiscal deficit of the Centre and the States Was as large as 10.0 pr cent of GDP in 2001-02.

In India, the fiscal imbalance has been caused mainly by imprudent increase in public expenditure. Therefore. reduction in the fiscal deficit. GDP ratio is to be brought about by containing public expendilure. At present

the tax - GDP ratio is quite high which le4ves little scope for additional resource mobilisation through tax sources. The government expenditure which was about 19 per cent of GDP in 1970-71 rose Sharply to about 25.6 per cent by 1 980-81 and stood at 31 per cent of GDP in 1990-91. Therefore, if fiscal imbalance is to be corrected, it is necessary to reduce the government expenditure to around 25 per cent of GDP. However, in 2000-01. the government expenditure constituted 29.5 per cent of CDP which explains why the combined fiscal deficit of the Centre and the states in this year was as much as 10.0 per cent of GDP. Hence containment of public expenditure is absolutely essential, but enough care should be taken to see that the government's capital expenditures in hey infrastructural and social sectors are not curtailed. This would require concerted effort at containing the revenue expenditure, particularly the consumption expenditure of the government consisting mainly of defence expenditure and administrative expenditure, subsidy payments and interest payments.

Although for the purpose of fiscal adjustment containment of the government expenditure should receive overriding priority, some effort at additional resource mobilisation through tax and non-tax sources may also be necessary in the short-run. In 21101-02, the government revenues were 18.5 it is generally agreed that the revenues of the government should be around 25 pr cent of GDP. In India, since built-in revenue elasticity with respect to GDP is around unity, almost all the increase in revenue has to be obtained from additional revenue mobilisation efforts. The Planning Commission has stated, "The required additional revenues will have to be generated by a judicious mixture of broadening the tax base, rtionalising the tax rates and through non-tax source."5 The government can also mobilise some resources by targeting black money which presently is estimated to be around 40 per cent of GDP.

An area where there is considerable scope for revenue mobilisation is public services. User charges on publicly provided utilities such as irrigation, electricity, water, road transport and higher education are much below their cost of provision. The overall recovery rates on services provided by the Central government are as low as about 35 per cent They are even lower at about 14 per cent for the services provided by the State governments. Hence, unrecovered. costs of public utilities are large and are a kind of subsidy to the users. The government justifiablyraise user charges on public utilities like electricity, irrigation, transportation and water.

The government, however, does not seem to he serious about additional resource mobilisation through raising the recovery rates on public utility services. It has also failed to cut down its consumption expenditures and subsidy payments. Its interest payments continue to increase as there is no serious attempt to liquidate substantial part of the existing stock of internal debt. Having failed in adopting hard corrective measures, the government has opted for some soft options such as reduction in capital expenditures and social services in real terms. A fail in capital expenditure by government is generally expected to cause an overall decline in the rate of capital formation. while the containment of expenditure on social services adversely affects the human well-being. During the first three years of economic reforms India faced a decline in the rate of capital formation due to sharp squeeze on budgetary capital expenditure. The rate of gross capital formation in the public: sector fell from 9.3 per cent of GDP in 1990-91 to 8.2 per cent in 1993-94. In the private sector, the decline in the rate of gross capital formation was from 14.7 per cent of GDP in 1990-91 to 13.0 per cent of GDP in 1993-94. There was a further decline in the rare of gross domestic capital formation in the public sector since 1993-94. In 2001-02 it was as low as 6.3 per cent of GDP. However, there was an uptrend in the private secter and the rate of domestic capital formation in this sector rose to the record level of [illegible] per cent in 1995-96 which, however, could not be sustained in the next five years and stood at 16.1 per cent in ;001-02. Adverse effects of reduction in expenditure on social services are not quantifiable in a short period. Nonetheless they are always there and would be clearly visible in the long period.

Balance of Payments Adjustment

At present balance of payments situation is not as precarious as it was in 1990-91. The level of foreign exchange reserves has risen from a meagre $ 2.2 billion in March 1991 to S 79.2 billion on May 16,2003. This accumulation of foreign exchange reserves suggests that the Indian economy has moved to a somewhat stable and sustainable balance of payments position in the last ten years. The current account deficit was 3.2.per cent of GDP in 1990-91 but fell to 0.4 per cent in 1991-92 mainly due to import compression which in turn adversely affected the overall performance of the economy. The government adopted a policy of import liberalisation in 19921~3 considering a relatively comfortable foreign exchange reserves position. This raised the balance of trade deficit from $ 2,798 million in 1991-92 to $ 5,447 million in 1992-93 and in the process the current account deficit climbed to 1.7 per cent of GDP. At this juncture the situation appeared to be slipping out of control but in 1993-94an impressive growth of exports of

the order of 20.2 per cent reduced the trade deficit bringing down the current account deficit to 0.4 per cent of GDP.

The trade deficit widened to S 9,049 million in 1994-95. This was due to a higher import growth of 34.3 per cent and a lower export growth of 18.4 per cent. However, there was some improvement in the invisibles account. Hence, the year 1994-95 ended up with a current account deficit of S 3.369 million which was around 1.0 per cent of GDP. This was a sustainable balance of payments position and was not expected to present any financial problems. The current account deficit, however, rose to 1.7 per cent of GDP in 1995-96. This reflected the higher availability of external resources to bridge the higher saving investment gap. Developments on the trade account during 1996-97 eased the pressure on the current account of the balance of payments and the current account deficit declined to 1.2 per cent of GDP in 1996-97. It rose to 1.4 per cent of GDP in 1997-98 but again declined to around 1.0 per cent of GDP in 1998-99 and 0.5 per cent of GDP in 2000-01. In 2001-02, the country witnessed a surplus on current account amounting to 0.3 per cent of GDP (this surplus had occurred after a gap of 24 years).

Policies relevant to the balance of payments which were adopted during the past twelve years were guided by both stabilization and structural reform considerations. In India's case, the balance of payments problems arose largely from inadequate coverage of imports by export earnings. In the beginning of the 1980s. this coverage ratio was only 52.4 per cent and led to a massive trade deficit. There was some improvement in during ate 1980s and in 1999-91 export earnings accounted for about 66.2 per cent of the value of imports. Obviously even this was an unsustainable position which required a series of moves on the exchange rate and the exchange rate regime.

To begin with in July 1991 there was a devaluation of rupee of about 22.2 per cent. Subsequently though formally no further devaluation was announced but under a managed float exchange rate regime, rupee has continued to depreciate in nominal terms against major currencies In fact, the nominal effective exchange rate of rupee depreciated by as much as 41.2 per cent in two years -from April 1991 to March 1993. Thereafter the rupee was somewhat stable against major currencies. This is evident from the fact that in the three year period from April 1993 to March 1996, the nominal effective exchange rate of rupee depreciated by only 16.4 per cent. Over the five year period from April 1991 to March 1996 inflation rate in India was much higher than in the major industrial economies. It is on account of this reason that real effective exchange rate of rupee depreciated much less in this period. Considering the overall situation, the rupee was reasonably strong. In fact, introduction of partial convertibility of rupee under the dual exchange rate system in 1992-93, full convertibility of rupee on trade-account in 1993-94 and full convertibility of rupee on current account in 1994-95 contributed a lot to the strength of the rupee. It is noteworthy that before rupee was made convertible, illegal channels for private remittances were preferred to banking channels which adversely affected die

balance of payments position.. The convertibility of rupee made improvement in private transfers as a result the deficit in the invisibles account in 1990-91 was converted into a surplus.

The year 1995-96 saw an end to the prolonged stability of the rupee-dollar exchange rate from March 19 The rupee traded in a wide range of Rs. 31.41 to 36.63 during April 1995 to February 1996. This required the policy guided correction in the exchange rate of rupee in the second half of 1995-96 as a result of which the exchange rate of rupee remained reasonably stable during 1996-97. In August 1997 the stability of the rupee exchange rate was again disturbed. For five months me exchange value of the rupee continued to fall. The rupee touched 38.4(3 to the dollar on November 26, 1,997. Thus the Reserve Bank had to intervene effectively by using its foreign exchange reserves to support the rupee. It also introduced certain measures to mop up excess liquidity in the system. These measures arrested steep slide in the exchange value of the rupee and finally it got stabilised in a narrow range of Rs. 39 to Rs. 40 per dollar. However, this stability also proved shortlived and the downward pressure on rupee re-emerged pushing down the exchange value of the rupee. During 2001-02, the exchange rate of the rupee moved in a range of Rs. 46.56-Rs. 48.85 per dollar and the monthly average exchange rate of the rupee depreciated by 4.0 per cent during the year. The rupee depreciated further to Rs. 49.06 a dollar in May 2002 but strengthened thereafter. At the end of January 20 the exchange rate of the rupee was Rs. 47.80 per dollar. Presently exchange rate management by the Reserve Rank of India (RBI) attempts to moderate excessive volatility in the exchange rate and maintain orderly market conditions to ensure that the exchange rate remains consistent with economic fundamentals 'Towards this end, the RBI monitors closely the developments in the financial markets at home and abroad and carefully coordinates its market operations with suitable monetary, regulatory and other measures, as considered necessary from time to time."

The balance of payments current account position will, however, be greatly influenced by export growth which so far has been less than adequate, "Exports will have to grow at around 14 per cent in value (9 per cent in volume) to achieve a sustainable balances of payments position."7 However, for rapid expert growth the real exchange rate is critically important because export competitiveness largely depends on it. According to Joshi and Little, "The correct policy assignment in India is to target the exchange rate oil export competitiveness." This is particularly important because recent studies have refuted elasticity pessimism.9 P Joshi and Little further argue that an appropriate exchange rate policy is necessary but not sufficient to promote exports. It will have to be accompanied by fiscal consolidation, trade reform, infrastructure development and incentives for private investment in export Capacity.

Structural Reforms

Since July 1991 comprehensive liberalisation measures have been undertaken to Improve the supply-side of the economy Among these the more importance are: (1) Trade and capital flows reforms; (2) industrial deregulation; (3) Disinvestment and public enterprise reforms; and (4) Financial sector reforms

Trade and Capital Flows Reforms

Given the roots of the crisis of 1991 in the international sector it is natural that the main focus of economic reforms has been on trade and capital flows. In this regard, it is now often claimed that the country has chosen to draw correct lessons from the global development expenses of the past few decades. The experience of the rapidly growing less developed countries in the recent years suggests that a policy regime with fewer tariff and non-tariff trade barriers, and which provides incentives to production for both exports and domestic market enables a country to achieve not only a higher export growth but also a sustainable rapid economic growth, The inherent limitations of an inward oriented import subtituting trade policy are now obvious. From its own experience this country has also learnt that such a policy not only hampers an efficient resource use

and consequently economic growth but it also sustainable balance of payments. Therefore, under trade reforms there has been main emphasis on greater openness.

Since July 1981, the government has introduced a series of reforms in the trade sector which will help integration of the Indian economy better with the rest of the world. Among these reform measures, devaluation of rupee in July 1991 and subsequentiy its depreciation against the currencies of the leading industrialised countries, introduction of the covertibility of the rupee first on trade account and then for the entire current account transactions, liberalisation of import regime, substantial reduction in customs tariff rates, decanalisation of many itemsof trade and wide ranging measures to give a thrust to exports are important.

The system of fixed exchange rates was abandoned by India in September 1975 and since then the system of managed exchange rate float has been in operation. Under the new system the rupee was nor expected to appreciate against other currencies, causing a decline in the international competitiveness of the Indian exports. However, due to higher rate of inflation in India as compared to that in the developed countries, the real effective exchange rate of rupee did not fall as much as the nominal effective exchange rate of the rupee. Hence, as already written earlier, the government formally devalued rupee by around 22 per cent in July 1991 to restore India's international competitiveness. This was followed by a liberalisation of the foreign trade regime through dismantling Of some physical controls. Not only the import procedures were simplified but a significantnumber of items were shifted outside the purview of import licensing. Exporters were given entitlement equal to 30 to 40 per cent of their export earnings in the form of Eximscrips against which even restricted items could be imported, this system was. however, later on replaced by the dual exchange rate system under the liberalised exchange rate mechanism. Under this system partial convertibility of rupee wets introduced. The 1993-94 Budget introduced full convertibility of rupee on trade account and thus the dual exchange rate system was replaced by a unified exchange rate system. Since the rupee exhibited good Strength after the announcement of full convertibility on trade account, full convertibility of the rupee for the entire current account transactions was introduced in August 1994 alongwith some relaxation of exchange control.

As a first step towards a gradual reduction in the tariffs, the1991-92 Budget has reduced the peak rate of import duty from more than 300 per cent to 150 per cent. The process of lowering the customs tariff rate was carried further in subsequent Budgets. The 1995-96 Budget reduced the peak rate of import duty from 65 per cent to 50 per cent. This was further reduced to 40 per cent in the 1997-98 Budget and 25 per cent in the 2003-04 Budget.

Earlier a large number of exports and imports used to be canalised through public sector agencies. During the last decade, large number of export and import items have been decanalised. Decanaisation of imports and exports is in important step towards opening of more areas of the external sector to the private sector.

The government had undertaken wide-ranging measures to promote export even prior to 1991 but even then the coverage of imports by export earnings was quite low. In 1990-91 this coverage ratio was only 66.2 per cent and led to massive trade deficit. However, over the years the situation has improved and in 2001-02, export earnings accounted for 78.0 per cent of the value of imports. This significant change in the trade balance position seems to have been realised on account of various export promotion measures which the government has undertaken recently al P major component of structural reforms. Apart from the systems of Eximscrips and liberalisad exchange rate mechanism which were shortlived, the government has undertaken a variety of export promotion measures. The important measures introduced are-establishment of Export Oriented Units for Promoting exports from the agricultural and allied Goods scheme for the services sector, adoption of a more rational and convenient criterion for recognition of export houses/Trading houses/Star Trading houses, broadening of areas of activity in Export Processing Zones duty free import for exports under the advance licensing scheme, setting up of Special Economic Zones (SEZs), and creation of an exporters' grievance cell in the Ministry of Commerce to facilitate action On problems being faced by exporters. Besides

these some more schemes/measures have been introduced to accelerate the country's transition to a market oriented economy, to stimulate growth by providing access to capital goods, intermediates and raw materials and to enhance technological strengths of the economy thereby Improving the global competitiveness of Indian exports.

The government has also liberalised capital flows in the form of foreign direct investment as a part of the package of external sector reforms. Foreign companies are now allowed to use their trade marks, accept appointment as technical or management advisers, borrow and accept deposits from the public and repatriate profits. These liberalisation measures in respect of foreign investment though highly acclaimed in the official circles, have exposed the industrial activity to extensive control of multinational corporations (MNCs). According to Dalip Swamy, the possible onslaught of MNCs in coming years will lead to increasing use of capital intensive technology and the consequent displacement of labour.

Industrial Deregulation

Historically, India's domestic economic activities have been subject to a wide array of physical controls. In the industrial sector, such controls took various forms: industrial licensing which regulated entry and expansion, reservation of a large number of industries for the public sector as well as small scale Sector; time consuming procedure required for the exit of industrial units; and price and distribution controls on various industrial products. Jagdish Bhagwati and and Padma Desai have been highly critical of this regulatory system. [illegible] J, Ahluwalia also blamed the industrial licensing system and bureaucratic controls for the industrial stagnation during the second half of the 1960s and 1970s. 12 L. K. Jha recognised the positive role of regulatory apparatus in a planned economy, but nonetheless argued that the industrial licensing machinery over the years had become a major obstacle to industrial development. The long time taken by the industrial [illegible] authorities to give clearance to the various proposals made it impossible for any project of importance to [illegible] attempts within tile scheduled time period. Tile industrial licensing authorities often took exception to the attempts of the industrial units to produce more than licensed capacity. Thus the objective of maximisation of output from a given licensed capacity got undermined. Policy of price control resulted in misallocation of resources and encouraged complete disregard to costs. Jha also criticised the MRTP Act. He stated, "The checks imposed on the larger business under the MRTP Act meant that in certain key industrial sectors which needed massive investment for which the smaller business houses could not muster adequate resources, the expansion of capacity became particularly difficult."

K. N. Raj, a strong supporter of economic planning, was disillusioned long ago with the regulatory apparatus in this country. While delivering the Second V. T. Krishnamachari Memorial Lecture in 1985 he had remarked "For the industrial licensing system, as it grew over a period of nearly three decades, had accumulated much fat and filth. It had ceased to perform effectively most of the functions it was designed for earlier; became a major source of political and bureaucratic corruption: and was being used by powerful vested interests to throttle competition from less influential potential rivals within the country, and increase their monopolistic (or oligopolistic) power even in industries in which there were no economies of scale to justify the growth of such enterprises. In the process, the Monopolies and Restrictive Trade Practices Commission had also been reduced to the proverbial 'grin without a cat' in Alice in Worderland." 14K .N. Raj further asserts, "Given the balance of political and economic forces in the country perhaps very little could be done to improve the regulatory apparatus, and, it was, wiser therefore to rather abandon the dishonesty and hypocrisy of it all than maintain pretences...." 15

Limit on the size of the companies which was earlier enforced under the Monopoly and Restrictive Trade Practices Act has now been scrapped. This will allow industrial units to grow to optimum size and enjoy the benefits of economies of scale. The anti-monopoly legislation until this relaxation was made, had prevented many firms from growing to Optimum size and thus achieve higher efficiency levels. The industrial location

policy has been both simplified and liberalised. The phased manufacturing programme under which domestic manufacturers were required to increase the domestic input-content of their products in a specified period has also been abolished under the new industrial policy. It is widely believed that these relaxations of the regulatory apparatus governing the industrial activity in this country i? the past have considerably eased the entry barriers which should make the industrial sector more competitive both domestically and internationally. However, a major limitation of the structural reform in the industrial sector is that it has failed to evolve appropriate rules and procedures regarding exit of unviable industrial units. The existing industrial exit policy is highly restrictive and time-consuming. This is one factor which has fed to widespread industrial sickness.

In recent years, it has been increasingly realised that the regulatory device has led to widespread inefficiency in the industrial sector. The government had, therefore, relaxed some of these controls even before it committed itself to structural reforms in 1991. The thrust of the new -industrial policy announced in July 1991 is on deregulation of the industrial economy in a substantial manner and opening up a large number of industries to the private sector. ?he requirement of industrial licensing has been abolished for all but 6 product categories. These are alcohol, cigarettes, hazardous chemicals, industrial explosives, electronics aeroscape, and drugs and pharmaceuticals: Bulk drugs industry. however, has been delicensed.

In another significant step the number of industries reserved for the public sector has been reduced from 17 to 3. Now core industries like iron and steel, electricity, air transport, ship building, heavy machine industries etc. and even strategic industry like defence production have been opened for the private sector.

Public Sector Reforms and Disinvestment

The public sector was originally intended to he the engine of self-sustained economic growth. it was also conceived to hold the commanding heights of the economy and to lead to technological advance. In order to fulfil these roles, it was necessary for the public sector to generate adequate investible surpluses, No doubt public sector contributed significantly to the expansion of the industrial base. Its role in diversifying the industrial structure has been no less. However, it has failed to generate sufficient internal resources for its further expansion and, as a result, has now become a major constraint on economic growth. Under structural reforms the government has decided to give greater managerial autonomy to public enterprises to enable them to work efficiently. In addition to this, two other key elements of the government's strategy for public enterprise reform are the promotion of increased private sector competition in areas where social considerations are not paramount and partial divestment of equity in selected enterprises. On careful consideration it becomes clear that the role of managerial autonomy is of great importance to improve the performance of the public enterprises. Nonetheless the government does not seem to be acting decisively in this matter. As discussed earlier, the government has taken concrete steps for encouraging private entry into sectors previously dominated by the public sector. Disinvestment in the form of transfer of a part of the ownership of State owned enterprises to the public is another form of privatisation undertaken by the government.

Equity amounting to Rs. 29,481 crore in 48 public sector undertakings was disinvested to public sector financial institutions, mutual funds, private corporates and general public till January 31, 2003. The government set up the Disinvestment Commission in August 1996 for suggesting the modalities for undertaking disinvestment of equity in select public sector undertakings. The process of disinvestment is being looked after by the Ministry of Disinvestment.

Initially the government had talked of disposing off burdensome loss-making PSUs while well performing PSUs were to be given autonomy to enable them to develop as global Indian multinational corporations. However, there is virtually no evidence of any such initiative in practice. The government policy seems to be entirely limited to selling off shares of prime PSUs with the aim of bridging budget deficits.

Arun Ghosh er al have aptly remarked, "In fact, while the loss making PSUs provide the ideological justification for the privatisation of PSUs, the privatisation process has been almost entirely confined to those PSUs that

are earning considerable profits. In fact, the sale of PSUs equity during the last eight years clearly shows that the direction of PSU reforms has nothing to do with making prime PSUs into global players and restructuring or privatising loss making PSUs."

In India, there is a lack of enthusiasm for outright privatisation, which seems to many experts to be justified. Privatisation often fails to yield allocative efficiency because output is sub-optimal in the absence of an effective anti-trust law. Further, as Bimal Jalan points out, the bale of public enterprises would be of little help unless macroeconomic environment is improved and it is quite probable that if macroeconomic stabilisation is successful, disinvastment of equity In public sector may not be necessaly,17 But this viewpoint is not shared by many. It is often argued that there are strong reasons for disinvestment in public sector undertakings. R. K, Mishra et al point out that disinvestment of share holdings enables public sector undertakings in acquiring their corporate identity whereby they can "keep pace with the market dynamism flowing from quick business reflexes resulting from their being distanced away from the government."18 Further, disinvestment permits public enterprises td develop their own financing plans reducing thereby their dependence on the government In any case, these have never been the considerations behind disinvestment deals. There is now considerable evidence to believe that disinvestment exercise has become a device to transfer public assets to private corporates at throwawav prices. (BALCO) Bharat Aluminium Company-a profit making PSU estimated to be worth more than Rs. 5,000 crore, was squandered away for one-tenth of its value in a sleazy deal. There is now considerable evidence to believe that shares PSUs are usually undersold in haste creating suspicion the highest and the mightiest.

Financial Sector Reforms

A vibrant, efficient and competitive financial system is necessary to support the structural reforms in the real economy. As correctly pointed out by the Tenth Five Year plan, "An important outcome of financial sector reforms is that it contributes to greater flexibility in the factor and produce markets. With the real sector becoming increasingly market driven and engulfed by a competitive environment there is need for a matching and dynamic response from the financial sector."19 This is possible only if the productivity and efficiency of the financial system improves. Keeping this in view, the government set up Committee on the Financial System in 1991 and on Banking Sector Reforms in 1998 (Narasimnham Committees).

The Committee on Financial System was asked to examine the country's financial system and its various components and to make recommendations in respect of the following:

1. For improving the efficiency and effectiveness of the Financial System, with special reference to economy of operations, accountability and profitability.
2. For infusing greater competition into the financial system so as to enable the banks and other financial institutions to respond more effectively to the credit needs of the economy.
3. For ensuring appropriate and effective supervision over the various entities in the financial sector, in particular the commercial banks and term lending institutions.

The Committee was also required to review the existing legislative framework and to suggest necessary amendments for implementing the recommendations.

The report of the Narasimham Committee on Financial System (submitted in December 1991) has in recent years been the basis for financial sector reforms in this country. The Committee's approach to the problem of financial sector reform was based on three inter-related premises. The first was that the spirit of competitive efficiency that is being introduced in the real sectors of the economy should also cover the financial sector to obtain meaningful results. The second premise was that for performing this task effectively in an environment of competitive efficiency, the financial system should be healthy and capable of generating adequate profits. The third premise was that the financial sector to operate on an efficient basis would need to have operational flexibility and autonomy in decision making, particularly in respect of credit and investment.

The Narasimham Committee on financial system has among other things, recommended (a) establishment of ii four tier hierarchy for me banking structure with 3 or4 large banks including State Bank of India at the top and rural banks at the bottom mainly engaged in financing agriculture and related activities; (b) assigning supervisory functions over banks and financial institutions to a separate quasi autonomous body sponsored try the Reserve Bank of India; (c) phased achievement of 8 per cent capital adequacy ratio as recommended by the Basle Committee; (d) abolition of branch licensing policy; (e) phased reduction in statutory liquidity ratio starting from 1991-92; (f) deregulation of interest rates which are related to the bank rate on the basis of guidelines provided by the Chakravarty Committee: (g) competition among financial Institutions which will adopt a syndicating or participating approach rather than a consortium approach; (h) retention by the Industrial Development Bank of India of only its is refinancing role and delegation of its direct lending activity to a separate corporate body: (i) prudential guidelines should govern the Government of financial institutions: (j) proper classification of assets and full disclosure and transparency of accounts of banks and other financial institutions; and (k) setting up of a Separate institution by the Government of India to be known as Asset Reconstruction Fund with the purpose of faking over a portion of the loan portfolio of banks which has become bad and doubtful and whose recovery is not easy due to slow legal process.

The Narasimham Committee on Financial System also made recommendations regarding credit programmes and investment. Thus, the Committee's recommendations are concerned with almost every aspect of the health of the financial sector. They relate to issues of declining profitability and efficiency and seek to restore the autonomy and flexibility of operations within an overall framework of monetary stability. To sum up, the recommendations of the Narasimham Committee oil Financial System cover policy aspects, organistional issues, operational procedures and accounting practices but underlying them all is the central point of enhancing the inherent strength of the financial institutions and improving their advances portfolio qualitatively.

The report of the Narasimham Committee on Financial System was placed before the Parliament in December 1991, and since then it has become a basis for introducing reforms in the banking sector. The major reform measures undertaken during the past few years are as follows:

1. The level of the statutory liquidity ratio and the cash reserve ratio were progressively raised during the 1980s for combating inflationary pressures generated by large budgetary deficits. This, however, adversely affected the profitability of banks a6dpressurised them to charge high interest rates on their commercial sector advances. The government has over the past eleven years brought down both statutory liquidity ratio and cash reserve ratio in a phased manner. The effective statutory liquidity ratio has been lowered down to 25 per cent. The cash reserve ratio which was the only effective instrument of monetary control in India is being no longer depended upon to control inflation. It has thus been brought down to 4.4 per cent.

2. The RBI introduced new Prudential norms in respect of income recognition, classification of assets, provisioning of bad debts and capital adequacy. The minimum capital standards were prescribed in accordance with the Basle Committee norms under which banks were required to maintain unimpaired capital funds equivalent to 8 per cent of the aggregate of the risk weighted assets. Banks were expected to touch a 8 pr cent capital to risk weighted asset ratio by March 1996. Foreign banks operating in India operating abroad were, however, required to attain 8 per cent by March 1993 and March 1994 respectively.

3 The Central .government provided budgetary support of Rs. 17,346 crore for recapitalisation of public sector banks till 1996-97. This, however, Was not sufficient for achieving the norms by all banks.

Hence, banks had to raise debt and equity resources from the public. By the end of March 200[illegible] only two public sector banks could not achieve the prescribed 8 per cent capital to risk weighted assets ratio which was raised from 8 per cent to 9 per cent from the year ended March 2000.

4. The earlier formats of the balance sheet and profit and loss account did not reflect the true financial position of banks. Hence, they were revised and made effective from the bank accounting year 1991-92.

5. Commercial banks attaining capital adequacy norms and prudential accounting standards have been given freedom to set up new branches without the approval of the Reserve Bank of India. Banks can now also rationalise their existing branch network by relocating branches, opening of specialised branches, setting up controlling offices etc.

6. The RBI has announced guidelines for setting up banks in the private sector. These banks should be financially viable and should avoid concentration of credit and cross holdings with industrial groups. Further, they will have to observe priority sector lending targets as applicable to other banks. Ten private banks have already started functioning and, in principle, approval has also been given to three other proposals for setting up new local area private sector banks.

7. Number of interest rates slabs on banks advances were reduced from about 20 in 1989-90 to 2 in the financial year 1994-95. This attempt to unify interest rate structure aims at reducing the degree of cross-subsidy in the banking system.

8. The supervisory system of the RBI has been strengthened with the establishment of a new Board for Financial Supervision under the chairmanship of a Deputy Governor of the RBI. The Board ensures implementation of the regulations with respect to credit management, asset classification, income recognition, provisioning, capital adequacy and treasury operations.

9. Agreements between the RbI and public sector banks have been made to improve the management and the quality of the performance of the latter. This includes management information system and the internal audit and control mechanisms.

10. Recovery of debts due to banks and other financial institutions in the past has been unsatisfactory. Hence, an Act was passed in 1993 under which Special Recovery Tribunals have been set up to facilitate quicker recovery of loan arrears.

11. The guidelines for determining the maximum premissible bank finance have been make more flexible. Banks will now have greater freedom in determining the working capital needs of the borrowers and responding to local requirements in an appropriate manner.

Following the recommendations of the Narasimham Committee on Financial System the above reform measures were undertaken. Meanwhile, major changes had taken place in the domestic economic and institutional scene. Also, there was a movement towards global integration of financial services. Under the circumstances banking system had to be stronger and better equipped to compete effectively in a fast changing economic environment. The government thus appointed the Committee on Banking Sector Reforms under the Chairmanship of M. Narasimhma. The Committee submitted its report in April 1998. Its major recommendations are as follows:

1. Strong banks should be merged and relatively weak and unviable ones should be closed. Mergers between banks and development financial institutions may be considered if it makes economic and commercial sense.

2. The country should have two or three banks with international orientation, eight to ten national banks and a large number of local banks. The third tier banks should remain confined to smaller geographical regions. The first and second tier banks should take are of the needs of the corporate sector

3. The Committee recommended new and higher norms for capital adequacy. It suggested that the minimum Capital to Risk-weighted Asset Ratio (CRAR) be increased to 10 per cent from its earlier level of 8 per cent.
4. Budgetary support for recapitalisation is not viable and should thus be abandoned.
5. Legal framework is not adequate for credit recovery. It should be strengthened.
6. Net non-performing assets for all banks he brought dawn to below 5 per cent by the year 2000 and to 3 per cent by 2002.
7. There should be rationalisation of branches and staff.
8. Bank boards should be depoliticised under the RBI supervision.
9. The policy of licensing new private sector banks may be continued.
10. Foreign banks may be allowed to set up subsidiaries or joint ventures in India. Such subsidiaries or joint ventures should be treated on per with other private banks and subject to the same conditions with regard to branches and directed credit as these banks.
11. There has to be an integrated system of regulation and supervision to regulate and supervise the activities of banks, financial institutions and non-bank finance companies. The agency for this purpose be renamed as the Board for Financial Regulation and Supervision (EFRS).

The second half of the 1990s saw the dangers associated with the mindless liberalisation in the financial sector world over. Incidents like those of the Barings Bank and the bank failures during the South-East Asian crisis exposed the problems which arose from inadequate regulation and supervision of banks. Hence the Committee on Banking Sector Reforms under the Chairmanship of M. Narasimham particularly stressed on prudential measures like the increase in the Capital to Risk-weighted Assets Ratio (CRAR), the introduction of market risk on government securities, the stricter Non-Performing Assets (NPAs) norms and provisioning requirements and the introduction of asset-liability management guidelines, and risk management guidelines.

In line with these recommendations of tile Second Narasimham Committee a gamut of measures to strengthen the banking system have been announced. Important measures from this point of view are: raising the CRAR to 9 per cent, strengthening prudential accounting norms, laying down Asset Liability Management (ALM) and Risk Management guidelines and directing the banks to provide additional information in the 'Notes to Accounts' in the balance sheets to increase transparency. In 2002, Securitisation, Reconstruction of Financial Assets and Enforcement of Security Act was passed in order to provide a satisfactory legal framework for the recovery of bank credit.

An Apprisal of Economic Reforms

Since July 1991 the government has undertaken both stabilisation programmes and structural reforms as two components of the economic reform package. There is now considerable evidence to suggest that the avowed objectives of the stabilisation and structural reform programmes have been achieved only partly. The annual point to point inflation rate which was below 2 per cent till the end of May 2002, rose to 4.4 per cent as on January 18, 2003. Fiscal imbalances have not been corrected and the gross fiscal deficit of the Central government alone was as high as 5.9 per cent of GDP in 2001-02. Considering the Centre and the States together the fiscal deficit in 2001-02 is likely to be around 10.0 per cent of GDP. The only apparent sign of success is to be seen in the external sector where the stock of foreign exchange reserves (excluding gold) was as high as $ 79.2 billion in May 2003.

In the real sectors, the structural reforms have shown mixed results. In 1991-92 there was near stagnation However, since 1992-93 during the nine years upto 2001-02, GDP increased at the rate of 6.2 per cent per annum. In the first two years of structural reforms, there was near stagnation in the industrial sector However, industrial production picked up in 1993-94 and the average rate of growth of industrial production during the Eighth Plan turned out to be 7.4 per cent per annum (same as the target). Industrial production slowed down in the latter half of 190s with the result that the average rate of growth during the Ninth Plan was only 5.0 per cent which was considerably less than the Ninth Plan target of 8.2 per cent per annum. Since 1990-91 there was a steep fall in both savings and investment rates for three years. However, both savings and investment rates showed an upturn in 1994-95 but were at modest levels in 2001-02.

These modest gains from structural reforms notwithstanding, the economic reforms have been subjected to various criticisms.

The EPW Research Foundation has pointed out that "the new economic policy is seriously flawed in conception......in its contents, strategy and approach and in many other respects."20 The shortcoming can be broadly classified under the major categories:

(i) absence of a broader development strategy;

(ii) wrong sequencing of reforms;

(iii) hasty pace of reforms;

(iv) prerequisites of reforms ignored; and

(v) absence of human development goals as an integral part of the strategy.

1. **Absence of a broader development, strategy.** The focus of both macroeconomic stabilistion and liberlisation is to create a competitive environment in industry in which entrepreneurial decision-making will depend entirely on the market forces, The government's new industrial policy, therefore, lacks a well defined strategy. The south-east Asian countries which recorded high rates of industrial growth during the decades of 1960s, L970s and 1980s, in contrast, did so on the basis of some structured blueprints and by a process of significant State intervention The case of industrialisation ill South Korea is 4Uite revealing, The government in this country steadfastly pursued a policy of heavy industrialisation despite the stiff opposition from the IMF and the World Bank. Judged against the experiences of these countries, the interventionist strategy of the government in this country can be criticised only for lack of dynamism. On the basis of our experience in the past it is patently wrong to conclude that a well articulated industrial strategy and heavy State intervention have intervention role to play in accelerating industrial growth.

2. **Wrong sequencing of reforms.** As a result of wrong sequencing of reforms, serious distortions have surfaced in economic management Then are at least three examples of wrong sequencing of reforms. First, while for drastic reduction in fiscal deficit, revenue deficit and even budget deficit the prerequisites are decisive reduction of non-development expenditures and widening the tax base, the government has initiated fiscal correction programme with surrendering of revenue through substantial reductions in tax rates and compression Of capital expenditure Second, a more obvious case of inappropriate sequencing relates to compression of government's capital expenditure and contraction of public investment before ensuring (hat the private sector and the foreign investors will fill the gap. The third ease of flawed sequencing is of liberalising imports of capital goods before adopting a strategy for technology advancement of the domestic capital goods sector. The latter was necessary for adopting outward oriented strategy of economic growth.

3. **Hasty pace of reforms.** The rapid pace of reforms has been determined by controversial goal to

globalise the Indian economy quickly. This has led to rapid deterioration in the quality of industrial structure. EPW Research Foundation points out, "A sharp reduction in industrial growth, reduction in the growth of capital goods' industries, a relative shift exports away from manufactures, and arresting of the growth of industrial employment have been some of the glaring effects of rapid reforms without providing for some breathing time and appropriate checks and balances for the Indian industry."21

4. **Prerequisites of reforms ignored.** The literature and stabilisation and structural reforms is full of evidence that the shocks of these policies are better absorbed and their consequences for the well-being of the masses are very much reduced if the society has already reached a certain minimal level of human development. South Korea, Malaysia and Thailand have been the successful cases in the recent past but in all these countries not only the socio-economic structure was far more egalitarian due to land reforms and such other measures but the human development indices like life expectancy and literacy rates were at higher levels, while infant mortality was at a lower level before they embarked on significant structural reform programme. In contrast, the Indian situation is s not at all encouraging from the point of view of human development and socio-economic structure.

5. **Absence of human development goals as an integral part of the strategy.** The stabilisation and structural reform proramme in India is being implemented against a background of incomplete structural transformation, widespread poverty, low level of human development and distorted pattern of expenditure on health and education oriented towards the relatively well off sections of the society. Given these dismal conditions and a low rate of economic growth, structural reforms must be undertaken with a human face. This requires that human development goals should be an integral part of the strategy of structural adjustment. Unfortunately in India no such attempt has been made.23

Parthasarthi Shome and Hiranya Mukhopadhyaya have examined at length whether India's eco-economic reforms of the 1990s are sustainable. Their analysis shows, "India's reforms of the 1990s while having achieved a distinct beginning have not demonstrated sustainability. After the initial set of actions in rationalisa6on of the tax structure, financial sector reform, and opening up of trade, the speed of reform slowed down, and only short-term macroeconomic policies-some good, some bad, but in any event, inadequate were used. The spurt in economic growth was followed by a deep recession."24

India's Economy Since Economic Reforms

How has India's economy performed since the economic reforms remains a contentious issue and opinions continue to be divided. To illustrate, Arun Ghosh has argued, 'The consequences of the NEP (new economic policy) are likely to be extremely adverse for the future of the Indian economy." He further asserts, "In brief, in no sector or manner has the NEP succeeded.'" However, Kirit Parikh thinks"-the reforms have put the Indian economy on a higher growth path, which it should continue to ride even without a lot of additional new reforms.... With more sensible policies, we have an opportunity to accelerate our growth further and take-off into a high growth trajectory."26 It is not surprising to find such unsupported statements in official government publications particularly of the finance ministry, but it is certainly dubious that in recent years some well known economists have conveniently ignored the mixed outcome of the economic reforms. By distorting the facts, these economists contend that the reforms instituted so far have been, by and large, successful in achieving an accelerated growth in the new liberalised environment and this helps to reduce poverty.

In the following pages we shall attempt to assess assess the performance economy since the reforms. Ten years have passed since the beginning of the reforms and it is a fairly long period to assess their impact on various aspects of the economy.

Macro-Economic Performance

The trend rate of growth of GDP was 5.6 per cent per annum during the eleven year period since the reforms, compared to 5.9 per cent during the six year period from 1985-86 to 1990-91. In the post-reforms period annual growth rates were also lower in all the three sectors, viz, primary, secondary and teritary, compared to annual growth rates in the preceding six years (from 1985-86 to 1990-91). The industrial sector on which the government has been pinning its hopes for acceleration of over-all growth rate registered a lacklustre growth. As compared to 7.4 per cent per annum increase in GDP in the secondary sector during 1985/86-1990/91, the average annual rate of increase in GDP in this sector was only 5.7 per cent during 1991/92-2001102.

Inflation was higher upto 1996 since the reforms as compared to pre-reform period. Thereafter, it had distinctly slowed down. The economy is more open and the share of merchandise imports plus exports in current GDP at market prices has gone up to 17.6 percent in the 199s as against 12.4 per cent during 1985/86-1990/91. Balance of trade position has shown some improvement and the country's foreign exchange reserves are considered to be adequate by the government for 7-8 months' import requirement. However, R Nagaraj is not so confident about India's foreign exchange reserve position. Expressing his doubts he states, 'In relatively open financial markets, whether the present level of reserve is adequate to withstand an external shock is debatable - with a variety of non-resident repatriable deposits continuing to account for the majority of the reserves."28

India's fiscal deficit as a proportion to GDP has declined in the post-reform period. However, the revenue deficit is as high as it was during the ore-reform period. This means that the borrowing for current consumption remains large. The tax-GDP ratio has not improved in the 1990s despite increase in revenue from direct taxes. The tax-revenue position is far from satisfactory due to fall in indirect tax revenue. Faced with this situation, the government has reduced public investment and to a lesser extent public spending (as a proportion to GDP). These structural adjustments are Rot entirely unexpected But they raise certain questions which must be answered to judge the quality of adjustments. First it is to be examined as to who and which sectors bore the burden of these adjustments? Has private investment, both domestic and foreign, come into the industries from which the public sector has withdrawn? Does the performance of the industrial sector which has been the focus of structural reforms suggest that the Indian economy is on a sustainable growth path?

Economic Reforms, Income Inequality and Poverty

Since the structural reforms have adversely affected poor in many countries, it was expected to happen in this country also after the reforms process was initiated in the mid-1991. The benefits of growth automatically do not trickle down. However, Jagdish Bhagvati, T.N. Srinivasan and Deepak Lal feel otherwise." They argue that economic growth improved significantly as a result of the economic reforms since 1991 which in turn has reduced poverty. They however discreetly avoid making observations on income inequality. These economists do not consider it necessary to examine relevant data carefully.

Industrial Policy

After Independence, the Government of India spelt out its approach to the development of the industrial sector in the Industrial Policy Resolution 1948. This was followed by the Industrial Policy Resolution, 1956 In between, the government introduced the Industries development and Regulation) Act, 1951 to regulate and control the development of the private sector. In 1969, MRTP Act (Monopolies and Restrictive Trade Practices Act) was adopted to prevent concentration of economic power and control monopolies. Another legislation that had considerable implications for industrial policy (as far as the Participation of foreign companies in industrial sector of India is concerned) was the Foreign Exchange Regulation Act (FERA) adopted in 1973. However, all these measures which guided and determined the State intervention in the field

of industrial development failed in achieving the objectives laid down for 'hem. They also created a number of inefficiencies, distortions and rigidities in the system. Therefore, the government started liberalising the industrial policy in 1970s and 1980s. The most drastic liberalisation was carried out in 1991 when a New Industrial Policy was announced.

We shall discuss the MRTP Act in chapter 31 on 'Private Sector in the Indian Economy' and the FERA in chapter 38 on 'Multinational Corporations, FERA and FEMA.' Other constituents of industrial policy are discussed in this chapter.

Industrial Policy Prior to 1991

Industrial Policy Resolution, 1948

The first important industrial policy statement was made in the Industrial Policy Resolution, 1948 issued by the Government of India on April 6,1948. The Resolution accepted the importance of both private and public sectors in the industrial economy of India. It divided the industries into the following four categories:

1. **Industries where State had a monopoly.** In this category, three fields of activity were specified - arms and ammunition, atomic energy and rail transport.
2. **Mixed sector,** In this category, the following 6 industries were specified - coal, iron and steel, aircraft manufacture, ship building, manufacture of telephone, telegraph and wireless apparatus (excluding radio sets) and mineral oils. New undertakings in this category were to be set up by the State but existing private undertakings were allowed to continue for 10 year, after which the government was to review the situation and acquire any existing undertaking after paying compensation on a fair and equitable basis.
3. **The field of government control.** 18 industries of national importance included in this category. The government did not undertake the responsibility of developing these industries but considered them of such importance that their regulation and direction was necessary. Some of the industries included were-automobiles, heavy chemicals, heavy machinery, machine tools, fertilizers, electrical engineering, sugar, paper, cement, cotton and woollen textiles.
4. **The field of private enterprise.** All other industries (not include in the above three categories) were left open to the private sector. However, the State could take over any industry in this sector also if its progress was unsatisfactory.

The 1948 Resolution also accepted the importance of small and cottage industries as they are Particularly suited for the utilization of local resources and for creation of employment opportunities.

Industrial Policy Resolution, 1956

The 1956 Resolution laid down the following Objectives for the industrial policy: (i) to accelerate the rate of growth and to speed up industrialization; (ii) to develop heavy industries and machine making industries; (iii) to expand public sector; (iv) to reduce disparities in income and wealth; (v) to build up a large and growing cooperative sector; and (vi) to prevent monopolies and the concentration of wealth and income in the hands of a small number of individuals.

These objectives, it was thought, would help in generating more employment opportunities and in raising the standard of living the masses. For this purpose, stress was laid on cooperation between public and private sectors but an increasing role was envisaged for the former so that, in due course of time, it could gain 'commanding heights' of the economy.

The 1956 Resolution divided the industries into the following three categories:

1. **Monopoly of the State.** In this category 17 industries were included whose future development was to be the exclusive responsibility of the State. These were listed in Schedule A appended to the Resolution. Of the 17 industries, 4 industries-arms and ammunition, atomic energy, railway and air transport - were to be government monopolies. In the remaining 13 industries, new units were to be established by the State but existing private units were allowed to subsist and expand. New units in the private sector could also be allowed 'when the national interest so required.'

2. **Mixed sector of public and private enterprise.** In this section 12 industries listed in Schedule B (appended to the Resolution) were included. These were: all other minerals (except minor minerals), road transport, sea transport, machine tools.. ferro-alloys and tool steels, basic and intermediate products required by chemical industries such as manufacture of drugs, dyestuffs and plastics, antibiotics and other essential drugs, fertilizers, synthetic rubber, chemical pulp, carbonization of coal, and aluminium and other non-ferrous metals not included in the first category. In these industries, State would increasingly establish new units and increase its participation but would not deny the private sector opportunity to set up units or expand existing units.

3. **Industries left for private sector.** All industries not listed in schedules 'A', or 'B' were included in the third category. These industries were left open to the private sector. Their development was to depend on the initiative and enterprises of the private Sector, though even here the State could start any industry in which it was interested.

The 1956 Resolution emphasised the mutual dependence of public and private sectors. The only 4 industries in which private sector was not allowed to function were arms and ammunition, atomic energy, railways and air transport. In all other industries either the private sector was allowed to operate freely or its help could be obtained if the government deemed fit, However, the private sector was to remain subject to various government regulations and controls as specified in Industries (Development and Regulation) Act 1951 and other related regulations.

The 1956 Resolution recognised the importance of small-scale and cottage industries just as the 1948 Resolution had done. It also called for die reduction in regional imbalances and inequalities. For this purpose, it advocated that transport facilities, power and other facilities should be provided in backward regions.

As compared to the 1948 Resolution, the 1956 Resolution considerably enlarged the area of Operation of the public sector as the exclusive responsibility of the State was enlarged from 6 to 17 industries (Schedule A). In addition, another category including 12 industries (Schedule B) was defined where the State could participate on an increasing scale. However, the 1956 Resolution dropped the (threat) of nationalization that the 1948 Resolution contained and the division of industries in different categories was more flexible in the former as compared to the latter. The fact is that the basic objective of both the Resolutions was the aame-strengthening the mixed economy structure of the country.

Industries (Development And Regulation) Act, 1951

To control and regulate the process of industrial development in the country, an Act was passed by the Parliament in October 1951. Known as the industries (Development and Regulation) Act, 1951, the Act came into force on May 8, 1952. Though it aimed al both, development and regulation of private sector, its main task over they ears has been to concentrate more on the 'regulation' aspect The objectives that the Act sought to accomplish were: (i) the regulation of industrial investment and production according to plan priorities and targets; (ii) protection Of Small entrepreneurs against competition from large industries; (iii) prevention of monopoly and concentration of ownership of industries; and (iv) balanced regional development with a view to reducing disparities in the levels of development of different regions of the economy. It was hoped that through the instrument of industrial licensing, the State would be able to (i) direct investment in to the most

important branches, (ii) correlate supply and demand in the domestic market, (iii) eliminate competition, and (iv) ensure the optimum utilisation of social capital.

1. **Restrictive Provisions.** Under 'his category come all measures designed to curb unfair practices adopted by industries. These provisions were as follows: (i) Registration and licensing of industrial undertakings-Undertakings of all those industries which were included in the schedule of the industries (Development and Regulation) Act, 1951, were required to be registered whether they come under the private sector or the public sector. Even if the existing undertakings intended expanding their activities, they required prior permission of the government; (ii) Enquiry of industries listed in the schedule-The responsibility of the State does not end with the registration or granting of licences to the undertakings. If the working of a particular industrial unit was not satisfactory (say, for example, them was substantial underutilization of capacity or product was not up to the mark or cost of production end price were excessive), the government could set up an enquiry into the affairs of the particular undertaking; and (iii) Cancellation of registration and licence-If a particular industrial undertaking had succeeded in obtaining industrial licence and registration by submitting wrong information, the government could cancel the registration under article 10(A) of the Act. In the same way, the government could cancel the licence if the undertaking was not setup within the stipulated period.
2. **Reformative Provisions.** In this category, following provisions were considered: (i) Direct regulation or control by the government-If the government felt that a particular industry is as not being run satisfactorily, it could issue directions for carrying out reforms. If these directions were not heeded to, the government could take over the management and control of that unit in its hands: (ii) Control on price, distribution, supply, etc.-The government was empowered in the Act to regulate or control the supply, distribution and price of the product manufactured by units belonging to the industries listed in the schedule of the Act, if it so wished; and (iii) Constructive To inspire mutual confidence and elicit cooperation from the workers, the government established Central Advisory Council and a number of Development Councils for different products.

In the initial stages 37 industries (specified under the Act) were brought under the purview of the Act which was later extended to include 70 industries. Of these specified industries only those units were brought under the Act where the capital employed was Rs. 1 lakh or more. Since the net of coverage was too small, it was decided t, over all units (irrespective of size) under the Act in 1953 but the excessive administrative strain brought upon the authorities as a consequence of this decision, compelled them to scrap this decision in 1956. It was stated that henceforth the Act would be applicable only to enterprises employing 50 or more workers if worked with the aid of power or employing 100 or more workers if worked without the aid of power. In 1960 another change was made and all enterprises with fixed capital of Rs. 10 lakh or less were exempted from the licensing procedure. The exemption limit was raised to Rs. 25 lakh in 1963 and (subject to certain conditions) to Rs. 1 crore in 1970. The March 1978 industrial policy statement liberalized the licensing policy further by raising the exemption limit from Rs. 1 crore to Rs. 3 crore. It was later raised to Rs. 5 crore. The government announced a major package of industrial delicensing during the year 1988-89. This package provided that henceforeth, only projects involving an investment in fixed assets or more than Rs. 50 crore, if they are located in backward areas, or more than Rs. 15 crore if they are located in non-backward areas would require industrial licences.

Review of Pre-1991 Industrial Policy and Liberalisation Trends

The actual operation of the industrial policy (particularly the industrial licensing policy) has been a subject of much debate and criticism. Several studies on the implementation of the licensing policies and the functioning of the industrial approval system pointed out a number of flaws and deficiencies. Reports of the various

Committes and Commissions appointed by the government itself (Monopolies Enquiry Commissions in April 1964, Dr. R.K. Hazari in 1965 and Dutt Committee in 1967) pointed out that the licensing policy had failed to achieve its objectives. In many case, the results were just the opposite of what the government had planned. The main points of criticism have been as follows:

1. **Licensing and underutiliztion of capacity.** Licensing was supposed to ensure creation of capacities according to plan priorities and targets. However, no clear priorities for private sector were laid down in Plans and therefore the private sector chose those industries which appeared appeared more profitable. In technical curiosity of the D.G.T.D. (Directorate General of Technical Development) and were, therefore, granted licenses in defiance of me needs of essential industries producing commodities for mass consumption.

   The grant of a licence to an enterprise was no guarantee that the production capacity permitted would actually be installed. The government had the right to take away a licence only several years later Because of this fact, capacity created, in some cares, was less man allowed Many industries (especially those belonging to the large monopoly houses) indulged in such Practices to restrict output and raise prices. Since the government had no guarantee that the licensed capacity would actually be installed within the stipulated time, it adopted the practice of granting licences for capacities far in excess of the plan targets, from the end of the Second Plan. In those cases where actual implementation was larger than expected (as, for example, in the case of paper industry, cement industry and creamic production) a sizable unutilized capacity appeared. In some cases overlicensing of an industry deterred the licences fromimplementing their full licensed capacities for fear of excesive capacity creation in the industry. As a consequence of this, industries over-licensed in the Third Plan were marked by under fulfillment of capacity.

2. **Licensing and concentration of economic.** As noted by Aurobindo Ghosh, in India: "It is industrial licensing which limits are areas of private investment and also determines entry into specific industries The total volume of licensable private investment is normally (through not always) fixed in relation to the total Plan target of private investment in industry. This generally holds true of licensing in particular industries also; i.e. in correspondence with Plan targets of capacity in specific industries. In such a situation, oligopolistic rivalry proceeds principally through competition for investment opportunities at the stage of entry into the industry itself'. I This explains the behaviour of the large industrial houses in India who sought pre-emption of investment opportunities through acquiring as much industrial licences as possible thereby ensuring an increasing share of new capacities created on the one hand, and on the other hand keeping out potential rivals. Since a major objective of the Industries (Development and Regulation) Act was the prevention of monopoly and concentration of the ownership of industries, it was expected to foil the attempt of the large industrial houses. However, as ah Enquiry Committees have noted, the operation of licensing policy actually helped the large houses in achieving their ends in a number of ways. As notcd by Ihe Dult Committee, the licensing authorities many times used their discretionary powers in favour of the large houses. This "has been revealed through their different practices, e.g. their early intimation of impending licensing to an applicant, inadequate scrutiny slid or expeditious disposal of licence applications, 'on file decisions' without going through the Licensing Committee, reversal of earlier decisions, etc."

3. **Discretionary powers of licensing authorities.** In his study published recently, Martinussen has pointed out that because of the considerable discretionary powers vested in the regulatory agencies, the whole system tended to promote corruption, rent-seeking and discrimination based on personalistic relationships.' In this context, Martinussen emphasizes two features of the formal bureaucratic institutions

functioning in India: First, "although separated from the rest of society by effective socialisation processes and specific rules which govern their behaviour, government officials often remain loyal to outside social networks. They are inclined in general to favour members of their own social network."3 Second, "the individual government official at higher levels of the hierarchy is vested with considerable discretionary powers in his discharging of administrative functions. This has increased the scope for outside influence and for discrimination based on personalistic relationships."4

Because of the loyalty to outside social networks and personalistic relationships, a strong nexus between high government officials and managers of large industrial houses has emerged in this country. As a result, the actual functioning of the industrial approval system in India has favoured large industrial houses. In his empirical study, Martinussen found that none of the large industrial houses included in his sample had sustained severe setbacks due to government regulations. On the contrary, the managers or the board members of large industrial houses told him that they had received all the licences they wanted, although with some delay in most of the cases. Even with regard to industries explicitly reserved for the public sector, several of the respondents cited instances where their companies had obtained permissions to set up units or expand production.' The whole system of operational controls simply favoured large business houses as only they had enough resources to cope with the bureaucracy in Delhi. Newcomers and smaller enterprises could rarely exploit personalistic relationships with the government officials and were therefore left out. Thus the industrial approval system impeded entry of new promoters and enerpreneurs, contrary to official objectives.

4. **Licensing and regional imbalances.** One of the avowed objectives of industrial licensing policy was (he reduction in regional inequalities and imbalances. However, the actual operation of this policy has accomplished just the opposite-it tended to increase regional inequalities. As noted by the Dutt Committee, the four industrially advanced States of Maharashtra, Gujarat, West Bengal and Tamil Nadu benefited the most from the operation of this policy. For example, in the decade 1955-56, these four industrially advanced States accounted for 59.3 per Cent of the appfisrti8gs and 62.42 per cent of the licences approved. On the other hand, the poor States of Bihar, Orissa, Uttar Pradesh and Madhya Pradesh received only 15.5 per cent of total licences approved. These trends continued in later years-also. For instance, during the thrirteen years period 1979 to 1992, the four industrially advanced States of Maharashtra, Gujarat, Tamil Nadu and West Bengal received 46.4 per cent of total licences issued whereas the combined share of Dlhar, Orissa, Madhya Pradesh and Uttar Pradesh was only 16.2 per cent."

   Because of this discrimination against the backward region-, the government decided to issue more licences to such regions, However, even here the developed States benefited more as it were their backward areas that got more licences as compared to the backward areas of the poor States. For instance, of the total 2.321 licences issued to backward areas during 1982 to 1992, 3ackward areas of the four developed States of Maharashtra, Gjarat, Tamil Nadu and West Bengal got 17.6 per cent licences while the backward areas of Bihar, Orissa anJ Madhya Pradesh got only 9.8 per cent of the total licences.7

5. **Delays in processing of applications.** Two developments added significantly to the burden on both the regulatory authorities and the private entrepreneurs, On the one hand, the coverage and degree of detail of the regulations was increased significantly (for instance an amendment to the IDR Act in 1953 made it compulsory for companies to obtain a licence for the production of any 'new article' while in 1956 industrial activity and products were defined in much greater detail, thus adding to the number of permissions required), while on the other hand, industrial growth and diversification increased the scarcity of resources allocated administratively. The outcome was increasing delays in the processing

of applications.8 Moreover, the Licensing Committee worked in a very haphazard manner and there were no definite criteria adopted for acceptance or rejection of applications. This lack of explicit economic criteria was accompanied by the generally poor quality of technical examinations conducted by the Directorate General of Technical Development (DGTD) which took an unnecessarily long time for disposing of cases and submitting its recommendations to the Licensing Committee. All these factors impeded industrial growth.

The Liberalisation Trends

Because of the above criticisms indicating the failure of the industrial licensing policy in achieving its objectives, the Government of India announced a number of liberalisation measures in the Industrial Policies announced in 1974 1973 and 1978. In 1980, the government came forward with an Industrial Policy Statement which served as a guideline to various liberalisation measures undertaken through the 1980s. Some of these measures were as follows:

Exemption from Licensing. The limit of exemption from licensing was continuously raised up. In March 1978 the limit was fixed at Rs. 3 crore. During 1980s it was first raised to Rs. ... and then to a whopping Rs. 15 crore for projects located in non-backward areas and Rs. 50 crore for projects located in backward areas in 1988-89 (under certain conditions).

Relaxations to MRTP and FERA Companies. Under the pretext of expanding industrial production and promoting exports, various concessions were provided to companies falling under the MRTP Act (Monopolies and Restrictive Trade practices Act) and FERA (Foreign Exchange Regulation Act). The most important relaxation related to the raising of the limit for MRTP companies from Rs. 20 crore to Rs. 100 crore (i.e., by five times) at one stroke in March 1985. In May 1983, the government notified that MRTP companies are eligible to set up, without the approval of the government, new capacities in industries of high national importance for industries with substitution potential or those using sophisticated technology. In December 1985, the government permitted the unrestricted entry of large industrial houses and companies governed by FERA into 21 high - technology items of manufacture. With this permission, the large industrial houses falling within the purview of the MRTP Act and FERA companies were allowed to freely take up the manufacture of 83 items. The government specified a list of 33 broad groups of industries under Appendix I in which MRTP and FERA companies were permitted to set up capacities, provided the concerned items are not reserved for the small-scale or public Sectors. Various other concessions like regularisation of excess capacity and capacity re-endorsement facilities to set up industries in backward areas etc. were also granted to MRTP and FERA compalnies.9

Delicensing. With a view to encouraging production, the government delicensed 28 broad categories of industries and 82 bulk drugs and their formulations. For these industries only registration with the Secretariat for Industrial. Approvals was now required: no licence had to be obtained under the Industries (Development and Regulation) Act. This was subject to the conditions that the undertakings concerned did not fall within the purview of the Monopolies and Restrictive Trade Practices (MRTP) Act or the Foreign Exchange Regulation Act (FEIW), that the article of manufacture was not reserved for the small scale sector, that the undertaking concerned was not located witin specified urban locales. During 1989-90 some more industries were delicensed.

Re-endorsement of Capacity. With a view to improving capacity utilisation in industries, the government announced a scheme capacity re-endorsement in April. 1962. During 1986, this scheme was liberalised to allow undertakings which had achieved 80 per cent capacity utilization (as against 94 per cent earlier) to avail of the facility. The re-endorsed capacity was to be calculated by taking the highest production achieved during any of the previous five years plus one-third thereof ?he undertakings which were able to achieve capacity utilization equal to the re-endorsed level were to get further re-endorsement according to the highest Production

achieved in subsequent years. The number of industries for which automatic re-endorsement of capacity was not available was reduced from 77 to 26. With a view to encourage modernisation, renovation, replacement, etc.. the government announced in 1986 exemption from licensing requirements of increase up to 49 per cent over licensed capacity.

Broad Banding of Industries. The scheme of broad banding of industries was introduced in 1984. This implied classification under broad categories-of two-wheelers, four-wheelers, tractors, as well as machinery for fertilisers, pharmaceuticals, and paper and pulp etc., into generic categories. Thus, to take one example, Cars, jeeps, light, medium and heavy commercial vehicles, etc., were clubbed together into the generic category of "four wheelers" This measure was intended to enable the manufacturers to change their product-mix rapidly to match changes in demand patterns without incurring procedural delays and other costs associated with seeking amendments to their industrial licences. Broad- banding was extended in stages to cover 45 broad industry groups.

Minimum Economic Scales of Operation. Another important concept introduced in the field of industrial licensing was that of minimum economic level of operation. This was introduced in 1986. The idea was to encourage realisation of economic of scale by expansion of existing installed capacities of undertakings to minimum economic levels of Operation. With this end in view, minimum economic capacities (MECs) were specified for 108 industries till 1989. Expansion of existing installed capacities Was encouraged upto these MECs if they fell short of the latter. During 1989-90 MECs were specified for Some more industries.

Development of Backward Areas. For promoting the development of backward areas, the govement extended the scheme of delicensing in March 1986 to MRTP/FERA companies in respect of 20 industries in Appendix I for location in centrally declared backward areas. The scheme was later extended to 49 industries for location in any centrally declared backward area and to 23 non-Appendix-I industries for location in category 'A' backward districts.10 The conditions permitting MRTP and FERA companies to establish non-Appendix I industries in backward were also liberaliseed.

Recognising that one of the impediments blocking the industrialisation of backward areas of the country is the absence of infrastructural the government announced the decision in 1988-89 to Set up 100 growth centres spread across the country over a period of frve years or so. It was decided to provide funds of the order of Rs. 25 crores to Rs. 30 crores to each growth centre for creating infrastructural facilities of a high order.

Incentives for Export Production. Various concessions were announced by the government in its industrial policy and export-import policy from time to time to promote the expansion of exports. As mentioned earlier, MRTP and FERA companies were permitted (outside the Appendix I industries) if the product is perdominantly for export. With a view to providing fillip to production in industries of high national priority and/or those meant exclusively for export, the government introduced Section 22-A in the MRTP Act whereby it could notify industries or services to which Sections 21 and 22 of the Act will not apply. In October 1982 all 100 per cent export oriented industries set up in the Free Trade Zones were exempted from Sections 21 and 22 of the Act. Is addition, the government identified some industries which were specially important from export angle. These industries were allowed 5 per cent automatic growth per annum, up to a limit of 25 per cent in a plan period over and above the normal permissible limit for 25 per cent excess production over the authorized capacity.

Enhancement of Investment Limit for SSI Units and Ancillary Units. As stated earlier, the July 1980 Statement fixed the investment limit for small-scale industries at Rs. 20 lakh and for ancillary units at Rs. 25 lakh. In March 1985 these limits Wen enhanced to Rs. 35 lakh and Rs.45 lakh respectively. For tiny units, the investment limit stood at Rs.2 lakh. A government notification issued in April 1991 raised the investment limit for small scale industry from Rs, 35 lakh to Rs. 661akh and for ancillary units from Rs, 45 lakh to Rs. 75 lakhs. In August 1991, the investment limit for tiny units was raised to Rs. 5 lakh. In February 1997, the investment limit for small-scale units and ancillary units was raised to Rs, 3 crore. The investment limit for

tiny units was raised from Rs. 5 lakh to Rs. 25 lakh. The investment limit for small-scale industry was reduced to Rs. 1 crore in 1999.

New Industrial Policy, 1991

In line with the liberalisation measures announced during the 1980s the government announced a New Industrial Policy on July 24, 1991. This new Policy de-regulates the industrial economy in a substantial manner The major objectives of the new policy are "to build on the gains already made, correct the distortions or weaknesses that might have crept in, maintain a sustained growth in productivity and gainful employment and attain international competitiveness."11 In pursuit of these objectives, the government announced a series of initiatives in respect of the policies relating to the following areas:

A. Industrial Licensing

B. Foreign Investment

C. Foreign Technology Agreements

D. Public Sector Policy

E. MRTP Act

A package for the Small and Tiny Sectors of industry was announced separately in August 199 (already discussed in detail in Chapter 28).

Abolition of Industrial

Industrial Licensing policy in India has been governed by the Industries (Development and Regulation) Act 1951. As we have discussed above, industrial liocnsing policy and procedures hare been liberalised considerably from time to time. Yet, the industrial licensing policy has all along been resented and bureaucratic as it led to unnecessary governmental interference, delays in investment decisions to achieve the objectives laid down for it by the government. On account of these considerations, and in order to liberalise the economy and to enable the entrepreneurs to make investment decisions on the basis of their own commercial judgement. the 1991 industrial policy abolished industrial licensing for all but 18 industries. The 18 industries for which licensing was kept necessary were as under-coal and lignite; Petroleum (other than crude) and its distillation products; distillation and brewing of alcoholic drinks; sugar; animal fats and oils: cigars and cigarettes, asbestos and abestos-based products; plywood and other wood based products; raw hides and skins and leather; tanned or dressed fruskins; motor cars; paper and newsprint; electronic aerosepae and defence equipment; industrial explosives; hazardous chemicals; drugs and pharmaceutical; entertainment electronics, and white goods (domestic refrigerators, washing machines, airconditioners, etc.). With the passgae of time, most of these industries have also been delicensed. As of now, licensing is compulsory for only 6 industries. These are alcohol, cigarettes, hazardous industry which has been delicensed) and industrial explsives

In respect of delicensed industry, no approval is required from the government. However, entrepreneurs are required to submit an Industrial Entrepreneur Momorandum (IEM) to the Secretariat for Industrial Approvals (SIA) which acknowledges receipt. Since the announcement of new industrial policy till 2002,47,312 IEMs involving an estimated investment of Rs. 10,37,256 crore and employment of more than 81 lakh persons were filed. During the same period, 3,773 LOIs (letters of intent) involving a proposed investment of Rs. 1,07,682 crore and proposed employment of 8.26 lakh were filed.

Public Sector's Role Diluted

The 1956 Resolution had reserved 17 industries for the public sector The 1991 industries policy reduced this number to 8: (i) arms and amunition, (2) atomic energy, (3) coal and lignite, (4) mineral Oils, (5) mining of iron, ore, chrome ore, gypsum, sulphur, gold and diamond. (6) mining of coper, lead, zinc, tin, molybdenum and

wolfarm, (7) minerals specified in the schedule to the atomic energy (control of production and use order), 1953, and (8) rail transport. In 1993, items 5 and 6 were deleted from the reserved list. In 1998-99, items 3 and 4 were also taken out from the reserved list. On May 9, 2001, the government opened up arms and ammunition sector also to the private sector. This now leaves only 3 industries reserved exclusively for the public sector.

The new industrial policy also states that the government will undertake review of the existing public enterprises in low technology, small scale and non-strategic areas as also when there is low or nil social consideration or public purpose. Sick units will be referred to the Board for Industrial and Financial Reconstruction (or a similar body) for advice about rehabilitation and reconstruction. For enterprises remaining in the public sector, it is stated that they will be provided a much greater degree of management autonomy through the system of MOU (memorandum of understanding).

The government has also announced its intention to offer a part of government shareholding in the Public sector enterprises to mutual funds, financial institutions, the general public and the workers. A beginning in this direction was made in 1991-92 itself by divesting part of the equities of selected public sector enterprises. Over the Period 1991-92 to 2001-02 the government has raised Rs. 26,139 crore through this means. The new industrial policy indicates the government's intention to invite a greater degree of participation by the private sector in important areas of the economy.

MRTP Limit Goes

Under the MRTP Act, all firms with assets above a certain size (Rs. 100 crore since 1985) were classified as MRTP firms. Such firms were permitted to enter selected industries only and this also on a case-by-case approval basis. In addition to control through industrial licensing, separate approvals were required by such large firms for any investment proposals. The government felt that this was having a deleterious effect on many large firms in their plans for growth and diversification. The new industrial policy therefore scrapped the threshold limit of assets in respect of MRTP and dominant undertakings. These firms will now be at par with others, and not require prior approval from the government for investment in the delicensed industries. The MRTP Act has been accordingly amended. The now amended Act gives more emphasis to the prevention and control of monopolistic, restrictive and unfair trade practices so that consumers are adequately protected from such practices.

Freer Entry to Foreign Investment and Technology

As in the case of domestic industrial investment, foreign investment has also been traditionally regulated in India. In the case of both foreign technology agreements sought by Indian firms as well as foreign investment, it was necessary to obtain specific prior approval from the government for each project. It was argued that this caused undue delays and government interference and also hampered business decision-making. Therefore, the new industrial policy prepared a specified list of high technology and high-investment priority industries (listed in Annexure III) wherein automatic permission was to be made available for direct foreign investment upto 51 per cent foreign equity. The industries in which automatic approval was granted included a wide range of industrial activities in the capital goods and metallurgical industries, entertainment electronics, food processing, and the services sectors having significant export potential. Besides, these included a number of other industries which are important for the rapid growth of the economy.

In January 1997, the government also announced the first ever guidelines for foreign direct investment for expeditious approval of foreign investment in areas not covered under automatic approval. Priority areas for foreign direct investment proposals as mentioned in the guidelines included infrastructure, export potential, large-scale employment potential particularly for rural areas, items with linkages with the farm sector, social Sector projects like hospitals, health care and medicines, and proposals that lead to induction of technology

and infusion of capital. Foreign direct investment approvals were, however, to be subject to sectoral caps [illegible] per cent (40 per cent for NRIs) in the banking sector; 51 per cent in non-banking financial companies [illegible] per cent in power, roads, ports, tourism and venture capital funds; 49 per cent in telecommunications; 40 per cent (100 per cent for NRIs) in domestic air taxi operations/airlines; 24 per cent in small-scale industries [illegible] per cent in drugs/pharma industry for bulk drugs; 100 per cent in petroleum; and 50 per cent in mining except for gold, silver, diamonds and precious stones.

The list of industries eligible for foreign direct equity investment under the automatic approval route [illegible] Reserve Bank was further expanded in 1997-98 and 1998-99. In 199F98 equity investment up to 100 per cent by NRIs/OCBs (overseas Corporate Bodies) WBS permitted in high priority industries. These included [illegible] priority industries in metallurgical and infrastructure sectors and 13 other priority industries, hitherto eligible for 74 per cent and 51 per cent equity investment respectively. Foreign equity investment in mining [illegible] categories of industries) was also allowed upto 100 per cent for NRIs/OCBs. During 1995-99, the scope of foreign direct equity investment under the automatic approval route or Reserve Bank was enhanced. In [illegible] drive to simplify foreign direct investment procedures, Indian companies were permitted to accept investment under automatic approval route without obtaining prior permission from Reserve Bank of India. Foreign equity upto 100 per cent has been permitted in electricity generation, transmission and distribution (excluding atomic reactor power plants) and in construction and maintenance of roads, highways, vehicular bridges, toll roads, vehicular tunnels, pens and harbours. However, foreign equity in projects of these industries under the automatic approval route was not to exceed Re. 1.500 crore.

During 1999-2000, the government decided to put all items under the automatic route for foreign direct investment/NRI and OCB investment except for a small negative list. The negative list include all proposals requiring industrial licence under the Industries (Development and Regulation) Act, 1951; cases having foreign investmetit.more than 2A percent in the equity capital of units manufacturing items reserved for the small-scale sector; and for all items requiring industrial licence in terms of the locational policy notified under the New Industrial Policy, 1991. Many decisions were taken in 2000-01 also to further liberalise foreign direct investment policy. Some of the important decisions include: (i) 100 per cent foreign direct investment permitted for Business to Business e-commerce: (ii) removal of cap on investment in the power sector. (iii) 100 per cent foreign direct investment permitted in oil refining: (iv) 100 per cent foreign direct investment allowed in Special Economic Zones (SEZs) for all manufacturing activities; (v) 100 per cent foreign direct investment allowed in telecom sector for certain activities with some conditions; (vi) offshore Venture Capital Funds/ Companies allowed to invest in domestic venture capital undertakings as well as other companies through the automatic route, subject only to SEBI (Securities and Exchange Board of India) regulations and sector specific caps on foreign direct investment; (vii) Existing companies with foreign direct investment are eligible for automatic route to undertake additional activities covered under automatic route; (viii) foreign direct investment up to 26 per cent is eligible under automatic mute in the Insurance Sector as prescribed in the insurance Act, 1999, subject to obtaining a licence from the Insurance Regulatory and Development Authority (IRDA); (ix) automatic route is available to proposals in the Information Technology sector, even when the applicant company has a previous joint venture or technology transfer agreement in the same field, etc.

More concessions and incentives to foreign direct investment (FDI) were announced in 2001-02 and [illegible] 03. The main incentives are as follows: (i) In the pharma sector, 100 per cent FDI has been allowed through the automatic route (earlier on, the limit WBS 74 per cent); (ir3 100 per cent FDI has been allowed [illegible] against the prevailing 74 per cent; (iir7 For the hotel and tourism industry the FDI has been raised to 100 per cent through the automatic route from the prevailing 51 per cent; (iv) 100 pr cent FDI has also been allowed in two fresh areas-courier services and Mass Rapid Transport System (MRTS); (V) 100 per cent FDI has been allowed in development of integrated townships and regional urban infrastructure: (vi) In the telecom sector, FDI limit has been raised to 100 per cent for me following activities - (a) Internet Service Providers

(ISPs) not providing gateways (both for satellite and submarine cables), (b) Infrastructure providers providing dark fiber (IP category I), (c) Electronic Mail, and (d) Voice Mail; (vii) Subject to Reserve Bank guidelines, the foreign investment limit in the banking sector has been hiked from 20 per cent to 49 per cent; (viii) FDI upto 26 per cent has been allowed in defence production, and (ix) Foreign firms have been permitted to pay royalty on brand name/trade mark as a percentage of net sales in case of technology transfer.

Other Liberalisation Measures

Industrial location policy liberalised. In a departure from the earlier locational policy for industries, the new industrial policy provided that in locations other than cities of more than 1 million population, there will be no requirement of obtaining industrial approvals from the Centre, except for industries subject to compulsory licensing. In cities with a population of more than 1 million, industries other than those of a non-polluting nature, were required to be located outside 25 kms. of the periphery.

Major amendment in the industrial location policy was effected during 1997-98. The requirement of obtaining industrial approvals from the Central government (except for the industries under compulsory licensing) for establishing units at locations not falling within 25 kms of the periphery of cities having a population of more than 1 million was dispensed with. However, notified industries of a non-polluting nature such as electronics, computer software and printing, may be located within 25 kms of the periphery of cities with more than 1 million population. Other industries are permitted only if they are located in designated industrial areas set up prior to July 25, 1991. Zoning and Land Use Regulations as well as Environment Legislation continue to regulate industrial locations.

Aboilition of Phased Manufacturing Programmes for new projects. To increase the pace of indigenistaion in manufacturing, Phased Manufacturing Programmes have been in force in a number of engineering and electronic industries. The new industrial policy has abolished such programmes in future as the government feels that due to substantial reforms made in the trade policy and the devaluation of the rupee, there is no longer any need for enforcing the local content requirements on a case-by-case. administrative basis. Various incentives that are currently available to manufacturing units with existing Phased Manufacturing Programmes will continue.

Removal of mandatory convertibility clause. A large part of industrial investment in India is financed by loans from banks and financial institutions. These institutions have followed a mandatory practice of including a convertibility clause in their lending operation; for new projects. This has provided them an option of converting part of their loans into equity if felt necessary by their management. Although this option has not generally been exercised, it has often been interpreted as an unwarranted threat to private firms of takeover by financial institutions. The new industrial policy has provided that henceforth financial Institutions will not impose this mandatory convertibility clause.

Appraisal of New Industrial Policy

According to J.C. Sandesara, the new industrial policy seeks to raise efficiency and accelerate industrial production in five different ways: 12

(1) A number of changes in industrial licensing policy, foreign investment foreign technology agreements and MRTP Act are such as to do away with the prior clearance of the government. In such cases, project time and, therefore, project cost will be reduced. Material and human resources engaged in cultivating contacts and 'getting things done' will be released for more productive uses. Thus efficiency will improve.

(2) The changes in respect of foreign investment and foreign technology agreements are also designed to attract capital, technology and managerial expertise from abroad. This will raise the availability of such

scarce resources in the country on the one hand, and will improve the level of efficiency of production on the other hand.

(3) Some changes as regards public sector may enhance the 'allocative efficiency'. Opening up of eleven areas (so far reserved for the public sector) to the private sector implies an opening for the sector which has, by and large, given a better account of itself. Closure, liquidation or rehabilitation etc. of sick/weak public sector units will free resources for more productive use. Similarly, privatisation may make for improved efficiency of the public sector, through its being subjected to the stock market discipline.

(4) Other measures in this area such as purposeful formulation and implementation of Memorandum of Understanding and its monitoring, professionalisation and greater autonomy may be expected to improve the performance of the enterprises that will remain in the public sector.

(5) Greater emphasis in controlling and regulating monopolistic, restrictive and unfair trade practices and the strengthening of the powers of the MRTP Commission will curb anti-competitive behaviour of firms in the monopolistic, oligopolistic and ineffectively competitive markets and thus promote competition and efficiency.

However, the new industrial policy 1991 has invited scathing criticism from a number of quarters. The main points of criticism are as follows:

1. **No evidence of positive impact on industrial growth.** As noted above, the new industrial policy considerably reduced the interventionist barriers to the entry of domestic and foreign investors, resulting in what has been proclaimed as a much more competitive environment in the industrial sector, that this 'much more competitive environment' would, in itself, induce higher growth rates in the industrial sector. However, this expectation has been belied as there is no evidence of a positive impact of the new industrial policy on industrial growth. In fact, as noted in the chapter on 'industrial Development during Planning Period,' the average rate of growth of industrial production fell from 7.8 per cent per annum in the pre-reform decade (1980-81 to 1991-92) to 6.6 per cent during the post-reform decade (1992-93 to 2000-01). What is more, the decade of 1990s witnessed erratic and fluctuating industrial growth rates in different years. The rate of industrial growth was only 4.1 per cent in 1998-99, 5.0 per cent in 2000-01 and merely 2.7 per cent in 2001-02. Particularly disappointing has been the performance of the capital goods sector. This suggests that "liberalization per se has not been enough to ensure high rates of growth of investment and productive activity, and that other strategies may be necessary to encourage the 'animal spirits' of entreprenurs.13

2. **Distortions in production structure.** From the point of view of long run industrial development, the most important group of industries is the group of capital goods industries. However, as highlighted in Table 3 of the chapter on 'Industrial Development during Planning Period, the rate of growth of this group of industries fell drastically from 9.4 per cent per annum during 1980s to only 5.4 per cent per annum during 1990s. This points to the distortions in production structure during 1990s the main emphasis has now shifted to the consumer goods sector (particularly the sector of consumer durables). As a result, the rate of growth of consumer durable goods sector was as high as 11.6 per cent per annum in 1990s.

3. **Threat from foreign competition.** In the early euphoria of liberalisation, the private sector industrialists welcomed the new industrial policy 1991 but they soon came to realise that opening up the Indian economy to foreign competition meant more and cheaper imports, more foreign investment, opportunities to the MNCs (multinational corporations) to raid and takeover their enterprises, and worse, their inability to meet the challenge from MNCs due to their weak economic strength visa-vie the MNCs. In the new liberalised scenario that has emerged in the post-1991 reform phase, the Indian businessmen

are facing unequal competition from MNCs. The 'unequal competition' stems from a number of masons discussed in detail in the section on 'Effects of Globalisation' of chapter 39 on 'India and the World Economy.' As stated therein, the Indian enterprises Suffer from 'size disadvantages' as they are just minuscules in comparison with MNCs; they have for long operated in a protectionist environment which promoted inefficiencies in production; the cost of capital to Indian business is much higher than for MNCs; they are very weak financially in comparison with MNCs; high, multiple and cascading indirect taxes-especially at the local level, where they are not applicable to foreign imports - result in making Indian goods uncompetitive; etc. On account of these reasons, the Indian industry associations (Particularly the Confederation of result in policy-induced de-industrilisation."14 The overall business demand is for a level playing field.

4. **Dangers of business colonalisation.** The various measures to promote foreign investment contained in the new industrial policy and tile various concessions to such investment announced in recent years have provided opportunities to MNCs to penetrate the Indian economy and gobble up Indian enterprises. Baldev Raj Nayar has pointed out three strategies adopted by the MNCs to penetrate the Indian economy through FDI (foreign direct investment).15 One, some foreign investors have bought off existing local brands alongwith their branded products with the aim of replacing such products with their own internationally known products, eliminating in the process the possibility of competition From the local products. Two, some foreign investors initially opted for joint ventures with Indian parterns to gain easy foothold in the domestic industry but, once having consolidated their position, reduced the Indian partner to a subordinate position or simply ousted him. Thus many Indian businessmen feel that MNCs simply use them as a 'door mat' for entry and spread risk only to be dumped later. Three, some foreign investors. even as they started out with local partners in a joint venture, then went on to set up parallel 100 per cent subsidiaries of their own in the same field. which were then favoured with greater sources and more modern technology, rendering the joint venture uncompetitve and useless. The aggression which MNCs have shown to devour domestic enterprise has raised the dangers of business colonalisation and many critics wonder whether in 10 years from now there would be any big Indian brands left at all in the Indian

5. **Misplaced faith in foreign investment.** Various policy pronouncements of the government in recent years indicate that it expects foreign investment to help in technological upgradation of the industrial sector and push up export earnings. However, this faith ill foreign investment is misplaced. As pointed out by H.K. Pranjape, none of the MNCs operating in this country has attempted to develop India as an important base for a significant part of its world-wide research and development work. Despite various tax concessions and incentives none of the multinationals tried to expand export markets. They undertook export activities only to the extent they were compelled to do so under export obligations, or when it was found necessary to do so in order to be able to earn foreign exchange for importing some of their essential requirements. In fact instead of developing India as a major production and export base, many MNCs have only attempted to use 'heir international trade capacities and contacts mainly for exporting goods manufactured by other-usually small scale- units. Thus they have operated mom as trading than as manufacturing and exporting concems.16

   Coming to the import of foreign technology, Parnjape again expresses some reservations. ccording to him, in the whole eagerness to import foreign technology, little attention seems to have been paid to the Possibility that production and managerial technologies found more suitable in other countries may not necessarily prove to be the best in our circumstances. As correctly pointed out by him, one of the very Purposes of India's industrialisation is to ensure that is to ensure that our very large manpower resources are effectively utilised. This implies the adoption of labour-intensive and capital saving

technologies in whichever areas it is feasible to do so. This may imply major readjustment in technologies that have developed in the labour scarce and capital abundant rich countries. This will not be an easy task. Moreover, despite talks of globalisation, nlany rich countries an reluctant to permit unrestricted export of technologies as, in many areas, technologies are common for civilian and defence related items. MNCs which make a technological breakthrough are also usually reluctant to permit use of their up-to date technologies even by their subsidiaries unless these are located in politically safe countries. India obviously does not satisfy this criterion From the view point of these MNCs and the defence authorities of the USA and other rich

6. **Personalistic relationships and corrupt practices continue to prevail.** As stated earlier, the 'licence permit raj' of the pre-1991 period provided ample scope for rent seeking as the entire operations of the industrial licensing policy were governed by personalistic relationships. According to John Dengbol-Martinussen while de-licensing and de-regulation has undoubtedly discouraged rent seeking and corruption at the Central government level, these practices have continued and may have even increased at the State government level. This is due to the reason that while the number of interaction points between government officials and entrepreneurs have declined at the Union level, these have generally increased at the State level providing ample scope for continued interaction on personalistic basis."

The Competition Act, 2002

In the present phase of economic reforms based on the three pillars of libsralisarion, privatisation and *globalisation, the Act, as seen in its original spirit, appeared redundant.* A number of its provisions in the present-day context lost relevance and required to be substituted with new provisions in tune with the contemporary trends in business environment. The Act did not address a number of present-day issues like the abuse of intellectual property rights. In many respects its provisions were draconian and the implementation and control structure was heavily bureaucratic in nature. The Act was often cited as one of the main hindrances to foreign direct investment in the country.

The MRTP Act has been replaced by the competition Act 2002 on the recommendations of the SVS Raghavan Committee. As already pointed our, all the cases pertaining to RTPs and MTPs under the MRTP Act have been transferred to the competition commission of India established under the new Act and will be decided according to the provisions of the repealed MRTP Act. The major provisions of the Competition Act 2002 are as follows:

Major Sections of the MRTP Act and their provisions

Section	Provision
2(0)	Defines an RTP.
33(1)	Gives 'deemed' RTPs.
33(1)(f)	Defines resale price maintenance.
33(1)(j)	Defines price control arrangement.
35(h)	Provides for registration requirement of RTPs.
38	Provides'gateways' to RTPs.
36A	Defines UTPs
2(i)	Defines MTPs
31(2)	Specifies Powers of the Central Government in respect of MTPs.

2(g)	Defines interconnected undertaking.
27(2)	Powers of the Central Govt. for division of undertakings.
5	Relates to formation of MRTPC by Central Government.
10(a)	Relates to power of MRTP Commission to enquire RTP.
10(b)	Relates to power of MRTP Commission to enquire into MTP.
36B	Relates to power of MRTP Commission to enquire into UTP.
12(2)	Confers powers of a Civil Court to MRTP Commission.
12(B)(1)	Relates to power of the Commission toward compensation.
37(1)	Power to the Commission to issue 'cease and desist' order.
37(2)	Power to the commission to issue order to the contending parties to make amends.
15(a) to 15(c)	Restrictions on the powers of the Commission regarding MTPs, RTs and UTPs.
12(c)	Enforcement of Commission's orders through civil courts.
11	Relates to power of the DGIR regarding preliminary investigation.
3	Provides exemptions from MRTP provisions.
Chapter-wise Provisions	
Chapter III	Control and regulation of the concentration of economic power to the common detriment (now repealed, except three sections).
Chapter IV	Control of monopolies and monopolistic trade practices.
Chapter V & VI	Prohibition of restrictive trade practices.
Chapter V(B)	Introduced by MRTP (Amendment) Act, 1984 regulating unfair made practices.

Coverage and Applicability

The Act like the earlier MRTP ACTI applies to the whole of India except the state of Jammu and Kashmir. Th, Act however empowers it to exempt any class of enterprises from the Act in interest of public or national security. It can also exempt any practice or agreement arising out of and is accordance with any obligation, assumed by the country under any treaty, agreement or convention with other countries. Under the Act, no civil court has jurisdiction to entertain any suit or proceeding which the competition commission established under the Act is empowered by the Act to determine. However, the provisions of the Act are in addition to and not in derogation of the provisions of the any other law in force.

Prohibition of Anti-competitive Agreements

The Act prohibits persons and enterprises from entering into any agreement which has adverse impact on competition, any area of production, supply, distribution, storage, acquisition or control of goods or provision of service in the country, the Act prohibits the following agreements as these have anti-competitive effects:

- Decisions taken by an association of persons or enterprises which:
  - a) Directly or indirectly determine purchase or sale price:
  - b) Limits or controls production, supply, markets; technical development, investment or provision of services

c) Shares the marker or source of production or provision of service by way of allocation of geographical area of market;

d) Results in bid rigging or collusive rigging.

- Tie-in arrangements
- Exclusive supply arrangements
- Refusal to deal
- Resale price maintenance.

As can be easily seen, most of these provisions were contained in the MRTP Act also

Prohibition of Abuse of Dominant Position

An enterprise under the Act is considered to abuse its dominant position in the market if it:

- Imposes unfair or discriminatory condition or price purchase or sale of goods or service;
- Restricts production of goods or services or market in respect of these;
- Restricts technical or scientific development to the detriment of the consumer interests;
- Indulges in practices which deny market access to others
- Use its dominant position in one relevant market to enter into or protect other relevant market

The Act provides that no enterprise shall abuse its dominant position.

Regulation of Combinations

Under the Act, combinations have been defined L terms of assets and turnover limits of enterprises after acquisition, merger or amalgamation. The act prohibits persons or enterprises person entering inter a combination which is expected to have adverse effect or competition within the relevant market in India. In that case the combination shall be void. Since provision however does not apply to share subscription or financing facility or any acquisition by a public financial institutions, foreign institutional investor, bank or Venture capital fund. pursuant to any covenant of a loan agreement or investment agreement.

Establishment of The Competition Commission

The Act provides for the establishment of Competition Commission of India Consisting of a Chairman and 2-10 members to be appointed by the central government, and having a term of five years. There is also the provision for the appointment of a Director-General to assist the basic duties of the Commission as provided in the Act are:

- elimenate practices having adverse impact on competition;
- promote and sustain competition:
- protect the interest of consumers; and
- ensure Freedom of trade carried out by other participants in markers I India.

The Commission can enquire into any violation of the provisions of the Act. In order to determine whether in agreement has an appreciable adverse impact on competition, it may apply any one or more of the following competition criteria:

- reation barriers to new entraps in the market;
- oreclosure of competition by hindering entry; into the market;
- ccrual of benefits to consumers;

- mprovement in production or distribution of goods or services; and
- romotion of technical, scientific and economic development by means of production or distribution of goods or services.

Criteria of Dominant Position

The Act provides for the following major criteria by which the competition commission of India may determine whether an enterprise commands a dominant position in the market.

- Market size, resources and economic power of the enterprise;
- size and importance of the competitors;
- vertical integration of the enterprise;
- monopoly position acquired through a statute and dependence of consumers on the enterprise;
- carriers to entry in the field of operation of the enterprise;
- countervailing buying power;
- structure and size of the market in which the enterprise operates;
- relative advantage gained by way of contribution of the enterprise to economic development;
- Social obligation and costs.

If an agreement of an enterprise in a dominant position is found to be in contravention to the Act, the commission can order the enterprise to discontinue and not to re-enter such agreement or discontinue such abuse of dominant position.

Investigation of Combinations

The Act empowers the Competition Commission to conduct enquiry into any merger or amalgamation of enterprises if such business combination's are expected to have adverse Impact on the existing state of competition. In order to determine whether a business combination has or expected to have adverse impact on competition, any of the following criteria may be applied:

- The extent of barriers in the marker;
- actual and potential level of competition from imports;
- level of combination in the marker;
- monopoly power of the combination that might result;
- extent of effective comperirion likely to sustain in the market; and
- extent of vertical integration in the marker:
- benefits of combination in reation to the loss of competition;
- impact on innovations.

The Act lays down detailed procedure for investigation. If a combination is likely to have significantly adverse impact on competition, the commission may even pass orders that the combination shall not be *given effect*.

No civil court has the jurisdiction to entertain any suit or proceeding in respect of any matters which the commission is empowered by the Act.

Conclusion

The competition An 2002 is a more liberal and flexible version of the earlier MRTP Act which had gradually become irrelevant and anti-growth with the passage of rime. The new Act recognises anti-competitive

practices in a wider context and institutes a flexible but effective mechanism to product and promote competition. Much of course will depend upon the spirit with which the new Act is implemented In particular, it must avoid the pit falls which characterized the implementation of its predecessor Act.

Introduction

An important hallmark of the process of economic reforms initiated in the country in 1991 is that it has made the economy more competitive as compared to the pre-reform period. Though the degree of competitiveness in the business environment in India is much less as compared to a number of industrial marker economies in Europe and North America and a number of emergent market economies in east-Asia and elsewhere, there have been clear signs of movement towards marker system and competition in recent years. The movement towards greater competition in various sectors of the economy including manufacturing, infrastructure and services has taken place through deregulation, privatisation and globalisation. The present stance of various macroeconomic policies, as discussed in the various preceding chapters, has been in the direction of marketisation of the economy, encouragement to private enterprise and opening up of the economy to foreign competition through international trade and investment. In the process, the structure of government controls has been diminishing and private capital is being increasingly substituted for public capital in various sectors of the economy. Chapter 30 exclusively deals with public sector disinvestment in the context of public enterprise reforms

The Concept and Logic of Competition

There is enormous literature on the rationale and benefits of market competition or competitive markets. Standard managerial economics tells us that given the resources and technology, an economy is efficient when it is able to provide its consumers with the most desired range of products at minimum cost and this is possible under the mechanism of a competitive market. An economy is in competitive equilibrium when the forces of demand and supply are exactly balanced, leading to the determination of equilibrium price. In a particular product segment, marginal cost and marginal value or utility of a product are exactly balanced at the equilibrium price. Once the efficiency is achieved, it is nor possible to reorganise production in order to make someone better off without making someone else worse off in that particular situation.

As a reference point, standard managerial economics visualises a situation called perfect competition which, in practice, is difficult to realise bur describes an idea market form characterised by the following features:

- A large number of buyers and sellers (or producers) so that no individual buyer or seller can affect the marker price or working of the market by varying individual demand and supply.
- All the firms in a particular industry produce homogenous products, the homogeneity being in respect of technical characteristics of the product, services associated with the sale or delivery of the product to the consumer.
- A uniform price rules throughout the marker and is determined by industry demand and supply. This price is given for an individual firm, which merely has the status of a price taker and can sell any amount at the prevailing price.
- There are no barriers to entry or exit from the industry and any firm can move in or out, depending upon its business prospects.
- All the firms pursue the goal of profit maximisation.
- There is no government intervention, regulation or control by way of tariffs, subsidies, rationing etc
- Perfectly competitive conditions exist in the markers for factors of production as well.

- All buyers and sellers have complete knowledge of market conditions and flow of information (relating to present as well as future) is free and costless.

In real life, however, cbmpetition has a different connotation as the markers are imperfect and take such forms as monopoly, monopolistic competition and oligopoly. The firms compete on the basis of price, product quality, after-sale services, product delivery, product information and positioing, advertising and associated services. Competition is characterised by inter-firm rivalry, competitive strategies and the degree of competition is closely related to number of firms in the market and the distribution of market share between them. Government interventions and controls, barriers to entry and exit, legislative control, immobility of the factors of production dominance of public sector firms and obstructions in the free flow of marker knowledge or information tend to reduce the degree of competition and increase market imperfection. The extent of market imperfection can be gauged in terms of the divergence between the actual price and the competitive price in a particular product market. There is, however, an important exception. Sometimes, a monopolist, through a practice known as limit pricing, sets such a low price for its products so as to prevents the entry of new firms in the marker, potential firms find it commercially unviable to operate at the prevailing price of the monopolist. Similarly, existing firms, through price leadership, can reduce competition or tact collusion through such forms as trade associations, cartels, market sharing or strategic alliances. Sometimes competition creates a paradoxical situation in which competition is self-killing. It happens when the firms with widely divergent competitive strengths compete with one another forcing the marginal firms to go out of business. The end result could be monopoly or oligopoly. This situation may also result through corporate takeovers, mergers, or amalgamations between rival firms.

Competition Versus Contestability

Competition may be distinguished from contestability. In standard managerial economics, contestability refers to the ease with which a firm can enter or leave the industry. Firms enter the industry as they are attracted by profits and tend to leave when they Pre not able to recover the normal price or the average variable cost at prevailing level of output. Under perfect contestability there Ire no barriers to entry and exit and the total number of firms in the industry is unstable and uncertain. In this situation, it is possible that monopoly exists with limit pricing. This point has been referred to earlier also. Under threat of potential competition, the monopolist is compelled to set a competitive price which is low enough to make the entry of other firms unviable. In practical world, however, business decisions are affected more by actual rather that potential competition and there exist a significant barriers to entry.

Some of the major benefits expected from competitive markets are the following:

- Growth of entrepreneurial culture leading to increase in the number of producers and sellers in the marker.
- Increase in investment and capital formation leading to increase in the supply capabilities:
- A strong incentive for developing cost-cutting technologies through sustained research and development efforts.
- Reduction in wastage and improvement in efficiency and productivity.
- Greater customer focus and orientation.
- Increased possibility for entering and tapping foreign markets.
- Conducive environment for growth of international trade and investment.
- Better resource and capacity utilisarion.
- Wider range of availability of Roods and services and wider choice for consumers.

On account of these perceived benefits, the governments of different countries take steps to generate and promote competition. This however, requires a suitable economic system and the constitutional framework as well as an appropriate macroeconomic policy set-up. In centrally controlled, planned or socialist economies the shift to a free enterprise system, is not easy. It requires major shift in the institutional systems and structure, production systems, socio-economic policies and the fundamental philosophy of the government itself. For this, the transition period could be long. A number of economies in Eastern Europe are facing serious transition problems in the gradual process of liberaisation towards market-oriented systems. The movement rewards market-based systems is generally slow and has to be based on adaptive processes.

Regulation of Competition

As already pointed our, market competition, particularly between firms of highly unequal, competitive strength, can be self-destructive. In unregulated markets, there can be widespread negative spillover effects called 'competitive externalities'. The negative effects could be in the form of information a symmetries, unethical collusions, hostile takeovers, malicious interlocking directorates in companies, transfer pricing, strategic market alliances, unjustified market segmentation and differential pricing and a number of other monopolistic and unfair trade practices. These factors result in anticompetitive outcomes, which underscore the need for regulation of competition (Box 23.1).

Examples of Some negative Spillover Effects of Competition

One type of negative spillover effect takes place when a particular technology or standard developed by a company gets an edge over competitors and becomes widely prevalent. Microsoft's Windows operating system has now become universal for personal computers. It can be used to lock our competition in related markets. Microsoft has already faced an allegation that it was tweaking its operating system to perform optimally by using its own Internet browser software and rejected those developed by rival companies. There is similarly a possibility that a camera manufacturer designs the product in such a way that film cartridge of a particular size would fit and an electric company may decide to make power point which would fit only a particular plug manufactured by the same company. Such anticompetitive behaviour needs to be regulated.

The regulation and protection of competition usually requires a competition (or antimonopoly) policy backed by an appropriate legislation. There are three basic areas of competition policy:

- Control of dominant firms by regulation.
- Control of mergers to prevent the possibility of monopolies
- Control of anti-competitive acts like full line forcing and predatory pricing.

In India, we had a long tenure of Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 replaced recently by Competition Act, 2002 which was passed in December 2002. In the UK, Competition Act, 1980 empowers the office of Fair Trading (OFT) to investigate anti-competitive practices. In the USa, the Anti-Trust Legislation seeks to control monopoly and restrictive practices in favour of competitive. It specifically deals with price discriminations, exclusive dealings and interlocking directorates and shareholders and shareholding among competing companies.

Tests of A Good Competition Policy

The competition policy of a country generally refers to set of government measures aimed at stimulating competition, encouraging growth, preventing monopolistic, restrictive and unfair trade practices, promoting efficiency and protecting the rights of the consumers. The policy should take into account not only the present state of competition but also potential competition and future prospects. It must discourage speculation and facilitate the building up of rational and healthy expectations with regard to the future. A good competition policy continuously monitors the competitive actions, reactions, strategies and counter-strategies of various

firms in different market segments and must be able to distinguish between healthy and unhealthy (or unethical) practices. Corresponding to the dynamic character of competition, the competition policy has to be flexible to respond to the genuine needs and expectations of the producers, sellers, consumers and economic growth in general. In the present era of globalisation, the competition policy must be cast in the international, rather than national context. A good competition policy, broadly speaking, is expected to have the following contours:

- It should be capable of controlling the misuse of the market power of dominant firms. It should have a clear perception of dominance and should develop unambigous criteria for determining the abuse of dominance.
- It should be able to identify the anti-competitive effects of mergers and acquisitions and provide a prescription to deal with the same.
- It should check barriers to entry subject to the provisions of industrial policy.
- It should be able to identify and monitor collusion, cooperation or alliances between independent firms in various institutional forms (like cartels and trade associations) to restrict, suppress or modify competition. Collusion may take a number of tacit or explicit forms and may involve output restriction, price fixation, distribution controls or market sharing. In many cases, collusions are designed to prevent the entry of potential firms.
- If should be capable of monitoring and preventing anti-competitive agreements between business organisations.
- It should be able to identify restrictive and unfair trade practices and provide a continuous mechanism to prevent the same. Box 23.2 provides some main anti-competitive and unfair trade practices that a competition policy must deal with.
- It must ensure that competition leads to better productivity and efficiency and wider choice to the consumer.
- The policy should apply to all the major segments of the economy including agriculture, agribusiness, manufacturing, infrastructure, utilities and services.
- It must provide suitable defenses and protection measures to the marginal, vulnerable or weaker enterprises in the small-scale
- sector, which have national importance.
- The policy must accommodate International fact and influence in the national interest.
- The policy should be able to create a level playing field for various categories of enterprises and must target an optimum degree of competition, which is in the best of interest of the economy from the point of view of growth, equity and social justice.

Policy Effectiveness and the Concept of Regulatory Capture

As already pointed out, the competition policy must be flexible and adaptable to changing circumstances. Quant'tative restrictions and limits often erode the basic spirit of the policy and Sometimes prove counter-product ,e. For example, a ceiling of 30 per cent on the market share as pan of definition of a dominant firm may deny it scale economies that may be necessary for it to be competitive in the global market. An investment ceiling, similarly, may discourage the flow of foreign direct investment. Limits on the size of

employment to prevent a firm from obtaining a dominant position may compel firms to prefer capital-intensive technology leading to greater industrial unemployment. The rules of the competition game have to be set prudentially, lest the policy may itself start generating anti-competitive effects.

A feeble policy implemented with loopholes and indifference can create a worse situation magnifying the negative externalities of competition. A situation called 'regulatory capture' arises when business organisations are successful in corrupting the regulators and obtain the official Stamp of sanction on their anti-competitive and anti-consumer practices. The regulatory watchdog must be effective and professionally managed with legislative support. It has to be kept free from political interference and the competition legislation and policy must be founded on logical, clear and realistic concepts and procedures.

Some Anti-Competitive and Anti-Consumer Practices that a Competition Policy Must deal with There has been great proliferation of anti-competitive and anti-consumer practices in the wake of growing competition all over the world. A large number of such practices are difficult to identify or simply go unnoticed due to the absence of complaints or indifference of regulatory agencies. Detection of such practices requires consumer awareness, alertness of regulatory authorities and reliable market intelligence and database system. Different countries have different provisions to deal with such practices, the main types of which are the following:

- **Predatory Pricing:** Setting pricing at very low levels with the objective of weakening or eliminating competition or to keep out new entrants. The prices are later raised after the above objectives are achieved. It helps in establishing and maintaining the monopoly power and exploiting the consumer.
- **Full-Line Forcing:** The exercise of market power to force a buyer to take a full range of products rther than only one or few actually demanded. Its another variant is tie-in sales in which the sale of product carries with it a condition that some other product has to be purchased at the same time.
- **Vertical Restraints:** Restrictions or conditions imposed on the seller or buyer of an item (for example, the condition of buying a telephone handset from the same agency which provides the telephone connection).
- **Resale Price Maintance:** The practice in which a manufacturer requires its distributors to resell the product at certain prices or at not less than minimum prices which he has set for his products. In UK, Resale Prices Act was passed in 196) whereby the practice was stated to be against public interest.
- **Exclusive Dealing:** The restriction by a manufacturer on the distributors that they will not deal in the products of other manufacturers producing the same product or its substitutes.
- **Collective Price Fixation:** An agreement between sellers or buyers collectively to sell or buy products at pre-determined prices.
- **Market Sharing:** An agreement between independent sellers to divide the total market and allocate different segments between themselves to prevent competition and charge higher prices or fix arbitrary terms of sale.
- **Manufacturing Process Control:** An agreement between producers not to employ a particular technology or machinery so as to gain a competitive edge over others. This prevents adoption of better or new technology.

- **Association Boycott:** An agreement between the members of a business association providing expulsion or boycott of a member whose actions am in contravention to the purposes with which the association is formed.
- **Rice Control Arrangement:** An agreement between independent firms through an institutional arrangement like a trade association or otherwise to sell products at predetermined prices so as to eliminate price competition.
- **Limiting Technical Development:** Measures undertaken by a 6rm to prevent technological development or capital investment by other firms so that competition is circumscribed.
- **Deceptive Practices:** Deceptive, unfair or veiled actions by a firm which have the effect of preventing or reducing competition in production, supply or distribution of a product.
- **Output Restriction:** Restricting or controlling the production or flow of goods and services causing unreasonably high pikes.
- **Veiled Quality Deterioration:** Unreasonably lowering the quality of product in a veiled manner and selling the inferior product at same or higher prices.
- **False Representation:** Misleading actions, giving wrong impressions about product price, quality, discount, free gifts, renovated second hand goods passed as new, quality certification or sponsorship or usefulness of the product.

Factors Contributing to competitive Environment in India

Since the beginning of economic reforms in 1991, there has been a gradual build up of the competitive environment in the country. The degree of competition in terms of various parameters, has increased in the various sectors of the economy including industry, finance markets, infrastructure and a large number of service areas. Competition has increased both in terms of the number of competing entities in most of the sectors as well as the role of the market mechanism. There has been a general trend towards deregulation and withdrawal of the government from the economic field. However, movement in this direction is slow and gradual but the sign are definite.

Public Sector Disinvestment and Privatisation

Since the begining of the reform process in 1991, there has been an almost consistent programme of privatisation through public sector disinvestment. During 1991-2003, the sum total of the annual disinvestment targets was Rs. 78,300 crore of which, however, about 38 per cent was realised. Privatisation, as a matter of policy, is expected to spur competition leading to higher efciency and productivity. In the early nineties, privatisation progrmme involved sale of minority stakes in some public sector undertakings. Towards the late nineties, the focus shifted towards strategic sales. In the year 2002-03, there was 100 per cent disinvestments in the ten hotels of India Tourism Development Corporation an one hotel of Hotel Corporation of India. Equity disinvestment was 26 per cent each in Hindustan Zinc Ltd., IPCL and Modern Food Industries (India) Ltd. The main objective of the privatisation policy was to unleash the productive potential of the public sector, preventing at the same time, energence of private monopolies. The disinvestments programme is discussed.

Opening up of New Sectors to Private Enterprise

Another factor adding directly to competition has been the opening up of sectors earlier reserved for the public sector to private enterprise. During the last two decades, the number of Industries Exclusively reserved for the public sector has been gradually declining. In the new industrial policy of 1991, only eight industries were kept reserved for public sector operation and the number has now come down to only four viz. defense

products energy, railway transport and specified minerals-the rest being open to the private or cooperative sectors. This de-reservation has led to increase in the number of firms in various segments where earlier only few public enterprises operated.

Delicensing

Competitive environment in the country has significantly increased with delicensing of a large number of industries. Delicensing reduces entry barriers, encourages the flow of private investment and encourages competition. The new Industrial Policy of 1991 abolished the requirement of industrial licensing for all industries except 18 specified industries in which case compulsory licensing was retained due to their strategic, social and environment importance. The exempted list was reduced to nine in 1997-98 and further to five later. Earlier, license was mandatory for establish in a new industrial unit, expanding the capacity of an existing unit, changing the location of an existing unit or continuation of business units in certain cases. Under the present policy, freedom from licensing is available for substantial expansion of existing units. Further, industrial units enjoy broad-banding facility, which gives product flexibility to producers Greater freeddom of entry into a large number of indust5ial segments has substantially brightened up the competitive environment in the country.

What is board banding?

Broad banding refers to increase in the number of items that a licenced industry can produce within the licensed range of products. This facility is provided by specifying a broad or genetic product group rather than specific products within a general category. An industrial license for the majufacture of motorcycles, when broad-banded as two-wheelers, would include scooters and mopeds as well. Similarly, an industrial license for chemicals is much wider than license for manufacture of pharmaeuticals. With broad banding, new firms can enter the industry and existing firms can expand their product lines and become more competitive through economies of scope of (or diverstification economies).

De-reservation of SSI Items

During the period 1996-2003, about 100 items earlier reserved for exclusive production by the small scale industries were de-preserved allowed for production by medium and large industrial units as well. Some of the major items in the de-reserved list are garments, leather goods, sports goods and toys, Not only this, about 600 items on the list of reserved products are new freely importable. Thesemeasures have increased competition not only between the domestic and foreign firms but also between small and large firms within the domestic economy. The trend towards de-reservation started on a significant note following the recommendations of the Abid Hussain committee Report (1997), which, among other measures, recommended abolition of reservation The Second Census of Small Scale Industries revealed that 233 items, reserved for the SSI sector, were either not produced at all or were produced in insignificant volumes. Further, as many as 90 products in the SSI reservation segment were produced by only one firm each. The de-reservation of a growing number of items has created conditions for, greater competition in the economy as more medium and large firms can take up the production of de-reserved areas.

Liberalisation of Foreign Direct Investment (FDI)

Though the inflow of foreign direct investment in the country has been weak in spire of economic reforms and liberalisation of FDI policy, still the sustained rise in FDI brought in by the MNCs has added to the competitive environment.. There is, in fact, a two-way relationship between FDI and competition FDI contributes to competition and existence of competitive conditions indues FDI inflow and MNC entry. During 1991-2002, about 16,000 FDI proposals, involving FDI amount only of Rs. 2,84,812 crore were approved. Against this approved amount, the actual inflow was Rs. 1.29,838 crore. In addition, about 7500 foreign technology agreements were approved as a result of which a number of firms with foreign

technical collaboration with a wide range of industrial segments have been established adding to competition. The favourite sectors of FDI and foreign technical collaborations have been energy (including power and petroleum refining) tlecommunications (including basic telephone services, cellular mobile

and radio paging), electrical equipment (includingcomputer software and electronics, transportation, chemicals (excluding) fertilizers), food processing industries and various services, the first three segments accounting for about one-half of the total FDI inflow during 1991-2032. These flows are more fully discussed.

Infrastructure Deregulation and Facilitation

Infrastructure deregulation has produced a twin effect from the paint of view of competition:

- Increase in the number of firms engaged in infrastructure projects and related services; and
- Corportisation of a public utilities and their functioning along modem corporate lines.

The government is in the process of setting up an equity fund of Rs. 1000 crore to help equity investment in infrastructure projects. Industrial Development Finance Corporation (IDFC) has been entrusted with the responsibility of developing an institutional mechanism to coordinate debt financing by banks and All India financial institutions providing long-term finance in case of projects involving investment of Rs.. 250 crore and above.

In the power sector, by the year 2002, twenty two stares had either sec up or were in the process of setting up State Electricity Regulatory Commission,- and nine State Electricity Boards had been corporatised. In telecommunication, competition has been introduced in almost all the service segments. The international long distance business has been opened up for unrestricted entry of new firms. The monopoly of VSNL over international long distance has ended In its review of the competitive conditions in the cellular market, Telecom Regulatory Authority of India (TRAI) has recommended deregulation of the cellular tariff. The ambitious National Highway Development Project (NHDP) involving strengthening or-multiple laning of about 13,000 km lengths of highways banks on private developers with market driven allocative mechanism and compensation systems.

In order to encourage private investment in major sea ports, bidding procedures and documentation and bid selection criteria have been streamlined and made transparent. Under the scheme of private sector privatisation for port development, more than 40 projects involving port capacity addition of about 160 million tonnes per annum and private investment of about Rs. 10,800 crore arc at various stages of evaluation and implementation.

In the civil aviation sector, there are two scheduled private airlines and 40 non-scheduled operators providing air taxi and air transport services. The annual number of passengers availing air services of the private operators increased from just 15,000 in 1990 to about 6.7 million in 2001. At present, private operators account for more than one-half of the total air traffic of passengers. Disinvestment of Air India and Indian Airlines is already on the cards. In urban infrastructure, there is provision of 100 per cent FDI but there has been hardly any inflow of foreign investment in this segment.

Import Competition

During the reform years, competition has increased not only between the domestic enterprises hut also between domestic and foreign firms via imports.. With the gradual progress towards trade liberalisation under the WTO regime, the level of imports in a number of product areas has increased consistently, changing the competitive scenario in the country. The country's imports, which were % 24.1 billion in 1990-91, stood at $44.9 billion in 200102. Most of the Imparts are industrial goods so that import, competition is more intense in capita goods and raw materials. Of late, import competition has increased in electronic goods and small valued products, which are of concern to small-scale industries. Some of the major products in which import competition has substantially increased are food and allied products, chemicals, iron and steel, medicinal

products, computer software (physical form) and professional equipment (Table 23.1). The rise in imports in recent years has been mainly due to falling import tariffs, removal of quantitative restrictions and overall liberalisation of the import regime. The mean collection rate (defined as the ratio of realised import revenue including additional custom duty, countervailing duty and special additional duty) to the value of imports, which was 47 per cent in 1990-91 consistently declined to 16per cent in 2001-02. A large number of items, which were on the negative import lists earlier, are now freely importable. Trends in India's foreign trade are more fully discussed.

Table 5 : Composition of India's Import Basket 2001-02

Sr. No.	Product	%Share in total imports
1.	POL'	27.2
2.	Capital goods	11.4
3.	Pearls, precious stones	9.0
4.	Gold and silver	8.8
5.	Electronic goods	7.4
6.	Chemicals	5.4
7.	Professional equipment and optical goods	2.0
8.	Others	28.8
	All Products 100	

Note: Petroleum, oil and lubricants.

Source: Govt. of India, Economic Survey, 2002-03, Table 6.8, p. 108

High-Growth Industry Segments

A competitive environment is characterised by a large number of firms in each product category. The smaller the number of firms, the narrower is the competition. Competition in a market in which there are few firms (called non-collusive oligopoly) is generally more intense as compared to competition between a large numbers of firms. A strategic action taken by one firm induces matching competitive from the rival firms, which are always alert to maintain or even increase their markets share. Then the are market situation in which a few firms dominate market with substantial market shares and a large number of smaller firms together claim market share. The firms with high monopoly power are in close competition with each other while others operate within narrow local or regional markers or are content in their respective niche areas. These are hybrid market forms, which depict the characteristics of both oligopoly and monopolistic competition.

The decade of 1990s witnessed intensification of competition in a large number consumer, and industrial products areas. The degree of competition has been varying between different industrial segments as well as within segments over the years In the competitive process, a large number of firms entered, made exit or underwent mergers or acquisitions. The growth has been relatively faster in such products as automobiles, washing machines, air-conditioners, communication products (like mobile handsets), TVs, computers and peripherals. In the In the intermediate products category, polyester filament yam and packaging products have registered imperative growth. In terms of growth of domestic consumption, most of the top 20 items were in the category of consumer durables. To a good extent, in reflects the rise of consumerism in the wake of growing competition, which has brought forth a large number of new and innovative consumer products

generating consumer interest. Table 23.2 lists the industries that have experienced annual growth race of 20 per cent or above during 1991-2001.

Table 6 : List of industries which have experienced annual growth rate of 20% or above in increased competition during the reform years 1991-2001

Industry	Growth rate	Industry	Growth Rate
Acetic acid	20.8	Energy metals	24.4
Printing ink	25.8	TV picture tubes	20.3
PVC	24.7	Medical equipments	20.4
Synthetic resins	21.0	Process control equipments	22.0
Polyester films	25.3	Computers and peripherals	27.9
Packaging goods	27.7	Passenger cars	23.1
Plastic tanks, containers etc.	20.3	Multi utility vehicles	24.7
Rubber contraceptives	20.5	Motor cycles	23.4
Cycle tubes	21.0	Three wheelers	24.6
Floor, wall tiles	20.9	Piston rings	22.6
Ophthalmic glass and contact lenses	29.6	Gaskets	20.7
Sponge iron	21.1	Carburetors	24.7
Copper and products	20.0	Steering gear	22.9
Air-conditioning equipment	22.9	Shock absorbers	22.7
Washing machines	112.7	Brake rings	20.0

Source: Extracted from CMEI (2002), Industry Market size and Shares, August pp. 3-6

There are however an equally large number of industries where the impact of better competitive environment on growth is not realised. This can be related to a number of factors such as failure to attain cost competitiveness, lack of product innovation, technological stagnation or stickiness of demand. Such factors vary widely across industries.

India's Present Competition Policy

India's present competition policy is contained in the latest Competition Act 2002. The basic objectives of the Act are:

- to prevent practices having adverse effect on competition;
- to promote and sustain competition in markets;
- to protect the interests of consumers; and
- to ensure freedom of trade carried on by other participants in one market.

The Act covers the whole of India except the state of Jammu and Kashmir and replaces the earlier MRTP Act. The Act prohibits anti-competitive agreements or arrangements as mentioned in Box 23.2. It further

prohibits the abuse of dominant position of a firm which enables it to operate independently of competitive forces prevailing in the relevant market or affects its competitors, consumers or the relevant market in its favour. The Act seeks to regulate takeovers, mergers and amalgamations between firms which have the effect of reducing competition.

Competition Commission of India (CCI) is established under the Act which he entrusted with the task of eliminating practices having adverse impact on competition, protecting the interests of consumers and ensuring freedom of trade carried on by other participant. Under the Act, while determining the adverse effect or competition, the following six factors or criteria are taken into account:

- Creation of barriers to new entrants is the market;
- Driving existing competitors out of the market;
- Foreclosure of competition by hindering entry into the market;
- Accrual of benefits to consumers;
- Improvement in production or distribution of goods and services; and
- Promotion of technical, scientific or economic development by means of production or distribution of goods and services.

The commission further has the responsibility of providing advice to the government on matters relating to competition policy. It is obliged to take suitable measures for the promotion of competition advocacy, creating awareness and imparting training or competition issues.

Industries (Development and Regulation) Act

The Industries (Development and Regulation) Act, 1951, which came into force on and from May 8, 19[illegible] is the most important law designed to implement the Industiral Policy of the government of India, by empowering the Central Government to take necessary measure for the development and regulation of the industrial sector.

Objective

The main objective of the IDRA is to provide the Central Government with the means to implement their industrial policy. Thus, the principal objective of the Act is to empower the Central Government to

(i) take necessary steps for the development of industries;

(ii) regulate the allocation of investment and the pattern and direction of industrial development: and

(iii) control the activities, performance, conduct and results of industrial undertakings in the public interest.

Salient Features of the Act

(i) The IDRA Provides for the establishment of a Central Advisory Council for the purpose of advising the Central Government on matters concerning the development and regulation of scheduled industries and a Development Council for purposes such as recommending measures for improving the performance of industries and solving specific problems.

(ii) It empowers the government to regulate the establishment of industrial undertakings and certain activities of industrial undertakings by means of licensing.

(iii) The government can, under the Act, investigate the affairs and conduct of industrial undertakings and take necessary measures for remedying the problems.

(iv) The Act empowers the Government to regulate the production, quality, price and distribution of commodities pertaining to the scheduled industries.

(v) The government may exercise control over or take over the management of industrial undertakings to ensure their proper management, in the public interest.

These aspects are dealt with in some detail in the following pages.

Coverage or the Act

The provisions of the Industries (Development and Regulation) Act, 1951, which extends to the whole of India, apply to all industrial undertakings manufacturing any of the items included in the scheduled industries. The scheduled industries are those industries which are included in the Firs Schedule to the Act. The First Schedule includes 38 categories/groups of industries. These are very important industries whose locations and development are to be regulated by the Central Government.

The Act applies only to those "industrial undertakings" which confirm to the definition of the Act. The Act defines an industrial undertaking as any undertaking pertaining to a scheduled industry carried on in one or more factories by any person or authority including government.

For the purpose of this Act, a factory means any premises, including the Precincts thereof, in any part of which a manufacturing process is being carried on or is ordinarily so carried on-

(i) with the aid of power, provided that fifty or more workers are working or were working thereon on any day of the preceding twelve months; or

(ii) without the aid of power, provided that one hundred or more workers are working or were working thereon on any day of the preceding twelve months and provided further that in no part of such premises any manufacturing process is being carried on with the aid of power.

Exemptions from the Act

Section 29 B of the Act empowers the government to exempt any industrial undertaking or class of industrial undertakings or any scheduled industry or class of scheduled industries from the application of any part or the whole of the Act on certain considerations like the smallness of the size of Investment of number workers employed, stage and development of the industry Concerned etc. Accordingly, a number of industries have been exempted from The licensing provisions or the Act and within me industries covered by licensing. projects involving investment upto certain specified limits are exempted from licensing, Subject to certain conditions.

Central Advisory Council and Development Councils

Section 5 of the Act provides that the Central Government may establish a Central Advisory Council for the purpose of advising it on matters concerning the development and regulation of the Scheduled industries. The Advisory Council shall consist of a Chairman and other members, not exceeding thirty in number, all of whom shall be appointed by the Central Government from among persons who are in its opinion capable of representing the interests of the owners, employees, consumers, primary suppliers, etc., of the industrial undertakings in the Scheduled industries.

The Act provides that the Central Government may establish for any scheduled industry or group of Scheduled industries a Development Council which shall consist of members Who, in me opinion of lhe Central Government, are capable of representing the interests of owners, employees and consumers of the industrial undertakings in the Scheduled industry or group of scheduled industries and persons having special knowledge of matters relating to the technical or other aspects of the scheduled industry or group of scheduled industries.

A development council may perform any of the following functions which may be assigned to it by the Central Government:

(i) Recommending targets for production, coordinating production programmes and reviewing progress from time to time;

(ii) Suggesting norms of efficiency with a view lo eliminating waste obtaining maximum production, improving quantity and reducing costs;

(iii) Recommending measures for Securing the fullest utilisation of the installed capacity and for improving the working of the industry, particularly of the less efficient units;

(iv) Promoting arrangements for better marketing and helping in the devising of a system of distribution and sale of the produce of the industry which would be Satisfactory to the consumer;

(v) Promoting standardisation of products;

(vi) Assisting in the distribution of controlled materials and promoting for obtaining materials for the industry;

(vii) Promoting or undertaking inquiry as to materials and equipment and as to methods of production, management and labour utilization, including the discovery and development of new materials, equipment and methods of improvements in those already in use; the assessment of the different alternatives and the conduct of experimental extablishment and of tests on a commercial scale.

(viii) Promoting that raining of persons engaged or proposing engagement in the industry and their education in technical or artistic subjects relevant thereto;

(ix) Promoting the re-training in alternative occupations of personnel engaged in retrenched from the industry;

(x) Promoting undertaking scientific and industrial Search into matters affecting industrial psychology and research into matters relating to the production and the consumption or use of the goods and services supplied by the industry;

(xi) Promoting improvements and standardisation of accounting and costing methods and practices

(xii) Promoting or undertaking the collection and formulation of statistics:

(xiii) Investigation possibilities decentralizing stages and processes of production with a view to encouraging the growth of allied small-scale and cottage industries;

(xiv) Promoting the adoption of measures for increasing the productivity of labour. including measures for ensuring safer and better working conditions and the provision and Improvement of incentives for workers;

(xv) Advising on aany matters relating to the industry (other than remuneration and conditions of employment) on which the Central Government may request the Development Council to advise it and undertaking inquiries for the purpose of enabling the Development Council to advise; and

(xvi) Undertakings arrangements for making available to the industry information obtained and for advising on matters with which the Development Council is concerned in the exercise of any of their functions

A development council shall also perform such other functions as it may be require to perform under any other provision of this Act.

Regulation of Scheduled Industries

(i) **Registration of Undertakings:** Act provided that all the industrial undertakings that existed, including the industrial undertakings of which the government was the owner in the scheduled industries which

were listed in the First Schedule to the Act should be registered with the governments within the Prescribed Period and issued with a certificate of registration containing the productive capacity of the undertaking and such other details as prescribed.

(ii) **Industrial Licensing:** After the commencement of the Act, no person or authority (other than the Central Government and other governments with the previous permission of the Central Government) can establish any news industrial undertakings except under, and in accordance with, a licence issued in that behalf by the Central Government.

Power to Investigate, Exercise Control, Take Over Management, etc.

The Act empowers the Central Government to make or cause to be made a full and complete investigation where it is of the opinion that in respect of any scheduled industry or undertaking, there has been, or is likely to be, an unjustifiable or a substantial fall in the output or a marked deterioration in the quality of the output or an unjustifiable rise in the price of the output.

If, after any such investigation, the Central Government is satisfied that action under Section 16 is desirable, it may issue such directions to the industrial undertaking or undertakings concerned as may be appropriate in the circumstances for all or any of the following purposes, namely-

(a) Regulating the production of any article or class of articles by the industrial undertaking or undertakings and fixing the standards of production;

(b) Requiring the industrial undertaking to take such Steps as the Central Government mar consider necessary to stimulate the development of he industry to which the undertaking or undertakings relate;

(c) Prohibiting the industrial undertaking or undertakings from resorting to any act or practice which might reduce its or their production capacity or economic value;

(d) Controlling the prices, or regulating the distribution, of any article or class of articles which have been subject matter of investigation.

The Act also provides that any directive of the above nature may be issued By the Cenral Government t any time when a case relating to any industry or industrial undertaking or undertakings is under investigation. Such a directive shall have effect until it is amended or revoked by the Central Government.

If the industrial undertaking to which any of the above-mentioned Directives have been issued has failed to comply with such directives, the Central Government is empowered to authorize any person or body of persons To take over the management of the whole or any part of the undertakings or to Exercise in respect of the whole or any part of the undertakings such functions Of control as may be specified in the order,

This Act also provides that a full and complete investigation may be made if the Central Government is of the opinion that any industrial undertaking is managed in a manner highly detrimental to the scheduled industry concerned or to the public interest. If the Central Government is satisfied as a result of the investigation that the industrial undertaking is managed in a manner highly detrimental to die scheduled industry concerned or to the public interest, it may authorize any person to take over-the management or exercise any control is may be specified.

Any such notified order shall have effect for such period not exceeding five years as may be specified in the order. However, the Act also provides that, if the Central Government is of the opinion that it is expedient in the public interest that any such notified order should continue to have effect after the expiry of the period of five years aforesaid, it may, from time to time, issue a directive for such continuance for such period, not exceeding two years at a time, as may be specified in the directive, provided that the total period of such continuance (after the expiry of the said period of five years) does not exceed twelve years.

The Central Government may, by a notified order, cancel the order of taking over of the management or exercise control if at any time it appears to the government, on the application of the owner of the industrial undertaking or otherwise, that the purpose of the order has been fulfilled or that for any other reason it is not necessary that the order should remain in force. On the cancellation of the order, the management or the control, as the case may be, of the industrial undertaking shall vest in the owner of the undertaking.

The IDRA further provides that the Central Government may authorize any person to take over the management or exercise the functions of control of any undertaking if it is satisfied, in relation to the industrial undertaking, that:

(a) The persons in charge of such industrial undertaking have, by reckless investments or creation of encumbrances on the assets of the industrial undertaking, or by diversion of funds, brought about a situation which is likely to affect the production of articles manufactured or produced in the industrial undertaking and that immediate action is necessary to prevent such a situation; or

(b) It has been closed for a period of not less than three months (whether by reason of the voluntary winding up of the company owning the industrial undertaking or for any other reason) and such closure is prejudicial to the concerned scheduled industry and that the financial condition of the company owning the industrial undertaking and the condition of the plant and machinery of such undertaking are such that it is possible to restart the undertaking and such restarting is necessary in the interest of the general public.

The Act also empowers the government to take over the management or exercise the functions of control, with the permission of the High Court, of any undertaking owned by a company ds liquidation, if it is satisfied that the running or restating of the industrial undertaking is necessary in the public interest.

Power to Provide Relief to Certain Industrial Undertakings

We have seen above that, in certain cases, the Central Government may take over the management or exercise the functions of control of the whole or part of an industrial undertaking. The ID & R Act empowers the, Central Government to provide certain relief to an industrial undertaking or any pan thereof, the management or control of which has been taken over by the government. In the interest of the general public, with a view to preventing a fall in the volume of production of any scheduled industry, it may, by a notified order, declare that-

(a) All or any of the enactments specified in the Third Schedule shall not apply or shall apply with such adaptations, to such industrial undertaking, as may be specified in the notified order [The Third Schedule to the Act includes : (i) The Industrial Employment (Standing Orders) Act, 1946; (ii) The Industrial Disputes Act, 1947; and (iii) The Minimum Wages Act, 1948).];

(b) The operation of all or any of the contracts, assurances of property agreements, settlements, awards, standing orders or other instruments in force (to which such industrial undertaking or the company owning such undertaking i, a Party or which may be applicable to such industrial undertaking, company immediately before the date of issue Of such notified order shall remain suspended or that all or any of the rights, privileges, obligations and liabilities accruing or arising thereunder before the said date, shall remain suspended or shall been forceable with such adaptations and in such manner as may be Specified in the, notified order.

The notified order shall remain in force, in the first instance, for a period of one year, but the duration of such order may be extended from lime to time by a further notified order by a period not exceeding one year at a time. But no such order shall remain in force after the expiry of the period for which the management of the industrial undertaking was taken over, or .for more than eight years in the aggregate from the date of the issue of the first notified order, whichever is earlier.

Sale or Reconstruction

Where the management of control of an industrial undertaking has been. taken over by the Central Government, it may, at any time during the continuance of such management, control, call for a report from the authorised person on the affairs and working of the industrial undertaking, and in submitting the report the authorised person shall take into account the inventory and the lists of members and creditors.

On receipt of such a report:

(a) The industrial undertaking may be sold ass running concern if the government considers it necessary or expedient in the interest of the General public so to do; or

(b) Reconstruct the company owning the industrial undertaking if the government is satisfied that it is necessary so to do in the interest of the general public or the shareholders, or to secure proper management of the company owning the industrial undertaking.

Price and Distribution Control

For securing an equirable distribution and availability at a fair price of any article ex class of articles relating 10 any scheduled industry, the Central Government may, under Section 18-G, by a notified order, provide for regulating the supply and distribution thereof and trade and commerce therein, notwithstanding anything contained in any other provision of this Act.

A notified order made in this respect may provide for -

(a) Controlling the price at which any such article, or class of articles thereof, may be bought or sold;

(b) Regulating by licences, permits, or otherwise the distribution, transport, disposal, acquisition, possession, use or consumption of any such article or class thereof;

(c) Prohibiting the withholding from sale of any such article or class thereof ordinarily kept for sate;

(d) Requiring any person manufacturing, producing or holding in stock such article or class of articles for sell the whole or a part of the articles to such person or class of persons and in such circumstances may be specified in the orders;

(i) where the price can, consistently with the controlled price, if any, be fixed by agreement, the price so agreed upon;

(ii) where no such agreement can be reached, the price calculated with reference to the control price, if any, fixed under this section;

(iii) where neither clause (i) nor clause (ii) applies, the price calculated at the market rate prevailing in the locality at that date;

(e) Regulating or prohibiting any class of commercial or financial transactions relating to such articles or class thereof which, if unregulated, are likely to be detrimental to the public interest,

(f) Requiring persons engaged in the distribution and trade and commerce in any such article or class thereof to exhibit statement of the stock and price of the articles;

(g) Collecting any information or statistics with a view to regulating or prohibiting any of the aforesaid matters; and

(h) Any incidental or supplementary matters, including, in particular, the grant of issue of licence permits or other documents and charging fees thereof.

No order made in exercise of any power conferred by this Section (18-G) shall be called in question in any court.

In this Section (18-G), the expression "article or class of articles" relatable to any scheduled industry includes any article or class of articles imported into India which is of the Same nature or description as the article or class of articles manufactured produced in the scheduled industry.

Powers of Inspection

For the purpose of ascertaining the position of working of any industrial undertakings or for any other purpose mentioned in this Act or the rules made thereunder, any person autorised by the Central Government in this behalf shall have the right to -

(i) enter and inspect any premises;

(ii) order the production of any document, book, register or record in the possession or power of any person having the control of, or employed in connection with, any industrial undertaking, and

(iii) examine any person having the control of, or employed in connection with any industrial undertaking (Sec. 19).

Decision of Central Government Final on Certain Matters

Section 23 of the Act provides that, if for the purpose of this Act, any question arises as to whether-

(i) there has been substantial expansion of an industrial undertaking, or

(ii) an industrial undertaking is producing or manufacturing any new article,

the decision of the Central Government thereon shall be final.

CHAPTER 6

PUBLIC ENTERPRISES IN INDIA

The mixed economy of India is characterised by the co-existence of public, private, joint and cooperative sectors. The pattern of industrial development of the country has been influenced to a very significant extent by the roles given to these sectors by the industrial policy.

Public Sector

The objective of accelerating the pace of economic development and the political ideology which gave the public sector a dominant role in the industrial development of the nation led to rapid growth of the state owned enterprises (SOEs) sector in India.

As the Bureau of Public Enterprises observes, *born as the outcome of the conscious policy of* the government to speed up the industrialisation of the country with a view to give added impetus to economic growth as well as to achieve certain socio-economic goals as enunciated in the Industrial Policy Resolutions of the government, these enterprises came to cover a wide spectrum of activities in basic and strategic industries like steel, coal, minerals and metals, petroleum, heavy engineering, chemicals, fertilizers and pharmaceuticals etc. on the one hand, and consumer goods, trading and marketing activities, transportation services, contracts and consultancy services, tourist services, financial services, development of small industries etc. on the other.1

Objectives

The public enterprises which were promoted as an instrument for implementation of the government's socio-economic policies, had a multitude of objectives set for them, viz.,

- To help in the rapid economic growth and industrialisation of the country and create the *necessary infrastructure for economic development.*
- To earn return on investment and thus generate resources for development.
- To promote redistribution of income and wealth.
- To create employment opportunities.
- To promote balanced regional development.
- To assist the development of small-scale and ancillary industries.
- To promote import substitution, save and earn foreign exchange for the economy.

Growth and Performance of Public Enterprises

There had been a phenomenal growth of the public sector since the commencement of planning. In fact, even before the commencement of planning and the adoption of the goal of the socialistic pattern of society, the public sector was assigned an important role in the industrialisation and economic development of the country. The Industrial Policy Resolution of 1948 made it very clear that the manufacture of arms and ammunition, the production and control of atomic energy, and the

ownership and management of railway transport would be the exclusive monopoly of the Central Government. It was resolved further that in another six industries the state alone would set up new undertakings. These six industries were: coal, iron and steel, aircraft manufacture, ship-building, manufacture of telephone, telegraph and wireless apparatus, excluding radio receiving sets, and mineral oils.

The Industrial Policy Resolution of 1956 enlarged the role of the public sector. It stated "The adoption of the socialist pattern of society as a national objective as well as the need for planned and rapid development require that all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector. Other industries, which are essential and require investment on a scale which only the State, in present circumstances, could provide, have also to be in the public sector. The state has, therefore, to assume direct responsibility for the future development of industries over a wide area."

Schedule A to the Resolution enumerated 17 industries, the future development of which would be the exclusive right of the state. Schedule B to the Industrial Policy Resolution 1956 contained a list of 12 industries which would be progressively state-owned and in which the state would, therefore, generally take the initiative in establishing new units. The Schedules A and B reproduced in the Annexure to the chapter on Industrial Policy.

TABLE 1 : GROWTH OF PUBLIC ENTERPRISES

	Investment (Rs. crores)	Total No. of Enterprises
1. At the commencement of Ist Plan (1-4-1951)	29	5
2. At the commencement of Ist Plan (1-4-1956)	81	21
3. At the commencement of Ist Plan (1-4-1961)	953	48
4. At the commencement of Ist Plan (1-4-1969)	3902	85
5. At the commencement of Ist Plan (1-4-1974)	6237	122
6. At the commencement of Ist Plan (1-4-1980)	18,225	186
7. At the commencement of Ist Plan (1-4-1985)	42,811	221
8. At the commencement of Ist Plan (1-4-1992)	1,18,492	237
9. At the commencement of Ist Plan (1-4-1997)	2,01,500	238
10. As on 31st March, 2000	3,03,400	232

The four decades since the commencement of planning witnessed a substantial growth and expansion of the public sector in India. Investment in industrial undertaking by the Central government increased from Rs.29 crores in five units at the commencement of the First Five Year Plan (1951) to Rs. 1,18,492 crore at the commencement of the Eighth Plan (1992) in 237 units. It further increased to

over two lakh crore (Rs. 201,500 crore) spread over 238 units at the commencement of the Ninth Plan (1997). At the end of 1999-2000, it was about Rs. 3,03,400 crore in 232 units.

There were also about 1100 State level public enterprises (SLPEs) with an estimated investment of about Rs. 50,000 crores.

Major part of the Central public sector investment was in the steel, coal, minerals and metals, power and petroleum sectors.

The wide range of product and activities of Central public sector enterprises included manufacturing of steel, mining of coal and minerals, extraction and refining of crude oil, manufacture of heavy machinery, machine tools, instruments, heavy machine building equipment, heavy electronical equipment for thermal, and hydel stations, building transportation equipment, telecommunication equipment, ships, submarines, fertilizers, drugs and pharmaceuticals, petro-chemicals, cement, textile, and a few consumer items such as bread, newsprint/paper, footwear and contraceptives, operation of air, sea, river and road transport, operation in national and international trade, consultancy, contract and construction services, inland and overseas telecommunication services, hotel and tourists services, etc.

At the beginning of the 1990s, the public sector was dominant in many industries. The PSEs contributed the entire output in the case of petroleum, lignite, copper and primary lead, about 98 of zinc, with over 90 per cent of coal, more than half of steel and aluminium and about one-third of fertilizers. The public sector, thus, came to occupy a commanding position in several critical industries. While setting up of new enterprises was mainly responsible for the fast growth of the public sector, nationalisation of certain industries like coal, copper, insurances, major part of commercial banking sector and a number of sick units has also contributed to this growth.

A significant feature of the public sector investment is the predominance of investment in few crucial sectors, namely, steel, minerals and metals, petroleum, coal and chemicals and fertilizers.

The public sector certainly had a very important role to play in the development of this vast and populous developing economy characterised by dearth of capital, entrepreneurship and technology. However, keeping the private sector completely out of many industries and giving the private sector only a secondary role in many other industries characterised by scope for a substantial privatisation, including dereservation of industries for the public sector, in fact, amounts to an acceptance of this.

The performance of many public enterprises has been far from satisfactory. One can, of course, speak of the contribution of the public sector towards GDP, employment generation, exports etc. the pertinent question. However. is have these contributions been adequate when compared tip the massive investments that have gone into the PSEs and at what level of efficiency these enterprises have been operating? Further, to what extent these enterprises, particularly the monopolies, have been customer friendly?

A large number of PSEs, including several monopolies, have made huge losses. Despite the huge losses incurred by a number of enterprises, the PSEs as a whole could make profits mainly because of the enormous profits made by several public sector monopolies.

Several of the loss making PSEs has been either in non-priority sectors or in sectors where the private sector has proved to be more efficient. A number of losses making units are sick units.

A variety of factors have been identified for the unsatisfactory performance of a large number of public enterprises. While the project formulation has improved over the years, huge cost and time over-runs continued to take place in project implementation. This was on account of problems. Further, the locational and investment decisions in some sectors and projects are observed to have adversely affected performance. It has been noticed that inappropriate location, irrational product-mix and imposed marketing arrangements critically affected the performance of some projects. In the fertiliser sector, choice of technology having been tied to availability of foreign financing had adversely affected their operations. On the other hand, in power sector, excessive investment in generation

capacities with incommensurate attention to transmission networks had created serious imbalance. Uneconomical pricing/tariff rates signifying large cross sub sides reduced the internal resources generation in this sector. This had direct implications for reinvestment on the one hand, and [illegible] demand for power, on the other. These also contributed, among other things, to the heavy losses incurred by most of the State Electricity Boards, which continuously failed to realise the three per cent statutory rate of return on assets.

A number of other problems including allocation of resources, delays in the filling up of top level posts, tight regulation and procedures for investment and restrictions on functional autonomy of the enterprises (e.g., in respect of labour and wage policy), etc. have for long been noticed as serious constraints on PSE operational efficiency.

The public sector is generally criticised for inadequate generation of internal resources. The Department of Public Enterprises points out that generation of internal resources by public enterprises is constrained by the following factors.

1. Public Sector Enterprises were set up not only for commercial consideration but also for factors such as generation of employment, promoting balanced regional development, etc.
2. Low return on investment on account of price constraints imposed on certain infrastructural goods and services of public enterprises.
3. A number of sick units in the private sector facing closure had to be taken over by the Government and these units form a sizeable part of the Central Public Sector.
4. Number of industries promoted in the public sector with long gestation period.
5. The impact of escalation in the prices of various inputs and periodical wage revision

The New Public Sector Policy

After the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems have been observed in the insufficient growth in productivity, poor project management, over-manning, and lack of continuous technological upgradation and inadequate attention to R&D and human resource development. The low rate of return on capital invested has inhibited the ability of the public enterprises to regenerate themselves in terms of new investments as well as in new technology development. This resulted in many of the public enterprises becoming a burden rather than an asset to the Government.

It was, therefore, decided to redefine the role of the public sector, in tandem with the economic liberalisation. According to the industrial policy announced on 24-7-1991, the following have been set as the priority areas for growth of public enterprises.

1. Essential infrastructure goods and services.
2. Exploration and exploitation of oil and mineral resources.
3. Technology development and building of manufacturing capabilities in areas which are crucial in the long-term development of the economy where private sector investment is inadequate.
4. Manufacture of products where strategic considerations predominate such as defence equipment.

Accordingly the number of industries reserved for the public sector was pruned to 8. These 8 industries were: (i) Arms and ammunition and allied items of defence equipment, defence aircraft and warships. (ii) Atomic energy. (iii) Coal and lignite. (iv) Mineral oils. (v) Mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond. (vi) Mining of copper, lead, zinc, tin, molybdenum, wolfram. (vii) Minerals specified in the schedule to the Atomic Energy (control of production and use) Order, 1958. (viii) Railway transport.

The list has been further pruned subsequently and now only atomic energy and railway transport are reserved for the public sector. In May 2001, the sensitive defence production, which was

hitherto reserved for the public sector, was thrown open to the private sector. Foreign investment up to 26 per cent has also been allowed in this sector.

The new industrial policy also indicated that the public sector would withdraw from the following cases:

1. Industries based on low technology.
2. Small-scale and non-strategic areas.
3. Inefficient and unproductive areas.
4. Areas with low or zero social responsibility or public purpose.
5. Areas where private sector has developed sufficient enterprise and resources.

The main elements of the current Government Policy towards Public Sector Under-takings (PSUs) are:

- Bringing down Government equity in all non-strategic PSUs to 26 per cent or lower, if necessary.
- Restructure and revive potentially viable PSUs.
- Close down PSUs, which cannot be revived.
- Fully protect the interest of workers

In order to give thrust to the process of disinvestment in PSUs, a new Department of Disinvestment was set up. The Department is responsible for all matters related to disinvestment of Central Government equity in Central Public Sector Undertakings, implementation of disinvestment decisions and implementation of the erstwhile Disinvestment Commission.

The new Policy also made it clear that the Government will ensure that the public sector is run on business lines as envisaged by in the Industrial Policy Resolution of 1956. It was also decided to close down unviable sick public undertakings.

The new public sector policy marks a much-needed change for accelerating the pace of development by better utilisation of the national resources (including entrepreneurial resources) and for increasing competition and efficiency.

The Industrial Policy Statement of July 1991 observed that in the 1950s and 1960s, the *principal instruments for controlling commanding heights of the economy was investment in key industries. Today, the State has other instruments of intervention, particularly fiscal and monetary instruments.*

Public Sector Ratnas

The Government in July 1997 unfolded its strategy to grant autonomy to some PSUs on an experimental basis. The objective of the new approach was to select some vanguard PSUs to support them in their drive to become global giants. The Government, after detailed and in-depth inter-ministerial discussions selected nine PSUs for making them truly world class entities and it euphemistically named these as Navaratnas.

These are Bharat Heavy Electricals Ltd. (BHEL), Bharat Petroleum Corporation Ltd. (BPCL), Hindustan Petroleum Corporation Ltd. (HPCL), Indian Oil Corporation Ltd. (IOC), Indian Petrochemicals Corporation Ltd. (IPCL), National Thermal Power Corporation Ltd. (NTPC), Oil and Natural Gas Corporation Ltd. (ONGC), Steel Authority of India Ltd. (SAIL) and Videsh Sanchar Nigam Ltd. (VSNL). Two more enterprises, GAIL and MTNL, were later given the same status. It was decided that these PSEs would have freedom to incur capital expenditure, decide upon joint ventures, set up subsidiaries/offices abroad, enter into technological and strategic alliances, raise funds from capital markets (international and domestic) and enjoy substantial operational and managerial autonomy.

The boards of these PSEs have been broad-based with induction of non-official part-time professional directors. All the measures have been taken with the objective of making the PSEs competitive.

Greater operational, financial and managerial autonomy has ... profit-making enterprises referred to as Mini-Ratnas, for making them ...

ORGANISATION OF PUBLIC ENTERPRISES

Public enterprises in India have been organised in the following forms.

Ministry

For the management of the Indian Railways, there is a full-fledged Ministry of Railways, Government of India. The Ministry of Railways undertakes and manages all ... enterprises connected with the railway transport of the country and have its own ... has to be presented to Parliament and approved by it. The Ministry has a Minister for R... body of management consists of the Railway Board, headed by a Chairman. Besides the ... Board has three members and a Financial Commissioner. All these five persons have ... secretary to the Government of India.

Departmental Undertakings

The study Team on Public Sector Undertakings has mentioned the following as the ... characteristics of Departmental Undertakings[2].

(a) It is financed by annual appropriations from the treasury and ... revenues are paid into the treasury.

(b) It is subject to the budget, accounting and audit controls applicable to ... activities.

(c) Its permanent staff consists of civil servants, and the conditions of recruitment ... are the same as for other civil servants.

(d) It can be sued only by following the procedure prescribed for filing suit ... government.

The Departmental Undertaking is directly subordinate to a Ministry.

The need for secrecy, strategic importance and similar conditions make ... the most suitable form of organisation in certain areas (for defence industry). ... such as the Army Clothing Factory, the Harness and Saddlery Factory, the Gun ... the Ishapore Ordnance Factory under the Ministry of Defence; the Chittaranjan Locomotive ... the Integral Coach Factory under the Ministry of Railways; and the Posts and Telegraphs ... Ministry of Communications are examples of the departmental form of organisation and ...

While the departmental system ensures effective government control, it suffers from ... of disadvantages such as too much governmental and political interference, lack of ... initiative in decision-making, etc.

Government Company

The principal characteristics of the Government Company, as mentioned by ... Public Sector Undertakings, are the following[3].

1. It has most of the features of a private limited company.
2. The whole of the capital stock, or 51 per cent or over of it, is owned by ...
3. The government appoints all the directors or a majority of ... extent to which private capital is participating in the enterprise.
4. It is a body corporate created under a general law, viz., the Companies ...
5. It can sue and be sued, enter into contract, and acquire property in its own name.
6. Unlike the public corporation, it is created by an executive decision ... without Parliament's specific approval having been obtained, and its ...

Association, though conforming to an Act, are drawn up and are revisable by the government.

7. Its funds are obtained from the government and, in some cases from private shareholders, and from revenues derived from the sale of its goods and services.
8. It is generally exempt from the personnel, budget, accounting and audit lawa and procedures applicable to government departments.
9. Its employees, excluding those who are on deputation, are not civil servants.

The Industrial Policy Resolution of 1948 had declared that the "management of state enterprises will, as a rule, be through the medium of public corporations under the statutory control of the Central Government, which will assume such powers as may be necessary to ensure this." But most of the public sector undertakings have been organised as companies.

The company form of organisation for public enterprises had come in for much criticism in the beginning. Since the government; in most cases, was the only shareholder, it was said that the provisions of the Company Law did not have much relevance to a government company. Another objection was that the organisation of public enterprises as companies reduced their accountability and diluted audit control. But this criticism was largely met by writing special provisions into the Companies Act in 1956 with regard to the submission of Annual Reports and Accounts and audit by the Comptroller and Auditor-General.

The Study Team on Public Sector Undertakings has pointed out that the principal defects generally attributed to a government company are the following.[4]

1. It evades the constitutional responsibilities, which a state-owned-enterprise should have, to government and Parliament.
2. The law regulating limited companies become a mere fiction because all or most of the functions normally vested in the shareholders and in the management are reserved to government.
3. A meeting of shareholders in the case of a government company is meaningless, for the declaration of profits and the appointments to the Board are naturally reserved to the government.
4. The extent of autonomy that it provides can be materially affected or altered by the executive agencies of the government.

Mainly relying on the above considerations, most of which had emerged from a U.N. seminar held at Rangoon in 1954 (and later endorsed by another U.N. seminar held at New Delhi in December, 1959), the Estimates Committee recommended[5] that all wholly state-owned public undertakings should generally be in the form of statutory corporations, and the company form should be an exception to be resorted to only:

(1) When the government may have to take over an existing enterprise in an emergency;
(2) Where the state wishes to launch an enterprise in association with private capital; or
(3) Where the government wishes to start an enterprise with a view eventually to transferring it to private management.

The government, however, did not accept this recommendation on the ground that the "company form was advantageous in that it allowed the flexibility and autonomy necessary for the successful operation of commercial enterprises and also provided for parliamentary control over the companies under the special provisions of the Companies Act."[6]

The decision taken by the government in 1961 on the recommendations of the Krishna Menon Committee on the form of organisation reads as follows: "Government consider that the form of management of the undertakings should be determined by the requirements of each case. Accordingly, from the point of view of flexibility of operations, the company form of management would be preferable. In some instances, it would be necessary to form statutory corporations, while in a few

others, for various reasons, it would be desirable to run the undertakings as departmental organisations."[7]

From the characteristics of the government company mentioned above, it is clear that when the whole capital stock is not owned by the government, it is still generally regarded as a government company provided that the government owns not less than 51 per cent of the capital stock. Such companies are also described as "mixed" or "joint" companies. In such concerns, the government usually enjoys a substantial control of the management. Examples of such companies include Ashok Hotel and Hindustan Shipyard Ltd.

However, there were also examples of the management of the government companies being entrusted to private hands. Hindustan Machine Tools Ltd., Hindustan Shipyard Ltd., Hindustan Housing Factory Ltd., and Indian Telephone Industries Ltd., were, in the beginning, given out to foreign private firms for management.

Public Corporation

The important features of the public corporation (also known as statutory corporation) as mentioned by the Study Team on Public Sector Undertakings are given below:[8]

It is owned by the State.

1. A special law defining its objectives, powers and privileges and prescribing the form of management and its relationship with government departments creates it.
2. It is a body corporate and can sue and is sued, enter into contracts and acquire property in its own name.
3. Except for appropriations to provide capital or to cover losses, it is usually independently financed; it obtains funds by borrowing either from the government or, in some cases, from the public and through revenues derived from the sale of goods and services, and has the authority to use and re-use its revenue.
4. It is ordinarily not subject to the budget, accounting and audit laws and procedures applicable to government departments.
5. Excluding the officers taken from government departments on deputation, the employees of public corporations are not civil servants, and are not governed by government regulations in respect of conditions of service.

As the Study Team has pointed out, in most democratic countries, the public corporation has been the common form of organisation for public enterprises. "in the United Kingdom, the USA and Canada, the form of public corporation has been adopted. In Italy, the company form has been retained for concerns brought within the public sector; but it is confined to the sub holding companies and operating units. The two top management institutions that control all the operating units and sub-holding companies are the ENP[9] and IRII[10] and they are statutory corporations. Thus, it is only in India that the government seems to have adopted the method of running companies by directly holding shares in them. In Italy, the state holdings are administered by public corporations, which, in turn, hold shares in a number of companies. In India, the government companies have been subjected to both. While it is sometimes claimed that the advantages of the two systems, state managements and private enterprises, have been combined in government companies in India, many witnesses who appeared before us held the view that government companies had merely succeeded in accumulating the disadvantages of both."[11]

Preferring the public corporation to the company, the Team has pointed out that though "from the government pronouncements on the subject it appears that the company form is conducive to greater autonomy, the reports of the Parliamentary Committees indicate the very opposite."[12] In support it has also quoted the following comments made by the Estimate Committee: "The Committee has noticed that in the relations manner as departments and offices of government, controlled and supervised by the secretariat. The state undertakings have thus become adjuncts to Ministries and are

treated more or less on the same lines as any subordinate organisation of office."[13] The Team, therefore, felt that "the setting up of the public corporation will ensure a measure of real autonomy for the public enterprise."[14]

Holding Company

One of the important recommendations of the Study Team has been that integral public authorities should be created for particular sectors of industry and entrusted with the task of the general development of the respective sectors, including the running of undertakings in those sectors and the setting up of new projects. The Team recommended that, to promote this integration, it was necessary to amalgamate public under-taking in such a manner that one integral corporation functioned in each major area of public enterprise, operating the existing units and setting up new projects in the field of the industry entrusted to the corporation.

According to the Study Team, the setting up of the integral public corporation in the industrial and manufacturing field would result in the following advantages.[15]

1. It will end the fragmentation of the industrial effort in the public sector and promote the integration of the efforts to develop each industry in the public sector.
2. It will reduce the span of government control, for many of the functions that are co-ordinative per se will be taken care of at the level of the integral corporation.
3. It will make government control more effective by confining it to a higher level and concentrating it on the few vital and strategic points that the government should control to discharge its responsibility for the formulation of policy and for ensuring that policy is implemented by the management.
4. It will secure for the management at the operating level greater detachment from direct bureaucratic control and political influence, both of which are inimical to initiative experimentation and vigorous management.
5. It will enable public enterprises to establish otherwise expensive staff organisation in fields like designing and consultancy, cost and management, accounting, industrial engineering, and research.
6. It will lead to better personnel management in public enterprises, and greater uniformity in the terms and conditions of service of the employees.
7. It will enable the corporation to avail of the economies of large-scale operations and to establish common service facilities like training for the particular requirement of the industry and purchase and sales organisations with effectiveness and economy.
8. It will provide much wider prospects to the managerial and technical personnel of public enterprises, increasing the capacity of these enterprises to attract and retain suitable personnel.
9. It will result in a more rational deployment and utilisation of designing and construction engineering personnel and expensive construction equipment.

Suitable Form of Organisation

While each type of organisation has its own advantages and disadvantages, for a particular category of undertakings one form may be more suited than the others. The recommendations of the Study Team on Public Sector Undertakings in this respect are as follows.

1. Industrial and Manufacturing Undertakings: All public undertakings in the industrial and manufacturing field should be entrusted to public corporations, each governing a number of operating units in the same area of industry. It would be advantageous to retain the company form for units in which there is an element of private participation but in such cases, the state owned shares held in the company should be owned not by the government directly but in the name of the public corporation.

However, the departmental form is generally regarded as the one suitable for undertakings that provide the services that affect the totality of the community or the security of the country.

2. Public Utilities and Services: It has been generally recognised that public utilities and services require greater statutory authority for their operations. Their operations also serve the community in general or a primary need of industry. The public corporation form is, therefore, more suitable for undertakings falling in the category of public utilities and services. The statutes of existing corporations in this category should be revised with a view to ensuring that they are in accord with the needs of autonomy and flexibility.

3. Promotional and Developmental Undertakings: The company form is not suitable for promotional and developmental undertakings. The very nature of these undertakings signifies that the accent is on non-commercial objectives, although the operations are sought to be carried on commercial lines and not on departmental lines. The government may re-examine the desirability of continuing these undertakings as government companies.

4. Commercial and Trading Concerns: A common objective of these undertakings is to act as instruments for the social regulation of trade and business in the field of their operation. Since these undertakings operate in competition with their counterparts in the private sector, there is perhaps some justification for retaining the company form of organisation for these undertakings.

PRICING POLICY IN PUBLIC ENTERPRISES

The public sector pricing policy is an issue that has been widely debated. Should the public sector undertakings earn profits? If they should earn profits, what should be the level of the profits? In areas where there are good prospects for making profits, should they exploit the market to the maximum or should there be a limit to profit rates? Should all the undertakings be run on commercial lines, or is it sufficient if the public sector as a whole makes profit?

If the public sector undertakings are not required to make a profit, what should be the pricing policy? Should it be marginal cost pricing, average cost pricing, or no-profit, no-loss pricing? What should be the factors that should determine the choice of any of the above policies?

These are the basic issues in public sector pricing. An understanding of the important theories of public sector pricing would make some of these issues more clear.

Theories of Pricing

Marginal Cost Pricing: Marginal cost pricing refers to the method of setting prices in which price is made equal to the marginal cost of production. The marginal cost pricing implies that the price is set at the point at which the demand curve cuts the marginal cost curve.

The marginal cost pricing theory was first advocated by Professor Harold Hotelling in his article, "The General Welfare in Relation to Problems of Taxation and of Railway and Utility Rates," published in Econometric in 1938. In this article, he argued that, by adopting the marginal cost pricing even if the public utilities ran at a loss, which had to be financed by lumpsum payments by the state, total economic welfare would be increased by such a pricing policy.

When production is subject to the law of decreasing costs (or increasing returns), the marginal cost price is lower than other prices (average cost price, no-profit, no-loss price, etc.). This lower price enables the poor sections of the society to increase their consumption of public utilities. That is why Hotelling argued that marginal cost pricing would improve economic welfare.

When production is subject to the law of decreasing costs, if marginal cost pricing is adopted, the total revenue will obviously be less than the total cost. It has been argued that this deficit in revenue should be made good by taxing the rich. When this is done, the rich pay a part of the cost of the public utilities consumed by the poor. Thus, marginal cost pricing would achieve an income re-distribution in favour of the poor and thereby an enhancement in total economic welfare.

But it should be pointed out here that it is not always possible to cover the revenue gap by progressive taxation. In India, and in many developing countries, there is a limit to the amount that can be raised by means of direct taxes. The situation may necessitate higher commodity taxation, which may turn out to be regressive and/or deficit financing. If commodity taxation and deficit financing cause a rise in prices, it is likely to make the plight of the poorest sections more miserable, for the poorest strata usually do not have the economic capacity to consume even the subsidised public utilities. The marginal cost pricing, therefore, sometimes reduces the total economic welfare even under conditions of decreasing costs.

When production is subject to the law of increasing costs (decreasing returns), the marginal cost price represents at higher price than the average cost price or no-profit, no-loss price. Hence, marginal cost pricing under conditions of increasing costs will reduce the total economic welfare, for this higher price will reduce the poor people's consumption of public utilities.

If marginal cost pricing is adopted when production is subject to the law of increasing costs, the enterprise can generate some surplus.

There are some practical difficulties in marginal cost pricing. "Where there are multiple products or services, the determination of detailed costs of each item may be a very costly and complicated affair." There may, as a result, be large economies of administration if services involving unequal costs are charged at a uniform rate. This is the reason why the post office charges the same price for carrying letters from one street to another or from one corner of the country to another.

"The marginal cost cannot be accurately assessed because the factors are indivisible and the various charges on new factor intakes are not the charges on factor use needed for additional increments of output. Marginal costs would be high at points where capacity gets exhausted and for additional production new capacities have to be created. In such cases, the costs incurred at such points are abnormally high and thus the marginal cost cannot be a basis for price fixation."

"If the price is to equal marginal cost, fluctuations in demand and supply would lead to frequent fluctuations in prices, which is not very desirable".[17]

Average Cost Pricing: Average cost pricing refers to the method of setting prices in which price is equal to the average cost of production. Under average cost pricing, the total revenue equals total cost. Average cost pricing, thus, ensures the absorption of the full cost of production into the price.

When calculating the total cost, it is usual to include normal profit in it. Hence the average cost includes also the normal profit. The average cost price is, therefore, a little higher than the no-profit, no-loss price.

It has been argued that, in the case of the railways, posts and telegraphs, multipurpose projects, etc., the average cost can be more easily calculated than the marginal cost.

The mayor considers the average cost pricing to be fair and just because of the following reasons.[18]

1. Public undertakings are expected primarily to meet needs, that is, to provide an optimum volume of supplies cheaply without seeking any profit.
2. Every purchaser pays the entire cost of the unit or units consumed by him instead of paying only the additional cost of producing these units.
3. Since nobody is required to pay more for the goods he purchases than the amount it actually costs to produce those goods, there is no exploitation.
4. The average cost price is a reliable criterion for investment in many cases.
5. The average cost principle ensures that the entire expenditure of the undertaking is covered and thereby secures the viability and the autonomy of the undertaking.

Under conditions of decreasing costs, the average cost price is higher than the marginal cost price. Hence, the demand for goods or services will be lower if the average cost is the criterion for fi. ing the price. It will, it has been argued, adversely affect the interests of the consumers.

When production is subject to the law of increasing costs, the average cost is lower than the marginal cost, and hence the average cost pricing will benefit the poor.

The INRICE Theory Committee points out the "the recommendation ... that price should be fixed in terms of average unit costs is in practice inapplicable. To take one example, in the transport sector ... no satisfactory method of allocating costs according to their origin has yet been found. The problem is at present insoluble on account of practical considerations; moreover, the task of correctly allocating cost elements is fraught with theoretical difficulties of principle, which cannot be overcome by any degree of improvement of the accounting systems of individual economic units and the economy as a whole"[19]

No-Profit, No-Loss Pricing: As the name indicates, the no-profit, no-loss theory holds that the price should be fixed in such a way that there will be neither any profit nor any loss. In other words the price should just cover all the costs of production.

The average cost price usually includes the normal profit. The no-profit, no-loss price, however, does not provide for normal profit.

Unlike the marginal cost price, the no-profit, no-loss price does not require any subside for in this case there is no deficit in the revenue because of the equality between the total revenue and total cost. In other words, there is no need for any "cross subsidisation".

When the price is fixed on the no-profit, no-loss basis, the non-consumers of the commodity or service are not compelled, directly or indirectly, to bear a burden for the benefit of the consumers. At the same time the consumers are given a fair deal, for they bear nothing more than the actual cost of their consumption.

Like the average cost price, the no-profit, no-loss price relieves the state of the burden of mopping up resources to make good the deficit incurred when marginal cost pricing is adopted – when the production is subject to the law of decreasing costs.

Professor Arthur Lewis argues that if the corporation makes a profit or loss, it should be required to adjust its prices so as to eliminate the profit or loss. He advocates this principle on the ground that it will prevent over or under-expansion of the industries concerned and will avoid inflationary or deflationary tendencies.

Profit-Making Pricing: The theory of making profits purports that the prices should be high enough to provide some surplus after absorbing all the costs.

That the public sector enterprises should generate a surplus with which to finance future development plans has been widely accepted today.

Many developing countries have assigned a very important role to the public sector in national development plans. Since the taxable capacity is low and the scope of domestic resource mobilisation through other means is limited, the public sector, which has absorbed large chunks of investment, should be expected to make a significant contribution to the pool of investible funds.

Many economists and planners argued that as the public sector acquired a more prominent position, the role of taxation, deficit, financing, etc., in resource mobilisation should decline and the surplus provided by the public sector should increase. In an economy where the public sector occupies an important position in production and supply, there is good scope for mopping up resources by an appropriate public sector pricing policy. As a matter of fact, in communist countries, most of the financial requirements of the government are met by the surpluses generated by public enterprises through a pricing strategy that serves this purpose.

It may be pointed out here that had the public sector in India generated a reasonable return on the enormous capital investment in them, the pace of economic progress would have been faster. In the absence of a satisfactory level of surpluses from the public sector, we were compelled to put up with more taxes, more deficit financing (which are inflationary in nature) and the slow pace of economic growth.

Indian Public Sector and Profit Objective

It is quite clear from the plan documents and the pronouncements of people like the Prime Minister that the public sector in India is expected to augment resource availability for national development by making profits. According to the late Prime Minister, Mrs. Gandhi, we advocated the public sector for three reasons: "to gain control of the commanding heights of the economy; to promote critical development in terms of social gain or strategic value rather than primarily on consideration of profit; and to provide commercial surpluses with which to finance further economic development."[20] Thus, making profits to make resources available for investment has been certainly an important objective of the Indian public sector.

A 12 per cent return on investment in the public sector was generally regarded as reasonable.

V.K.R.V. Rao, a well-known economist who was also a Union Minister and a member of the Planning Commission, pleaded that the pricing policy of the public enterprises "should be such as to promote the growth of national income and the rate of this growth ... Public enterprises must make profits, and the larger the share of public enterprises in all enterprises, the greater is the need for their making profits. Profits constitute the surplus available for savings and investments on the one hand and contribution to national social welfare programmes on the other; and if public enterprises do not make profits, the national surplus available for stepping up the rate of investment and the increase of social welfare will suffer a corresponding reduction... Hence the need for giving up the irrational belief that public enterprise should, by definition, be run on a no-profit basis."[21]

As the Taxation Enquiry Commission has remarked, "in certain cases, where the state has made a substantial investment, a policy of regulating prices so as to secure an adequate return on the capital invested is not only unobjectionable but may, indeed, be desirable. This is particularly so in the conditions of economically underdeveloped countries, where public enterprise itself, fostered at state expense, may in turn play a role in financing the country's development."[22] The Industrial Policy Resolution, 1956, states: "It is to be expected that public enterprises will augment the revenues of the state and provide resources for further development in fresh fields."

Our Five-Year Plan documents have pointed out that the public sector should make a significant contribution to the pool of investible funds by generating commercial surpluses. As one Plan document has observed, "substantial investments have been made in the public sector,... and every effort must be made to ensure that they yield an adequate surplus on the basis of which to plan a further advance. Development has, in due course, to become self-financing; the surpluses from past investments constitute the source for further development. It is important that in choosing their projects for implementation, the Central as well as State Governments keep constantly in mind the needs to get results from these investments as quickly as possible."[23]

The Fourth Plan mentioned that the government had accepted in principle the recommendation of the Committee on the Working of State Electricity Boards (Venkataraman Committee) that the rate of return on capital employed should be raised to 11 per cent per annum on the basis of a phased programme. As regards the irrigation charges, the Plan document cited the important recommendations of the Committee to Suggest Ways and Means of Improving Financial Returns from Irrigation Projects (Nijalingappa Committee), and underscored the need to mop up resources from the beneficiaries of the irrigation projects. The Plan document further suggested: "Efforts should be directed to raise the rate of returns on capital employed to 15 per cent by industrial and commercial undertakings other than public utilities."[24]

The Fifth Plan also emphasised the need to ensure a reasonable return on public sector investments by improving their operational efficiency. The Draft Five Year Plan, 1978-83, suggested that the Central Government's non-departmental undertakings should aim at earning a return on investment of 10 per cent per annum.

The Sixth Plan has suggested: "Almost all the Central and State enterprises would need to adopt appropriate pricing policies in order to achieve an adequate rate of return on capital employed.

Although a substantial revision of tariffs, freight rates and prices had been undertaken in the past, the additional receipts have largely been absorbed by escalation of working expenses due to the revision of emoluments to their employees, rise in input costs, etc. It is, therefore, essential to ensure that the additional resources generated by these enterprises during the Sixth Plan period by way of revision of prices, tariffs, etc., are not eroded by cost increases and that efforts are made simultaneously to secure the maximum feasible improvement in the functioning and efficiency of these enterprises."[25]

The preceding paragraphs make it quite clear that the public sector in India is required to make a profit to step up the level of investment and accelerate the pace of economic progress. This, however, does not mean that each and every enterprise is expected to make a contribution by way of profit.

There are some public enterprises, which are not specifically required to operate on commercial basis, while most of the enterprises are expected to generate commercial surpluses. for instance, the agreements between the Government of India, the WHO and the UNICEF require the Hindustan Insecticides and the Hindustan Antibiotics to operate on no-profit, no-loss basis. The FCGC has also been intended to be run on the same principle. Most of public enterprises, including the Road Transport Corporations, Electricity Boards and State Financial Corporations, have been expected to conduct their business on commercial lines.

In short, public enterprises as a whole should generate commercial surpluses to augment the pool of investible funds.

Influences and Guidelines on Pricing Policy

A uniform price for all the public enterprises is ruled out because the nature of goods or services they produce or provide the production function and the market situations are not uniform. On the basis of the nature of the business, public enterprises in India may be classified into the following categories.

(1) Enterprises engaged in the production or provision of public utilities and services.
(2) Enterprises engaged in the production of consumer goods.
(3) Enterprises engaged in the production of basic and capital goods.
(4) Enterprises engaged in the trading business.
(5) Financial enterprises.

The determinants of the pricing policies of these different classes of enterprises, obviously, differ.

The Administrative Reforms Commission has recommended that the following principles should be kept in view in formulating the pricing policies of public enterprises.[26]

(1) Public enterprises in the industrial and manufacturing field should aim at earning surpluses to make a substantial contribution to capital development out of their earnings, besides making a contribution to the national exchequer.
(2) Public enterprises should in any event pay their way and should not run into losses except in pursuance of the express directive issued by the government in public interest.
(3) In the case of public utilities and services, greater stress should be laid on output than on return on investment, the former being extended up to a level at which marginal costs is equal to price.
(4) While determining the price structure commensurate with the surpluses expected from them, public enterprises should keep the level of output as near the rated capacity as possible, subject, of course, to the volume of demand for the product.

The Bureau of Public Enterprises is intimately concerned with the problems of pricing. Its main activity is directed towards dealing with specific cases as they arise, rather than with general industry studies. It also issues guidelines to public enterprises on pricing policies. The BPE issued the following guidelines.[27]

(1) For enterprises, which produce goods and services in competition with other domestic producers, the normal market forces of supply and demand will operate, and their products will be governed by the prevailing market prices.

(2) For enterprises, which operate under monopolistic or semi-monopolistic conditions, the landed cost of comparable imported goods would be the ceiling. Within this ceiling it would be open to the enterprises to have price negotiations and fix prices at suitable levels. If the landed cost is found or believed to be artificially low, or in other exceptional circumstances it is considered necessary to have higher prices, then the matter should be referred to the Administrative Ministry, the BPE (now DPE), and the Ministry of Finance.

(3) Ministries and government departments and public sector enterprises should invariably purchase their requirements from public sector undertakings to the maximum possible extent. Quality requirements and reasonable delivery schedules should of course be enforced, subject to negotiation for agreement on price. Price preference not exceeding 10 per cent will be admissible to public sector undertakings. Where a public sector undertaking requires price preference of more than 10 per cent, the Purchasing Ministry, department or public enterprises should endeavour to reach an agreement by negotiation; where such an agreement is not possible within a reasonable time, the cases have to be submitted to the Cabinet Committee for Economic Co-ordination. Price preference even up to 10 per cent cannot be permanent or taken for granted.

Every effort should be made to bring down costs and achieve competitiveness.

The pricing policies and practices are profoundly influenced by the competitive situation, the nature of the industry, the supply-purchase relationship with other public enterprises and government departments, etc. "Even a cursory examination of the market conditions under which the public enterprises produce and sell their goods and services would reveal several types of situations. Some enterprises come under a system of price control and regulation, while others operate in the open market; still others operate in international markets. For some enterprises, the Central Government is the sole buyer, others are linked to State Governments and other public enterprises which are their main customers. One can easily see that the managements of public enterprises are not entirely free to set their prices without some constraints."[28]

On the basis of the pricing criteria and practices of different kinds of enterprises, the Bureau of Public Enterprises has made the following broad classifications.[29]

1. Enterprises under a system of price control by the government.
2. Enterprises which sell their products entirely to the government.
3. Enterprises, which sell their products mainly to State Government enterprises or to other public, sector enterprises.
4. Enterprises selling their products in the international market.
5. Enterprises operating in the open market.
6. Steel.
7. Price fixation by arbitration and award by the government.

Pricing Practices

Some examples of the pricing policies and methods followed by public enterprises are given below:

- **Administered Prices:** In the past, prices of certain commodities like steel, coal, oil, fertilizers, etc., were fixed by the government. As a part of the economic reforms, most of the goods have been freed from the administered prices.
- **No-Profit, No-Loss Prices:** Some undertakings like the Hindustan Antibiotics price the products on the no-profit, no-loss basis.
- **Cost-Plus Prices:** Several enterprises fix prices on a cost-plus basis.

- **Competitive Prices:** The liberalisation has increased the relevance of this strategy.
- **Following the Leader:** Price decisions of a few public enterprises are based on the behaviour of the leader. For instance, the Kerala Soaps and Oils followed this strategy in respect of some of their products.
- **Parity Pricing:** For the products of some of the enterprises, which had a monopoly position in the domestic market, parity with the landed cost of the imported product was sought. This was, for instance, true of the Hindustan Shipyard, which established the UK parity.
- **Subsidised Prices:** Some enterprises, which enjoy the benefit of a subsidy from the government, sell their products below the cost of production. An example was the price of the contraceptive produced by the Hindustan Latex.
- **Trade Association Pricing:** Air-India International, like other international airlines, adopts the fares and freights determined by the International Air Transport Association (IATA). Similarly, the Shipping Corporation of India fixes its prices on the basis of the recommendations of the Shipping Conference.
- **Discriminatory Pricing:** Many public enterprises practice price discrimination. This has been true of public sector financial institutions, Electricity Boards and the Railways.

PUBLIC SECTOR AND INDIAN LANNING

Central Government Enterprises

As on March 31,2002, there were 242 Central Government undertakings, excluding banks financial institutions and departmental undertakings like the Railways, Ports etc. The growth of investment in Central Government undertakings is shown in table 1. It will be clear from the table that since 1951, the number of industrial and commercial undertakings of the Central Government had increased from 5 in 1950-51 to 240 units in 2001-2002 and the capital investment had increased from Rs.29 crores to Rs.3,24,632 crores on 31st of March 2002. The investment is in the form of equity capital and long-term loans.

Public Enterprises Survey, 2001-2002 gives some interesting information regarding the pattern of investment (Table 2). Bulk of the investment is in those producing and selling goods; at the end of March 2002, over Rs.1,97,400 crores, or 60.8 per cent of investment was in these industries Even here, bulk of the investment (about 53 per cent) is in basic industries like Steel, Coal, Power Petroleum fertilizers, etc. Nearly 36 per cent of investment is in enterprises rendering services, of these, the most prominent are financial services (17.8 per cent).

TABLE 2. Growth of Investment in Central Government Enterprises

As on March 31	No. of Units	Total Investment (Rs. crores)
1951	5	29
1961	47	950
1980	179	18,150
1990	244	99,330
2001	242	2,74,198
2002	240	3,24,632

SOURCE: Government of India, Public Enterprise Survey, (2001-2002).

Among services, the most important were financial services accounting for Rs.57,836 crores (17.8 per cent), followed by and Telecommunication Services 8.2 per cent.

Table 3: Break-up of Investment in Central Government Enterprises (2001-2002)

	Investment (Rs. crores)	Per cent of Total
1. Enterprises under construction	**10,349**	**3.2**
2. Enterprises producing/selling goods	**1,97,408**	**60.8**
i. Power	46,013	14.2
ii. Steel	23,536	7.3
iii. Coal & Lignite	27,279	8.4
iv. Petroleum	36,735	11.3
v. Fertilizers	18,122	5.6
vi. Chemicals & Pharmaceuticals	5,989	1.8
vii. Minerals & Metals	5,665	1.7
viii. Engineering	9,043	2.8
ix. Textiles	18,715	5.8
x. Consumer goods	3,210	1.0
xi. Transportation equipment	2,976	0.9
xii. Agro-based industries	125	0.0
3. Enterprises producing services	**1,16,875**	**36.0**
i. Financial Services	57,836	17.8
ii. Industrial Development and Technical Consultancy Services	14,780	4.6
iii. Transportation Services	6,919	2.1
iv. Telecommunication Services	26,495	8.2
v. Other Service	10,845	3.3
Grand Total	**3,24,632**	**100.0**

SOURCE: *Compiled from Government of India, Public Enterprises Survey (2001-2002), Vol. I.*

The giant top 10 enterprises in the Central Public Sector (Table 3) accounted for a total *investment of Rs. 1,48,193 crores on 31st* March 2002 *(46% of total investment of* Rs.3,24,632 crores in 240 enterprises).

As a result of the deliberate policy of encouraging public sector, heavy investment was made in the public sector, so as to facilitate the process of industrialisation in the country, by establishing heavy and basic industries and create infrastructure of power, electricity and transport, Except for the short span of five years (1968-69 to 1973-74) in which growth rate of investment was about 10 per cent, throughout the rate of growth of investment averaged between 16 and 19 per cent per annum.

TABLE 4: Top to Enterprises in Terms of Investment

	Name of the Enterprise	Rs. crores as on 31-3-2002
1.	Bharat Sanchar Nigam Ltd.	23,129
2.	National Thermal Power Corporation Ltd.	19,394
3.	Housing & Urban Development Corporation Ltd.	18,046
4.	Steel Authority of India	13,571
5.	Power Grid Corporation of India Ltd.	13,342
6.	Indian Railway Finance Corporation Ltd.	13,130
7.	Rural Electrification Corporation Ltd.	12,322

8.	National Hydro-electric Power Corporation Ltd.	11,906
9.	Power Finance Corporation	11,870
10.	Indian Oil Corporation Ltd.	11,481
	Total	**1,48,193**

SOURCE: Public Enterprises Survey (2001-2002), Vol. 1.

In terms of investment, Bharat Sanchar Nigam Ltd. topped the list of 10 enterprises in the Central Public Sector in India, followed by National Thermal Power Corporation Ltd. But in terms of gross turnover in 2001-2002, Indian Oil Corporation Ltd. topped the list with a total turnover of Rs.1,14,864 crores, followed by Hindustan Petroleum Corporation Ltd. Rs.44,434 crores and Bharat Petroleum Corporation Ltd. Rs.39,830 crores. Taking these three petroleum companies, it may be noted that they accounted for Rs.1,99,128 crores or 41.6 per cent of the total turnover of all CPSUs

Total Investment in Public Sector

Central Government Public Sector Enterprises recorded a total investment of Rs.3,24,632 crores in 2000-01. The State level Public enterprises accounted for Rs.1,62,000 crores as on 31-3-2000. Besides them departmental like Railways, Posts and Telegraphs and other departments account for an investment of nearly Rs.20,000 crores. If all these were included, then the total public sector investment in the entire country, in all kinds of enterprises (departmental and non-departmental), at the Centre, State and local, would be around Rs.5,16,630 crores.

TABLE 5: Top 10 Enterprises in Terms of Turnover (2001-02)

	Name of the Enterprise	Rs. crores	% of Total
1.	Indian Oil Corporation Ltd.	1,14,864	24.0
2.	Hindustan Petroleum Corporation Ltd.	44,434	9.3
3.	Bharat Petroleum Corporation Ltd.	39,830	8.3
4.	Food Corporation of India	31,556	6.6
5.	Bharat Sanchar Nigam Ltd.	24,300	5.1
6.	Oil and Natural Gas Corporation Ltd.	23,233	4.8
7.	National Thermal Power Corporation Ltd.	17,911	3.7
8.	Steel Authority of India	15,684	3.3
9.	Gas Authority of India Ltd.	10,573	2.2
10.	IBP Co. Ltd.	8,453	1.8
	Sub-total (1 to 10)	**3,30,837**	**69.1**
	Total Turnover of all enterprises	**4,78,728**	**100.0**

SOURCE: Public Enterprises Survey (2001-2002), Vol. 1.

Objectives of Public Sector

We conclude this section by broadly summarizing the objectives of setting up public enterprises in India:

(i) To promote rapid economic development through creation and expansion of infrastructure;
(ii) to generate financial resources for development;
(iii) to promote redistribution of income and wealth;
(iv) to create employment opportunities;
(v) to promote balanced regional growth;

(vi) to encourage the development of small scale and ancillary industries; and
(vii) to promote exports on the one side and import substitution, on the other.

2. ROLE OF THE PUBLIC SECTOR IN INDIA

After the attainment of independence and the advent of planning, there has been a progressive ex-pansion in the scope of the public sector. The passage of Industrial Policy Resolution of 1956 and the adoption of the socialist pattern of society as our national goal further led to a deliberate enlargement of the role of public sector.

To understand the role of the public sector, we must have a comprehensive view of the entire public sector. We should include besides autonomous corporations, the departmental enterprises. While doing so, not only the enterprises owned and run by the Central Government are covered, but the enterprises run by the State Government and local bodies should also be included.

It would not be appropriate to use any single measure to estimate the role of the public sector in the Indian economy, rather it would be desirable to use a few indicators, e.g., employment, investment, value of output, national income generated, savings, capital formation and capital stock.

Share of Public Sector in Employment

There are two important categories of public sector employment: (a) Government administration and defence and other government services like health, education, research and various activities to promote economic development; and (b) public sector proper i.e., economic enterprises owned by the Centre, State and Local Government Table 4 shows the size and growth of employment in the organised sector since 1971. The total number of workers employed in the public sector in 1971 was 71 lakhs, but by March 2001, their number grew to about 191 lakhs. Since employment in the public sector is confined to the organised sector, public sector employs 70 per cent of the workers employed in organised sector of the Indian economy.

TABLE 6: Public and Private Sector Employment in India

(In lakhs)

	Public Sector (1)	Private Sector (2)	Total (3)	1 as % of 3 (4)
1971	71	121	192	55
1981	155	74	229	68
1991	190	77	267	71
2001	191	87	278	70

SOURCE: Compiled from Economic Survey, (2002-2003)

From table 6, it may be noted that 50 per cent of the total employment (i.e. 191 lakhs) in the public sector was in Government administration and community and personal services and the balance 51 per cent was spread in other economic enterprises run by the Centre, State and local governments. The biggest chunk of employment in economic enterprises was in transport, storage and communications was of the order of about 30 lakhs and next in importance was manufacturing (14 lakh). 5.0 lakh persons employed in agriculture and other allied activities reflect employment under Employment Guarantee Scheme rather than any productive activity in the normal sense.

The share of public sector in total employment in the organised sector (public plus private) reveals that in transport and communications, electricity, gas and water and construction, the share of the public sector is in the range of 95-98 per cent, a situation of total dominance. These are the traditional areas, which have been the exclusive preserve of the public sector since the days of the

British rule. However, in manufacturing, the share of the public sector was about 27 per cent of the total since its entry in this area is of recent origin. With the nationalisation of coal mines and takeover of 20 major commercial banks, there has been a significant improvement in the position of the public sector. In an overall sense, the public sector is a big employer (70 per cent of total) in so far as the organised sector of the Indian economy is concerned.

TABLE 7: Employment in the Public Sector in 2000

		(Lakhs)	Percent of total
1.	Manufacturing	14.3	7.5
2.	Transport, storage and Communications	30.4	20.1
3.	Financing, insurance, real Estate and business services	12.8	6.7
4.	Government administration, Community, social and personal services	98.3	51.4
5.	Others sectors	35.6	18.6
	Total	**191.4**	**100.0**

SOURCE: Compiled and computed from Government of India, Economic Survey (2002-2003)

Share of the Public Sector in GDP

During the last five decades, the share of the public sector in net domestic product (NDP) has shown a steady improvement. Measured at current prices, public sector accounted for 7.5 per cent of NDP in 1950-51, its share in 1999-2000 had risen to 24.1 per cent. Public sector, therefore, accounts for about one-fourth of national output. This is largely due to a rapid expansion of the public sector enterprises.

There is a big increase in the share of public administration and defence from 4.5 per cent to 10.1 per cent between 1950-51 and 1999-2000. The share of public sector enterprises, however, rose from 3 per cent in 1950-51 to 13.2 per cent in 1999-00. Despite this fact, the private sector still occupies a dominant position in the economy. There are some sectors such as agriculture and small-scale sector in which the share of the state is almost zero. However, in insurance, civil aviation, defence equipment, indigenous, crude oil production, etc., government ownership is cent per cent. Increasingly, industries of strategic and national importance are being brought under state ownership

Share of the public sector in saving and capital formation

Gross domestic capital formation has increased from 10.7 per cent of GNP during the First Plan to 24.6 per cent during the Eighth Plan. (Refer table 7).

However, the share of the public sector improved from 3.5 per cent during the First Plan (1951-56) to 9.2 per cent during the Eighth Plan. The share of the public sector which accounted for one-third of capital formation during the First Plan gradually increased to about one-half during the Sixth Plan, and has thereafter declaimed to about 30 per cent in 1997-98.

However, the share of savings by the public sector has not undergone a similar change. The share of the public sector in gross domestic saving rose from 1.7 per cent of GNP during 1951-56 to merely 4.6 per cent during the Fifth Plan but declined thereafter and touched a low of 1.4 per cent during Eighth Plan. This share became negative during 1999-00 and 2000-01. In relative terms, the

share of public sector improved marginally from 17 per cent during 1951-56 to 21 per cent during 1974-79 (Fifth Plan period) and thereafter declined continuously till it touched a low level of 6.3% of total savings during the Eighth Plan and further low of 4.5% in 1997-98.

TABLE 8: Share of Public and Private Sectors in Gross Domestic Saving and Gross Domestic Capital Formation

Averages for Plan Periods	As % of GDP at market prices		
	Public Sector	Private Sector	Total
Gross Domestic Savings			
First Plan : 1951-56	1.7	8.7	10.4
Second Plan : 1956-61	2.0	10.4	12.4
Third Plan : 1961-66	3.4	10.9	14.3
Fourth Plan : 1969-74	3.0	14.4	17.4
Fifth Plan : 1974-79	4.6	17.0	21.6
Sixth Plan : 1980-85	3.6	16.5	20.1
Seventh Plan: 1985-90	2.3	18.1	20.4
Eighth Plan: 1992-97	1.4	21.9	23.3
1997-98	1.0	22.1	23.1
2000-01	-1.7	25.1	23.4
Gross Domestic Capital Formation			
First Plan	3.5	7.2	10.7
Second Plan	6.6	8.8	15.4
Third Plan	8.4	8.3	16.7
Fourth Plan	7.2	10.9	18.1
Fifth Plan	9.5	11.7	21.2
Sixth Plan	11.1	10.5	21.6
Seventh Plan	10.7	12.1	22.8
Eighth Plan	9.2	15.4	24.6
1997-98	1.1	24.1	25.2
2000-01	6.8	17.2	24.0

SOURCE: CMIE, Basic, Statistics Relating to the Indian Economy, Vol.1. All India, August 1994 and CSO, National Accounts Statistics (2002).

Three basic causes for the decline of the share of the public sector in total savings.

(i) Rapid increase in state expenditure at a rate higher than increase in state revenues.

(ii) The inefficiency of the government and the public sector enterprises and their consequent failure to generate internal surplus commensurate with the increase in their capital stock.

(iii) The self-defeating efforts of the government to make up the shortfall in resources through excessive borrowings from the banking sector (better known as deficit financing).

Accordingly the savings of the private sector had to be diverted to the public sector so that it can meet its expanding obligation in the process of development, this fact, however, does not absolve the public sector to generate adequate internal surplus by improving its efficiency.

Share of the public sector in gross fixed capital formation

The term capital stock refers to the total stock of plant and machinery, equipment and tools and other capital goods available at a point of time for further production. However, the term investment (or gross capital formation) refers to annual flow of goods partly to meet the needs of depreciation of the capital stock and partly to increase the size of the total capital stock on a net basis.

But the amount of capital employed per unit of output in the public sector is far greater than in the private sector. This is largely due to the differences in the nature of investment in the public sector. The important differences are:

(i) A good part of the public sector investment goes into economic intrastructure (roads, buildings, irrigation works, bridges, etc.) which is essential for economic development but does not contribute to output in the normal sense of the term.

(ii) Public sector has played a significant role in developing the key sectors of the economy, e.g., railways, iron and steel, power, oil exploration, irrigation, etc. By their very nature are areas of high capital intensity.

(iii) The projects in the public sector have longer gestation periods. Partly this is due to the technological nature of investment in heavy and basic industries and partly it is due to the inefficiencies in public agencies in the installation of these projects.

(iv) There is lower utilisation of capacities in the public sector and this is also responsible to an extent to lower output capital ratios.

(v) Areas of higher output-capital ratios fall largely or wholly in the private sector. This includes consumer goods industries, small-scale and cottage enterprises and agriculture.

TABLE 9: Public Sector Gross Fixed Capital Formation at 1980-81 prices

Year	Value in Rs. crores	Compound Annual Growth Rule (Per cent per Annum)
1950-51	1.640	
1960-61	5.160	12.1
1970-71	6.330	2.0
1980-81	11.770	6.3
1993-94*	68.853	
1998-99	110.289	9.9

* At 1993-94 prices

SOURCE: CSO, National Accounts Statistics, (1998) and (2001).

Data given in table 8 reveal that gross fixed capital formation (GFCF) during 1950-51 to 1960-61 was of the order of 12.1 per cent per annum. This was the natural consequence of the enthusiasm generated in the Second Plan to undertake the massive development of heavy and basic industries. However, this process of acquiring new plants and undertaking investment in hither to unexplored areas did continue upto 1965-66 when GFCF shot up to the peak level of Rs.7.870 crores, but the drought of 1965-66 and the recession that followed in 1966-67 reversed the trend and the annual growth rate slumped to 2 per cent during the 1960s. Later it picked up to 6.3 per cent during seventies and 6.1 per cent during the Eighties. Thus public sector has made a tremendous contribution in improving Gross Fixed Capital Formation, more especially in the capital goods sector and thus laid the foundations of a strong industrial base in India. During 1993-94 and 1999-2000, however, GFCF growth rate was of the order of 2.5 per cent at 1993-94 prices.

Volume of Sales/Income of the Public Sector

Table 9 explains the trend of growth of sales in Central public enterprises. In 1987-88, percentage of sales to capital employed (CE) was 146 and this ratio declined to 123 per cent in 2001-2002. Between 1987-88 and 2001-2002, the annual average growth rate of sales was 13.5 per cent, while that of capital employed was 14.9 per cent. This is an "eloquent measure of the dynamic expansion of the public sector in India."

Infrastructure Development by the Public Sector

Rapid industrialisation of a backward but developing country like India depends upon the creation of infrastructure or economic overheads such as transportation, communication, power development, basic and key industries, etc. Unless the infrastructure is created, it is not possible for other industries to come into existence or to develop fast enough. But the development of basic and capital goods industries and creation of infrastructure involves heavy investment, low yield and long gestation period. These investments were, therefore, not attractive to the private sector not could the private sector raise such huge resources in the Fifties and Sixties. Naturally, it was left to the Government to develop them and most of the public enterprises were set up in these industries. The private sector welcomed government investment in developing these industries, as it stood to gain directly.

TABLE 10: Growth of Sales in Public Sector Enterprises

(Rs. crores)

Year	Sales Turnover	Capital Employed	% Sales to CE
1987-88	81,270	55,620	146
1990-91	1,18,680	1,02,080	116
2001-02	4,78,728	3,90,261	123
Annual Average growth Rate between 1987-88 to 2001-2002	13.5	14.9	

SOURCE: Public Enterprises Survey, 2001-02

In facet, the basic rationale of public enterprises soon after India launched ambitious economic plans was to create and expand the infrastructure and this they have done quite successfully, by and large. Their contribution to the Indian economy should therefore, be judged from this angle and not from the point of view of profit alone.

Strong Industrial Base in India

Despite many criticisms against the public sector enterprises, there is no denying the fact that rapid industrialisation in the first three decades after independence in the first three decades after independence was mainly due to the public sector. The Industrial Policy Resolutions reserved certain industries—atomic energy, ammunition and armaments, aircraft, etc.—with the government in the interest of national security. The state also took the responsibility for the development of key industries such as coal, iron and steel, aircraft, ship-building, etc. The rest of the industries were left to the private sector. But the experience of the first three Plans showed clearly that the private sector had inherent handicaps and that it was not suitable for rapid industrial development. At the same time, the Planning Commission realised that a much more diversified development in the field of industries was necessary if Indian economy had to become self-generating. Naturally, the government had to come in a big way to undertake the development of basic and strategic industries, capital goods industries and even some

consumer goods industries, a strong industrial base has been laid, though there are still many weaknesses and gaps in the industrial structure of the country. Credit has to be given to the public sector for this achievement. Even after the introduction of economic reforms, private sector investment has not increased as expected and it is being suggested that the public sector should take up the responsibility of infrastructure development.

Dominance of public sector in critical areas

Public sector has entered into a wide spectrum of industries and products. Its operations extend from basic and capital goods like steel, coal, copper, zinc, and other minerals, heavy machinery on the one hand and on the other, we find drugs and chemicals, fertilizers, consumer goods like textiles, hotel services, watches, bread, etc. Most of these industries have a strategic importance in the Indian economy since they have high linkages.

In highly critical areas such as copper, lead, coal, petroleum products, hydro and steam turbines the snare of public sector in 100 per cent. In quite a large number of products, it ranges between 50 to 95 per cent.

Role of public sector in Export Promotion

Most of the public sector enterprises have been started keeping in mind the requirements of the Indian economy, in the fields of production and distribution. However, some public enterprises [illegible] done much to promote India's exports. The State Trading Corporation (STC) and the Minerals and Metals Trading Corporation (MMTC) have done a wonderful job of export promotion in all parts of the world, especially in the East European countries. That metal ores have become the second largest single item on our list of exports has been due to the pioneering efforts of these organisations. Considerable success has been achieved in pushing up the exports of Indian handicrafts, light engineering goods and many other new items of exports. Hindustan Steel Ltd., the Bharat Electronics Ltd., the Hindustan Machine Tools, etc. are some of the public enterprises which are exporting increasing proportion of their output and earning foreign exchange. For instance, the HSL has made huge strides in the field of exports.

The foreign exchange earnings of the public sector enterprises have been rising from Rs crores in 1965-66, to Rs. 5,830 crores in 1984-85 and finally to Rs. 20,886 crores in 2001-02. There is no denying the fact that the export performance of the public sector enterprises has been quite creditable.

Role of the Public Sector in Import Substitution

Some public sector enterprises were started specifically to produce goods which were formerly imported and thus to save foreign exchange. The entry of Hindustan Antibiotics LTD. and the Indian Drugs and Pharmaceuticals LTD. (IDPL) into the manufacture of drugs and pharmaceuticals so as to remove the monopolistic stranglehold of foreign concerns in this field helped India save foreign exchange used for importing these items. Likewise, the Oil and Natural Gas Commission and the Indian Oil Corporation Ltd. had saved foreign exchange by way of import substitution. Complete self sufficiency may not be possible at present, but a determined effort should be made to achieve this goal in the shortest possible time.

Role of Public Sector in raising internal resources

The generation of internal resources by the public sector has assumed greater importance because, in addition to financing their own planned expansion and development, they are also expected to generate surplus for financing the needs of other priority sectors.

Internal resources consist of depreciation and retained profits. With every five-year plan, the public sector was able to mobilise larger internal resources. During the Sixth Plan (1980-81 to 1984

85), internal resources, amounting to Rs. 14,710 crores were generated -- Rs. 2,940 crores per annum on the average. During the Seventh Plan internal resources of the order of Rs. 29,750 crores were generated. During the Eighth Plan, PSUs generated internal resources of the order of Rs. 1,01,212 crores—a creditable record indeed. During 2001-2002, internal resources generation was of the order of Rs. 52,545 crores. It is really encouraging to note that Central public enterprises have succeeded in increasing their internal resource generation over the years. This trend should be welcomed.

Contribution to the Exchequer

Apart from generation of internal resources and payment of dividend, public enterprises have been making substantial contribution to the Government exchequer through payment of corporate taxes, excise duty, customs duty and other duties; in this way they help in mobilizing funds for financing the needs for the planned development of the country. Table 10 illustrates the growth of contributions of public sector enterprises to Central exchequer. We include here (a) corporate tax (b) Central excise duty (c) customs duties and (d) other duties.

TABLE 11: Contribution of Public Enterprises to Central Exchequer

(Rs. crores)

Year/Period	Amount Total	Contributed Average*
Sixth Plan (1980-85)	27,570	5.510
Seventh Plan (1985-90)	69,410	13.880
Eighth Plan (1992-97)	1,33,780	26.760
1997-98 and 2001-02	2,69,110	53.822

- Figures rounded

SOURCE: Public Enterprises Survey, 2001-02. P.28

It is clear from table 10 those public enterprises contributed Rs.27,570 crores during the Sixth Plan but as much as Rs.1,33,780 crores during the Eighth Plan. From an annual average of Rs.5,510 crores during the Sixth Plan, the contribution of public enterprises has increased to Rs.53,822 crores during 1997-2002.

Thus, from every angle, the public sector has grown in importance and has come to occupy a prominent place in the Indian economy. What we have described above relates mostly to enterprises in the Central sector. We do not, however, have adequate statistics for state public sector enterprises and the little information we have of them is not flattering to the states.

3. CAUSES FOR THE EXPANSION OF PUBLIC ENTERPRISES

In a developing economy like India, some industries had to be brought within public ownership and control, for otherwise rapid growth of the economy was thought to be impossible. Nationalising some of the industrial, banking and insurance units and starting new units was expected to help in speeding up the rate of economic growth. Therefore, public enterprises became an essential part of the economic development programme of India. In this section, we shall study the need for or the rationable of public enterprises in the context of economic planning in India.

(i) Rate of Economic Development and Public Enterprises. The justification for public enterprises in India was based on the fact that the rate of economic development planned by the government was much faster than could achieved by the private sector alone. In other words, the public sector was essential to realise the target of the high rate of development deliberately fixed by the government.

To fulfil this ambitious plan target, the government had to resort to compulsory saving through taxation. In the words of Professor Ramanadham, "Having gathered the resources, the government and other important policy making bodies like the Planning Commission are under the normal human temptation to use the funds under the government's own aegis and it appears to be an avoidable botheration for the administration to offer the money to private enterprises in the first instance and then go about instituting the necessary checks and balances for the sake of ensuring the safety and proper use of funds. Instead it appeals as preferable to Parliament as well as the administrative bodies to launch industrial enterprises in the public sector."

(ii) Pattern of Resource Allocation and Public Enterprises. In Professor Ramanadham's words. "The main reason for the expansion of the public sector lies in the pattern of resources allocation decided upon under the plans." In the Second Plan the emphasis was shifted to industries and mining, mainly basic and capital goods industries to be developed under the aegis of the public sector. Thus more resources for industrialisation were funneled through the public sector. Under these circumstances. "It is inevitable, that the public sector must grow not only absolutely but also relatively to the private sector."

(iii) Removal of Regional Disparities through Public Enterprises. Another important reason for the extension of the public sector was the anxiety for balanced development in different parts of the country and to see that there were no serious regional disparities. Public enterprises of the Central Government were set up in those regions which were underdeveloped and where local resources were not adequate. Good examples are the setting up of the three steel plants at Bhilai, Rourkela and Durgapur and the Neyveli Project in Madras which were meant to help industrialise the regions surrounding the projects. In certain cases, the State Governments were unable to raise adequate resources for development of its regions. The only alternative available was the setting up of projects by the Central Government or to start enterprises, which were financed by the Centre.

(iv) Sources of funds for Economic Development. Initially, state was an important source of funds for development. The surplus of government enterprises could be re-invested in the same industries or used for the establishment and expansion of other industries. It may be noted that private sector industries can also plough back whole or substantial amounts of their profits for expansion However, profits in private enterprises are declared as dividends among shareholders. This would only create inequalities among people. But profits of public sector industries can be directly used for capital formation.

(v) Socialistic Pattern of Society. The socialistic pattern of society calls for extension of public sector in two ways. For one thing, production will have to be centrally planned as regards the type of goods to be produced, the volume of output and the timing of their production. It may be comparatively easy to achieve this through the public sector rather than through private sector We may quote the Second Five-Year Plan here: "The adoption of the socialistic pattern of society as the national objective, as well as the need for planned and rapid development require that all industries of basic and strategic importance, or in the nature of public utility services should be in the public sector. Other industries which are essential and require investment on a scale which only the state, in present circumstances, could provide, have also to be in the public sector."

Besides, one of the objectives of the Directive Principles of the Indian Constitution is to bring about reduction of the inequalities of income and wealth and to establish an egalitarian society. The Five-Year Plans have taken this up as a major objective of planning. The public enterprises were used as major instruments for the reduction of inequalities of income and to bring about a more equitable distribution of income in several ways: (a) The profits of public enterprises would go to the government unlike those of private enterprises which go to enrich private pockets. (b) There could be effective regulation of income of top executives in public enterprises, taking, of course, steps to maintain high managerial efficiency. (c) The public enterprises could be asked to adopt discriminatory

price policies which would benefit the low-income consumers; and (d) they, generally, make it easy to raise wage income of the low-paid staff.

Explaining the importance of the public sector in a mixed economy and its role in the establishment of a socialist pattern of society, Professor V.K.R.V. Rao opined. "Sectors of economic activity which involve either monopoly conditions of strategic economic power or possession of large resources in private hands should be publicly owned and operated as public enterprises. It also means that public enterprise should make itself responsible for the building of the economic overheads on the external economies like transport, power, fuel, and basic capital goods without which increase in the production of consumption goods and services either on the required scale or necessary economic basis will not be possible, irrespective of whether it is to be in the private or public sector. It also means that the extension of the public sector, in economic enterprise will be followed by a substantial growth in the volume of national saving and investment as well as the funds available for government outlay on social services... Without public enterprise, there can be no private enterprise. In fact, it is the former that enables the full growth of the latter."

(vi) Limitations and Abuses of the Private Sector. The behaviour and attitude of the private sector self was an important factor responsible for the ex-pansion of the public sector in the country. When the Americans insisted on the Bokaro Project to be set up in the private sector. Mr. J.R.D. Tata openly confessed that the private sector was not in a position to mobilise resources to the tune of Rs.700 crores. Thus, the private sector did not want to move into certain sectors or if it wanted to move in, it did not have the necessary resources. This was understandable but the private sector was unwilling to take even the normal risks of business. During the Second Plan period and later, many of the licences issued to the private sector for setting up fertiliser units were surrendered when the need for fertiliser production was paramount for the country to push an agricultural breakthrough. To give another example, the business recession of 1966-67 frightened the private sector cement industry from expansion, even though it had given an undertaking to the Government to expand. To safeguard the long-term prospects of the economy, the Government had to set up the Cement Corporation of India to boost the production of cement. The failure of the private sector drug industry to manufacture antibiotics and at the same, its tremendous exploitation of the consumers-to the extent of holding them to ransom was responsible for the entry of the Government in drugs and pharmaceuticals industry.

In a number of cases, the Government was forced to take over a private sector industry or industrial units either in the interest of workers or to prevent excessive exploitation of consumers. The private sector Life Insurance companies was taken over by the Government to protect the interest of the insured from the shortsighted and rapacious private exploiters. The top 20 commercial banks were nationalised, among other things, to prevent bank funds being used for building up private industrial and commercial empires. The takeover of sick cotton mills was due to the failure of the private sector. The point to note here is that often the private sector did not function as it should and did not carry out its social responsibilities. Accordingly, the Government was forced to takeover or nationalise the private sector units.

To sum up, the expansion of the public sector was aimed at the fulfillment of our national goals, viz., the removal of poverty, the attainment of self-reliance, reduction in inequalities of income, expansion of employment opportunities, removal of regional imbalances, acceleration of the pace of agricultural and industrial development, to reduce concentration of ownership and prevent growth of monopolistic tendencies by acting as effective countervailing power to the private sector, to make the country self-reliant in modern technology and create professional, technological and managerial cadres so as to ultimately rid the country from dependence on foreign aid.

5. PERFORMANCE OF PUBLIC SECTOR UNDERTAKING

While the Government has been pushing ahead with more and more public sector undertakings, there has been considerable criticism about the poor performance and in some cases utter

failure of government undertakings in the country. Some economists have argued that profit should not be used as a criterion for judging the performance of public enterprises According to them, public enterprises are guided by a variety of considerations in determining prices and it would not be appropriate to use profit as a criterion of their efficiency. This is particularly so in social utility services, like railways, posts and telegraphs, supply of water, electric energy, etc. The State should not raise the prices of the these services, even though costs may have risen. Similarly, the public enterprises have a bulk of their investment in heavy and basic enterprises. Such enterprises have long gestation period and a part of the investment may be under construction. It would, therefore, be appropriate to calculate the rate of return on effective capital employed and thus not include the capital employed in undertakings under construction or in expansion or capital work-in-progress. In other words, "profitability" of the running concerns alone should be the index of their performance.

Besides, the term 'profitability' should not always be used in a business or a pure commercial sense with reference to public enterprises, which are not permitted to manipulate depreciation or other payments to show higher rate of return. Moreover, PSUs offer much better reward for labour in terms of wages and salaries and other perquisites in comparison with small and medium enterprises in the private sector. To judge their performance, an adjustment should, therefore, be made for a higher social rate of return. The concept of total surplus generated in the form of declared profits, retained profits and depreciation becomes more relevant in the case of private sector enterprises and not for PSUs. This is not to suggest that profitability should not be considered as an index of efficiency, but to emphasize that the problem should be viewed in a proper perspective.

TABLE 12: Financial Performance of Centre's Public Enterprises
(Running Enterprises excluding insurance companies)

Year	No. of Units	Capital employed	Gross profit before tax	Net profit before tax	Net profit after tax	Rate of Return: Gross profit to capital employed (%) 6=(3 + 2)	Rate of Return: Net Profit after tax to capital employed (%) 7=(5÷2)
	1	2	3	4	5	6	7
SIXTH PLAN							
1980-81	168	18,207	1418	19	203	7.8	-1.1
1981-82	188	21,935	2654	1025	446	12.1	+2.0
1982-83	193	26,590	3469	1547	618	13.1	+2.3
1983-84	201	29,856	3565	1480	240	11.9	+0.8
1984-85	207	36,382	4628	2099	909	12.7	+2.5
SEVENTH PLAN							
1985-86	211	42,965	5287	2173	1172	12.3	+2.8
1986-87	214	51,835	6521	3101	1771	12.6	+3.4
1987-88	220	55,617	6940	3353	2030	12.5	+3.6
1988-89	226	67,629	8572	4404	2993	12.7	+4.4
1989-90	233	84,760	10622	5293	3789	12.5	+4.5
1990-91	236	1,01,702	11359	3820	2368	11.2	+2.3
1991-92	237	1,17,991	13675	4003	2355	11.6	+2.0

EIGHTH PLAN							
1992-93	239	1,40,110	15957	5076	3271	11.4	+2.3
1993-94	240	1,59,836	18555	6654	4544	11.6	+2.8
1994-95	241	1,62,451	22630	9767	7187	13.9	+4.4
1995-96	239	1,73,948	27587	13621	9574	15.9	+5.5
1996-97	236	2,31,178	30915	15378	10188	13.4	+4.4
NINTH PLAN							
1997-98	236	2,49,855	37206	19216	13582	14.9	5.4
1998-99	235	2,65,093	39727	19702	13203	15.0	5.0
1999-00	232	3,02,947	42270	22037	14331	13.9	4.7
2000-01	234	3,31,372	48767	24967	15653	14.7	4.7
2001-02	230	3,90,032	63257	38299	26045	16.2	6.7

Note: Gross Profit before tax = (Net profit + interest + corporate tax paid)
Total capital employed = (Fixed assets minus depreciation plus working capital)
Source: Public Enterprises Survey, (2001-2002), Vol. 1.

Although profit maximisation (or in the case of public enterprises, the generation of surplus) may not be the sole criterion to judge their performance, yet it cannot be denied that it would be a folly to ignore it altogether. It has been aptly pointed out that profit maximisation may not be treated as a positive virtue but it may well be a 'good whip' to prevent the public enterprises from misbehaving. Thus the principle of profit maximisation has a negative virtue that it impels enterprises to reduce wastes of resources and inefficiency arising therefrom. From this point of view, the argument for generation of surplus by public enterprises to be used for economic development has a great force.

'Net Profit after tax' as a measure of profitability

The usual criterion for measuring the profitability is the ratio of 'profit after tax' to the shareholders funds (viz., paid-up capital and reserves).

The Public Enterprises Survey gives financial performance of all running Central PSUs excluding insurance companies. Table 11 gives total capital employed gross profit before tax and net profit after tax since 1970-71. The following facts can be highlighted from table 11:

(i) It was only after 1981-82 that the Central PSUs turned the corner and started yielding positive net profit after tax – from about Rs.50 crores in 1981-82 to about Rs.13,582 crores in 1997-98. In percentage terms, the net profit after tax ranged between 2 per cent to 5.4 per cent of total capital employed between 1982 and 1998. In most of the years, however, net profits after tax used to average around 2 to 3 per cent only.

(ii) It is useful to remember that the capital employed in the Central PSUs was generally raised by way of long-term loans from the market and from financial institutions and banks at a much higher rate of interest. Accordingly, the yield rate of Central PSUs represented by net profit after tax was pitiably low.

(iii) A very interesting point about the financial performance of the Central PSUs is that the major part of the profits was contributed by the petroleum sector enterprises. For instance, in 2001-02 net profit after tax came to Rs.26,045 crores of which about Rs.12,714 crores (or 49 per cent) came from petroleum enterprises alone.

(iv) **Public Enterprises Survey** estimates the net profit by the profit-making enterprises along with the losses suffered by loss-making enterprises. In 2001-02, 119 profit making enterprises earned a total net profit of about Rs.36,432 crores and 109 loss making units incurred a total loss of Rs.10,387 crores. In recent years, an attempt has been made by the Government of India to study each loss-

making enterprise to determine the factors responsible for the persisting situation and initiate remedial action.

Although the Government of India has been presenting a rosy picture about the performance of public sector enterprises, still two observations need to be made.

Firstly, a very narrow range of profit-making enterprises accounts for bulk of the total profit. Petroleum industries, financial services, power and telecommunication services contribute bulk of the profits. Among the principal loss incurring enterprises are textiles, consumer goods, engineering goods and fertilizers.

Secondly, the Government is achieving a higher profitability ratio by increasing administered prices of goods produced in the public sector, rather than through reducing cost, improving efficiency and capacity utilisation. The manipulation of administered prices to cover the inefficiencies of public enterprises is an unhealthy trend, more so on account of its other social implications, both in terms of imposing burdens on the people and providing the bureaucrats an easy escape route.

Employees' Welfare in Public Enterprises

While evaluating the performance of the public sector it is necessary to refer to the gains to the employees in the form of a steady improvement in their emoluments, provision for housing, medical care and educational facilities. A close perusal of table 11 reveals that the real wage (emoluments) per employee in the public sector went up from Rs.28,820 in 1986-87 to Rs.56,564 in 2001-02. The annual growth rate of real wages works out to be 4.3 per cent during this period.

This indicates the social benefits in terms of raising the wage levels of the working class. A total expenditure of Rs.3,060 crores in the form of maintenance of houses, educational facilities, medical care etc., was spent in 2001-02 for the benefit of the employees.

TABLE 13: Trend of Emoluments in Public Enterprises

	1986-87	2001-2002
Average emoluments of public sector Employees (Rs. per annuam at current Prices)	28,820	1,93,225
Consumer Price Index of industrial Workers (1982=100)	137	468
Average Real emoluments (1982 prices as base)	28,820	56,564
Index of growth in emoluments	100	196

Note: Computed on the basis of the data provided in Public Enterprises Survey, (2001-2002), Vol I

As on March 2002, public sector enterprises spent Rs.6,756 crores on townships for workers housing. As a result of it. 8.74 lakh houses (including those under construction) have been provided to 17.4 lakh workers working in them. In other words, nearly 44 per cent of the workers have been provided housing. This is creditable achievement. In this sense, the public sector has acted as a pace setter in providing amenities to labour. The private sector should certainly follow the public sector in this regard.

The image of the public sector has started looking up. Had the public sector been not called upon to act as an orphanage for the "sick units" of the private sector especially textile mills, its performance would have been still better. These mills were virtually on the brink of a total collapse. The public sector by assuming responsibility of rehabilitation for these sick units had to bear a burden

to save 1.6 lakh employees from the specter of unemployment. This social responsibility would certainly lead to a lower level of profits. This explains why it is not appropriate to treat profits as the sole criterion of efficiency of the public sector.

6. SHORTCOMINGS OF THE PUBLIC SECTOR

It would be unreasonable to argue that all is well in the public undertakings. There is much scope for improving the efficiency and working of public sector enterprise. The main points, which merit consideration, are:

(i) Mounting Losses. A review of the working of public sector enterprises reveals that either the profit in them has been deplorably low or that they have been making losses. As compared with the performance of the Central Government, however, the State Governments are having perennial loss makers like irrigation works. State Electricity Boards and State Road Transport. The biggest losses are made by SEBs. It is estimated that the losses incurred by SEBs rose from Rs.4,117 crores in 1991-92 to Rs.24,063 crores in 2001-02 these losses were incurred because power was supplied at a mere 240 paise per unit as against the production and distribution cost of 350 paise per unit.

The losses of State Road Transport Undertakings (STRUs) were of the order of Rs.1,282 crores in 1997-98. The situation has been summed up ably by CME in the following words: "It is the losses of the Central Government enterprises, which have generally received maximum publicity. It is not realised, however, that the worst culprits in this respect are to be found among state governments. There, the State Electricity Boards, the irrigation works, the Road Transport Corporations and other State Government owned enterprises have the most scandalous record of making losses."

So far as the Central Government is concerned, the public sector enterprises have shown a net profit of Rs.26,045 crores in 2001-02, as against a loss of Rs.203 crores in 1980-81. This indicates overall improvement. But 50 per cent of the total profit is contributed by petroleum enterprises only by raising the price of oil. The Government should, therefore, make a case-by-case study of the loss incurring enterprises and take remedial action.

(ii) Political factors influence decision about location. It has been noted that in many situations, political factors influence decisions about location of projects. Powerful ministers in the ruling party make promises about the future location of projects in a state irrespective of the results of the feasibility study about costs. This approach leads to a considerable wastage of capital resources. A classic instance of this political but irrational approach, is the decision of the Central Government to break-up the MIG aircraft project into two parts to be located in two separate states. These two locations-Nasik and Koraput are over 900 kms apart. This was done to satisfy two powerful political bosses from two states.

(iii) Delays in completion and increase in costs of construction. Many reports on the working of public sector projects have pointed out that many of the projects took longer time to complete than was initially envisaged. Not only that, the cost of the projects was also revised upwards. For instance, in the case of Trombay Fertilizer Project, it took 6-7 years to complete against the original estimate of 3 years. Similarly, the original estimate of cost was Rs.27 crores (1959) and the final cost stood at about Rs.40 crores (1965). Most of the delay in construction time-schedule and increase in costs can be traced to poor and inadequate project planning. It is very necessary to prepare comprehensive construction plans so that the avoidable delays and increases in costs should not put additional burden on the scarce resources.

(iv) Over-capitalisation Public sector projects are charged with over-capitalisation. In other words, the input-output ratio obtaining in many projects was unfavourable. The Study Team found several undertakings, viz. Heavy Engineering Corporation, Hindustan Acronautics, Fertilizers Corporation (Trombay Projects), etc. over-capitalised. In this connection the Study Team mentioned: "The causes leading to over-capitalisation can be traced to inadequate planning, delays and avoidable expenditure during construction, surplus machine capacity, tied and resulting in the compulsion to

purchase imported equipment on a non-competitive basis, expensive turn-key contracts, bad location of projects and the provision of housing and other amenities on liberal scale."

(v) Price Policy. The pricing policies of the public sector undertaking a.e. not guided solely by the profit maximisation principle, but are under the regulation and control of the Government. Most of the public enterprises produce products, which serve as inputs for other sectors of the economy. It would be suicidal from the point of view of the overall growth of the economy if the prices of steel, oil, fertilisers or coal are fixed very high. The public sector has to keep in mind the social implications of its price policy. In this connection, it is important to remember that in much case, under public pressure, prices are kept low even when costs and prices have been rising. This naturally affects commercial profitability.

In most public sector enterprises, pricing policies are not rational. They have no declared price policy, except perhaps that they have some departmental directives and adhoc piecemeal orders. It is being gradually realised in the country that profit should be recognised as an index of efficiency and that the profit motive is not inconsistent with the broad objective of the socialist pattern of society. There can, however, be not hard and fast rule on the question of price policy for public sector undertaking. There are some enterprises, which are run by the Government mainly to protect the interests of consumers, and considerations of profit should be the least important. But there are some public enterprises, which are basic to others, and public operations can help in all-round economic development only when prices are fixed without regard to high profits. There is yet a third group of public enterprises in which high profit policy can safely be adopted. It is necessary that the Government classifies its enterprises under these three groups and acts accordingly.

(vi) Use of manpower resources in excess of actual requirements. It has been brought out that in most public enterprises manpower is in excess of actual requirements. There is poor manpower planning and this is clearly reflected in the inadequate arrangements for training and education of workers. The unsatisfactory salary and wage rates and the absence of incentives to staff have resulted in the flight of personnel from the public sector to the private sector. It has been suggested that top position in a public sector undertaking should also be opened to its employees. Besides, professional and technical persons of an undertaking should be trained and induced into man-agreement.

Labour indiscipline was one of the causes for the poor performance of the public sector enterprises in recent years. Indiscipline among the workers and poor management-labour relations plagued many of the large government enterprises. Supervision was also difficult in giant undertakings. The situation is not very happy, Government should make a determined bid to improve industrial relations.

(vii) Capacity utilisation. During 2001-02, 110 units or 52 per cent of all manufacturing producing units had recorded capacity utilisation of more than 75 per cent. On the other hand, 38 public sector enterprises operated in the capacity utilisation range of 50 to 75 per cent and 64 functioned below 50 per cent utilisation of rated capacity. This is certainly not an optimum situation. It is very necessary to find the causes of low capacity utilisation and thus remedy the situation by appropriate measures.

(viii) Faulty controls. The poor performance of public sector enterprises is often ascribed to faulty controls, financial and otherwise, exercised over them. At present, the Finance Ministry and the Minister-in-Charge of the undertaking and the Parliament exercise control. The Ministry of Finance exercises excessive financial control over the operations of public enterprises in India, which have to submit to all the budgetary controls applicable to Government departments. The audit of the Auditor-General tends to be inhibitive of all initiative by the enterprises. Parliamentary control over the operations and capital development plans of public enterprises tend to become quite rigid. There is, therefore, the need to provide greater functional autonomy to the management of public enterprises.

(ix) Inefficient management. Managerial effectiveness and efficiency are crucial factors in improving the overall performance of the public enterprises. For efficiency in business and industrial

enterprises it is necessary that operational decisions are prompt. This necessitates a large measure of autonomy and flexibility of operations in the Government enterprises. Again, delegation of authority and elasticity in working are needed in a high degree. Within the enterprise itself the delegation of authority from the top management to lower levels is another essential condition for efficiency in operation. Every officer should know what he is required to do and what result he is expected to produce. Unfortunately, there has been general failure to define responsibilities and duties in public sector enterprises in India. Finally, the successful operation of public enterprises is dependent upon the availability of experienced persons to fill up top positions. Public enterprises are sarcastically referred to as 'colonies for bureaucrats'. In the initial stages, the officers of the ministry who provided funds, for the projects, also pre-empted the right of management. In this way they infused 'bureaucratic blood' in the system. An unfortunate practice has been to use bureaucrats as chairmen, managing directors and managers of public enterprises. Many of them are not really qualified to run industrial enterprises. The government should progressively shift to professionalised management in these enterprises.

In conclusion, it may be pointed out that the picture of the public sector generally painted by Federation of Indian Chambers of Commerce and Industry. Forum of Free Enterprise and such other organisations is too black. It is equally true that all the public sector enterprises are not functioning efficiently. The competitiveness of the private and public sector projects should act as the motivating mechanism for improving efficiency in both the sectors.

7. NEW DIRECTIONS OF POLICY ON THE PUBLIC SECTOR

The expansion of the public sector was based on the Industrial policy Resolution of 1956, which assigned a strategic role to the public sector. Development of heavy and basic industries and the provision of infrastructure were the main tasks of the public sector. Massive investments were made over the past 45 years to build the public sector. Many of these enterprises successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in a number of areas. There is no doubt that the public sector established an industrial base of the economy which enabled the private sector to undertake investments in other areas as infrastructural facilities were made available by the public sector. "However, after the initial concentration of public sector investment in key infrastructure areas, public enterprises began to spread into all areas of the economy including non-infrastructure and non-core areas. This has resulted in poor general overall performance of the public sector which has manifested itself in low or negative returns to public investment."

To improve the performance of the public sector, the Government of India announced in July 1991 the new Industrial Policy, which contained the following decisions pertaining to the public sector.

(i) Portfolio of public sector investments will be reviewed with a view to focus the public sectors on strategic, hi-tech and essential infrastructure. Whereas some reservation for the public sector is being retained there would be no bar for area of exclusivity to be opened up to the private sector selectively. Similarly the public sector will be allowed entry in areas not reserved for it.

(ii) Public enterprises which are chronically sick and which are unlikely to be turned around will, for the formulation of revival/rehabilitation schemes, be referred to the Board for Industrial and Financial Reconstruction (BIFR), or other similar high level institutions created for the purpose. A social security mechanism will be created to protect the interests of workers likely to be affected by such rehabilitation packages.

(iii) In order to raise resources and encourage wider public participation, a part of the government's share holding in the public sector would be offered to mutual funds, financial institutions, general public and workers.

(iv) Boards of public sector companies would be made more professional and given greater powers.

(v) There will be a greater thrust on performance improvement through the Memoranda of Understanding (MOU) system through which managements would be granted greater autonomy and will be held accountable.

Revival Sick PSUs

In pursuance of the policy announced in 1991, the Government brought out a monograph on the Performance of the Central Public Sector Enterprises and decided to refer the chronically sick enterprises to the BIFR for the formulation of revival/rehabilitation schemes. Till the end of March 2001, 66 PSUs have been referred to BIFR, which has so far sanctioned revival packages in respect of 13 PSUs.

In case of 27 units, winding up operations have been undertaken. It is heartening to note that [illegible] units are no longer sick and have started earning profits. 12 cases are under enquiry by the BIFR

The Government has also been opening out certain important and strategic areas to the private sector. The power sector is being opened to the foreign companies. Similarly, the Government has to invite multinationals in the tele-communication sector. As there is very strong resistance by the trade unions to moves of privatization, the Government pushes its policy of opening out areas hitherto reserved for the public sector to private sector – indigenous or foreign – cautiously.

The main elements of Government policy towards public sector Undertakings (PSUs) are:

1. Bring down Government equity in all non-strategic PSUs to 26 per cent or lower if necessary.
2. Restructure and revive potentially viable PSUs.
3. Close down PSUs which cannot be revived, and
4. Fully protect the interest of workers.

VRS to shed the load of excess workers

Secondly, the Government had been making an effort to shed the load of excess workers in the public sector. It initially toyed with the idea of exit policy but abandoned it due to the strong resistance by the trade unions. It followed a policy of offering a package for voluntary retirement scheme (VRS) and it has succeeded. Public Enterprises Survey (1992-93) mentions: "Large scale employment generation by public enterprises has over the years, led to a situation where some of the enterprises are saddled with over-employment or excess manpower resulting in low level of manpower productivity. Government had initiated a voluntary retirement scheme in public enterprises during 1988 to help them shed excess manpower and to improve the age-mix and skill-mix." As a result of the VRS, the number of regular employees, which stood at 22.19 lakh in 1990-91, have been brought down to 17.42 lakh in 2000-01. The National Renewal Find (NRF) was created in February 1992 to provide a safety net to persons seeking voluntary retirement. A sum of Rs.540 crores was released in 1993-94 and till March 1998, a total sum of Rs.1,500 crores was released for NRF. The government has revised the VRS and made it more attractive. As a consequence, according to Public Enterprises Survey 2000-2001, [illegible] lakh employees opted for VRS upto 31 March 2001. All this is being done to reduce surplus manpower in PSUs.

Memorandum of Understanding (MOU)

The Government on the recommendations of the "Committee to Review the Policy for the Public Enterprises (Arjun Sengupta Committee (1985)) has entered into Memoranda of Understanding (MOUs) with a number of PSUs. The main aim of the MOU is to bearing about a balance between autonomy and accountability. Leaving the public enterprises, which were to be referred to the BIFR the Industrial Policy (1991) extended the scope of Memorandum of Understanding (MOU) to all public sector enterprises (PSEs). The main goal of the MOU Policy is to reduce the "quantity" of control and increase the "quality" of accountability. This is sought to be done by specifying in clear terms the

measurable goals and giving each PSE greater operational autonomy to achieve them. The real purpose of MOU is to manage PSEs by management by objectives rather than management by control.

By holding them accountable for procedures, not only has the scope of MOU Policy enlarged significantly but the focus of MOU Policy has also become market, oriented and in tune with other reforms initiated by the Government. For the first time, since the inception of the public sector, an attempt has now been made to free them from the administrative control of the Ministries and permit them to operate autonomously in a competitive environment.

104 Public sector enterprises (PSEs) had signed MOUs for the year 2001-02. According to the Public Enterprises Survey (2001-2002) on the basis of the self-evaluation by 104 PSE, 42 were rated excellent, 24 very good, 15 good, 12 fair and only 3 were rated poor.

PRIVATISATION OF PUBLIC SECTOR ENTERPRISES: THE DISINVESTMENT PROGRAMME IN INDIA

MEANING AND RATIONALE OF PRIVATISATION

Privatisation is a process by which the government transfers the productive activity from the public sector to the private sector. Many countries of the world-industrial market economies, for former socialist economies (belonging to Central and Eastern Europe and Soviet Union), and a large number of developing countries belonging to Asia, Africa and Latin America-have launched massive programmes of privatisation during the period of last two-three decades or so. While many industrial market economies (particularly OECD member countries) have carried out the programme of privatisation on their own accord, former communist countries and many developing countries were forced by the IMF and World Bank to carry out privatisation as a condition for assistance under the economic stabilisation and structural adjustment programmes.

According to the supporters of privatisation, the rationale for privatisation and disinvestment is as follows:

1. The private sector introduces the 'profit-oriented' decision making process in the working of the enterprise leading to improved efficiency and performance. Moreover, private ownership establishes a market for managers, which improves the quality of management.

2. While personnel in the public enterprises cannot be held responsible (or accountable) for any lapse, the areas of responsibility in the private sector are clearly defined. This makes it possible to take people to task in the private sector units for any blunders committed by them whereas in public sector units, it is easy to pass the buck. Even when responsibility is defined in the public enterprises, there are too many pressures and forces operating to reduce its effective implementation.

3. Private sector firms are subject to capital market disciplines and scrutiny by financial experts. In fact, the ability to raise funds in the capital market is crucially dependent on performance. Not so in the case of public enterprises. On account of government ownership of these enterprises, they have easy access to credit and budgetary support irrespective of their performance. Thus there is no compulsion for these enterprises to perform well.

4. According to Bimal Jalan, political interference is unavoidable in public corporations and is a major cause of decline in operational efficiency. "Such political decision-making reflects itself in the less than optimal choice of technology or location, overstaffing, inefficient use of input, and purchase

or price preferences for certain suppliers." Most governments also impose non-economic objectives on public enterprises.

5. Many public sector enterprises remain 'headless' for long periods of time. This causes confusion and delay in decision-making as nobody is sure how the new incumbent will act (or react) on the policy decision being undertaken. Such a situation does not exist in private sector enterprises as the heir apparent is identified early on and groomed to take over the reins when the time actually arrives.

6. In a quick changing business environment it often becomes necessary to take spot decisions without having to worry too much about not having consulted others. In fact, 'delayed decision-making is often equivalent to making no decision at all.' In public enterprises, the concept of response time is almost totally absent as no one is willing to disturb the status quo. Not so in the case of private sector enterprises. Because of the very nature of management in these units, it becomes easier to react to changing situations fast.

7. Private sector firms are more subject to liquidation, threat of takeover, and loss of assets for owners than public sector enterprises. When owners stand to lose control over assets, there is greater likelihood of remedial measures being taken earlier.

8. According to Bimal Jalan, efforts to improve managerial efficiency in public enterprises by administrative measures are generally short-lived and unsustainable as, sooner or later, political considerations take precedence over economic or commercial considerations. This has happened in many countries including Italy, France, Korea, India and Pakistan.

9. The very survival of private sector enterprises depends on customer satisfaction since only such satisfaction can ensure more widespread and repeat buying. As against this, so the argument goes, caring for the customer is generally not a priority with public sector enterprises. Once privatisation occurs, the need to create and sustain markets will lead to a sea change in the attitude of these enterprises towards customers. Hence, quality of services will improve.

METHODS OF PRIVATISATION

The first major programme of privatisation was adopted in U.K. by the conservative government of Margaret Thatcher during 1980s. In this swift and widespread programme, a large number of public sector companies that dominated a wide swathe of industry and services in U.K., including railways, acroscape, oil, telecommunications, mining, and bus services were sold off. This was followed by privatisation in France and many other OECD countries, former communist countries, and developing nations. The methods of privatisation used by these countries were frequently one or a combination of the following methods.

Initial Public Offering (IPO). This is the most important method used for privatisation in UK and OECD countries. Under this method, the shares of public sector undertakings (PSUs) are sold to the retail investors and institutions. The government may, in some cases, sell shares of a PSU in international market also. The IPO method is the best method in the case of those countries, which have a strong capital market. In fact, OECD countries raised as much as two-thirds of all their privatisation proceed in 1990s through IPOs. The main advantage of the IPO method are as follows: (i) it ensures wide participation of retail investors and thus helps in a broad-based control of the public sector entity at the same time as it helps in the widening and deepening of the capital market; (ii) it is likely to face less resistance from the PSU employees as there is a continuity in the management; (iii) it can be used to offer shares to the employees; and (iv) it can be employed usefully in those cases where the government wants to raise resources but does not want to lose control of the enterprise. However, the main problem in this method is the problem of 'valuation' – i.e. what should be the 'price' of the share? Since in most countries shares of public sector undertakings are not traded on the stock exchanges, it is not possible to find out the right price at which the government should sell the shares of a PSU. As we shall point out later in this chapter, as a result of this problem, the Government of

India actually obtained much less through disinvestment as it could have had (because in many cases the shares were undervalued). Moreover, this method cannot be adopted in small countries with weak capital markets and institutions.

Strategic Sale. In this method, the government sells its share in the PSU to a strategic partner. As a result, the management passes over to the buyer. The advantages claimed for this method are as follows: (i) the performance and efficiency of the enterprise is expected to improve as the private partner introduces better management practices on the one hand, and the unit is freed from government shackles on the other hand; (ii) the government may realise a better price as the strategic partner may be willing to pay more because of the synergy he perceives in combining the PSU business with his own existing business; (iii) the strategic partner would be willing to inject more capital into the PSU and modernise its business operations as he would be keen in generating profits; (iv) loss-making PSUs will be unattractive to the public whereas a strategic acquirer can have the skills to turnaround the business even after paying a reasonable price; and (v) this method is the most important method of disinvestment in small countries with weak capital markets and in those countries where shares of PSUs are not traded (and hence it is not possible to know the 'share price'). However, this method has a number of disadvantages; (i) this method is 'unfair' as many ordinary citizens cannot participate in it; (ii) the whole process of selecting a strategic partner and setting the terms of sale depends on the ministers and officials. Thus the whole process is non-transparent and arbitrary. Since it is very difficult to assess the 'actual' value of the enterprise, the strategic partner often connives with government officials to get control over the company at a value far less than the actual value of the enterprise. As a result, the government gets a far less realisation from the sale vis-à-vis the actual value; (iii) the acquisition of a PSU with a significant market share by a partner in a similar business can lead to a monopolistic or oligopolistic situation, which could be harmful to consumer interests; (iv) there is a serious risk of employees losing their job as the strategic partner is likely to restructure the PSU business to align with his existing business; and (v) once even a small part of the equity is sold to a strategic partner, other potential bidders will be put off, thereby lowering the value of the rest of the PSU's share.

Smaller countries, especially those in the former Soviet Union and Eastern Europe (the so-called 'transition economies') have often relied more on the method of strategic sales to privatise their PSUs. This is due to the reason that most of these countries did not have well-developed capital markets and shares of PSUs were not traded. Therefore, it was not possible to find the correct share price of a company. Some OECD countries during the last couple of years have also followed this method. In some cases, a combination of IPO method and strategic sales method is adopted. Two approaches are followed in these instances: (i) first a controlling stake is sold to a strategic buyer through a direct sale in order to provide the company with a good management and then subsequent stakes are sold through a public offering to retail and institutional investors as a means of developing the equity market; or (ii) first a share in the company is sold on the stock markets, and once its 'market price' is determined, a controlling stake is sold to a strategic partner. This is closer to what is happening in the case of our oil companies.

In most OECD privatisations, a portion of the shares are allocated for sale to employees, in order to ensure their participation in privatisation and to gain their support. Poland's sale of a stake in telecom company TPSA, for instance, involved a series of steps including a strategic sale, subsequent public offering and a share going to the employees.

Sale to Foreigners. This is a variant of the strategic sales method where the buyer is not a domestic company but a foreign company. In small countries, the amount of domestic private capital is often limited. Therefore the government sells its stakes to a foreign company. At times, sales to a foreign company are preferred as the expectation is that the foreign company will bring with it world-class technology and expertise to run the PSU. For instance, Hungary received $ 12 billion through privatisation over the period 1990 and 1998 and of this, as much as 60 per cent was contributed by

foreign investors. The countries of South America have also seen many key companies, including two water companies in Chile, pass into foreign hands in the 1990s. In case where the government has set up a PSU in collaboration with a foreign company, it may simply sell its stake to the latter. This is what the Government of India has done in the case of Maruti Udyog Ltd. where it has sold its stake to the foreign collaborator Suzuki company of Japan.

Equal-Access Voucher Programmes. This form of privatisation involves distribution of vouchers across the population and attempts to allocate assets approximately evenly among voucher holders. Such programmes excel in speed and fairness. However, they raise no revenue for the government and have unclear implications for corporate governance. Mongolia, Lithuania, the former Czechoslovakia, Albania, Armenia, Kazakstan, Poland and Romania (in its 1995 programme) followed this method of privatisation. The Czech Republic's equal-access voucher programme has been the most successful to date. In two successive waves, the Czech transferred more than half the assets of public enterprises into private hands. Citizens were free to invest their vouchers directly in the firms being auctioned. However, to encourage more concentrated ownership and to create incentives for more active corporate governance, the programme allowed the free entry of intermediary investment funds to pool vouchers and invest them on the original holders' behalf. More than two-thirds of the voucher-holders chose to place their vouchers with these competing funds. This led to concentrated ownership of the Czech industrial sector in these large funds. These funds are now participating actively in monitoring managerial performance, imposing financial strategic investors, etc. Thus, the Czech experience shows how a well-designed voucher-programme can overcome many problems. "It can depoliticize restructuring, simulate development of capital markets, and quickly create new stakeholders with an interest in reform." However, as correctly pointed out by the World Development Report, while funds monitor the functioning of firms, the question is who will monitor them? Supervising financial agents is difficult even in established market economies and is even more problematic in transition economies, where norms of disclosure and fiduciary responsibility are weak and watchdog institutions are still in a highly underdeveloped state.

Management – Employee Buyouts. In this route to privatisation, managements and employees themselves buy major stakes in their firms. This method has been widely used in Croatia, Poland, Romania, and Slovenia. In addition, several voucher-based programmes, such as those of Georgia and Russia, gave such large preferences to insiders that most privatised firms were initially owned mainly by managers and employees. The advantage of this method is that it is easy to implement both politically and technically. It might also be better for corporate governance if insiders have better access than outsiders to the information needed to monitor managers. However, as pointed out by the World Development Report, the risks and disadvantages of the method are many, particularly in large-scale buyout programmes that include many unprofitable firms in need of restructuring. One important disadvantage is that benefits are unevenly distributed: employees in good firms get valuable assets while those in money-losers get little or nothing of value. The second disadvantage is that government tends to charge low prices to insiders and thus realizes little revenue. Finally, managers or employees can connive to block entry of outsiders. At times, outsiders may hesitate to invest in firms with significant insider ownership – legally or illegally acquired – because of potential conflicts of interest between insiders and outside owners. In Russia's mass privatisation programme of 1992-94 (which, despite the use of vouchers, was basically a management-employees buyout programme because of its preferential treatment of managers and workers), insiders ultimately acquired about two-thirds of the shares in the 15,000 privatised firms (accounting for 60 per cent of industrial assets) while outsiders obtained only 20 to 30 per cent (about 10 to 15 per cent each went to investment funds and industrial investors), and rest remained in government hands. This exercise soon became politically unpopular as the masses felt that they had been left with the dregs while managers engaged in 'asset stripping', and effective control of the best companies passed into the hand of a chosen few.

THE DISINVESTMENT PROGRAMME IN INDIA

As stated in the chapters on 'Industrial Policy' and 'Public Sector in the Indian Economy', there has been a marked change in the perception towards the role of public sector in the Indian economy since 1991. Some economists argued that the fiscal crisis of 1991 was a result of the public sector's inability to generate adequate returns on investment. The government's attitude also changed markedly as is clearly demonstrated in the following statement made in the New Industrial Policy, 1991: "After the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems are observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate to R & D (Research and Development) and human resource development. In addition, public enterprises have shown a very low rate of return on ments as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government." Consequently, the New Industrial Policy, 1991, advocated privatisation of public sector enterprises. For purposes of privatisation, the government has adopted the route of disinvestment, which involves the sale of the public sector equity to the private sector and the public at large. The main approach of the government in this regard is to bring down its equity in all non-strategic public sector undertakings to 26 per cent (or lower) and close down those public sector undertakings which cannot be revived. The disinvestment programme began in 1991-92 and government stakes in 48 companies have been sold in varying degrees by 2002-03. Till 1998-99, the government used to sell minority stakes through domestic or international issue of shares in small trances every year. Post 1999-2000, there has been a greater stress on strategic sale—involving an effective transfer of control and management to a private entity, the argument being that the government would get a better price from the private sector if it were ceding actual control. The prominent companies that have witnessed strategic sale in the recent past include Modern Foods, BALCO, CMC, VSNL, IBP, ITDC Hotels, Maruti Udyog Ltd. and HZL.

Objectives of the Disinvestment Programme

The government of India laid down the following objectives for its privatisation programme: (i) raising of resources, (ii) reducing day to day interference in the working of the public sector enterprises by loosening the shackles of bureaucratic government control, and (iii) giving the managements the autonomy to act on their commercial judgement. In a suo moto statement laid in both Houses of Parliament on December 9,2002, the government announced its policy that the main objective of disinvestment is to put national resources and assets to optimal use and in particular to unleash the productive potential inherent in the PSUs. The policy on disinvestment thus specifically aims at:" (i) modernisation and upgradation of public enterprises; (ii) creation of new assets; (iii) generation of employment; (iv) retiring of public debt; (v) to ensure that disinvestment does not result in alienation of national assets, which, through the process of disinvestment remain where they are. It will also ensure that disinvestment does not result in private monopolies; (vi) setting up a Disinvestment Proceeds Fund; (vii) formulating the guidelines for the disinvestment of natural asset companies; and (viii) preparing a paper on the feasibility and modalities of setting up Asset Management Company to hold, manage and dispose the residual holding of the government in the companies in which government equity has been disinvested to a strategic partner. In this statement, the government also announced its decision to disinvest in two oil companies – Bharat Petroleum Corporation Ltd. (BPCL) and Hindustan Petroleum Corporation Ltd. (HPCL).

Rangarajan Committee on Disinvestment of Shares

The Government appointed a Committee on Disinvestment in Public Sector Enterprises under the chairmanship of C. Rangarajan in 1993 to suggest the correct method of divestiture. In its Report the Committee suggested that the best method for disinvestment be by offering shares of PSUs to be general public at a fixed price through a general prospectus. However, since these shares have not been traded so far on the stock market, it would be difficult to decide the 'fixed price' at which they should be offered to the public. Once a reasonable time has elapsed and a normal trading atmosphere established in the market, this indeed would be the best method. Till then, the auction method with wide participation may be adopted. The other important recommendations of the Committee were as follows:

1. As far as the target level of disinvestment is concerned, it should be decided on the basis of the desirable level of public ownership in an activity or unit consistent with industrial policy. In all those units, which are reserved for the public sector, the percentage of equity disinvested should be 49 per cent so that the government (by owning 51 per cent equity) retains control over the management. In other cases, the percentage of equity to be disinvested should be 74 per cent.

2. Instead of year-wise targets of disinvestment, a clear action plan should be evolved.

3. A number of steps need to be undertaken which may include corporatisation of the PSEs, restructuring of finance with a proper debt-equity gearing and an independent Regulatory Commission for the concerned sector, if necessary.

4. The choice of method of valuation of shares of a PSE needs to take into account the special circumstances affecting PSEs operations, such as, the past focus on social responsibilities rather than pure commercial considerations.

5. A scheme of preferential offer of shares to workers and employees in PSEs may be devised.

6. Ten per cent of the proceeds of disinvestment may be set apart by the government for lending to the PSEs on concessional terms to meet their expansion and rationalisation needs.

7. A Standing Committee on Public Enterprises Disinvestment may be constituted to oversee the action plan for reform, restructuring and disinvestment as well as monitoring the evaluation of progress made.

The Disinvestment Commission

The Government constituted a five member Public Sector Disinvestment Commission under the chairmanship of G.V. Ramakrishna in August 1996 for drawing a long-term disinvestment programme for the PSUs referred to the Commission. The Commission had wide ranging terms of reference and was asked to determine the extent of disinvestment in each PSU, modalities of disinvestment and the order in which the process should be undertaken. The long-term strategy of the Disinvestment Commission had four objectives: (i) strengthen PSUs, where appropriate, in order to facilitate disinvestment; (ii) protect employees' interest; (iii) broad-base ownership; and (iv) augment receipts for the government.

As a broad approach, the disinvestment Commission supported prior restructuring of the PSUs before disinvestment based on global experiences that restructuring before disinvestment enhances share value and maximises sales proceeds. The three broad areas of restructuring in Indian context would be corporate governance, financial restructuring, business and technological restructuring. Where restructuring involves administrative action without significant outlays and enhances share value, it could precede disinvestment. However, in cases that require considerable restructuring, a cost-benefit analysis may have to precede the actual exercise. When restructuring requires considerable effort, or is laced with uncertainties, it would be advisable to disinvest on as-is-where-is basis. An appropriate code of corporate governance would ensure that the enterprise would be run in the interest of its shareholders including minority shareholders, and would provide an optimal balance between autonomy and accountability. Financial restructuring is required not only for loss making public

enterprises but may be needed for other public sector enterprises as well where the capital structure may be skewed in favour of either debt or equity. As far as business and technological restructuring is concerned, it may be necessary to determine core competencies of each PSU and decide on the relative importance of each business. Business restructuring may involve having off businesses, which are no longer attractive from the point of view of returns or are a drag on other profitable operations. Technological restructuring may be required to sustain or improve the competitive position of technology driven public sector enterprises.

The Disinvestment Commission expressed itself in favour of adopting a case by case approach in terms of unit specific disinvestment strategy after taking into account various aspects of the units, for example, industry category, competitive position and profitability. Accordingly, the Commission broadly classified the PSUs into two categories for disinvestment, viz., the core group and the non-core group. The PSUs in the core group are defined as having a considerable market presence. In these PSUs, as the private sector is yet to mature fully, the public sector disinvestment would be limited to a maximum of 49 per cent for time being. The non-core group industries were defined as the units where private sector player had already made huge investments. With the aim of enhancing the intrinsic value of PSU shares, the Disinvestment Commission recommended that the core as well as non-core PSUs should be restructured prior to disinvestment.

For providing continuity to the process of disinvestment in various PSUs, the Commission recommended the formation of a Standing Empowerment Group (SEG), comprising the Cabinet Secretary, Secretaries of Ministry of Finance, Department of Public Enterprises, Administrative Ministry of the PSU alongwith the CEO of the concerned PSU. As far as the question of autonomy is concerned, the Commission recommended a graded delegation of autonomy for three categories of PSUs, namely general autonomy to all PSUs, additional autonomy to 'moderate performers' and full autonomy to 'strong performers.' As a necessary pre-condition to disinvestment for companies dealing with petroleum products, the Commission recommended the dismantling of the Administered Price Mechanism (ARM) for petroleum products. The Commission also gave its views on important issues like creation of Disinvestment Fund, revamped VRS, Employee-Pension-cum-Insurance Scheme, counseling service for employees availing of VRS and safeguards to officers and staff for bonafide commercial decisions.

The Disinvestment Commission examined each of the 58 PSUs referred to it and advised the government on the extent of disinvestment feasible as well as the mode of disinvestment and the steps to be initiated. The Disinvestment Commission had made recommendations under five broad categories. These were: (i) strategic sale involving change in ownership/management in 29 PSUs and trade sale of 8; (ii) offer of sale of shares involving no change in ownership/management in 5 PSUs; (iii) deferment of disinvestment in 8 PSUs and no disinvestment in 1; (iv) closure/sale of assets in 4 PSUs; and (v) employee buy-out/strategic sale in 2.

The government reconstituted the Disinvestment Commission in July 2001 with R.H. Patil as Chairman. The government has decided to refer all 'non-strategic' PSUs, including subsidiaries (but excluding IOC, ONGC and GAIL) to the Commission for independent advice. The Ministry of Disinvestment is looking after the process of disinvestment.

Proceeds from Disinvestment and Methodologies Adopted

As stated earlier, the Government has adopted two methods of disinvestment over the period 1991-92 to 2002-03: (i) selling of shares in select PSUs and (ii) strategic sale of a PSU to a private sector company. The former method was used over the period 1991-92 to 1998-99 and since 1999-2000 the emphasis shifted to the latter method. As far as the sale of shares is concerned, the government experimented with various variants as is clear from Table 1. This Table also gives the targets and achievements of disinvestment in different years.

Table 14
Disinvestment n PSUs and Methodologies Adopted

Year	No. of Companies In which Equity sold	Target Receipt for the year (Rs. in crore)	Actual receipt (Rs. in crore)	Methodology
1991-92	47 (31 in one tranche and 16 in other)	2500	3038	Minority shares sold by auction method in bundles of 'very good', 'good' and 'average' companies.
1992-93	35 (in 3 tranches)	2500	1913	Bundling of shares abandoned. shares sold separately for each company by auction method.
1993-94	-	3500	Nil	Equity of 7 companies sold by open auction but proceeds received in 94-95
1994-95	13	4000	4843	Sale through auction method, in which NRIs and other persons legally permitted to buy, hold or sell equity, allowed participating.
1995-96	5	7000	362	Equities of 5 companies auctioned and Government rode piggyback in the IDBI fixed price offering for the fifth company
1996-97	1	5000	380	GDR (VSNL) in international market.
1998-99	5	5000	5371	Domestic offerings with the participation of FIIs (CONCOR, GAIL). Cross purchase by 3 Oil sector companies i.e GAIL, ONGC and Indian Oil Corporation
1999-00	2	10000	1829	GDR (GAIL), Domestic issue (VSNL), restructuring (BALCO), MFIL's strategic sale and others.
2000-01	4	10000	1869	Strategic sale of BALCO, LJMC, Takeover KRL (CRL), CPCL (MRL), BRPL.
2001-02	10	12000	5632**	Strategic sale of CMC (51%), HTL (74%), VSNL (25%), IBP (33.58%). PPL (74%), and sale by other modes (ITDC & HCI), surplus reserves STC and MMTC.
2002-03	6	12000	3342@	Strategic sale of JESSOP (72%), HZL (26%), IPCL (25%) and other modes (HCI, Maruti).
Total	48*	78,300	29481**	

* Total number of companies in which disinvestment has taken place so far.

** Figures (inclusive of amount expected to be realised, control premium, dividend/dividend tax and transfer of surplus cash reserves prior to disinvestment etc.

@ Till January 31,2003.

Source: (i) The ET Disinvestment Survey: "One Thousand Ways to Lose Control", in *The Economic Times*, March 21,2003, and

(ii) Government of *India, Economic Survey*, 2002-03 (Delhi, 2003), Table 7.22, p.149.

Initially in 1991-92, the government offered shares for sale in 'bundles' involving a combination of equity from poor and good performers. In practice rather than held the government divest shares in loss-making PSUs at reasonable prices, bundling resulted in the government obtaining a very low average price for each bundle, implying that prime shares were handed over at rock-bottom prices. In 1992-93, the government abandoned the bundling of shares and sold shares of each company separately by the auction method. In 1994-95, NRI and other persons were allowed to participate in the auction. In 1996-97 and 1997-98, GDRs (Global Depository Receipts) of VSNL and MTNL in international markets fetched Rs. 380 crore and Rs. 980 crore respectively. In 1998-99, alongwith GDR and domestic offerings with the participation of foreign institutional investors, cash-rich PSUs (like ONGC, GAIL and IOC) wore forced to 'cross hold' shares in related PSUs by buying them from the government. Since 1999-2000, as stated earlier. The focus of the government shifted to the second method of disinvestment—the strategic sale of a PSU to a private sector company. As is clear from Table 1, the government resorted to strategic sale of a number of companies – (MFIL) (Modern Foods India Ltd),Videsh Sanchar Nigam Ltd. (VSNL), Indian Petrochemicals Corporation Ltd. (IPCL), Bharat Aluminium Company (BALCO), CMC Ltd. HTL Ltd. IBP, Indian Tourism Development Corporation (ITDC) (13 hotels), Hotel corporation of India Ltd. (HCI) (Hotels), Paradeep Phosphates Ltd. (PPL), Hindustan Zinc Ltd. (HZL), Maruti Udyog Ltd. (MUL) etc. Some details of these strategic sales are as follows: 100 per cent stake in MFIL sold to Hindustan Lever for Rs. 105.45 crore; 51 per cent stake in BALCO sold to Sterlite Group for Rs. 550 crore; 51 per cent stake in CMC Ltd. sold to Tata Sons for Rs. 1,491 crore; 25 per cent stake in VSNL sold to Tata group for Rs. 1,439 crore; 74 per cent stake in Paradeep Phosphates sold to Zuari Maroc Phosphates for Rs. 151.70 crore; 50 per cent stake in Maruti Udyog Ltd. sold to Suzuki Motor Corporation for Rs. 2,424 crore etc. In addition, *100 per cent equity in a number of hotels belonging to ITDC and Hotel Corporation of India has been* sold.

A CRITIQUE OF PRIVATISATION AND DISINVESTMENT

The policy of privatisation and disinvestment has been criticised on the following counts:

Undervaluation of Assets

A study of the data presented in Table I shows that the performance on the disinvestment front over the period 1991-92 to 2002-03 has been dismal. Only in three years---1991-92, 1994-95 and 1998-99—the targets for disinvestment were exceeded. According to C.P. Chandrashekhar and Jayati Ghosh, the success in 1991-92 was due to the decision to accept extremely low bids for share 'bundles', which included equity from PSUs, which would have otherwise commanded a handsome premium. The average price at which more than 87 crore shares were sold in this year was only Rs. 34.83 as compared with the average price realisation of Rs. 109.61 since then. In 1994-95, success was due to the off-loading of a significant chunk of shares in very attractive and profitable PSUs like BHEL, Bharat Petroleum, Container Corporation of India, Engineers India, GAIL, MTNL etc. And in 1998-99 the success was due to the reason that cash-rich PSUs like ONGC, GAIL and IOC were forced to buy shares of other PSUs. "This amounted to forcing PSUs, that needed further investment themselves so as to be restructured, to face up to the more liberal and competitive environment, to hand over their invisible surpluses to finance the fiscal deficit of the government."

In all other years, realisations from disinvestment were much less than the targets. The main reasons for this poor performance were as follows:

1. The government carried out the whole exercise of disinvestment in a hasty, unplanned and hesitant way. Thus it failed to realise not only the best value but also the other objectives of the disinvestment programme.

2. The government launched the disinvestment programme without creating the required conditions for its take-off. This would be clear from the fact that it did not try to list the shares of the public sector enterprises on the stock exchanges. Thus, adequate efforts were not made to build-up the much-needed linkage between the public enterprises on the one hand and the capital market on the other.

3. The government did not adopt suitable methods to oversee the disinvestment of public sector shareholding.

4. The Department of Public Enterprise and the Finance Ministry adopted techniques and methods, which resulted in far lower realisation than justified.

On account of all these reasons, there was considerable "under-pricing" of public enterprise shares resulting in considerable loss to the government. To illustrate, consider the underpricing in the first two rounds. In Report No.14 of 1993, the Comptroller and Auditor General of India pointed out that in these two rounds, the exact or loss to the government in percentage terms varied from 127 per cent in the case of HPCL (its share having been sold for Rs.243 against the market price of Rs.550) to as high as 616 per cent in the case of NLC (its share having been sold for Rs.11 against the market price of Rs.82). The average loss consequent upon the underpricing comes to about 256 per cent. If we apply this percentage to the divestiture proceeds for 1991-92 and 1992-93 we find that the potential proceeds would have been Rs.12,554 crore as against the actual realisation of only Rs.4,951 crore.[10] The same problem of underpricing continued in later rounds also. For example, in the seventh round of disinvestment carried out in 1994-95, a small fraction of ownership (generally less than 10 per cent) in high profile companies like the Oil and Natural Gas Corporation, Steel Authority of India, Indian Oil Corporation and Shipping Corporation of India was offered to private investors. The government set a target of raising Rs.4,000 crore from this disinvestment (actual realisation was Rs.4,843 crore). However, it has been estimated that given the then profitability of these high profile companies and their future prospects, the shares offered for sale could easily be worth Rs.8,000 crore. This shows that during the entire disinvestment programme, the public sector equity has been sold for a fraction of what it could actually fetch.[11] A recent example is the sale of BALCO by the government to Sterlite group in February/March 2001 for just Rs.551.50 crore. Its BALCO has been a cash-rich public sector company with reserves and surplus alone worth Rs.460 crore. Its Korba power plant is worth more than Rs.1,100 crore. It has been a profit-generating, dividend paying company contributing around Rs.300 crore to the government by way of taxes and duties. Surprisingly, the valuation of BALCO's assets was entrusted to someone licensed only to assess land and buildings. Out of 22 valuations done by this 'expert,' 15 relate to property assessment and 2 to bicycle factories.[12]

Undervaluation of assets implies substantial losses for the government and therefore for the tax-paying citizens of the country. There is a basic problem with all privatization of public assets which means that they tend to be associated ultimately with losses to the State exchequer rather than gains. If the governments sell the asset that provides income or profit equal to or more than the prevailing interest on government securities, then the government would lose future income by selling it. On the other hand, from the private sector's point of view, it makes no sense to purchase an asset unless it provides at least a rate of return equal to the rate of interest on government securities, because

[10] Sunil Mani, "Economic Liberalisation and the Industrial Sector," *Economic and Political Weekly*, May 27,1995, p.M-45.
Table 7 on p.M-41 and Table 8 on p.M-42,

[11] Assuming a fairly reasonable public earning multiple of 40 for seven corporations (ONGC, SAIL, IOC, MTNL, CCI, NFL and SCI), S.P. Kothari estimates the market value of the shares disinvested at Rs.7,263 crore. See S.P. Kothari, "PSU Divestment: Underselling". *The Economic Times*, November 17, 1994, p.8.

[12] *The Times of India*, February 22,2001, p.1.

that is where the private investor could otherwise put the money. "This means that for such sales to occur, either (a) the private investor must believe that it is capable of generating more profits than the public sector – but that is essentially a management issue and there is no logical reason why the public sector cannot also employ managers to achieve this; or (b) the asset must be undervalued so that the actual rate of return for the private buyer turns out to be higher, which really means that the State exchequer has lost the money."

Utilisation of Money from Disinvestment

As shown above, the public sector equity has been sold for a fraction of what it could actually fetch. However, this is only one part of the story. The entire manner in which the proceeds from disinvestment have been used is objectionable. When the programme of disinvestment was initiated in 1991-92, the Finance Minister had stated that a part of the proceeds would be used for providing resources in the NRF (National Renewal Fund) which can be used for various schemes of assistance to workers to the unorganized sector. Moreover, these "non-inflationary resources would also be used to fund...special employment creating schemes in backward areas". In 1997, the first report of the Disinvestment Commission headed by G.V. Ramkrishna stated that the proceeds of disinvestment should not be used to bridge the budget deficit, but instead should be placed in a separate fund to be used for four purposes: (i) retiring public debt; (ii) restructuring PSUs; (iii) developing the social infrastructure; and (iv) voluntary retirement schemes. Similar sentiments were expressed in various Budget Speeches of the Finance Ministers in various years. For the year 2001-02, the Finance Minister had set the target for disinvestment at Rs.12,000 crore of which Rs.7,000 crore was to be used to provide "restructuring assistance to PSUs, a safety net to workers and reduction of (the public) debt burden" while the remaining Rs.5,000 crore was to be used to provide "additional budgetary support to the Plan primarily in the social and infrastructure sectors". The list of objectives of disinvestment given earlier also expressed such lofty ideals. However, the actual experience with the utilisation of disinvestment proceeds during the last decade belies all these declarations. The government has used the entire proceeds from disinvestment to offset the shortfalls in revenue receipts and thus reduce the fiscal deficit, which it was required to do as part of the IMF stabilisation programme. In this context, the following comments of C.P. Chanrasekhar and Jayati Ghosh are pertinent: "The experience suggests that fiscal convenience was the prime mover of such disinvestment. Having internalized the IMF prescription that reducing or doing away with fiscal deficits is the prime indicator of good macroeconomic management, the government found privatisation proceeds of PSUs to be a useful source of revenue to window-dress budgets". Thus the resources generated from the disinvestment of PSUs have been used to meet current consumption needs. This amounts to frittering away of valuable public assets. It is like selling family silver to support a profligate life style. Moreover, once a PSU is privatised, the government is deprived of the future yields from this enterprise. This could be a large long-term loss in the case of profit generating PSUs. This points to the shortsightedness of the government's disinvestment programme.

Others Criticisms of Privatisation

1. It is often assumed that following privatisation, markets arise quickly to fill up the gap whereas the fact is that many government activities arise because markets have failed to provide essential services. As stated in the previous chapter, many PSUs were set-up in India in the post-Independence period in those fields in which the private sector was either not able to set-up units because of paucity of resources or was simply not interested because of the long gestation period and/or low profit generation possibilities. As argued by C.P. Chandrasekhar and Jayati Ghosh, "Public sector enterprises are not pure profit – making machines, but instruments used by governments to achieve a range of objectives. These could vary from closing infrastructure gaps that may remain if investment was purely private to ensuring access to products crucial to development at appropriate

prices. This would imply that investments are made even in areas where profits are low or non-existent because of the external benefits such projects deliver or those profits are foregone in order to keep prices down in pursuit of other objectives. To ignore such, possibilities and make profits, which contribute non-tax revenues to the government, the sole reason for establishing PSUs, is to conceal the actual grounds on which on which public capital formation has occurred in post Independent India or elsewhere in the world."

2. In late 2001, the Disinvestment Minister Arun Shourie defended privatisation through the strategic sale route by arguing that the interest saved by the government on the sums realised from the strategic sales of MFIL, BALCO, CMC and HTL was many multiples of the dividend it used to earn by holding onto those shares. However, as argued by Chandrasekhar and Ghosh, the relevant comparison is not the dividend (which is the part of profit of an enterprise that is paid to shareholders) but the profit per share, which was much higher in the case of all the above companies in which shares were divested. Moreover, as noted above, even profit is not an adequate indicator of the gain from the creation of a PSU.

In the above context, Chandrasekhar and Ghosh raise another valid point. The statement made by the Minister is not a vindication of privatisation itself. It is an admission of the fact that government has failed to manage the PSUs properly. "This reflects a failure of management, in which case the correct thing to do would be to change the management, not the ownership which is an entirely different issue."

3. One of the genuine fears of labour is that privatisation is bound to result in unemployment. Most of the privatisation experiments around the globe are testimony to the fact that this indeed does happen. The Government of India has been repeatedly harping on the tune that as a result of privatisation there has only been a 'marginal' retrenchment of labour. However, the fact of the matter is that there is a strong pressure from the corporate sector to 'reform' labour laws to enable it to hire and fire workers as it wishes and indications are that the government is falling in line. This means that the future employment scenario for labour is a cause of worry. The fear of retrenchment and consequent unemployment is all the more as there is no safety net scheme for labour worth the name. How many workers will be able to get VRS (voluntary retirement scheme) and on what conditions is only a matter of speculation. In any case, VRS is no solution of unemployment. A retrenched, unemployed worker is a frustrated man. Moreover, as argued by Joseph Stiglitz, there are large social costs of unemployment manifested in its worst forms, by urban violence, increased crimes, and social and political unrest. But even in the absence of these problems, there are huge costs of unemployment. "They include widespread anxiety even among workers who have managed to keep their jobs, a broader sense of alienation, additional financial burdens on family members who manage to remain employed, and the withdrawal of children from school to help support the family. These kinds of social costs endure long past the immediate loss of a job....Moving people from low-productivity jobs in State enterprises to unemployment does not increase a country's income, and it certainly does not increase the welfare of the workers".

The above dangers are all the more serious in those cases where a PSU is sold to a foreign company as the latter be more interested in maximising the stock market value for its shareholders rather than worrying about the interest of local labour.

4. At times, sale of a PSU to a private company can only result in the substitution of a public monopoly by a private monopoly. In such cases, inefficiencies and monopoly power will merely be transferred to the private sector, with the costs being borne by the consumers. Or, "monopolistic exploitation by efficient private owners replaces the inefficiencies of public ownership." This danger is particularly present in the case of public utilities. For example, in Cochabamba, Bolivia's third largest city, water supply was privatised and sold to a foreign consortium Aguas del Tunari in 1999. The consortium resorted to huge increases in tariffs and at the same time, put restrictions on the use of

water. This caused widespread resentment provoking riots. As a result, the government had no option but to put an end to the contract.

5. We have already discussed the issue of under-valuation of assets of PSUs earlier. Such undervaluation points to the prevalence of widespread corruption on the one hand, and complicity between sections of the government and particular business groups on the other hand (in the case of strategic sales). In this context, the comments of Joseph Stiglitz are pertinent, "Perhaps the most serious concern with privatisation, as it has so often been practiced, is corruption. The rhetoric of market fundamentalism asserts that privatisation will reduce what economists call the "rent-seeking" activity of government officials who either skim off the profits of government enterprises or award contracts and jobs to their friends. But in contrast to what it was supposed to do, privatisation has made matter so much worse that in many countries today privatisation will solve the problem. After all, the same corrupt government that mismanaged the firm will also handle the privatisation."

6. One of the important arguments in favour of privatisation of PSUs is the belief that this would improve their performance. However, some critics have pointed out that there is no positive relationship between ownership and performance. Therefore, according to them, the belief that privatisation, by itself, leads to better performance is questionable. For instance, Pranab Bardhan and John E. Roemer state: "Our claim is that competitive markets are necessary to achieve an efficient and vigorous economy, but that full-scale private ownership is not necessary for the successful operation of competition and markets." This claim is substantiated by the experience of China. The process of economic reforms was initiated in China in 1978. During 1978 and 1992, GNP grew at an annual rate of 8.8 per cent, while the industrial sector grew at a rate exceeding 10 per cent annum. As a result, China's GNP trebled over the 15 year period 1978-92. This remarkable growth was achieved not as a result of privatisation but by marketisation and opening up new areas for competition between the State owned enterprises and the non-State sector. One source of evidence for this is the positive correlation between total factor productivity in State enterprises and the relative size of the non-State sector. Using provisional level date for China from 1982 to 1990, it has been estimated that a ten percentage point increase in the non-State sector share of industrial output yielded an increase of 2.5 per cent to 4 per cent in total factor productivity in the State industry. As the non-State sector has grown, State enterprises have responded to the increased competitive pressure by becoming more productive. Thus the experience of China shows that to improve the efficiency of inefficient units it is necessary to create competitive market structure. It is a competitive environment, rather than ownership, that promotes allocative efficiency.

CHAPTER-7:

MONETARY AND FISCAL POLICIES IN INDIA

The Monetary and Fiscal Policies affect the financial sector and the economy in genera[illegible] can also be attuned to influence specific sectors or industries or segments.

The Monetary and Fiscal Policies have important influence on the Gross National Pr[illegible] (GNP).

GNP = C + I + G + X

Where:

C = Private consumption expenditure

I = Private investment expenditure

G = Government expenditure

X = Net exports

Three of the components of the GNP, namely C, I and X can be influenced by the moneta[illegible] policy which can also influence the private consumption and investment spending and exports [illegible] imports

The Government and the Central Bank (*i.e.*, the Reserve Bank, in India) make use of [illegible] fiscal and monetary weapons respectively to achieve stability and growth by influencing and regulat[illegible] the behaviour of the various classes of spenders as savers, consumers and investors. In other words, [illegible] fiscal and monetary policies are also important determinants of business prospects and investme[illegible] decisions. They can help make the overall economic situation and business prospects bright o[illegible] an unwarranted boom or unhealthy demand explosion. They can encourage investment and product[illegible] in certain priority sectors and discourage them in the non-priority sectors. They are also capable [illegible] influencing technological choice and investment and production patterns. In short, the fiscal [illegible] monetary policies can influence that aggregate supply and demand and the associated level [illegible] employment, wages, interest, rent, prices and profit. Hence the importance of monetary and fis[illegible] policies.

MONETARY POLICY

Monetary Policy refers to the use of instruments within the control of the Central Bank [illegible] influence the level of aggregate demand for goods and services or to influence the trends in cert[illegible] sectors of the economy. Monetary policy operates through varying the cost and availability of cred[illegible] these producing desired changes in the assets pattern of credit institutions, principally commerc[illegible] banks. These variations affect the demand for, and the supply of credit in the economy, and the le[illegible] and nature of economic activities.

The modern economy is regarded as a credit economy in the sense that credit forms the basis [illegible] most of the economic activities in such an economy. The level and nature of economic activities [illegible] an economy, obviously, are influenced by the cost and availability of credit. The central bank policies that affect the demand for and the supply of money, therefore, are very important to t[illegible]

industrial and commercial sectors. In a developed economy, credit forms a very important component of money supplies.

Measures of Money Stock

A knowledge of the measures of money stock in an economy would help us to understand monetary policy better.

The Reserve Bank of India employs four measures of money stock, namely, M1, M2, M3 and M4.

M1: The measure of money stock designated by M1 is usually described as the money supply. The components of money supply are currency with the public (*i.e.*, notes in circulation, circulation of rupee coins and circulation of small coins) and deposits (demand deposits with banks and other deposits with the RBI). As on 23 March, 2001, M1 was Rs. 3,78,528 crore.

Currency with the public forms less than half of the total money supply, whereas the demand deposits constitute more than 50 per cent of the money supply today.

In advanced countries, demand deposit forms a major part of the money supply. In India, the proportion of the currency in money supply has been declining. Two decades ago, it formed about three-fourths as against less than 50 per cent today.

M2: M2 is M1 + Post Office Savings Bank Deposits. As on 23 March, 2001, M2 was Rs.3,83,569 crore.

M3: M3 is M1 + Time Deposits with the banks. In other words, M3 is money supply plus fixed deposits with the banks. M3 is usually referred to as aggregate monetary resources. As on 23 March, 2001, M3 was Rs.13,06,091 crore.

M4: M4 is M3 plus the total Post Office Deposits. As on 23 March, 2001, M4 was Rs.13,32,060 crore.

Monetary Policy and Money Supply

As has been mentioned earlier, money supply comprises currency with the public and demand deposits. Both the monetary and fiscal policies can affect money supply.

The budgetary operations of the Government considerably affect the money supply. If the Government meets its budgetary deficits by borrowing from the Reserve Bank, there will be an increase in money supply, both in currency and bank deposits. The RBI has no control over budgetary operations, though it has opportunities of tendering advice to Government on this matter.

Another source of variation in money supply, over which the RBI's influence is restricted, is the country's international payments position.

Demand deposits are a very important determinant of money supply. As has already been mentioned above, in advanced countries demand deposits form a major part of money supply. In many developing countries, the proportion of demand deposits in money supply has been increasing. This is a trend associated with economic development and improvements in the bankisation and banking habits of the people.

Deposits with banks may originate in two ways-through passive creations or active creation. The former occurs when banks open deposit accounts for customers against the receipt of value either in cash or cheques drawn on other banks. The latter takes place when banks create deposits by extending credits. In the first case, the immediate effect is that there is no addition to the quantum of money, though its distribution may undergo a change; but ultimately it enables the banks to extend credit and thus results in an increase in money. In the second instance, the supply of money is augmented immediately. When a bank extends credit, it would result partly in a rise in deposits either with itself or with other banking institutions. Under the fractional reserve system, the banks can create deposits by a multiple of the reserves, since the payments made with the proceeds of bank loans are eventually redeposited with banks, leading to additional reserve funds.

Central banking instruments of control operate by varying the cost and availability of credit and these produce desired changes in the assets pattern of credit institutions, principally commercial banks. The item among banks assets having special significance in this connection is the credit extended by banks to their constituents, which is the sum of what are usually called loans, advances and discounts. The capacity of banks to provide credit depends on their cash reserves (comprising cash in hand and balances with the Reserve Bank), a substantial portion of the reserves being generally in the form of balances with the Reserve Bank. These increase through a rise in the deposit resources of banks, or by their borrowing from the Reserve Bank, or by sale of their investments. The regulation of credit by the Reserve Bank in essence means regulation of the quantum of the reserves of banks. If the Bank desires to bring about an expansion in credit, it adopts measures to augment the bank reserves. If credit is to be restricted, it attempts to curtail the reserves.

Instruments of Monetary Policy

The instruments of monetary policy (methods of credit control) may be broadly divided into:

- General (Quantitative) methods; and
- Selective (Quantitative) methods.

The general methods affect the total quantity of credit and affect the economy generally. The selective methods, on the other hand, affect certain select sectors. In other words, under the selective methods, certain qualitative distinctions are made between different sectors and segments of the economy; and selectivity is applied in regulating the flow of credit.

The statutory basis for the regulation of credit in India is embodied in the Reserve Bank of India Act and the Banking Regulation Act. The former Act confers on the Bank the usual powers available to central banks generally, while the latter provides special powers of direct regulation of the operation of commercial and co-operative banks.

General Credit Controls: There are three general or quantitative instruments of credit control, namely, the Bank Rate, Open Market Operations and Variable Reserve Requirements

In considering the general methods of credit control, it is important to stress that these are closely inter-related and have to be operated in co-ordination. All the three instruments affect the level of bank reserves. Open Market Operations and the Reserve Requirements directly affect the reserve base, while the Bank Rate produces its impact indirectly by variations in the cost of acquiring the reserve.

The use of one instrument rather than another at any point of time is determined by the nature of the situation and the range of influence it is desired to wield as well as the rapidity with which the change is required to be brought about. Open Market Operations, for instance, are suited to carry out day-to-day adjustments on even the smallest scale. Changes in Reserve Requirements produce an impact at once and affect the banks generally. The effects of Bank Rate changes are not confined to the banking system and the short-term money market; they have wider repercussions on the economy as a whole.

Bank Rate Policy: The Bank Rate, also known as the Discount Rate, is the oldest instrument of monetary policy. The traditional definition of Bank Rate is that it is the rate at which the central bank discounts or, more accurately, rediscounts-eligible bills. However, today, the term Bank Rate is used in a broader sense and refers to the minimum rate at which the central bank provides financial accommodation to commercial banks in the discharge of its function as the lender of the last resort.

The Bank Rate policy seeks to affect both the cost and availability of credit. The availability depends largely on the statutory requirements regarding the eligibility of bills for rediscounting, securities for collateral for advances, as also the maximum period for which the credit is available

As the central bank is the lender of the last resort, a commercial bank which is loaned up can obtain financial accommodation (*i.e.*, loan) from the central bank and re-lend it to its own customers.

An increase in the Bank Rate means an increase in the rate of interest charged by the central bank of its advances to commercial banks. Hence, an increase in the Bank Rate compels commercial banks to raise the rate of interest they charge on their loan and advances to their customers and vice-versa.

The importance of the Bank Rate lies in the fact that it acts as a pacesetter to all the other rates of interests. In a well-developed money market, like the London Money Market, all the market rates quickly and effectively respond to a variation in the Discount rate.

An increase in the Bank Rate implies an increase in the cost of credit and vice-versa. The demand for credit usually varies with the variation in the cost of credit. The central bank can therefore, hope to bring about a contraction in the money supply by raising the Bank Rate and an expansion in the money supply by lowering it.

As per the theory of Bank Rate, an increase in the Bank Rate reduces the extent of borrowings from the money market, the level of inventory holding, investment, employment and prices. A reduction in the Discount Rate has the opposite effects. The central bank may, therefore, attempt to contain an inflationary situation by raising the Bank Rate and fight a depression or recession by lowering it.

Open Market Operations: Open Market Operations refer broadly to the purchase and sale by the Central Bank of a variety of assets, such as foreign exchange, gold, Government securities and even company shares. In India, however, in practice, they are confined to the purchase and sale of Government securities.

Under the Open Market operations, the central bank seeks to influence the economy either by increasing the money supply or by decreasing the money supply.

To increase the money supply, the central bank buys securities from commercial banks and public. For instance, if the Reserve Bank of India buys securities worth Rs.100 crores, in the first instance the reserves of the commercial banks and currency with the public will increase by Rs.100 crores. However, the ultimate increase in money supply might be much more than this. When the central bank purchases securities from commercial banks the increase in their reserves might result in a multiple credit creation. Sometimes the purchase from the public may lead to an increase in the reserves of the banking system and credit expansion if the sellers of securities deposit the receipts with commercial banks. A sale of securities by the central bank has the opposite effects.

Open Market Operations have been employed by the Reserve Bank primarily to assist the Government in its borrowing operations and to maintain orderly conditions in the gilt-edged market. In this process, this instrument has been used to groom the market by purchasing securities nearing maturity to facilitate redemption and to make available on tap a variety of loans to broaden the gilt-edged market. As banker to the Government, it is the duty of the Reserve Bank to create in the gilt-edged market conditions that are favourable to the successful implementation of the Government's borrowing and refunding operations. On the other hand, the Government's loan operations themselves are so arranged as to be in harmony, as general stability of the money and capital markets. Open Market Operations have also been used to provide seasonal finance to banks. In the slack season, banks generally invest their surplus funds in Government securities, which they sell (or against which they borrow) during the busy season, in order to expand credit to industry and commerce, the Reserve Bank being generally ready to deal in these securities.

Variable Reserve Ratios: Commercial banks in every country maintain, either by the requirement of law by or custom, a certain percentage of their deposits in the form of balances with the central bank. The central bank has the power to vary this reserve requirement; and the variation in the

reserve requirement affect the credit creating capacity of commercial banks. For instance, if the reserve requirement is 10 per cent, the maximum amount the bank can lend is equivalent to 90 per cent of the total reserves. If the reserve ratio is raised to 20 per cent, the bank cannot lend more than 80 per cent of the total reserves.

The Reserve Bank of India is empowered to vary the cash reserve ratio between 3 per cent and 15 per cent of the total demand and time liabilities. To facilitate the flexible operation of this system the RBI has also been vested with the power to require the scheduled banks to maintain with it additional cash reserves, computed with reference to the excess of their total demand and time liabilities over the level of such liabilities on the base date to be notified by the Reserve Bank, subject to the proviso that the total reserve to be maintained with the Bank should not exceed 15 per cent of their demand, and time liabilities.

SLR: Action has also been taken to prevent banks from offsetting the impact of variable reserve requirements by liquidating their Government security holdings. The Banking Regulation Act has been amended, requiring all banks to maintain a minimum amount of liquid assets which shall not be less than a certain specified percentage of their demand and time liabilities in India, exclusive of the cash balances maintained under Section 42 of the Reserve Bank of India Act in the case of scheduled banks, and exclusive of the cash balances maintained under Section 18 of the Banking Regulation Act in the case of non-scheduled banks. This ensures that with every increase in the cash reserve requirements, the overall liquidity obligations are also correspondingly raised.

Selective Credit Regulation: Selective and qualitative credit control refers to regulation of credit for specific purposes or branches of economic activity. While general credit controls operate on the cost and total volume of credit, selective controls relate to the distribution or direction of available credit supplies. It may be mentioned here that some element of selectivity can be imparted to general credit controls also by giving concessions to priority sectors or activities. This has often been done in India.

The aim of selective controls is to discourage such forms of activity as are considered to be relatively inessential or less desirable. Selective credit controls have been used in the Western countries to prevent the demand for durable consumer goods outrunning the supply and generating inflationary pressure. In the USA, they have been used to regulate stock market credit as well. In India such controls have been used to prevent speculative hoarding of commodities like foodgrains and essential raw materials to check an undue rise in their prices. In addition to selective credit controls many central banks have acquired powers of direct regulation of the total magnitude, as also the distribution of advances and investments of individual banks as well as of the entire banking system.

Selective credit controls are considered to be a useful supplement to general credit regulation. From available experience, it appears that their effectiveness is greatly enhanced when they are used together with general credit controls. They are designed specifically to curb excesses in selected areas without affecting other types of credit. They attempt to achieve a reasonable stabilisation of the prices of particular commodities on the demand side, by regulating the availability of bank credit for purchasing and holding them. It should, however, be noted that prices are determined by the interaction of supply and demand, and that when supply is substantially short, what selective credit controls are likely to accomplish is to moderate the price rise rather than arrest the basic trend.

The Banking Regulation Act confers on the Reserve Bank the power to give directions to banking companies, wither generally or to any banking company or group of banking companies in particular, as to –

(a) the purposes for which advances may or may not be made;
(b) the margin to be maintained in respect of secured advances;

(c) the maximum amount of advances or other financial accommodation which, having regard to the paid-up capital, reserves and deposits of a banking company and other relevant considerations, may be made by that banking company to any one company, firm, *association of persons or individual;*

(d) the maximum amount up to which, having regard to the considerations referred to in clause (c) guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual; and

(e) the rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given.

The Reserve Bank is also empowered to issue, from time to time, to banking companies generally or to any banking company in particular, such directions as it deems fit in the public interest; or in the interest of banking policy; or to prevent the affairs of any banking company from being conducted in a manner detrimental to the interests of the depositors; or in a manner prejudicial to the interests of the banking company, or to secure the proper management of any banking company generally. The banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

Further, the Reserve Bank may caution or prohibit banking companies generally or any banking company in particular against entering into any particular transaction or class of transactions, and generally give advice to any banking company.

From time to time, the Reserve Bank has asked banks in its circular letters to exercise caution in their lending in general as well as lending against the security of specified commodities and shares.

The techniques of selective credit controls used generally are:

(a) *Minimum margins for lending against specific securities;*

(b) Ceilings on the amounts of credit for certain purposes; and

(c) Discriminatory rates of interest charged on certain type of advances;

In India, selective credit controls are operated under all the three techniques. While imposing selective controls, care is generally taken to ensure that credit for production, the movement of commodities and exports, is not affected. Selective controls are focused mainly on credit to traders financing inventories.

Moral Suasion: In addition to the above-mentioned methods of credit control, both quantitative and qualitative, it may be noted that the use has also been made in this country of moral suasion. Periodically, letters are issued to banks urging them to exercise control over credit in general or advance against particular commodities or unsecured advances. Discussions are also held with bankers for the same purpose. Such discussions between the bank and commercial banks have been frequent. The RBI has been able to build up over the years good informal relations with banks. Moral suasion, backed as it is by the Bank's vast powers of direct regulation, has proved quite useful. The use of this instrument is facilitated by the concentration of banking business in the hands of the Government.

FISCAL POLICY

Fiscal Policy is that parts of Government policy which is concerned with raising revenue through taxation and other means and deciding on the level and patter of expenditure.

The fiscal policy operates through the budget. The Budget is an estimate of Government expenditure and revenue for the ensuing financial year, presented to Parliament (in case of Union Budget) usually by the Finance Minister. Occasionally, in times of financial crisis, interim Budgets

may be introduced later in the year to increase taxation, expenditure without the formality [illegible]
budget.

THE UNION BUDGET

The Constitution of India provides that –

1. No tax can be levied or collected except by authority of law.
2. No expenditure can be incurred for public funds except in the manner provided [illegible] Constitution.
3. The executive authorities must spend public money only in the manner sanctioned [illegible] Parliament in the case of the Union and by the State legislature in the case of a State.

An estimate of all anticipated revenue and expenditure of the Union Government [illegible] ensuing financial year is laid before Parliament on the last working day of February every year. [illegible] known as the Annual Financial Statement or the Budget and covers the Central Government transactions of all kinds in and outside India during the year in which the statement is prepared [illegible] as ensuing year, or the Budget year, as it is known.

All receipts and disbursements of the Union Government are kept under two separate [illegible] namely, the Consolidated Fund of India and the Public Account of India. All revenue receipts [illegible] raised and money received in repayment of loans by the Union Government form the Consolidated Fund. No money can be withdrawn from this Fund except under the authority of an Act of Parliament. All other receipts and disbursements, such as deposits, service funds and remittances go into the Public Account, which is not subject to the vote of Parliament. To meet unforeseen needs not provided [illegible] Annual Appropriation Act, a Contingency Fund of India has also been established under Article [illegible] of the Constitution.

The presentation of the Annual Financial Statement is followed by a general discussion [illegible] Budget in both the Houses of Parliament. The estimates of expenditure from the Consolidated [illegible] India are then placed before the Lok Sabha in the form of Demands for Grants. Ordinarily [illegible] demand is made for each Ministry. All withdrawals of money from the Consolidated Fund [illegible] thereafter authorised by an Appropriation Act passed embodied in another Bill, which is passed [illegible] Finance Act of the Year.

The receipts and expenditure of the Central and State Governments are audited [illegible] Comptroller and Auditor-General who is independent of the executive, and his reports on the accounts are submitted to the President/Governor for having them laid before Parliament/State legislature.

The Structure of the Budget

The Budget is divided vertically into revenue (receipts) and expenditure (disbursements). Horizontally, it is divided into revenue account and capital account. The receipts are, thus, broken [illegible] into Revenue Receipts and Capital Receipts; and disbursements are broken up into Revenue Expenditure and Capital Expenditure.

The revenue expenditure includes all current expenditure of the Government on administration [illegible] and the capital expenditure includes all the capital transactions of the Government.

The revenue receipts include revenue from taxes, while capital receipts include market loans, external aid, and income from repayments and other receipts, such as income from public undertakings.

STATE BUDGET

Like the Union Government, State Governments, too, have their own budgets. The State Governments present estimates of receipts and expenditure to their legislatures before the beginning of the financial year and legislative sanction of expenditure is secured through similar procedure.

As in the case of the Union Government, the Constitution has provided for the establishment of a Consolidated Fund, a Public Account and a Contingency Fund for each State.

FINANCES OF THE UNION AND STATES

The Constitution of India has earmarked separate sources of revenue for the Union and the States.

Sources of Revenue for the Union

The Union List in the Constitution includes the following revenue subjects:

1. Taxes on income other than agricultural income;
2. Duties and customs, including export duties;
3. Duties of excise on tobacco and other goods manufactured or produced in India. except alcoholic liquors for human consumption and opium, Indian hemp and other narcotic drugs and narcotics;
4. Corporation tax;
5. Taxes on the capital value of assets, exclusive of agricultural land, of individual companies; taxes on the capital of companies;
6. Estate duty in respect of property other than agricultural land;
7. Duties in respect of succession to property other than agricultural land;
8. Terminal taxes on goods of passengers carried by the railways, by sea, or air; taxes on railway fares and freight;
9. Taxes other than stamp duties on transactions on stock exchanges;
10. Rate of stamp duty on bills of exchange;
11. Taxes on sale or purchase of newspapers and on advertisements published therein;
12. Fees in respect of any of the matters in the Union List, but not including fees taken in any court;
13. Any tax not mentioned in the State List or Concurrent List.

Sources of Revenue for the State

The State List in the Constitution includes the following revenue subjects:

1. Land revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights and alienation of revenue.
2. Taxes on agricultural income.
3. Duties in respect of succession to agricultural lands.
4. Estate duty in respect of agricultural land.
5. Taxes on lands and buildings.
6. Taxes on mineral rights, subject to any limitations imposed by Parliament by law relating to mineral development.
7. Duties of excise on the following goods manufactured or produced elsewhere in India: (a) alcoholic liquors for human consumption; (b) opium, Indian hemp and other narcotic drugs and narcotics.
8. Taxes on the entry of goods into a local area for consumption, use or sale therein.
9. Taxes on the consumption or sale of electricity.
10. Taxes on the sale or purchase of goods (other than newspapers).
11. Taxes on advertisements (other than those on newspapers).
12. Taxes on goods and passengers carried by road or inland waterways.
13. Taxes on vehicles, whether mechanically propelled or not, used on roads.
14. Taxes on animals and boats.
15. Tolls.

16. Taxes on profession, trades, callings and employment.
17. Capitation taxes.
18. Taxes on luxuries, including taxes on entertainment, amusements, betting and gambling.
19. Rates of stamp duty in respect of documents other than those specified.
20. Fees in respect of any of the matters in this list but not including fees taken in any court.
21. Fisheries.
22. Forests.
23. Irrigation, waters storage and water power.

Concurrent List

The main revenue items in the Concurrent List under the Constitution are:

1. Stamp duties other than duties or fees collected by means of judicial stamps but including rates of stamp duty.
2. Fees in respect of any of the matters in this list but no including fee taken in any court

The Finance Commission

Under the Constitution of India, a Finance Commission is to be constituted every fifth year or at such earlier time as the President considers necessary to make recommendations to the President as to:

1. The distribution between the Union and States of the net proceeds of taxes which are to be or may be divided between the States of the respective shares of such proceeds;
2. The principles which should govern the grants-in-aid of the revenues of the State in need of such assistance out of the Consolidated Fund of India; and
3. Any other matters referred to the Commission by the President in the interest of sound finance.

The recommendation of the Commission, together with an explanatory memorandum as to the action taken thereon, is laid before each House of Parliament. Eleven Finance Commissions were constituted since the commencement of the Constitution.

IMPORTANCE OF THE BUDGET

There is no other Government measure that affects the whole economy as the Budget. No wonder all sections of the people await the annual Budget with mixed feelings-anxiety, fear and hope. The endeavour of the Finance Minister is to present a Budget which gives maximum support to forces that can move the country forward on the path of growth with stability and social justice The Budget should set the stage for the achievement of economic and social goals.

The importance of functional finance and pump priming are recognised allover the world.

In India, today, about a half of the GDP is channeled into the Government sector by the Union, State and UT Budgets and disbursed by the Union, State and UT Governments under various development and non-development heads. These indicate the development and distributive importance and implications of the Budgetary operations.

There has been a steep increase in the Government expenditures, both in absolute and relative terms. The total budgetary expenditures (of the Centre, States and Union Territories) are about 50 per cent of the GDP today. The Central Government expenditures alone account for over one-fourth of the GDP today.

Gross capital formation out of the Budgetary operations of the Central Government is estimated to have increased from Rs.129 crore in 1950-51 to Rs.76,954 crore in 2000-01. In a developing economy like India, the Budget policy has to serve the following purposes:

1. Accelerate the pace of economic development by mobilising resources for the public sector and their optimal allocation;
2. Effect improvement in production in the private sector in accordance with the national priorities;
3. Effect improvements in income distribution;
4. *Promote exports and encourage import substitution; and*
5. Achieve economic stabilisation.

To serve these purposes, apart from the judicious allocation of the Budgetary resources, various fiscal incentives and disincentives are also employed by the Budget. An examination of the Budget Proposals will make these very clear.

Certain sectors or industries may be significantly impacted by the budget proposals like tax proposals or budgetary allocations.

In short, both monetary and fiscal operations have repercussions on the whole economy, affecting the price level, the balance of payments, and the levels of industrial activity and employment. While the monetary policy influences economic trends, especially investment, through the cost and availability of credit, fiscal policy directly affects the financial resources and purchasing power in the hands of the public. In a country which has adopted a programme of planned economic development, in which the public sector has an important part to play, fiscal policy is concerned largely with effecting structural changes in the economy, while monetary policy aims at regulating investment in the private sector and short-run management of the economy. When economic objectives are set, both *monetary and fiscal policies should aim at achieving these objectives. If they are to be successful*, a close co-ordination of monetary and fiscal policies is necessary, for they are complementary and not competitive.

The Monetary and Fiscal Policies are two important instruments employed by the authorities to influence the behaviour and performance of the financial sector and the economy in general. They may also be used to influence specific sectors or industries or segments. In other words, the fiscal and monetary policies are also important determinants of business prospects and investment decisions. They can help make the overall economic situation and business prospects bright or checks an unwarranted boom or unhealthy demand explosion. They can encourage investment and production in certain priority sectors and discourage them in the non-priority sectors. They are also capable of influencing technological choice and investment and production patterns.

Monetary Policy refers to the use of instruments within the control of the monetary authority (*i.e.*, the Central Bank of the country – the Reserve Bank of India) to influence the level of aggregate demand for good, and services or to influence the trends in certain sectors of the economy. Monetary policy operates through varying the cost and availability of credit. These variations affect the demand for, and the supply of credit in the economy, and the level and nature of economic activities.

There are, broadly, two instruments of monetary policy (methods of credit control), viz. General (Quantitative) methods; and Selective (qualitative) methods.

The general methods affect the total quantity of credit and the economy generally. There are three general or quantitative instruments of credit control, namely, the Bank Rate, Open Market Operations and Variable Reserve Requirements.

The Bank Rate, also known as the Discount Rate, refers to the minimum rate at which the central bank provides financial accommodation to commercial bank in the discharge of its function as the lender of the last resort. The lending rate of the commercial banks increases or decreases in accordance with the Bank Rate. The variation in the lending rate affects the demand for credit and, thereby, the money supply Open Market Operations refer broadly to the purchase and sale by the central bank of a variety of assets, such as foreign exchange, gold, Government securities and even company shares Under the Open Market operations, the central bank seeks to influence the economy

either by increasing the money supply or by decreasing the money supply. To increase the money supply, the central bank buys securities from commercial banks and public. A sale of securities by the central bank will have the effect of reducing the money supply. Commercial banks in every country maintain, either by the requirement of law or by custom, a certain percentage of their deposits in the form of balances with the central bank. The central bank has the power to vary this reserve requirement; and the variation in the reserve requirements affects the credit creating capacity of commercial bank.

In considering the general methods of credit control, it is important to stress that these are closely inter-related and have to be operated in co-ordination. All the three instruments affect the level of bank reserves. Open Market Operations and the Reserve Requirements directly affect the reserve base, while the Bank Rate produces its impact indirectly by variations in the cost of acquiring the reserve. The use of one instrument rather than another at any point of time is determined by the nature of the situation and the range of influence it is desired to wield as well as the rapidity with which the change is required to be brought about.

The selective methods are intended to affect certain select sectors. In other words, under the selective methods, certain qualitative distinctions are made between different sectors and segments of the economy; and selectivity is applied in regulating the flow of credit. While general credit controls operate on the cost and total volume of credit, selective controls relate to the distribution or direction of available credit.

Non-Performing Assets: A Menace to the Banking Industry

Banking being the key sector of any economy, its vigor and vitality indicate the health and prosperity of any nation. Ever since their glorious takeoff in 1969, banks in India have shown tremendous growth in terms of deposits and credits, branch expansion, general utility services, assistance to the priority sector etc. The New Economic Reforms in the line of privatization has given a new thrust to the banking sector as a whole and the private sector in particular. But still 8[illegible] per cent of our commercial banking at present belong to the public sector. Total deposits of the banks together amounted to Rs.1321, 185-cr, total credit Rs.731, 429 cr. as on 30th April, 2003

The operating profit of public sector banks in March 2001 was Rs.13793 cr. against Rs.5628 cr in 1995. Likewise the net profits rose from Rs.1116 cr. to Rs.4317 cr. The Capital Adequacy Ratio also showed considerable improvement during the above period from 9.46 per cent to 11.18 per cent against the standard rate of 9 per cent.Performance in terms of profitability is a benchmark for any enterprise including the banking industry. The credit-risk involved in the realization of advances and interest thereon is the greatest threat faced by the modern banks. The failure of the borrower to fulfill his contractual obligation in connection with the repayment of loans has resulted in mounting Non-Performing Assets (NPAs) in financial institutions, affecting their liquidity, profitability and equity. The gross NPAs of nationalized commercial banks alone as reported in the lokhsabha on 11-03-2003 was Rs.51470 cr. whereas the gross NPAs of all the public sector financial institutions together stood at Rs.71,000 cr. The banks with the highest amount of NPAs appear in the following order: SBI-Rs.15486 cr. PNB-Rs.4140 cr. BOI-Rs.372[illegible] cr. CBI-Rs.3376 cr. etc.

The magnitude of NPAs have a direct impact on banks' profitability as legally they are not allowed to book income on such accounts and at the same time banks are forced to make provision on such assets as per the RBI guidelines. The rapid hike in NPAs of banks is a matter of great alarm and anxiety to the government since it causes obstacles in the free flow of credit jeopardizing the health of the banking system and the economy ending up in doldrums.

Definition and Meaning of NPAs

A non-performing asset can be defined as a credit facility in respect of which the interest and/or installment of principal has remained past due for a specified period of time. The specified period of time was reduced in a phased manner over the years. An asset is classified as non-performing if the borrower does not pay dues in the form of principal and interest for a period of 180 days. However with effect from March 2004, default-status will be given to a borrower-account if dues are not paid for 90 days. If any advance or credit facility granted to a borrower becomes non-performing, the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status.

RBI Guide-Lines

Banks account for interest income on advances on accrual basis. But in accordance with the guidelines issued by the RBI, banks should not recognize interest income on non-performing assets until it is actually realized. The reason is that NPAs evolve significant uncertainty with respect to its ultimate collection.

As per RBI guidelines, bank-advances are classified into: 1) Standard assets, 2) Sub-standard assets, 3) Doubtful assets, 4) Loss assets.

Full provision for the amount outstanding must be made in respect of loss assets. This is because such asset is considered un-collectable and cannot be considered as bankable asset. Also in case of doubtful assets, banks are required of provide entirely fore the unsecured portion and an additional provision of 20-25% of the secured portion should be made depending up on the period for which the loan has been considered doubtful. In case of a sub-standard asset, a general provision of 10 per cent of total outstanding should be made.

Magnitude of NPAs

The world economy has slowed gown, recession at its peak, global stock markets tumbled and trade and commerce traversing through strange vistas of operation. The Indian economy has been much affected due to heavy fiscal deficit, poor infrastructure facilities, sticky legal system, dislocation of trade, commerce and industry in the wake of new economic policies, mounting unemployment etc. Under such situation it goes without telling that banks are no exception and they are bound to bear the brunt of the crisis. The total of NPAs together with interest outstanding at present, comes to around Rs.150,000 cr. for the financial sector in India.

The Table-1 reveals that gross NPAs of commercial banks under different kinds of ownership pattern clearly indicate a steadily increasing trend over the period. There is increase in NPAs in public sector banks but the hike is too steep in respect of private commercial banks of new origin where they are engaged in a kind of aggressive banking. The volume of NPAs of all commercial banks increased from Rs.58722 cr. to Rs.70904 cr. between 1999 and 2002, registering an increase of about quite adverse in all kinds of banks, but the new private sector banks depicted a dangerous tendency where the increase of NPAs was 683 per cent over the four-year period.

The incremental differences in NPAs of public sector and private sector banks on the whole, indicate slight decline in the rates of net NPAs to not advances. The public sector banks seem to have brought its upward trend under control. The occurrence of NPAs in public sector banks shows a softening trend over the 4-year period. The condition in private sector especially among those of new origin is still unsteady, showing a rising trend as per Table-2. The foreign banks appear to be less affected, compared to the other sectors.

NPAs of private sector banks were on the increase as compared to public sector banks during March 2002 also, when the NPAs of public sector banks declined by 0.7 per cent whereas the NPAs of 19 private sector banks went up by 170 per cent. NPAs of ICICI Bank rose from Rs.410 cr., to Rs.5010 cr., Global Trust Bank from Rs.154 cr., to 280 cr. Indusind Bank from Rs.223 cr., to Rs.368 cr.!

According to RBI records, there are about 2.53 lakh sick units in India. Around Rs.25800 cr., has been locked in these units. Out of the total number of sick units, a mere 2 per cent owe the banks Rs.21300 cr. 83 per cent of their NPAs. The majority of the sick units i.e., 2.5 lakh units owe only Rs.4500 cr.

The NPAs of commercial banks as on 31st March 2001, Rs.54000 cr., is divided between the non-priority sector at Rs.28525 cr., (53.3 per cent) and the priority sector accounting for Rs.25475 cr. (46.7 per cent On further analysis, NPAs of non-priority sector Rs.28525 cr., is distributed as between big industries Rs.11277 cr., (39.5 per cent), medium-scale industries Rs.7730 cr., (27.90 per cent) and small industries Rs.9518 cr. (32.60 per cent).

According to the report of the Parliamentary Standing Committee on Agriculture, recovery of direct agricultural advances constituted 69 per cent upto June 01. NPAs in this sector was only 13.84 per cent compared to 18.73 per cent in small scale sector. NPAs in total priority sector was only 44.49 per cent whereas it was 53.54 per cent in non-priority sector.

It is a matter of great distress that even co-operative banks are groaning under the weight of mounting bad debts. By January 2003, NPAs of urban co-operative banks have touched 22 per cent of the total advances! It is stated that Rs.11471 cr., of investors' money has turned into NPAs in these banks. Among the various states, Gujarat leads, with NPAs of Rs.4833 crore of 47 per cent of the advances! Andhra Pradesh comes second in the list with bad loans of 30.4 per cent. Tailing behind is West Bengal with 20.2 per cent followed by Tamil Nadu 18.3 per cent.

Factors that Contribute to NPAs in Financial Institutions

The origin of the problem of burgeoning NPAs lies in the quality of management of credit-risk by banks. The causes of this menace can be attributed to both internal and external factors.

Internal Factors

1) Poor credit-appraisal systems; 2) Improper SWOT analysis; 3) Non-compliance with the norms of lending; 4) Slackness in post-credit appraisal / supervision; 5) Absence of regular industry-visits and monitoring.

Receiving deposits for the purpose of lending is the cordinal function of banking. The banker should ensure that the principles of sound lending — liquidity, profitability, and security — are satisfied. Proper screening of the project is essential to judge its viability. He sould also make sure of the financial standing and credit — worthiness along with the credit — needs of the borrower as a part of the pre-credit analysis. Absence of qualified personnel in banks stands in the way of close monitoring and supervision of the loanees' accounts and performance. When loands are sanctioned without well-intentioned viability study, NPAs would be natural outcome.

External Factors

1) Industrial sickness; 2) Persistent losses due to stiff competition, lack of demand, labor-problems, non availability of raw-materials etc.; 3) Diversion of funds and willful default; 4) Non-viability of the unit project; 5) Change in government policies.

Industrial sickness is on the increase during this LPG era due to many reasons such as market-globalization technical deficiency, recession, decline in demand, poor economic growth etc. Timely detection of sickness and implementation of tailor-made rehabilitation program are essential to save those firms as well as the advances made by the bankers. Deliberate default committed by business tycoons amounts to looting of public money in abroad daylight.

As is clear from Table-3, 96.27 per cent of the total number of NPA accounts i.e., 9248626 accounts share Rs.9931 cr., whereas just 0.36 per cent i.e. 34282 accounts caused NPAs to the tune of Rs.37448 cr. In other words, 70.27 per cent of the NPAs were locked in 0.36 per cent of the npa account holders. Such a small number of account-holders hold the banking industry to ransom!

In addition, there are certain other general factors also such as recession in the economy, negative impact of economic reforms, multifarious kinds of scams, natural calamities, failure in the agriculture front, cyclical downturns in industry etc. that paved the way for bad loans in our banking industry.

Impact of NPAs

Mounting bad loans in banks affect the quantum of credit in the economy, reducing the flow of funds resulting in stunted growth of industry and commerce. Banks loose profit on account of the fact that they cannot book profits on doubtful advances. Also provisions should be made from profits against NPAs as per the RBI guidelines. The following are the adverse effects of NPAs:

1. Huge provisions against NPAs

Provisions and contingencies are on the increase on account of write off of bad loans. Nearly 65 per cent of the gross profits on an average go towards provisions! Provisions and contingencies account for more than 60 per cent of the gross profits during the previous years byt the percentage is 37 per cent in the year 2002, as shown by Table-4.

2. Drain on profitability

Banks will have to show much less profits than real profits earned during the year. And this is a loss to the national exchequer also. As per the Table-4, net profits of public sector banks constitute only 39 per cent, 31 per cent and 37 per cent during the three years. The write off of unrealized advances against profits amount to allowing the willful defaulters to loot the national wealth!

3. Banks' reluctance to lend

On a comparison between deposits and advances it may be noted that not more than 50 per cent of the advances are lent out and a huge amount is deposited in investments. Liquidity-position in banks is much better now with the recent rate-cuts in the CRR ratio and SLR ratio. Banks are swelling with funds these days. But they shy away from lending to corporates for fear of default.

4. High cost of funds due to NPA's

Quite often genuine borrowers find it difficult to obtain loans from banks as and when they need funds. Very often they have to undergo stringent conditions to their chagrin! Either the bank is reluctant in providing the funds or if it is provided, they come at a higher cost to compensate for the chances of default!

5. Mounting NPAs retard the economic growth

Finance being the life-blood of business, it should flow evenly and smoothly in order to ensure growth of all sections of the economy. But large-scale NPAs act as a blockade, hindering the system resulting in black money, uneven distribution of wealth and many other economic and social evils.

Steps Taken to Recover/ Prevent the NPAs

It is a grievous fact the banks and financial institutions in India face the problems of mounting non-performing assets and the problem is becoming more and more unmanageable. The government and the RBI are very keen on bringing the situation under control. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 was passed by Parliament, which is an important step towards elimination and / or reduction of NPAs. But the Securitisation Act 2002 has been proved ineffective, as it does not provide for attachment of personal assets of the borrowers or their kith and kin. By means of the Act, an amount of Rs.931 cr., was recovered against total NPAs of Rs.93000 cr. so far

Following are the steps taken at the bank-level to curb the bad loans:

- Negotiated settlements are encouraged to ensure recovery with minimum delay and expenses.
- Recovery Cells are set up in bank head-office.

- Settlement Advisory Committees are in operation.
- Credit-appraisal skills in banks are being upgraded.
- Debt-Recovery Tribunals function in major cities, with more and more powers to render them more effective.
- RBI governor's effort to change the Banking Secrecy Act to enable the banks to publish the defaulters' names was thwarted by industrial bigwigs.

It is distressing to note that the government is planning to buy back high-yielding bonds from banks at market-rate so that the profits arising therefrom can be used to write off bad loans! There is a move to write off NPAs with disinvestment money also. Such an action amounts to legitimatization of the crime committed by the dishonest borrowers at the cost of the unsuspecting tax-payers!

Suggestions

It is quite essential that the doctrine of financial responsibility of all borrowers must be enforced. The judicial system should be revamped to facilitate quicker recovery of dues from defaulters. It is essential to enforce the Securitization Act with more securities and personal assets of the defaulters.

Pre-credit and post-credit appraisals are to be done by banks more objectively. Close monitoring of borrower accounts, site/ factory-visits etc., are to be done regularly. Rehabilitation of viable sick units is essential. Consultancy and technical services must be provided to the borrower-units wherever necessary.

The Banking Secrecy Act must be amended to enable the publication of the defaulters' names. Wilful default must be treated as a criminal offence and hence dealt with seriously. Arrangements can be made for the exchange of credit-information in respect of defaulting customers amongst the banks so that further NPAs with other banks can be averted.

Table-1: Gross NPAs of Scheduled Commercial Banks as on March

(Rupees in Crores)

	1999	2000	2001	2002
Pub. Sr. banks	51710	53033	54672	56506
Pvt. banks. Old	4784	3815	4346	4850
Pvt. banks. New	871	946	1617	6822
Foreign banks	2357	2614	3106	2726
All com. Banks	58722	60408	63741	70904

Source: Economic and Financial Data, Southern Economist, Vol. 41 No. 21, March 1, 2003

Table-2: Net NPAs as Percentage to Net Advances of Scheduled Commercial Banks as on March 31

(Rs. [illegible])

	1999	2000	2001	2002
All Scheduled. Com. Banks	7.6	6.8	6.2	5.5
Public Sector banks	8.1	7.4	6.[illegible]	5.8
Old Private sector banks	9.0	7.1	7.3	7.1
New Private sector banks	4.5	2.9	3.1	4.9
Foreign com. banks in India	2.[illegible]	2.4	1.8	1.9

Source: Economic and Financial Data, Southern Economist, March 1, 2003

Table-3: Account-wise Distribution of NPAs, March 2001

	No. of Accounts	Rs. in crores
Less than Rs.1 lac	9243626 (96.27%)	9,931 (18.63%)
Rs.1 lac to Rs.10 lac	323813 (3.37%)	5915 (11.10%)
Over Rs.10 lac	34282 (0.36%)	37448 (70.27%)
Total	9606721	53294

Table-4: Provisions Against Bad and Doubtful Loans in Public Sector Banks

	2000	2001	2002
Gross Profits	13042	13793	21720
Provisions, bad loans and contingencies	7926	9476	8108
Net Profits	5116	4317	8108

CHAPTER-8: SECURITIES AND EXCHANGE BOARD OF INDIA

The Securities and Exchange Board of India (SEBI) was constituted in 1988 under a resolution of Government of India. It was later made a statutory body by the Securities and Exchange Board of India Act, 1992. According to this Act, the SEBI shall consist of a Chairman and five other members appointed by the Central Government (two members representing the ministries of Finance and Law, one member from the Reserve Bank of India and two other members).

With the coming into effect of the Securities and Exchange Board of India Act, 1992, some of the powers and functions exercised by the Central Government, in respect of the regulation of the stock exchange were transferred to the SEBI

Objectives and Functions of SEBI

According to the SEBI Act, it shall be the duty of the SEBI to take suitable measures.

(i) To protect the interests of investors in securities; and

(ii) To promote the development of and to regulate the securities market

Such measures may provide for —

(i) regulating the business in stock exchanges and any other securities markets;

(ii) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

(iii) registering and regulating the working of collective investment schemes, including mutual funds;

(iv) promoting and regulating self –regulatory organisations;

(v) promoting investors' education and training of intermediaries of securities markets;

(vi) prohibiting insider trading in securities;

(vii) regulating substantial acquisition of shares and takeover the companies;

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

(ix) performing such functions and exercising such powers under the provisions of the Capital Issues (Control) Act, 1947 and the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;

(x) levying fees or other charges for carrying out the purposes of this section;

(xi) conducting research for the above purposes;

(xii) performing such other functions as may be prescribed.

Powers of Central Government

The SEBI Act lays down that, in exercise of its powers or the performance of its functions, the Board shall be bound by the directions of the Central Government an questions of policy. However before any such direction is give3n, as far as possible the Board shall be given an opportunity to express its views.

The Act also empowers the Central Government to supersede the SEBI if it is of the opinion (a) that on account of grave emergency the Board is unable to discharge its duties and function, or (b) that the Board has persistently made default in complying with the direction issued by the Government or in the discharge

of its functions and duties, or (iii) that circumstances exist which render it necessary in the public interest to do so.

The period of supersession shall not exceed six months. The Central Government may reconstitute the Board before or on the expiration of the prior of supersession.

Amendments to SEBI Act

The Government has, on 25 January, 1995, promulgated an Ordinance to amend the Securities Exchange Board of India Act, 1992 so as to arm the Securities and Exchange Board of India (SEBI) with additional powers for ensuring the orderly development of the capital market and to enhance its ability to protect the interests of the investors.

To enable SEBI to respond speedily to market conditions and to reinforce its autonomy. SEBI has also been empowered to file complaints in courts without the prior approval of the Central Government, and to notify its Regulations without the prior approval of the Central Government.

The amendments provide SEBI with regulatory powers over corporates in the issuance of capital, the transfer of securities and other related matters. It has also been empowered to impose monetary penalties on capital market intermediaries and other participants for a listed range of violations. Hitherto, the SEBI Act provided for the suspension and cancellation of registration and prosecution of intermediaries. As suspension and cancellation lead to the stoppage of business, often adversely affecting others who have had business, with the affected intermediary, monetary penalties constitute an alternative mechanism for dealing with capital market violations. It is proposed to create an adjudicating mechanism within SEBI for leying penalties and it is also proposed to constitute a separate Tribunal to deal with cases of appeal against orders of the adjudicating authority. The appellate authority against orders of the Tribunal will be High Courts.

OTC Exchange of India

The establishment of the Over The Counter Exchange of India (OTCEI) marked the dawn of a new era in the history of stock exchanges in India. The PTC Exchange is a blessing for the small, both existing and new, companies and for investors, particularly small investors.

The OTCEI is meant primarily to trade securities of the listed companies, like the other stock exchanges. It is, however, a stock exchange with a lot of differences with those of other. "Although the basic framework of the OTC Exchange is that of a national market, yet there is no physical location, no counters, no trading ring, no stock exchange building and no hustle and bustle scenes as the conventional stock exchanges. The buyers and sellers living apart from each other trade is corporate securities over the telephone. The system cuts across urban and rural areas extending the frontiers of the stock market to the entire country. Those OTC markets are fully automated exchanges where transactions are completed through a network of telephones/tellers computers right from the first centre to the last centre. In addition, only professional people are authorised to render financial services."

The OTCEI has been promoted jointly by ICICI, UTI, IFCI, IDBI, SBI Capital Markets Ltd., Canara Bank Financial Services Ltd., GIC and LIC. These institutions are sponsor members of this Exchange.

Over the Counter basically implies trading across the counter in scrips which are listed on the OTC exchange.

Benefits to the Investors

The OTC Exchange offers a number of benefits to the investors. The important advantages of its from the point of view of the investors are:

(i) Quick payment of money to the sellers and quick delivery of shares to buyers.

(ii) Price transparency: On the OTCEI, the investor clearly knows the buying and selling [illegible] whereas he is not able to know the actual price at which the scrips are bought or sold for [illegible] other stock exchanges.

(iii) The OTCEI saves the investors from other unscrupulous behaviour of the brokers

(iv) Liquidity even for scrips of small and new companies.

(v) Fair prices.

(vi) Simple procedure of buying and selling.

(vii) Facility to sell even odd lots.

Benefits to the Companies

The OCT Exchange offers certain advantage to the companies also. The important benefits [illegible] companies are:

(i) Enables even smaller and less liquid companies to get listed.

(ii) Facilitate new issues at lower costs.

(iii) Makes raising capital through issues eay for small, new and closely held companies

(iv) Helps create market for scrips of small and new companies.

National Stock Exchange of India

The National Stock Exchange of India (NSEI) was established in 1994 by financial institutions [illegible] banks with IDBI as a nodal agency.

Many secondary market problems can only be completely solved by introducing scripless trading [illegible] de-materialisation of scrips in depositories. A beginning in this respect was made with the establishment of the NSEI.

The NSEI is conceived as a model exchange with a nation-wide electronic screen based "Scripless [illegible] "floorless" trading system in securities which will be both efficient and transparent and offer equal [illegible] nation-wide access to investors.

(i) Wholesale Debt Market, (WDM), and

(ii) Capital Market (CM).

The WDM is concerned with trading in instruments like Government Securities, PSU bonds, units [illegible] of UTI. CDs and CPs by corporate entities (like banks, institutions, brokerage houses).

The CM is concerned with equity and corporate debt instruments by both corporate entities and individuals. It will encourage high networth corporate trading members with dealer network and [illegible] settlement cycles.

Although formally inaugurated only in July 1994, the NSEI commenced operations in the WDM in June 1994 and trading in equities in the CM segment in November 1994.

The RBI has directed banks to use only the NSEI for all transactions in debt securities, done [illegible] through brokers, to ensure transparency and facilitate regulation (in place of the unregulated telephone market).

As a national exchange, the NSEI has set fairly stringent criteria for membership in terms of networth education and experience, to ensure that trading members are well capitalised and can provide [illegible] services to investors.

Initially, the NSEI opened membership to 13 cities, the operations are to cover the entire nation in due course using the satellite network.

There is a feeling that the functioning of the National Stock Exchange would weaken the Bombay Stock Exchange or other Exchanges. However, the NSEI should be viewed as an important step in providing efficient and transparent services to investing public. It may affect other Exchanges if they fail in providing transparency and efficiency. In fact, the operations of NSEI is expected to act as a spur for the modernisation of the Bombay Stock Exchange Online Trading (BOLT) system for introducing screen based trading system. The Bombay Stock Exchange has also taken the initiative for the establishment of a National Stock Market System (NSMS) for providing improved services to investors all over the country. Eventually the NSEI and other Stock Exchanges should compete in minimising transaction cost and in providing fair services to investors.

SEBI Guidelines for Fresh Issues

Capital issues had been controlled by the Controller of Capital issues (CCI) under the Capital Issues Control Act. Prior permission of the CCI was required for capital issues. The pricing of the issues wa salso controlled by the CCI.

As a part of the economic policy reforms, the Capital Issues Control Act was Replaced and the office of the CCI was abolished Subsequently, the Securities and Exchange Board of India (SEBI) on 11th June, 1987, issued guidelines for issue of capital, substantially liberalizing capital issues and pricing of the issues.

According to the guidelines, a new company can freely price its capital issues subject to a few conditions.

Existing private/closely held companies with a three year track record a consistent profitability 0 freely price the issue and list their securities on the stock exchanges.

The Guidelines, however, impose certain restrictions on bonus issues. Bonus issue within one year of earlier issue is not permitted. Further, bonus issue is lieu of dividend is prohibited.

Full underwriting is made mandatory.

The guidelines require the companies to make adequate disclosure to the SEBI.

The text of the SEBI Guidelines is given below:

First Issue of Companies

(a) A new company will be defined as one which has not completed 12 months of commercial operations and its audited operative results am not available, and where it is bet up by entrepreneurs without a track record. They will be permitted to issue capital to public at par.

Where a new company is being set up by existing companies with a five-year Track record of consistent profitability, it will be free to price its issue provided the participation or the promoting company and the issue price is made applicable to all new investors uniformly, provided that the prospectus or offer documents shall contain justification for issue price.

A draft prospectus containing the disclosures will be vetted by Securities and Exchange Board of India (SEBI) before a public issue is made.

No private placement of the promoters share shall be made by solicitation of share contribution from unrelated investors through any kind of market intermediaries. The share of the above companies can be listed an either the Over the Counter Exchange of India or any other stock exchange.

First Issue by Existing Private/Closely held Companies

(i) Such companies with 1 three year track record of consistent profitability shall be permitted to freely price the issue and list their securities on the stock exchange.

(ii) Not less than 20 per cent of the equity should be offered.

(iii) The draft prospectus will be vetted by SEBI to ensure adequacy of disclosures.

(iv) The pricing would be determined by the issuer and lead managers to the issue ... to specific disclosure requirements including:

(a) disclosures of the net asset value of the company as per the last audited balance ...

(b) justification for the issue price.

Public Issue by Existing Listed Companies

(a) These companies will be allowed to raise fresh capital by freely pricing their further ...

(b) Pricing the issue price will be determined by the issues the lead manager(s) to the ...

(c) Disclosures-

(i) the draft prospectus will be vetted by SEBI to ensure adequacy of disclosures

(ii) the prospectus or offer documents shall contain the net asset value ... justifiation far the price of the issue.

(iii) high and low price of the shams for the last two years.

Underwriting

(a) Underwriting is mandatory for the full issue and minimum requirement of 90 per cent ... is also mandatory for each issue f capital to the public. Number underwriters would ... the issuers.

(b) If the company does not receive 90 per cent of issued amount from public ... accepted development from underwriters, within 120 days from the date of opening of the ... company shall refund the amount subscription. In case of disputed development, the company should refund the subscription if the above conditions are not met.

(c) The lead manager(s) must satisfy themselves about the net worth of the ... outstanding commitments and disclose and same to SEBI.

(d) The underwriting agreements may be field with the stock exchange.

Composite Issues

Issues to the public by existing company can be period differentially as compared to the issues ... shareholders.

Fully Convertible Debentures/Partially Convertible Debentures/Non-Convertible Debentures

(a) Issue of FCDs having a conversion period more than 36 months will not be permissible ... conversion is made optional with "put" and "call" option.

(b) Compulsory credit rating will be required if conversion is made for FCDs after 18 months

(c) Premium amount on conversion, time of conversion, in stages, if any, shall be pre-determined ... stated n the prospectus. This interest rates for above debentures will be freely determined ... issuer.

(d) Issue of debentures with maturity of 18 months or less are exempt from the requirement ... appointment of Debenture Trustee or creating a Debenture Redemption Reserve (DRR) ... cases, the names of the debenture trustees must be state din the prospectus and DRR will ... in accordance with Section (N.I.). The trust deed shall be executed within six months of the ... of the issue.

(e) Any conversion in part or whole of the debenture will be optional at the hands of the debenture holder, if the conversion takes place at or after 18 months from the date of allotment, but before ... months.

(f) In case of NCDs/PCDs credit rating is compulsory when maturity exceed 18 months.

(g) Premium amount at the time of conversion for the PCD shall be pre-determined and stated in the prospectus. Redemption amount, period of maturity, yield on redemption for the PCDs/NCDs shall be indicated in the prospectus.

(h) The discount on the non-convertible portion of the PCD in case they are traded and procedure for their purchase on spot Grading basis must be disclosed in the prospectus.

(i) In case, the non-convertible portions of PCD/NCD an to be rolled over with or without change in the interest rate a compulsory option should be given to those debenture holders who want to withdraw and encash from the debenture programme. Roll over shall be done only in case when debentureholdrs have sent their positive consent and not on the basis of their negative reply.

(j) Before roll over of any NCD or non-convertible portion of the PCDs, fresh credit rating shall be obtained within a period of six months prior to the due date of redemption and communicated to debentureholders before roll over and fresh trust deed shall be made.

(k) Letter of information regarding roll over shall be vetted by SEBI with regard to the credit rating, debentureholder, resolution. Option for conversion and such other items which SEBI may prescribe from time to time.

(l) The disclosure relating to raising of debentures will contain amongst other things, the existing and future equity and long term debt ratio, servicing behaviour on existing debentures, payment of due interest on due dates on term loans and debentures, certificate from a financial institution or bankers about their non-objection for a second of *pari passu* charge being created in favour of the trustees to the proposed debenture issues.

(j) SIBI may prescribe additional disclosure requirement from time to time, after due notice.

New Financial Instruments

Issuer of capital shall make adequate disclosures regarding the terms and conditions of redemption, security, conversions and any other relevant features of-

Instruments such as Deep Discount Bonds, Debentures with Warrants, Secured Premium notes etc. so that an investor can make reasonable determination of the Risk, returns, safety and liquidity of the instruments. The disclosures shall be vetted by SEBI in this regard.

Reservation In Issues

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

(b) In case of issues of capital by new companies, reservations for employees of new companies, promoting companies, associate companies, working directors on a suitable percentage is permissible.

(c) Shareholders of group companies in case of existing companies can be offered capital on a preferential basis.

(d) Shareholders of promoters' companies shall also be eligible for preferential allotment.

(e) Reservations for NRIs shall be according to the schemes prescribed by RBI from time to time.

Deployment of Issue proceeds

(a) In case of issues, where on application and on allotment an amount together exceeding Rs. 250 crores is raised, the issuer will voluntarily disclose and make arrangements for the use of proceeds of the issue as per disclosure to be monitored by one of the financial institutions. A copy of their

monitoring report shall be filed with the SEBI by the institutions and ... of record.

(b) In issue of the above size and beyond, the amount to be called up on application allotment ... various calls should not exceed 25 per cent of the total quantum of issue.

Minimum Interval Time Between Two Issues

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

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

(c) The capital issue should be made fully paid on within 12 months from the date of ...

Employee Stock Option Scheme

This is a voluntary scheme on the part of the company to encourage employees to have ... participation in the company. Suitable percentage of reservation can be made by the issuer for the employees of the company or the promoters of the company as the need may arise. Reservation should not be more than ... per cent. Equitable distribution of shares among the employees will contribute to the smooth working of the scheme. The issuer may like to have non-transferability at his discretion in new issues ... employees' participation upto five per cent (maximum 200 shares) shall be non-transferable for ... three years.

Promoters' Contribution and Lock in Period

(a) Equity capital to be subscribed in any issue to the public by the promoters, i.e. those described in the prospectus as promoters, directors, friends, relatives and associates should not be less than ... per cent of the total issue of equity capital upto Rs. 100 crores and 20 per cent of the issue above Rs. 100 crores. In the case of FCDs, one third of the issue amount should be contributed by promoters, directors, friends, relatives and associates by way of equity before issue is made. In ... of PCDs, one third of the convertible portion should be brought in as contribution of promoters ... subscription by each of the friends/relatives and associates under promoters quota should not ... less than Rs. 1 lakh.

(b) This promoters' contribution shall not be diluted for a lock in period of five years from the date of commencement of the production or date of allotment whichever is later. Promoters must bring in their full subscription to issues in advance before public issues.

(c) All firm allotments, preferential allotments to collaborators, shareholders of promoter company whether corporate of individual shall not be transferable for three years from the date of commencement of production date of allotment whichever is later.

(d) The share certificate issued to promoters, friends, relatives and associates etc. should ... inscription "not transferable" for a period three to five years as may be applicable from the date of commencement of production of date of allotment whichever is later.

Bonus Shares

Subject to the provision to Sec. J(a) above, the company shall, while issuing Bonus shares, ensure the following.

(a) the bonus issue is made out of free reserves built out of the genuine profits or share premium collected in cash only;

(b) reserves created by revaluation of fixed a...s are not capitalized;

(c) the development rebate reserve or the investment allowance reserve is considered as free reserve for the purpose of calculation of residual reserves test only;

(d) all contingent liabilities disclosed in the audited accounts which have bearing on the net profits, shall be taken into account in the calculation of the residual reserve:

(e) all *residual reserves after the Proposed capitalization shall be at least 40 per cent of the Increased* paid up capital;

(f) 30 per cent of the average profits before tax of the company for the previous three years should yield a rate of dividend on the expanded capital base of the company at 10 per cent;

(g) the capital reserves appearing in the balance sheet of the company as a result of revaluation of assets or without accrual of cash resource are neither capitalized nor taken into account in the computation of the residual reserves of 40 per cent for the purpose of bonus issues;

(h) the declaration of bonus issue, in lieu of dividend, is not made;

(i) the company; (1) has not defaulted in payment of interest or principal on redemption thereof and (2) has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.;

(k) a company which announces its bonus issue after the approval of the Board of Directors must implement the proposals within a period of six months from the date of such approval and shall not have the option of changing the decision;

(l) there should be a provision i, the Articles of Association of the for capitalization of reserves etc., and if not the company shall pass a Resolution at its General Body Meeting making provisions in the Article of Association for capitalization;

(m) *consequent to the issue of bonus shares if the subscribed and paid up capital exceed the authorized* share capital, a resolution shall be passed by the company as its general body meeting for increasing the authorized capital;

(n) the company shall get it resolution passed as its general body meeting for bonus issue and in the said resolution the management's intention regarding the rate of dividend to be declared in the year *immediately after the bonus issue should be indicated;*

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

Guidelines for The Protection of the Interest of Debentureholders

Servicing of Debentures

Subject to provisions of Section F, a debenture redemption reserve (DRR) shall be created by all the companies raising debentures on the following basis:

(a) A moratorium upto the date of commercial production can be provided for creation of the debenture redemption reserve in respect of debentures raised for project finance.

(b) The debentures redemption reserve may be created either in equal instalments for the remaining period or higher amounts if profits permit.

(c) In the case of partly convertible debentures, DRR should be created in respect of non-convertible portion of debenture issue on the same lines as applicable for fully non-convertible debenture issue. In respect of convertible issues by new companies, the creation of DRR should commence from the year the company earns profits for the remaining life of debentures.

(d) Companies may distribute dividends out of general reserves in certain years if residual profits after transfer to DRR are inadequate to distribute reasonable dividends.

(e) DRR will be treated as a part of General Reserve for consideration of bonus issue proposals and for price fixation related to post tax return.

(f) In case of new companies, distribution of dividend shall require approval of the trustees to issue and the lead institution, if any.

(g) Company should create DRR equivalent to 50 per cent of the amount of debenture issue before debenture redemption commences. Drawal from DRR is permissible only after 10 per cent of the debenture liability has been actually redeemed by the company.

(h) In the case of existing companies prior permission of the lead institution for declaring dividend exceeding 20 per cent or as per the loan covenants is necessary if the company does not comply with institutional condition regarding interest and debt service coverage ratio.

(i) Company may redeem debentures in greater number of installments. The first installment may start from 5th instead of 7th year.

Protection of Debentureholders' Interest

(a) Trustees to the debenture issue shall be vested with the requisite powers for protecting the interest of debentureholders including a right to appoint a nominee director on the Board of the company in consultation with institutional debentureholders.

(b) Lead institution/investment institution will monitor the progress in respect of debentures project finance/modernisation/expansion/diversification/normal capital expenditure. The lead bank for the company will monitor debentures raised for working capital funds.

(c) Institutional debentureholders and trustees should obtain a certificate from the company's auditors in respect of utilisation of funds during the implementation period of projects. In the case of debentures for working capital, certificate should be obtained at the end of each accounting year.

(d) Debenture issues by companies belonging to the groups for financing replenishing funds acquiring shareholding in other companies will not be permitted.

(e) The companies shall, along with their application, file with SEBI certificate from their bankers that the assets on which security is to be created are free from any encumbrance and the necessary permissions to mortgage the assets have been obtained or a No Objection Certificate from the financial institutions or banks for a second or pari passu change in cases where assets are encumbered. The security should be created within six months from the date of issue of debentures. If for any reasons the companies are not in a position to create security within [illegible] months from the date of issue of debentures the company shall be liable to pay 2 per cent penal interest to debentureholders. If security is not created even after 18 months, a meeting of the debentureholders should be called within 21 days to explain the reasons thereof and the date by which the security would be created.

(f) The trustees to the debentureholders will supervise the implementation of the conditions regarding creation of security for the debentures and regarding the debenture redemption reserve.

General

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

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

(c) The quantum of issue, whether through a right or public issue, shall not exceed the amount specified in the prospectus/letter of offer. No retention of over subscription is permissible under any circumstances.

(d) Within 45 days of the closures of an issue a report in a prescribed form with a compliance certificate from the Chartered Accountants should be forwarded to SEBI by the lead manager.

(e) The gap between the closure dates of various issues, e.g., rights and Indian public should not exceed 330 days.

(f) In case of issues of debentures fully or partly made in the past, when the conversion was to be made at a price to be determined by the Controller of Capital Issues at a later date, the price of conversion and time of conversion shall be determined by the company in a duly organised meeting of the debentureholders and shareholders. The decision in the above meeting may be ratified by the shareholders in their meeting. Such conversions will be optional for acceptance on the part of individual debentureholders. The dissenting debentureholders shall have the right to continue as debentureholders if the terms of conversion are not acceptable to them. The letter of option to debentures should be vetted by SEBI.

(g) SEBI will have the right to prescribe further guidelines for modifying the existing ones to bring about adequate investor protection, enhance the quality of disclosures and to bring about transparency in the primary market.

(h) SEBI shall have the right to issue necessary classification to these guidelines to remove any difficulty in its implementation.

(i) Any violation of the guidelines by the issues/intermediaries will be punishable by prosecution by SEBI under Act.

(j) The provisions in the Companies Act, 1956 and other applicable laws shall be complied with an connection with issue of shares and debentures.

CHAPTER-9:
ASPECTS AND IMPLICATIONS OF THE INDIAN CONSTITUTION

The Indian Constitution incorporates a number of matters that are economically very significant and have far-reaching implications. The socio-economic and political objectives of the Indian Republic and the basic guiding principles of state functioning have been clearly laid down in the *Preamble* to the Constitution, the *Fundamental Rights* and in the *Directive Principles of State Policy*. The Constitution also outlines the economic powers and responsibilities of the Union Government and the State Governments.

The economic responsibility bestowed on the state by the Indian Constitution is so enormous that calls for great government interference in the functioning of the economy. In fact, a number of constitutional amendments, including the first amendment, were effected to enable the state to implement its economic policies and programmes.

It is indeed paradoxical that though the government, in the past, had proclaimed that certain policy measures had been taken and laws had been enacted to give effect to certain constitutional provisions, some of these very policies have been given up or reversed and Acts repealed since the liberalisation ushered in 1991 while those constitutional provisions continue unchanged.

The Preamble

The Preamble to the Indian Constitution states that,

> THE PEOPLE OF INDIA have solemnly resolved to constitute India into a SOVEREIGN SOCIALIST, SECULAR, DEMOCRATIC REPUBLIC to secure to all its citizens:
>
> JUSTICE, social, economic and political;
>
> LIBERTY of thought, expression, belief, faith and worship;
>
> EQUALITY of status and of opportunity;
>
> And to promote among them --.
>
> FRATERNITY assuring the dignity of the individual and the unity and integrity* of the Nation

The Preamble of a statute conveys the general object and intention of the legislature in enacting it. Although not an essential feature, whenever a Constitution contains a Preamble, it expresses the political, religious and socio-economic values which it envisages to promote. But, it does not control the meaning and scope of the other provisions of the Constitution. However, the Preamble may be a guide when the statute is vague. Otherwise, full effect should be given to the express words of the enactment.

The Preamble to the Indian Constitution lays down that the attainment of social, economic and political *justice*, and *equality* of status and of opportunity should be among the most important basic guiding principles of the functioning of the State. As if this were not enough, the Constitution was amended in 1976 to add, among other things, that India should be a socialist state. In fact, as early as December 1954, the Indian Parliament had accepted the *socialist pattern of society* as the objective of social and economic policy. As if to give this objective more prominence, it was incorporated in the Preamble to the Constitution in 1976 under the controversial 42nd Amendment.

As the Preamble conveys the general object and intention of the Constitution and would be a guide in the interpretation of a statute when it is vague, the abovementioned aspects of the Preamble to the Constitution give some indications of the need and scope for state intervention in the functioning of the economy with a view to discharging its duties and responsibilities for the realisation of economic and associated objectives.

The Fundamental Rights

It has been claimed that the Indian Constitution offers all citizens, individually and collectively, the best fruits of democracy and those basic freedoms and conditions of life which alone make life significant and productive. The rights enumerated in Part III of the Constitution cover a wide range and are declared to be fundamental and justiceable.

The theory of fundamental rights implies limited government. It aims at preventing the government and the legislature from becoming totalitarian, and in doing so it affords the individual an opportunity for self-development. But these rights are not absolute; they are subject to limitations imposed by the state in order to secure rights for all individuals or to promote the greater interests of the community or the state, or to serve the ends of a planned society.

The Fundamental Rights enumerated in Part III of the Constitution are:

1. Right to Equality
2. Right to Freedom
3. Right against Exploitation
4. Right to Freedom of Religion
5. Cultural and Educational Rights
6. Right to Constitutional Remedies

The Constitution had also guaranteed, under Article 19(1)*(f)*, the Fundamental Right to Property; and Article 31 had prohibited the deprivation of property of any person save by authority of law; and for the deprivation of property compensation had been payable. But, in 1976, the 44th Amendment of the Constitution abolished the fundamental right to property by deleting Articles 19(1)*(f)* and 31. However, Article 300 A of the new Chapter IV added to Part XII of the Constitution provides that "no person shall be deprived of his property save by authority of law." Thus, though the right to property is no longer a fundamental right, it has been retained as a Constitutional Right.

The Fundamental Rights also have economic significance.

The Right to Equality prohibits discrimination against any citizen on grounds of religion, race, caste, sex or place of birth. In public employment, it ensures equality of opportunity to all citizens. This is, however, subject to certain limitations, such as the right of the state to reserve posts for backward classes which, in the opinion of the state, are not adequately represented in the services.

The Constitution guarantees the citizens the fundamental right to freedom to practise any profession, carry on any occupation, trade or business. This right is subject to reasonable restrictions in the interest of the general public. Under the First Amendment to the Constitution (1951), the State is empowered to make laws relating to professional or technical qualifications necessary for practising any profession or carrying on any trade, business, industry or service, whether to the exclusion, complete or partial, of citizens or otherwise.

The Fundamental Right against Exploitation prohibits traffic in human beings, and beggary and other forms of forced labour; and any contravention of this provision shall be an offence punishable in accordance with the law. However, this does not prevent the state from imposing compulsory service

for public purposes. In imposing such service, the state shall not make any discrimination on grounds only of religion, race, caste or class, or any or them.

Thus, the Fundamental Rights enumerated in the Constitution guarantee a number of economic rights to the citizens; but at the same time, the State has the power to impose reasonable restrictions on such rights in the public interest. A very important thing to be noted is that this power of the state to impose reasonable restrictions in the public interest had resulted in a remarkable increase in the state's control over the business and a substantial expansion of the entrepreneurial or participative activities of the state. Consequently, there has been an abridgement of the economic liberty of the citizens embodied in Article 19(1)*(g)*.

Fundamental Duties

By the 42nd Amendment of the Constitution, adopted in 1976, Fundamental Duties of the citizens have also been enumerated. These enjoin upon a citizen among other things, to abide by the Constitution, to cherish and follow noble ideals which inspired our national struggle for freedom, to defend the country and render national service when called upon to do so and to promote harmony and spirit of common brotherhood amongst all people of India transcending religious, linguistic and regional or sectional diversities.

The Directive Principles

The Directive Principles of State Policy is a unique feature of India's Constitution. The Directive Principles are in the nature of directions to the legislature and executive that they should exercise their authority in such a manner as to ensure due respect for, and observance of, these principles. Although these directives are not justiceable, the courts cannot altogether avoid taking cognizance of them. They are the imperative basis of the state policy and the Constitution directs the state to apply these principles in making laws.

The Directive Principles that are economically very significant are quoted below.

(a) The State shall strive to promote the welfare of the people by securing and protecting as effectively as it may a social order in which justice, social, economic and political, shall inform all the institutions of the national life {Article 38(1)}.

(b) The State shall, in particular, strive to minimize the inequalities in income, and endeavour to eliminate inequalities in status, facilities and opportunities, not only among individuals but also amongst groups of people residing in different areas or engaged in different vocations {Article 38(2)}

(c) The State shall, in particular, direct its policy towards securing:

  (1) That the citizens, men and women equally, have the right to an adequate means of livelihood.

  (2) That the ownership and control of the material resources of the community are so distributed as best to subserve the common good.

  (3) That the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

  (4) That there is equal pay for equal work for both men and women.

(5) That the health and strength of workers, men and women, and the tender age of children are not abused and that citizens are not forced by economic necessity to enter a vocation unsuited to their age or strength.

(6) That children are given opportunities and facilities to develop in a healthy manner and in conditions of freedom and dignity and that childhood and youth are protected against exploitation and against moral and material abandonment (Article 39-A).

It may be noted that sections of Article 39 were quoted as the basis of certain policies and Acts.

(d) The state shall ensure that the operation of the legal system promotes justice, on a basis of equal opportunity, and shall, in particular, provide for legal aid, by suitable legislation of schemes or in any other way, to ensure that opportunities for securing justice are not denied to any citizen by reason of economic or other disabilities (Article 39-A).

(e) The state shall take steps to organise village panchayats and endow them with such powers and authority as may be necessary to enable them to function as units of self-government *(Article 40).*

(f) The state shall, within the limits of its economic capacity and development, make effective provision for securing the right to work, to education and to public assistance in cases of unemployment, old age, sickness and disablement, and in other cases of underserved wants (Article 41).

(g) The state shall make provision for securing just and humane conditions of work and for maternity relief (Article 42).

(h) The state shall endeavour to secure, by suitable legislation or economic organisation or any other way, to all workers, agricultural, industrial or otherwise, a living wage, conditions of work ensuring a decent standard of life and full enjoyment of leisure and social and cultural opportunities and in particular the state shall endeavour to promote cottage industries on an individual or co-operative basis in rural areas (Article 43).

(i) The state shall take steps, by suitable legislation or in any other way, to secure the participation of workers in the management of undertakings, establishments or other organizations engaged in any industry (Article 43-A).

(j) *The state shall promote with special care the educational and economic interests of the weaker* sections of the people, and, in particular, of the scheduled castes and the scheduled tribes, and shall protect them from social injustices and all forms of exploitation (Article 46).

(k) The state shall regard the raising of the level of nutrition and the standard of living of its people and the improvement of public health as among its primary duties and, in particular, the state shall endeavour to bring about prohibition of the consumption, except for medicinal purposes, of intoxicating drinks and of drugs which are injurious to health (Article 47).

(l) The state shall endeavour to organise agriculture and animal husbandry on modern and *scientific lines and shall, in particular, take steps for preserving and improving the breeds, and* prohibiting the slaughter of cows and calves and other milch and draught cattle (Article 48).

(m) The state shall endeavour to protect and improve the environment and to safeguard the [illegible] and wild life of the country (Article 48-A).

These Directive Principles make quite clear how important is the economic responsibility bestowed [illegible] the state by the Constitution.

Through constitutional amendments, new directives were added to provided a greater [illegible] orientation to development. For instance, in 1978, by the 44th Amendment, a new clause was added to Article 38; and this new clause contains a directive to strive to minimise the inequalities in [illegible] facilities and opportunities. The 42nd Amendment incorporated a new Article, 43-A, to direct the state to take suitable steps to secure workers' participation in management.

There have been many occasions when the Directive Principles and Fundamental Rights have been [illegible] conflict with each other. In the early days, the Supreme Court held that the Fundamental Rights were sacrosanct part of the Constitution and nothing, including the Directive Principles, could override them. But the view that the Fundamental Rights should be subordinated to the Directive Principles gained ground in later years.

While asking the *Lok Sabha* to refer the Constitution (Fourth Amendment) Bill to the [illegible] Committee, Prime Minister Nehru declared that the Fundamental Rights must subserve the Directive Principles. In the *Keshwanand Bharti vs. State of Kerala*, Justice Mathew observed that 'in building up a just social order, it is sometimes imperative that the Fundamental Rights should be subordinated to Directive Principles. Economic goals have an uncontestable claim for priority over ideological ones on the ground that excellence comes only after existence. It is only if men existed that there can be fundamental rights."

In short, the Directive Principles of State Policy enunciated in the Indian Constitution provide an enormous scope for government intervention in the functioning of the economy. However [illegible] interestingly, although state control of the economy had been deepened and widened as if it were a Constitutional requirement, this trend has been reversed since 1991 while the same Preamble and Directive Principles are held sacrosanct.

Role of Government in Business

Government plays a very important role in the modern economy. Even the modern capitalist or market economies are mixed or regulated system. In such economies, "a substantial share of the nation's product goes to satisfy public wants, a substantial part of the private income originates in the public budget, and public tax and transfer payments significantly influence the state of private income distribution."

Economic Role of Government

The government plays an important role in almost every national economy of the world. Even in the countries described as capitalist economies or market economies, "a substantial share of the nation's product goes to satisfy public wants, a substantial part of the private income originates in the public budget and public tax and transfer payments significantly influence the state of private income distribution. Moreover the budget policy affects the levels of employment and prices in the private sector."

The state control of economy is a universal phenomenon, the extent and nature of the control [illegible] widely between nations, depending upon the nature and stage of development of the economy, the behaviour of the private sector, the political philosophy, administrative system, etc.

Government normally play four important roles in an economy i.e., Regulatory, Promotion, Entrepreneurship and Planning Role.

1. **Regulatory Role:** Government Regulation of the business may cover a broad spectrum extending from entry into business to the final results of a business. The reservation of the business/industries to small-scale, public and co-operative sectors, licensing system etc., regulate the entry. Regulation of product mix, promotional mix etc. amount to regulation of the conduct of business.

   Results of business operations may be regulated by such measures as ceiling on profit margins, dividends, etc.

   Government regulation of the economy may be broadly classified into direct and indirect controls.

   Direct controls can be applied selectively from firm to firm and industry to industry. at the discretion of the state.

   Indirect controls are usually exercised through various fiscal and monetary incentives or disincentives.

2. **Promotional Role:** This role played by government is very important in developed countries as in the developing countries. In developing countries, where the infrastructure facilities for development are inadequate, the promotional role of government assumes special significance.

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

3. **Entrepreneurial Role:** In many economies, the state also plays the role of an entrepreneur establishing and operating business and bearing the risks. A number of factors such as socio-political ideologies; dearth of private business, neglect of certain sectors; like the unprofitable sectors, by the private entrepreneurs; absence of or inadequate competition in certain segments and the resultant exploitation of consumers, etc. have contributed to the growth of SOES in many countries.

4. **Planning Role:** In the developing countries, the state plays a very important role as a planner.

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

Separation of Powers

Separation of powers is an important feature of the Indian Constitution. "The separation of powers contemplates the idea that the governmental functions must be based on a tripartite division of

legislature, executive and judiciary. Each organ should be separate, distinct and sovereign in its own allocated sphere and it should not exercise the functions assigned to another." As Chief Justice Subba Rao observed in the Golak Nath v. State of Punjab, the Constitution demarcates the jurisdiction of these organs minutely and expects them to exercise their respective powers without overstepping their limits. They should function within the spheres allotted to them. No authority created under the Constitution is supreme; the Constitution is supreme and all the authorities function under the supreme law of the land.

Division of Power

India's Constitution distributes the items for legislation among three lists:

- Union List
- State List
- Concurrent List.

The respective jurisdictions of the Union and the States and their mutual relations have been clearly defined.

The Union has exclusive power to make laws on all matters in the Union List and the States have exclusive powers to make laws in the State List. Except for the Union Territories, the Centre cannot normally legislate on any matter included in the State List. Parliament can, however, do so if the Council of States recommends by at least two-thirds majority that such legislation is in national interest; if two or more States mutually agree that this should be done for such States and to implement treaties or international agreements or conventions.

Both the Union and States can legislate on matters in the Concurrent List. However, in case of any conflict between the Union laws and State laws, the Union laws shall prevail. Further, the Union has exclusive power to make laws on any matter not enumerated in the Concurrent List or State List.

Expansion in State Intervention

The first four decades of planning witnessed an expansion of state intervention in the economy. The Constitution was amended a number of times. The Constitution of India, which came into force in 1950, was first amended in the very next year. By the First Amendment of the Constitution, the State has been empowered to impose restrictions on the right of citizens to carry on any trade, business industry or service with a view to enabling the state to undertake any scheme of nationalisation or prescribing the professional or technical qualifications necessary for practicing any profession or carrying on any occupation, trade or business.

The state has, from time to time, acquired increasing powers to control private activity and enlarge its own ownership and management of the economy.

The brief account of the economic significance of the Indian Constitution given above makes it abundantly clear that the state has to shoulder a very heavy responsibility to attain the egalitarian goals set forth in the Constitution. Any responsibility should have commensurate authority also. Over the years, the Government has assumed enormous powers of control over the economy. How effectively and judiciously these powers have been exercised, and how satisfactorily the problems have been solved are different questions.

The Government has been very active in playing all the four important economic roles.

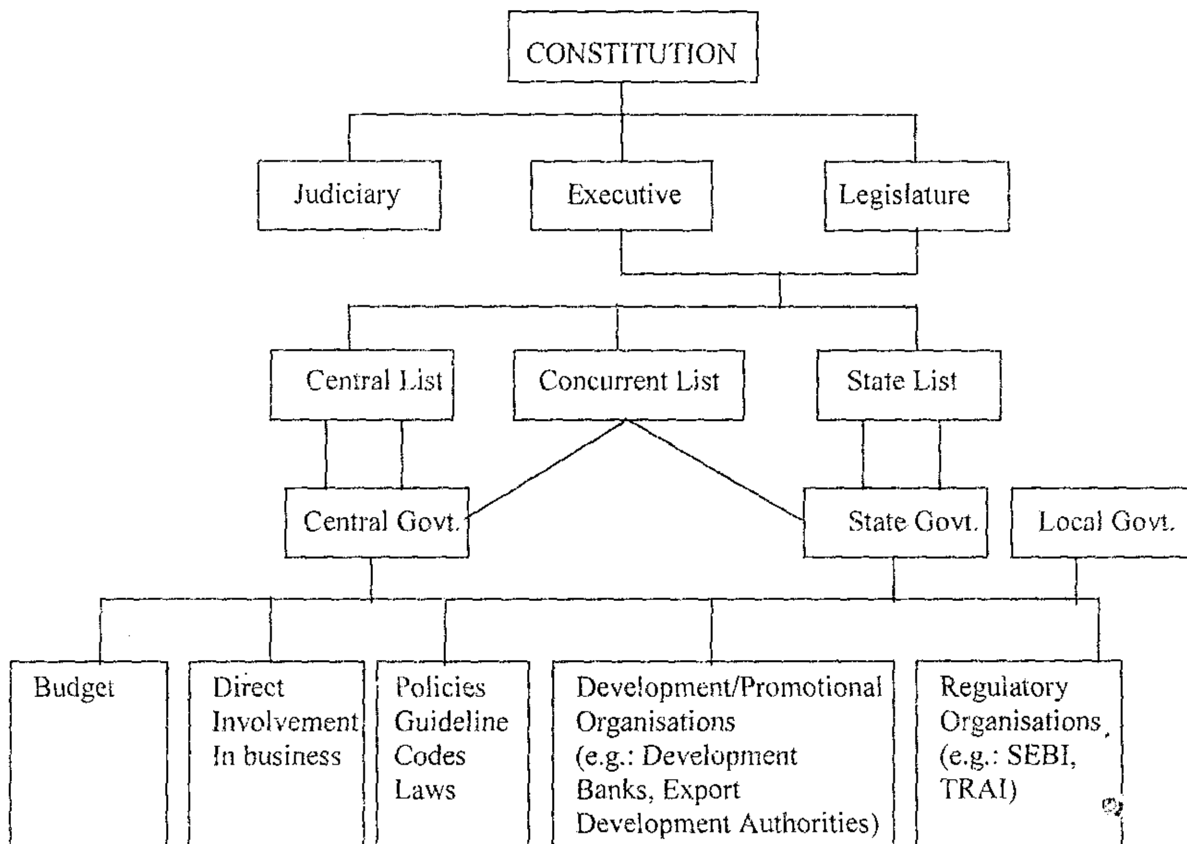


Fig: The Constitutional Environment

The first four decades have witnessed a clear trend towards an expanding control of the stat over the various segments of the economy. With the increase in the problems, there has also been a tendency on the part of the Government to arm itself with more and more powers of control over the functioning of the economy. The Industries (Development and Regulation) Act, the Companies Act. Capital Issues Control Act (repealed following the liberalisation), Securities (Contracts Regulation) Act, Monopolies and Restrictive Trade Practices Act, Essential Commodities Act, Prevention of Black marketing and Maintenance of Supplies of Essential Commodities Act, Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, Foreign Exchange Regulation Act (replaced by the Foreign Exchange Management Act in 200), Imports and Exports (Control) Act [replaced by the Foreign Trade (Development and Regulation) Act in 1992] etc., provide the Government with sweeping powers of control over industry and commerce, so much so that Government cannot escape the responsibility for any shortfalls, drawbacks, or imperfections in these sectors of vital importance to the economy.

There are quite a good number of industrial and labour laws which regulate employer-employee relations, working conditions, wages, bonus, labour welfare and social security, etc.

The commercial banking sector was brought under the effective control of the Reserve Bank of India by the Banking Companies Act of 1949 and the Amendment Acts of 1956 and 1962, the Banking Laws

(Miscellaneous Provisions) Act, 1963, etc. The Securities and Exchange Board of India (SEBI) regulates the capital market.

Indirect controls have also been playing their part in serving the national development goals. Various quantitative and qualitative monetary weapons have been deployed from time to time to regulate the economy, mainly to control prices. A number of fiscal and monetary incentives have been offered to encourage the growth of such priority sectors as the export industry, small industry and small business. Monetary, fiscal, financial and physical incentives have been provided for the accelerated development of the backward regions. Fiscal and monetary policies have also been employed, as disincentives to discourage certain undesirable or inessential activities. The direct controls had considerably grown in importance.

No less important that the regulatory role is the promotional role of the Government in India. Being a mixed economy, the state has to provide the necessary facilities for the growth of the private sector. Our industrial policy has assigned an important role to the private sector in a number of industries. State s promotional role include development of infrastructural facilities, fostering of institutions to provide financial aid development support to business.

The expansion in the entrepreneurial/participative role of the state was been very spectacular. The public sector has grown substantially, both vertically and horizontally. The total investment in the Central Government industrial enterprises has grown from Rs. 29 crores spread over 5 units on April 1951, to Rs. 2,23,000 crores in over 236 units in 1998. In some industries, the public sector gained an absolute or near monopoly, and it had a commanding position in a number of basic and heavy industries.

Both fresh investments and nationalisation have contributed to the growth and expansion of the public sector. More than 90 percent of the commercial banking sector came to be in the hands of the state. Successive nationalisations – the nationalisation of the Imperial Bank and the establishment of the State Bank of India out of it in 1955, the nationalisation of 14 major private banks in 1969 and another six in 1980 – have been mainly responsible for it. The insurance business in the country, too, had been nationalised. The dawn of the present century has witnessed the move towards privatisation/divestment.

Apart from monopoly in the field of railway transport, communications and air transport, the public sector accounted for a considerable share in shipping and road passenger transport. In the other sector, the public sector had virtual monopoly in coal mining, exploration and refining of petroleum and in the generation and supply of electricity.

At one time, the public sector corporations accounted for about one-tenth of the country's total foreign trade. Imports and exports of certain important items are *canalized* through public sector agencies.

As a consequence of the liberalisation, however, privatisation/divestment has been spreading.

The public distribution system has been expanded to remove the imperfections in the distribution of essential goods and to protect the interests of the vulnerable sections. The Government has been playing a major role as a planner. The Planning Commission was set up in 1950 and the First Five Year Plan was launched in 1951 with the objective of achieving a rapid rise in the standard of living of the people by, an efficient exploitation of the resources of the country, increasing production and offering opportunities to all for employment in the service of the community. Our Five Year Plans place special emphasis on improvements in the living conditions of the poor. The objective of distributive justice has been given added emphasis in the later Plans.

A significant aspect of Indian planning is the respect for democratic and property rights, unlike in centrally planned economy. In Indian planning, there has been the balancing of the various economic

elements and a sort of a fusion of the public, private and joint sectors, heavy and light industries, and big, medium, small and cottage industries.

In short, as Rosan observed, unquestionably, the Indian government held the levers that determined the levels of output of all large and medium-sized firms by: (1) its own direct production of a wide variety of inputs and final products; (2) its grant, or refusal, of permission to private firms to produce new items or to expand production; (3) its provision of capital funds – to, and control of security issues by, private firms; (4) its control of access to foreign exchange; and, (5) its control of imports.

There has, however, been a very significant relaxation of these controls since 1991.

An Evaluation of The control Regime in India

Planned development has enabled India, undoubtedly, to achieve significant progress in several spheres. However, the fact remains that the achievements in many areas have been much below the potential and targets. The rate of growth and the pace of development, in general, have been very slow due to the deficiencies and drawbacks of the development policies, regulatory measures and implementation.

In view of the dearth of entrepreneurial activities, investible funds and expertise in the private sector in the early days of development, assigning the public sector a very important role in the development process was inevitable. However, establishing exclusive monopoly or a predominant position for the public sector in many industries where private sector was capable of making progress in fact ran counter not only to the objective of, faster growth but also to some of the other social objectives. The policy of limiting the role of the private sector, particularly of the so-called large houses, has contributed in no small measure to the shortages and high prices of several goods and services.

The over-enthusiasm to encompass almost the whole gamut of economic activities by the public sector resulted in the state not being able to pay sufficient attention and resources for the development of certain critical sectors. The policy of barring the private sector from such critical sectors compounded the infrastructural problems.

The injudicious expansion of the public sector has created serious problems of public finance. It has increased the unproductive expenditure due to the swelling of the bureaucratic set up. State governments are burdened with the mounting losses of their enterprises, many of which are in the non-priority areas. Although many central government enterprises have been incurring huge losses, the central public sector as a whole has been making profits because of the enormous profits generated by enterprises in monopoly sectors like oil. The public sector has become notorious for time and cost overruns, overstaffing and general inefficiency.

The MRTP regulation, industrial licensing, indiscriminate reservation of items for the small scale sector, overemphasis on import substitution, highly restrictive policy towards foreign capital, technology etc. have retarded competition, decelerated growth and contributed to the foreign trade gap.

The licensing system in India, introduced as an instrument to help achieve some of the objectives of the industrial policy, not only failed to achieve its purpose but also produced several negative effects. Prof. Jagadish Bhagwati, an economist of international repute, in his Sir Purshotham Thakurdas Memorial Lecture in 1987 observed: "In essence, the industrial licensing system which had grown into a Frankenstein, that few of us foresaw in the early 1950s when we gave it birth, had degenerated into a series of arbitrary, indeed inherently arbitrary, decisions where one activity would be chosen over another simply because the administering bureaucrats were so empowered to choose some of them. Some of them even came to rationalise and believe in the social virtues of the system that gave them these absured powers."

There is a strong general feeling that not only that there were too many controls and [illegible] policies but also, as a World Bank expert points out, the principle of Indian [illegible] rules (and exceptions) to them, which are not only detailed and specific, but also [illegible] discretion.

The protection of the small scale sector too has had adverse effects on the exports

Similarly, the over-emphasis on import substitution as a development strategy and as a [illegible] achieve trade balance and the lack of appreciation of the export development potentials [illegible] severe adverse effects on the export development. While foreign exchange was available [illegible] indiscriminate import substitution genuine needs of the export sector were overlooked. [illegible] mid-fifties, while export industries like jute and cotton textiles were denied foreign exchange [illegible] much-needed modernisation, a much too liberal approach was followed in India [illegible] exchange to many non-essential industries in the name of import substitution".

Import substitution and the associated protection of domestic industries had other adverse [illegible] The sheltered domestic market acted as a deterrent to efficiency improvement and thus the [illegible] of newly established industries becoming at some stage earners of foreign exchange are [illegible] diminished."

There is a widespread impression that the price controls in India discouraged [illegible] production leading to corruption and black marketing.

In short, the controlled regime in India have had a number of adverse effects. The [illegible] that started in 1991 and which still continues is an acknowledgement of this fact.

CHAPTER-10:
SMALL-SCALE INDUSTRIES

"In view of the meagerness of capital resources there is no possibility, in the short run for creating much employment through the factory industries. Now consider the household or cottage industries. They require very little capital. About six or seven hundred rupees would get an artisan family started. With any given investment, employment possibilities would be ten or fifteen or even twenty times greater in comparison with corresponding factory industries."

- P.C.Mahalanobis

Definition of small-scale and cottage enterprises

A significant feature of the Indian economy since Independence is the rapid growth of the small industry sector. In the Industrial Policy Resolutions of 1948 and 1956, the small sector was given special role for creating additional employment with low capital investment. A new thrust was given in favour of small units by the Industrial Policy Statement of 1977. in 1950, the government grouped small-scale industrial undertakings into two categories – those using power but employing less that 50 persons and those not using power but employing less that 100 persons. All small-scale enterprises, however, had capital investment of less than Rs. 5 lakhs. None of these criteria taken singly would be a determining test as they undergo changes over a period of time. The third criterion, namely, the character of organisation and management, also cannot be considered a sound basis of classification. Apparently, the standing feature of small scale enterprises seems to be the personal character of its organisation and management in contrast with the predominantly impersonal organisation and management of large corporations. In small enterprises management is predominantly proprietary with individual ownership or partnership. But the ownership and management may also be identical in some of the large-scale industries. The criterion, therefore, becomes vague and inappropriate.

In 1966, the small-scale enterprises were defined as undertakings with a fixed capital investment of less than Rs. 7.5 lakhs and ancillaries with a fixed capital investment of Rs. 10 lakhs. Investment will imply investment in fixed assets in plant and machinery, whether held in ownership term or by lease or by hire purchase. In 1975 this limit was revised to Rs. 10 lakhs for small-scale enterprises and Rs. 20 lakhs in case of ancillaries. Subsequently, under the Industrial Policy Statement of 1980, this limit was further raised to Rs. 20 lakhs in case of small-scale units and Rs. 25 lakhs in case of ancillary units. Simultaneously, in the case of tiny units, the limit of investment has been raised from Rs. 1 lakh to Rs. 2 lakhs. In March 1985, the Government has again revised the investment limit of small-scale to Rs. 35 lakhs and for ancillary units to Rs. 45 lakhs.

As per the Industrial Policy Statement of May 1990, the investment ceiling in plant and machinery for small-scale industries (fixed in 1985) has been raised from Rs. 35 lakhs to Rs. 60 lakhs and correspondingly for ancillary units from Rs. 45 lakhs to Rs. 75 lakhs. Investment ceiling with respect to tiny units has been increased from Rs. 2 lakhs to Rs. 5 lakhs. According to the modified definition, an ancillary unit is one which sells not less than 50 percent of its manufactures to one or more industrial units.

During 1997, on the recommendation of Abid Hussain Committee, the Government has raised the investment limit on plant and machinery for small units and ancillaries from Rs. 60/75 lakhs to Rs. 3 crores and that for tiny units from Rs. 5 lakhs to Rs. 25 lakhs.

The Government in 2000 has reduced the investment limit on plant and machinery from Rs. crores to Rs. 1 crore, but the limit for investment in tiny units has been retained as Rs. 25 lakhs.

Classification

A common classification is between traditional small industries and modern small industries. Traditional small industries include khadi and handloom, village industries, handicrafts sericulture, coir, etc. Modern small-scale industries produce wide range of goods from comparatively simple items to sophisticated products such as television sets, electronic control system, various engineering products, particularly as ancillaries to the large industries. The traditional small industries are highly labour-intensive, while the modern small-scale units make use of highly sophisticated machinery and equipment. For instance, during 1979-80 traditional small industries accounted for only 13 percent of the total output but their share in employment was 56 percent. In that year, total output of traditional small industries came to Rs. 4,420 crores and this output was produced with the employment of 133 lakh workers, the average ouiput of labour in traditional small industries was roughly Rs. 3,323.

As against this, the share of modern small industries in the total output of this sector was percent in 1979-80 but their share in employment was only 33 percent. Obviously, these industrial units would be having higher labour productivity. For instance, in 1979-80 a total output of Rs. 24,885 crores was produced by 78 lakh workers in modern small-scale industries - the average product of labour being Rs. 31,900.

One special characteristic of traditional village industries is that they cannot provide full-time employment to workers, but instead can provide only subsidiary or part-term employment to agricultural labourers and artisans. Among traditional village industries, handicrafts possess the highest labour productivity; besides, handicrafts make a significant contribution to earning foreign exchange for the country. Under these circumstances, active encouragement of handicrafts is a must. On the other hand, traditional village and small industries are largely carried on by labourers and artisans living below the poverty line, while modern small industries can provide a good source of livelihood. Hence, if with an expansion of employment, the number of persons living below the poverty line has also to be reduced, then a rapid and much larger expansion of the modern small sector will have to be planned.

Role of Small-Scale Industries in Indian Economy

The small-scale industrial sector which plays a pivotal role in the Indian economy in terms of employment and growth has recorded a high rate of growth since independence in spite of the competition from the large sector and not so-encouraging support from the Government. This is evidenced by the number of registered units which went up from 16,000 in 1950 to 36,000 units in 1961 and to 33.7 lakh units in 2000-2001. During the last decade alone, the small-scale sector has progressed from the production of simple consumer goods to the manufacture of many sophisticated and precision products like electronics control systems, micro-wave components, electro-medical equipment, T.V. sets, etc.

The Government has been following a policy of reservation of items for exclusive development in the small-scale sector. At the time of the 1977 Census of Small-Scale Industrial Units, there were

177 items in the reserved list. By 1983, the reserved list included 837 items for exclusive production in the small-scale sector. These units produce over 7,500 commodities.

According to the survey of Manufacturing Enterprises carried out by CSO, in 1994-95, 72.4 percent of the registered units were located in rural areas and only 27.6 percent were in the urban areas.

Table 1: Ownership pattern of the small Manufacturing Enterprises

	Second All India Census (1987-88)	Manufacturing Enterprises Survey (1994-95)
Proprietary	81.0 %	97.6 %
Partnership	17.2 %	1.9 %
Limited Cos.	1.7 %	--
Not Reported	--	0.5 %
Total	**100.0 %**	**100.0 %**

Note: Include SSI units registered under the Factories Act.

Source: CSO, *Manufacturing Enterprises Survey* (1994-96) and *Second All India SSI Census (1987-88).*

Out of 145 lakh units registered under the Factories Act, about 98 percent were proprietary units and only 1.9 percent were registered under partnerships. In 1987-88, the Second All India Census of SSI units had reported 81 percent as proprietary units and 17 percent as partnership units and there were 1.7 percent unit operating as Limited Companies. But in 1994-95, not a single unit was reported as Limited Company. In other words, the dominant type in the ownership pattern is proprietary with a small fraction operating as partnerships.

Table 2: Industry wise Distribution of SSI units (1994-95)

In Lakhs

	Enterprises	*% of Total*
Wood products	28.73	19.8
Food products	23.94	16.5
Repair services	21.87	15.1
Beverages and Tobacco product	14.27	9.8
Misc. Manufacturing Industries	11.59	8.0
Hosiery and Garments	10.94	7.5
Cotton textiles	8.19	5.6
Others	28.57	11.8
Total	**145.04**	**100.0**

Source: CSO, *Manufacturing Enterprises Survey (1994-95)*

According to the CSO, Manufacturing Enterprises Survey (1994-95), one-fifth of the SSI [illegible] (19.8 %) were engaged in wood products, 16.5 % in food products and 15.1 % in repair services. These three industries accounted for 51.4 percent of the total number of SSI units. Cotton textiles, hosiery and garments were another major group accounting for 13.1 percent enterprises, followed by beverages and tobacco products for 9.8 percent. Besides this, SSI units were engaged in w[illegible] silk and synthetic fibre, jute textiles, paper products and printing , leather and leather products, chemical products, metal products, machinery (electrical and non-electrical), transport equipment etc.

Output and Employment of the Small Industries.

The number of small-scale units have grown from 4.2 lakhs in 1973-74 to 32.25 lakhs in 1999-2000. during the same period of 27 years, employment has grown from 4 million to 17.85 million and output has increased from Rs. 7,200 crores to Rs. 5,78,470 crores.

The average annual growth rate employment in the small-scale sector for the period 1980-81 [illegible] 1990-91 works out to be 5.8 percent and that of production to be 18.6 percent. Whereas the growth rate of employment is commendable and strengthens the belief that the absorption of surplus labour can really take place in the small-scale sector, the high growth rate of 18.6 percent exaggerates the achievements since figures of production are at current prices and thus they conceal the inflationary rise in production. At 1981-82 prices, production of the small-scale sector grew from Rs. 30,810 crores in 1980-81 to Rs. 85,025 crores in 1990-91, giving an annual average growth of 11.7 percent which is much higher than the growth rate of industrial production in the large-scale sector which was only 7.8 percent for this period. For the 7-year period 1993-94 and 2000-2001, production of the small scale sector (at 1993-94 prices) grew at the rate of 9.4 percent per annum. Employment growth during this period was of the order of 4 percent annum. [illegible] indicators show better performance of SSI Sector as compared to large scale sector and [illegible] production.

Table 3: Employment and Production in Small Scale Sector

	No. Of Units (in lakhs)	Production (At current prices)	Rs. Crores (At 1993-94 prices)	Employment Lakhs	Export Rs. Crores At current prices
1973-74*	4.20	7,200		39.7	39[illegible]
1980-81*	8.10	28,060		71.0	1,64[illegible]
1990-91*	19.50	155,340	155,340	125.3	9,1[illegible]
1993-94	23.81	241,648	241,648	139.4	25,307
1994-95	25.71	298,886	266,054	146.6	29,068
1995-96	27.24	362,656	296,385	152.6	36,47[illegible]
1996-97	28.57	411,858	329,935	160.0	39,470
1997-98	30.14	462,641	357,749	167.2	43,946
1998-99	31.21	520,650	358,296	171.6	48,979
1999-2000	32.25	572,887	416,736	178.5	5[illegible]
2000-01**	33.70	645,496	450,450	185.6	59,[illegible]

Compound Annual Rate of Growth

1973-74 to 1980-81	21.4	8.7*	8.7	22.6
1980-81 to 1990-91	18.6	11.7*	5.8	18.6
1993-94 to 2000-01	15.1	9.4	4.0	13.1

Note: *Growth rates of production for the period 1973-74 and 1980-81 as well as for 1980-81 and 1990-91 have been calculated at 1981-82 prices. **Estimated

Source: RBI, *Report on Currency and Finance* (1997-98) and *Economic Survey* (2001-2002)

There is an element of growth brought about by erstwhile large scale units being shifted to the small scale sector with every upward revision of investment ceiling for small-scale industries after 1973-74. Obviously, the growth rate of the small-scale sector has been faster both in terms of output and employment. In other words, the output employment ratio for the small scale sector is 1:1.4. The rapid growth of the small-scale industries has a great relevance in our national economic policies. The growth of the small sector improves the production of the non-durable consumer goods of mass consumption. As such, it acts as an anti-inflationary force. If a big push is given to the small sector, it can become a stablising factor in a capital-scarce economy like India by providing a higher output capital ratio as well as a higher employment-capital ratio.

In this connection, we may refer to the relatively low capacity utilisation of the small-scale industries. The capacity utilisation in the small sector as a whole was of the order of 53 percent. There were, however, many units having high capacity utilisation e.g., industries utilising 60 to 80 percent of the capacity included leather goods, readymade garments, tiles, woolen knitwear, etc. Industries like plastic products had very low capacity utilisation (29 percent).

Exports. Substantial increase in exports were observed in the case of ready-made garments, canned and processed fish, leather sandals and chappals, food products, hosiery and marine products, etc. The value of exports increased to Rs. 1,643 crores in 1980-81 and to a record high figure of Rs. 59,753 crores in 2000-2001. A very significant feature of exports from the small-scale sector is their share in non-traditional exports. The share of exports from the small-scale sector represents about 35 percent of total exports in 2000-2001.

Interstate dispersal of small industries. Interstate dispersal of industries indicated that six states, viz., Maharashtra, Tamil Nadu, West Bengal, U.P., Punjab and Gujarat account for 59 percent of the total units in the small sector, 62 percent of total employment, 66 percent of total investment in fixed assets and 69 percent of gross output. The States which have lagged behind in encouraging small-scale industries are Rajasthan, Madhya Pradesh and Orissa.

Some concentration was observed in the location of small-scale units on account of specialisation by particular districts. 92 percent of total woolen hosiery units were in Ludhiana,82 percent of cotton hosiery in Coimbatore, Ludhiana, Calcutta and Delhi,63 percent of bicycle parts and accessories in Ludhiana,52 percent of bolts and nuts in Ludhiana, Jalandhar,Howrah and Greater Bombay together with 21 percent of iron and steel castings and forgings in Jalandhar.

The obvious conclusions is that the growth of SSIs in terms of number and output is comparatively much higher in reserved items than in unreserved items. The policy of reservation has, therefore, positively helped the growth of this sector.

Despite such positive evidence in favour of reserved items, the Union Budget (1997-98) deserved 14 items hitherto manufacturer by SSI sector. These items included ice-cream, biscuits, synthetic syrups, a variety of automobile parts, corrugated paper and boards, vinegar, poultry feed, rice

milling, dal milling etc. Need it be mentioned that all the 14 items were among the se... category of SSI items manufactured. The Union Budget of 1998-99 decided to dereserve ... item' agricultural implements' Textile Policy (2000) has deserved the garment sector ... important item for small sector on June 29, 2001, dereservation of another 14 items relate... leather goods, shoes and toys was done. These decisions have adversely affected the small sec...

The Case For Small-Scale Enterprises

Small-scale enterprises have been the subject of controversy in the past and the controv... continues even to this day. Some are ardent supporters of small enterprises, while ... vehemently oppose them. It would be worthwhile to be examine the arguments favouring ... growth of small enterprises. All these arguments have been briefly summarised in the Ind... Policy Resolution of 1956 which states:

"They provide immediate large-scale employment; they offer a method of ensuring a m... equitable distribution of the national income and they facilitate an effective mobilisation ... resources of capital and skill which might otherwise remain unutilised. Some of the problems ... unplanned urbanisation tends to create will be avoided by the establishment of small centre... industrial production all over the country." The Industrial Policy Resolution, therefore, puts ... four arguments in favour of small enterprises.

1. The Employment argument

Emphasizing the employment argument Karve Committee 1955 stated: "The principle ... employment is at least as important to a successful democracy as that of self-government ... argument is based on the assumption that small enterprises are labour-intensive and thus ... more employment per unit of capital employed. It is also assumed that the low cost on overhea... in such enterprises partly compensates for the otherwise high cost vis-a-vis large enterprise... it is argued that, let alone capital goods industries and the building up of social and econom... infrastructure where capital-intensive projects are a necessity, in other spheres of production ... developing economy, small enterprises which help to enlarge the volume of employment ... scarce capital should be encouraged.

This argument has been opposed by Dhar and Lydall who hold that employment should n... created for the sake of employment. There should be an economic justification for it also. Dha... and Lydall argue, "Employment as such can be created by simply adding on extra workers at ... point one likes in the productive (or non-productive) process. The important problem, in ... words, is not how to absorb surplus resources, but how to make the best use of scarce resou... Thus the employment argument is really an "output-argument." It implies that small enterpr... maximise output from scarce capital and entrepreneurship. Employment creation follows ... necessary corollary. Dhar and Lydall on the basis of their enquiry find that whereas in la... enterprises working two or three shifts in quite common, it is not so in the case of sma... enterprises. Thus, though apparently small enterprises appear to employ less capital per unit ... output, but "in general, the most capital-intensive type of manufacturing establishments ... small factory using modern machinery and employing upto 50 workers."

Mr. R. Venkataraman has challenged the argument of Dhar and Lydall. Table 4 reveals that ... the output-employment ratio (which can serve as a measure of productivity) is the lowest in ... small-scale sector, employment-generating capacity of small sector is eight times that of the ... scale sector. But what is still more striking and significant is that the net output-capital ratio of

small and medium sectors worked out to 4 and 3.2 times that of the large-scale sector in 1965, despite the low productivity of labour in the small sector. In 1974-75, net capital-output ratio of large enterprises works out to be 3 times that of small enterprises. Professor P.C.Mahalanobis also supports Mr. Venkataraman when he states: "In view of the meagerness of capital resources there is no possibility in the short run, for creating much employment through the factory industries... Now consider the household or cottage industries. They require very little capital. With any given investment, employment possibilities would be ten or fifteen or even twenty times greater in comparison with corresponding factory industries."

Table 4: Capital, Employment and Output in Manufacturing Enterprises

(Rs.)

	Capital Size	*Fixed capital per employee*	*Value added per unit of Employment*	*Value added per unit of fixed capital*
1965	Small	2,018	2,359	1.17
	Medium	4,044	3,815	0.94
	Large	17,753	5,217	0.29
1974-75	Small	3,706	4,790	1.29
	Medium	7,935	8,785	1.11
	Large	30,536	13,736	0.43
1978-79	Small	16,582	7,051	0.43
	Medium	27,610	12,512	0.45
	Large	68,166	15,903	0.23

Source: Computed from *Annual Survey of Industries,* 1965, 1974-75 and 1978-79.

Although with an increasing trend of modernization of small enterprises, capital-labour ratio is rising, still the data for 1978-79 reveal that capital-labour ration in large enterprises is 4 times that in small enterprises. The output-capital ratio (value added per unit of fixed capital) is also favourable to small enterprises.

Table 5: Productive Capital, Employment and Value-added in Industries (1994-95)

Gross value Of plant and machinery	*Productive capital per employee* (K/L) (Rs.)	*Value added per unit of Employment* (O/L)	*Value added per unit of capital* (O/K)
Tiny units (upto Rs. 5 Lakhs)	33,020	25,683	0.78
Small-scale units (upto Rs. 50 lakhs)	1,04,826	64,148	0.61
Large units (50 lakhs and above)	5,89,523	1,61,371	0.27

Source: Computed form *Annual Survey of Industries,* 1994-95.

Data provided by the Annual Survey of Industries 1994-95) also indicate that the productive capital per employee in large units is 5.6 times higher than in small units. But the value added per unit of capital is higher in small units. There is no doubt that value added per unit of employment is 2.5 times in large units than in the small units. The results of the 1994-95 survey also support the case of small units both from the employment and output considerations of a capital scarce country trying to reconcile the output and employment objectives.

2. The Equality Argument

The equality argument suggests that the income generated in a large number of small enterprises is dispersed more widely in the community than income generated in a few large enterprises. In other words, the income benefit of small enterprises is derived by a large population while large enterprises encourage more concentration of economic power. In this way, small enterprises bring about greater equality of income distribution. It is also held by some that as most of the small enterprises are either proprietary or partnership concerns, the relations between the workers and employers are more harmonious in small enterprises than in large enterprises.

Dhar and Lydall consider this argument as fallacious. Statistical evidence suggests "there is a common tendency in all countries, for the average wage (or salary) to be lower in small factories than that in large factories." Moreover, the virtual non-existence of trade unions in small factories enables the employers to exploit the worker to the maximum. Thus, it is true that workers in small factories are neither economically better off than in large enterprises, nor do they obtain any benefits under social security schemes. Small enterprises, therefore, by paying low wages generate less savings and less taxes and hence result in lower growth potential.

There is no doubt that the argument of Dhar and Lydall does have some force. But on the contrary it is also true that in under-developed countries the workers have a choice between a low paid job in small enterprises, the workers have to lose even the small wage which they hope to get. Moreover, by a more effective implementation of the factory laws, the difference between the average wage of a worker in small enterprise and large enterprise can be narrowed down. Statistical evidence suggests that whereas small enterprises in India pay on the average only about 50 percent of the wage earned by a worker in large enterprises, in U.S.A. and Britain, a worker in a small enterprise earns about 80 percent or even more of the wage earned by his counterpart in a large enterprise. The whole argument advanced by Dhar and Lydall to oppose small enterprises becomes untenable if cognisance is taken of the fact that it is the inefficient and corrupt administration of the factory acts and lack of organisation among labour that help the exploitation of workers by the employers. There is, of course, no denying the fact that small enterprises encourage competitive elements and generate the impulses of self-development

3. The Latent Resources Argument

This argument suggests that small enterprises are able to tap latent resources like hoarded wealth, entrepreneurial ability, etc. Dhar and Lydall feel that mobilisation of hoarded wealth is one once-for-all gain. True, it is so, but is it not a fact that the idle hoards set in motion an income stream which moves on and on? To the extent small enterprises encourage dishoarding, there is definite gain to the community. Secondly, small enterprises encourage the growth of a class of small entrepreneurs which introduces a dynamic element in the economy. Dhar and Lydall feel that in view of the low levels of remuneration to the entrepreneurs in small enterprises, "there is no evidence of an overall shortage of small entrepreneurs in India." The assertion does not appear to

be very sound. If the small entrepreneurs were present in abundance, then what obstructed the growth of small enterprises? The growth of an entrepreneurial class requires an environment. Small enterprises provide that environment which encourages a growing network of feeder and complementary relations among plants and firms. It is in this environment that latent talents of individual entrepreneurs find self-expression in localised innovations and cost-saving measures. The growth of a very large number of small firms in the post-independence period only highlights the fact that given the basic conditions such as supply of power and credit facilities, the latent resources of entrepreneurship can be tapped by the growth of small enterprises only.

4. The Decentralisation Argument

This argument impresses the necessity of regional dispersal of industries. Large enterprises are mostly concentrated in metropolitan cities. The smaller towns and the countryside in order to benefit from modern industrialism must encourage small enterprises. Industrialisation of the country can become complete only if it penetrates into the remote corners of the country. It may be true that it may not be possible to start small enterprises in every village, but it is quite possible to select a group of villages and start small enterprises to cater to the needs of the small area from the local centre. The International Perspective Planning Team rightly pointed out: "a policy of trying to implant large amount of industry in the most backward areas as directly in villages is doomed to failure and cannot be justified economically. The focus for industrial development under a dispersal policy should be neither the metropolis nor the village, but rather the large range of potentially attractive cities and towns between these two extremes." Decentralisation of industrial enterprises also helps to tap local resources – such as raw materials, idle savings, local talents – and also improves the standard of living in backward regions. Moreover, Decentralisation helps to solve the problems of congestion in the few industrial towns by enlarging the area of employment.

To sum up: small enterprises need to be developed along with large enterprises. This is also the accepted policy of the government. No doubt that the employment argument has a substantial weight in it, but it would be suicidal to encourage inefficient small enterprises in the long run. From a long period point of view, the capacity of small manufacturers to become technically progressive and efficient and develop competitive strength shall be the only justification for their continuance. In the intervening period, it would be fair to protect them, and the government should help to create conditions which facilitate their growth.

Policies and Programmes to Remove Disabilities

Small enterprises are presently seriously handicapped in comparison with larger units by an inequitable allocation system for scare raw materials and imported components, lack of provision of credit and finance; low technical skill and managerial ability; and lack of marketing contracts. It *is, therefore, essential to develop an overall approach to remove these disabilities so as to* strengthen their competitive position.

Analysing the reason for sickness of the small scale units, the *Report of the Second All-India Census of Small Scale Industries Units* stated: "Financial Problems" was stated as the reason for closure of 35 percent of the units. This was more or less the case in every industry. In case of 14.4 percent of units, "marketing problems" was stated as the reason for closure. Here also, between industries, there was not much of a change in pattern. "Raw material non-availability" was stated as the reason for closure by 5.6 percent of units. 2.2 percent were stated to be closed down due to labour problems. While 19 percent reported to have closed for other reasons.

Table 6: Reasons for Closure of Small Sector Units

(Period 1980 to 1988 combined)

	Reason	*Percent*
1.	Financial problems	34.7
2	Marketing problems	14 4
3.	Raw Material problems	5.6
4.	Disputes among owners	3.7
5.	Natural calamity	3.4
6.	Labour problems	2.2.
7.	More than one reasons (combined)	16.5
8.	Other reasons	19.4
	Total	**100.0**

Source Compiled and computed from the data provided in *The Report of the Second All-India [illegible] Small Scale Industrial Units,* p 159.

Obviously, nearly 50 percent of the closures of SSI units were either the result of [illegible] working capital or their inability to market their products. It would, therefore, be appropriate [illegible] initiate measures to reduce sickness among small sector units

(i) **Credit and Finance.** The financial disability of small enterprises is beyond question. Their internal resources are so small that they have no surplus to live on during [illegible] period of business strain. This leads to instability of their profits which deters banks from giving unsecured loans. "Considering he vital role of small industries within the Indian industrial economy, the total amount of loans granted to small industries forms a very small part of the total loans to Indian industry." In March 1998, the share of small industries in total credit to industry was of the order of 27.1 % - in absolute terms, in a total credit of Rs. 1,61,130 crores, small industries received Rs. 43,958 crores. Nevertheless there is still a need for a positive change in the outlook and approach of our financial institutions towards small-scale enterprises Their credit worthiness should not be judged in terms of he value of the assets but in terms of he ability of the enterprise to do the job and earn profit. This requires the evolution of a system of integrated credit whereby long-term loan capital and short-term credit are provided adequately, at a reasonable rate of interest.

The Reserve Bank of India evolved a Credit Guarantee Scheme for Small-Scale Industries in 1960. The RBI takes upon itself the role of a guarantee organisation for the advances which are left unpaid including interest overdue and recoverable charges. Not only working capital but even advances for the creation of fixed capital are covered under the scheme under which loans sanctioned on the basis of guarantee aggregated to Rs. 7.6 crores in 1961-62. Rs. 163 crores in 1968-69 and Rs. 16,826 crores at he end [illegible] March 1990. This shows the steady increase in the flow of institutional credit to small-scale industrial sector. According to a study by the Reserve Bank, the small-scale entrepreneurs are "basically honest, enterprising and with far greater

personal stake in their enterprises than the large-scale enterprises." In support of this, the Reserve Bank *Report on Currency and Finance (1984-85)* pointed out: Under the Corporations scheme, 18,720 claims aggregating to Rs. 59 crores were received during 1984-85, out of which 11,408 claims were disposed of for Rs.12.5 crores. The claims made were only 0.5 percent of the total amount guaranteed. This is a creditable record of the honesty and credit-worthiness of small units. Despite the vast increase in credit facilities for small-scale industries, most artisans and craftsmen particularly those belonging to the poorer sections of the society and working in small towns and villages are unable to obtain their credit requirements.

(ii) **Marketing Assistance.** Small-scale firms suffer from marketing difficulties as their products are often unstandardised and of variable quality. Undoubtedly, the originality of design is their special quality but it leads to imperfection of the market, which tends to confer benefits to branded and advertised commodities. There is, therefore, a clear case for government to eliminate these imperfections by improving information, and bringing producers and dealers into close contact with one another. In order to provide guarantee for sale, the government gives preference upto 15 percent on some of the products sold by the small firms. The National Small-scale Industries Corporation assists small firms in obtaining a greater share of government and defence purchases but does not assume marketing responsibility. NSIC which was started in February, 1955, helped the establishment of 21,384 small-scale units. Besides, it was able to secure purchase orders for small industries from the Director-General of Supplies and Disposals.

(iii) **Allocation of Raw Material, Imported Component and Equipment.** The Second International Team studied the problem of availability of raw materials, imported components for production and selected imported equipment to the small enterprises and emphasised that the small-scale industry has not shared proportionately in the growing supplies of scarce raw materials. In pursuance of this recommendation, the Government started giving priority in raw material allocation to small-scale sector. The Seventh Plan expressed its deep dissatisfaction in this regard in the following words: "While various measures have been taken for supply of raw materials to the small-scale units through State Small Industries Development Corporations, *import quota etc., in actual practice the sector gets more or less a 'residuary' treatment in raw* material distribution/allocation."

(iv) **Technical Assistance.** The development of small-scale enterprises is hampered by the present low level of technology and shortage of trained and experienced supervisory personnel. Provision of technical service is, therefore, an important and justified form to aid to stimulate increased productive efficiency and encourage new product lines.

There are at present two arrangements for providing technical advice and assistance to small firms. First, the Central Small-scale Industries Organisation, through its Service Industries Organisation, through its Service Institutes and Extension Centres, provides a staff of technically qualified people whose job is to give advice to small entrepreneurs on the technical problems facing them. A second type of technical assistance is given by the common facility workshops, in undertaking difficult production operations on behalf of small firms at a cost which at present generally excludes interest and depreciation on the machinery employed. It is rather unfortunate that these production facilities a reunderutilized.

(v) **Industrial Estates.** An industrial estate is an attempt to provide, on a rental basis, good accommodation and other basic common facilities to groups of small entrepreneurs who would otherwise find it difficult to secure these facilities at a reasonable price. However, India's experience proved to be a partial success. Major factors accounting for the poor output and

employment performance of many estates include wrong location, unsuitability os sheds and space to the needy, low use of capacity in functioning firms, and occupation of factory sheds by government agencies. According to the Sixth Plan (1980-85), by March 1979, there were 662 completed industrial estates wherein 13,467 small-scale units were functioning, accounting for an annual production of about Rs. 636 crores and providing employment to about 2.2 lakh persons.

Despite the policy of encouragement adopted by the Government, in actual practice it has been observed that still several handicaps persist. Firstly, compared with large sector , the small sector has to wait much longer for the clearance of applications. No wonder, the large sector is able to obtain more government support. Secondly, many small industries, modern as well as traditional continue to feed the wants of the rich or elite sections in the society. This defects the very purpose of state support and leads to misdirection of resources. Thus, the policies of state support should be specifically directed to the production of commodities needed by the lower strata of our society. Thirdly, some of the large enterprises are misusing the concessions available in the category of small enterprises to their advantage. It has been pointed out by economists that because the small sector is not required to obtain licences for investment, this escape route has been used for *de facto* free entry by several industries, such as matches, sewing machines, bicycles, etc. Fourthly there is a heavy concentration of small enterprises in six states, viz. Maharashtra, Tamil Nadu, West Bengal, U.P., Punjab and Gujarat. The states which have lagged behind are: Rajasthan, Madhya Pradesh and Orissa. For future policy, therefore, the emphasis in state support should shift to greater encouragement in other states. This alone will bring balanced regional development.

The Seventh Plan reviewing the progress of small industries clearly states: "The modern small industries including powerlooms have not dispersed widely; most of these are concentrated in developed states and within these states also, a few areas which are either large cities, developed urban concentrations or industrial complexes account for most of the activity."

Lastly, on the question of grant of financial assistance by commercial banks to small industries, the Ninth Plan concludes: "The (small) sector has matured and is in a position to make a much greater contribution to the national economy as well as to meet the challenge of large industry, including multinational. The SSI Sector will be provided with necessary incentives and support including making available credit to facilitate its growth and development leading to increased contribution to output, exports and employment generation."

Village and Small Industries in The Plans

During the First and Second Plans, Rs. 42 crores and Rs. 187 crores were allotted to village and small industries. The actual expenditure during the Third Plan was estimated at Rs. 241 crores and during the Annual Plans (1966-69) at Rs. 132 crores.

One of the main objectives of small industries programme has been to protect such industries from the competition of large-scale industries. The Government failed in this objective. The Fourth Plan while admitted this fact cautioned the government in the following words: "The operation of the industrial licensing system has not been effective in preventing competition from the large industries and in providing the required degree of initial protection. Nor has it been possible to prevent concentration of industries in large cities and towns." The estimated outlay in the public sector for village and small industries worked out to be Rs. 251 crores in the Fourth Plan. Besides, the total amount of investment in the private sector exceeded the target of Rs. 560 crores envisaged in the Fourth Plan.

The Fifth Plan rightly mentions: "A significantly large number of persons already dependent on traditional industries like handloom, agriculture, coir, khadi and village industries are living below the poverty line... Therefore, the principal objectives of the programme for the development of different small industries in the Fifth Plan are to facilitate the removal of poverty and inequality in consumption standards of these persons through creation of large-scale opportunities for fuller and additional productive employment and improvement of their skills so as to improve their level of earning."

The estimate expenditure during 1974-78 on village and small industries aggregated to Rs 388 crores. At a result of it, production of cloth in the decentralised sector increased to 4,100 million metres in 1977-78 – 2,3.. million metres from handlooms and 1,800 millions from powerlooms. Between 1974-75 and 1977-78, exports of handicrafts rose from Rs. 194 crores to Rs. 440 crores. Similarly the production of small-scale industries increased from Rs. 538 crores in 1974-75 to Rs. 1,000 crores in 1977-78.

Village and Small Industries in the Sixth Plan

The Sixth Plan allocated a sum of Rs. 1,952 crores for village and small industries. This sector, however, received 1.8 percent of the total outlay. A review of the progress of the Sixth Plan reveals that production in this sector has increased from Rs. 33,538 crores in 1979-80 to Rs. 65,730 crores in 1984-85 and exports from Rs. 2,281 crores in 1979-80 to Rs. 4,558 crores in 1984-85 at current prices. With regard to employment, it increased from 234 lakh persons in 1979-80 to 315 lakh in 1984-85. Whereas the output target was exceeded in money terms, the employment target could not be achieved.

Village and Small Industries in the Seventh Plan

A review of the progress of village and small industries reveals that the achievement of modern small scale industries and powerboom cloth surged forward and was even more than the targeted level in terms of production, employment as well as exports. As against an achievement of Rs. 50,520 crores in production in 1984-85, the production of the modern small scale sector increased to Rs. 92,080 crores in 1989-90 indicating an annual average growth rate of 12.7 percent. However, the production of Khadi, village and handloom cloth and coir yarn and coir products fell short of targets. Another sector which performed exceedingly well was the handicrafts which touched a level of Rs. 6,400 crores in exports in 1989-90. In the overall scenario, production of village and small industries improved from Rs. 64,669 crores in 1984-85 to Rs. 114,314 crores in 1989-90 indicating a compound growth rate of 12.1 percent between 1984-85 and 1989-90 at constant prices. In terms of employment, the growth rate was 4.4 percent. In case of exports, the achievement was commendable. Exports from the village and small sector increased from Rs. 4,558 crores in 1984-85 to Rs. 14,807 crores in 1989-90 at current prices, the average annual growth of exports was 26.6 percent.

Table 7: Rate of growth of the small Scale Sector during the Seventh Plan (1985-90)

	Modern	Traditional	Total
Production	12.4	9.9	12.1
Employment	6.1	3.2	4.4
Exports	26,5	.26.6	26.6

Note: Computed from the data given in the *Eighth Five Year Plan* (1992-97)

Small Sector Industrial Policy

The Government announced its policy towards the small sector on 6th August 1991. The main features of the Policy were:

The Small Scale Industrial Sector has emerged as a dynamic and vibrant sector of the economy during the eighties. At the end of the Seventh Plan period, it accounted for nearly 35 percent of the gross value of output in the manufacturing sector and over 40 percent of the total exports from the country. It also provided employment opportunities to around 12 million people.

The primary objective of the Small Sector Industrial Policy during the nineties was be to impart more vitality and growth-impetus to the sector to enable it to contribute its mite fully to the economy, particularly in terms of growth of output, employment and exports.

Tiny Enterprises

Government have already announced increased in the investment limits in plant and machinery of small scale industries, ancillary units and export-oriented units to Rs. 60 lakhs, Rs. 75 lakhs and Rs. 75 lakhs respectively. Such limits in respect of "TINY" enterprises would now be increased from the present Rs. 2 lakhs to Rs. 5 lakhs, irrespective of locations of the unit.

Henceforth, all Industry-related service and business enterprises, irrespective of their location, would be recognised as small scale industries and their investment ceilings would correspond to those of tiny enterprises.

It was decided to widen the scope of the National Equity Fund Scheme to cover projects upto Rs 10 lacks for equity support (upto 15 percent).Single Window Loan Scheme was enlarged to cover projects upto Rs. 20 lacs with working capital margin upto Rs. 10 lacs.

Financial Support Measures

Inadequate access to credit – both short term and long term – remains a perennial problem facing the small scale sector. Emphasis would henceforth shift from subsidized/cheap credit, except for specified target groups, and efforts would be made to ensure both adequate flow of credit on a normative basis, and the quality of its delivery, for viable operations of this sector.

To provide access to the capital market and to encourage modernisation and technological upgradation, it was decided to allow equity participation by other industrial undertakings in the SSI, not exceeding 24 percent of the total shareholding. This would also provide a powerful boost to ancillarisation and sub-contracting, leading to expansion of employment opportunities.

A beginning has been made towards solving he problem of delayed payments to small industries by setting up of 'factoring' services through Small Industries Development Bank of India (SIDBI). Network of such services would be set up throughout the country and operated through commercial banks. Factoring services imply that SIDBI or any commercial bank will buy the manufacturer's invoices from SSI units and take the responsibility for collecting payments due to them by charging a commission.

Infrastructral Facilities

A Technology Development Cell (TDC) would be set up in the Small Industries Development Organisation (SIDO) which would provide technology inputs to improve productivity and competitiveness of the products of the small scale sector. The TDC would coordinate the activities of the Tool Rooms, Process-cum-Product Development Centres (PPDs), existing as well as to be

established under SIDO, and would also interact with the other industrial research and development organisations to achieve its objectives.

Adequacy and equitable distribution of indigenous and imported raw materials would be ensured to the small scale sector, particularly the tiny sub-sector.

Marketing and Exports

National Small Industries Corporation (NSIC) would concentrate on marketing on mass consumption items under common brand name and organic links between NSIC and SSIDCs would be established.

Though the Small Scale Sector is making significant contribution to total exports, both direct and indirect, a large potential remains untapped. The SIDO has been recognized as the nodal agency to support the small scale industries in export promotion.

Modernisation, Technological and Quality Upgradation

Industry Associations would be encouraged and supported to establish quality counselling and common testing facilities. Technology and markets would be established.

Indian Institutes of Technology (IITs) and selected Regional/other Engineering Colleges will serve as Technological Information, Design and Development Centres in their respective command areas.

Promotion of Entrepreneurship

Government will continue to support first generation entrepreneur through training and will support their efforts. Large number of EDP trainers and motivators will be trained to significantly expand the Entrepreneurship Development Programmes (EDP), Industry Associations would also be encouraged to participate in this venture effectively. Women entrepreneurs will receive support through special training programmes.

Village Industries: Handloom Sector

Handloom sector contributes about 30 percent of the total textile production in the country. It is the policy of Government to promote handloom to sustain employment in rural areas and to improve the quality of life for handloom weaver.

Janata cloth scheme which sustains weavers often on a minimum level of livelihood will be phased out by the terminal year of the VIII Plan replaced by the omnibus project package scheme under which substantial funds will be provided for modernisation of looms, training, provision of better designs, provision of better dyes and chemicals and marketing assistance.

Handicraft Sector- The key areas in handicrafts that could contribute towards a faster pave of rural industrialisation are production and marketing. Scheme for training and design development and for production and marketing assistance will be given encouragement.

Other Village Industries

The activities of the Khadi and Village Industries Commission and the State Khadi and Village Industries Boards would be expanded and the organisations strengthened to discharge their responsibilities more effectively.

The programmes of intensive development of KVI through area approach with tie-up with DRDA, TRYSEM and ongoing developmental programmes relating to weaker sections like Scheduled Castes, Scheduled Tribes and Women would be extended throughout the country.

An Assessment of Small Industry Policy

The policy statement after describing the small sector as "a dynamic and vibrant sector of the economy" during the eighties, lays down as the objective for the nineties: to impart more vitality and growth-impetus so that it can contribute its mite fully to the economy, particularly in items of growth of output, employment and exports. For this purpose, instead to deregulate and debureaucratize this sector so as remove all fetters on its growth potential. The new watchword, therefore, is "competition" and not "reservation."

The question arises: Does the new policy ensure a better economic environment in which the small and tiny sector will be able to realise its growth potential?

Firstly, let us take the question of supply of credit. Government has been proclaiming the myth of supply of "concessional credit" to the small sector, although the rate of interest on concessional credit was barely 0.5 percent to 1 percent lower than on non-concessional credit. But now even this myth is sought to be removed by the proposed shift from subsidized/cheap credit to adequate supply of credit. Even earlier, credit to small units was rarely cheap, considering the corruption that accompanies the grant of loans to the small sector and the long delays in its delivery. But for a pious statement of adequate supply of credit, no concretization of the volume of credit has been made.

Secondly, the policy statement makes an important recommendation regarding the provision of equity to be held by another undertaking upto 24 percent in a small unit. This other undertaking may be small or large, Indian or foreign. The basic premises on which this statement is based are Induction of equity only upto 24 % will imply minority participation by outsiders and thus, it would not be possible for the outsiders to dominate small units, and secondly, involvement of large or foreign firms in small units will bring about technology transfer from the large to the small sector. A closer scrutiny of these premises reveals that they are spurious. Ram K. Vepa, former Development Commissioner, Small Scale Industries in this connection writes: Even now, it is contended that a number of small units are controlled by the large units with this nominees acting as benami owners. It is feared that, through the new provision, this will be legalized and with a shareholding of 24 percent, supported by one or two of the family owning shares, the small unit becomes virtually (if not legally) a subsidiary of the large company. This is specially so in the case of an ancilliary unit where orders would be given only to such units and the entire ancillary unit can become an appendage of the large sector. The government would describe this development as integration of the small sector with the large sector, but this in fact is the dependency model of the small sector which makes it an underpinning of the large sector and this would be exploited by big business.

Regarding transfer of technology by the large units to the small units, it is doubtful whether the large units will ever like this to take place, but big units are interested to use the small units only as sub-contracting agencies for small jobs, they would never encourage them to become independent units in their own right.

Thirdly, several studies about the sickness of small units reveal that the big firms (or the principals) do not make timely payments to the small units even after the delivery of goods by the latter to the former. This obstructs the cash flow of the small firms. Unable to meet the working capital requirements, these units grow sick and close down, because the principals delay payments sometimes even by six months and in extreme cases by a year as well. It is expected that the new policy would incorporate a law to limit the payment of small sector dues within 45 days.

The Government has promulgated the Delayed Payments Act (1993) to remedy the situation. But the Ninth Five Year Plan reviewing the working of the Act states: "The Delayed Payments Act does not appear to have really helped the small scale industries. It is highly desirable to review this Act and make appropriate changes to ensure that it achieves its objectives from which it has been enacted."

Fourthly, Government policy does not even take note of the large number of sick units in the small sector. According to the *Economic Survey* (1993-94), there were 2.46 lakh sick units in the small scale sector with outstanding bank credit of the order of Rs. 3,100 crores. The basic question that arises is: Is it possible to prevent this large scale sickness in the SSI units? For this purpose, it is essential that greater professionalism in management of the small units be inducted. It would be, therefore, necessary that small entrepreneurs are given proper training in the management of enterprises. Such training is essential since the small entrepreneur has to perform several functions – organizing production, arranging finance, procuring orders to market his products and along with it, to maintain public relations etc.

But to save individual small enterprises to fall sick, it would be better to have umbrella type co-operatives of entrepreneurs so that they can guide young entrepreneurs in selecting projects for production, provide information on the supply of inputs, techniques of production and help in the marketing of the products. These co-operatives can also help in the adequate procurement of credit. In other words, the salvation of the small entrepreneurs lies in cooperativisation and not in corporatization of the small and tiny sector.

Lastly, the new small sector policy and the industrial policy do not make any mention of medium sector. So long as the small sector does not cross the limit of Rs. 60 lakhs, it remains in the category of SSI units, but the moment, it crosses this limit, it is transferred to the category of large sector. This is not a scientific approach to classification of industrial units. Since quite a good number of small units, in the process of their growth, naturally pass into the category of medium units, it would be more appropriate to define small, medium and large units. From the point of view of industrial policy, small and medium enterprises should be grouped as one category. In several countries of the world, it is customary to group small and medium unit as a continuous sector. This also helps to lay down policies for this sector as opposed to the large sector.

To sum up, the policy statement on small sector does make some headway in the sense that as against the provision of one time benefits to small industry like preference in land allocation, power connection etc. it provides for continuous support to the tiny sector like easier access to institutional finance, preference in government purchase and relaxation of certain labour laws. Since tiny sector is the nursery of traditional skills of the rural areas, the package of incentives proposed for the tiny sector will help it to grow in strength. This is welcome. Since the tiny sector caters to artisans and craftsmen both in the rural and urban areas, such a policy is helpful in the alleviation of poverty.

Despite these bright spots, the thrust of the small sector policy is to make the small sector an appendage of the big sector by introducing the provision of shareholding upto 24 percent by some other undertaking, may be small or large, Indian or foreign. It is really doubtful whether such a policy will help to transfer technology to the small sector or shall only increase the control of the large sector over the small sector. The omission of the sick small sector units in the policy statement is a serious lacuna and it is necessary that the Government should pay more attention to prevention of sickness in the small sector. Merely pumping in funds without developing a congenial environment in which SSI units can survive will not serve the objectives of policy. The

need of the hour, therefore, is to encourage co-operativisation among small entrepreneurs rather than encouraging corporatisation of the small sector in the name of integrating it with the large sector. The real danger lies in permitting the large sector to take benefit of the incentives provided for the small sector by creating fake units on the one hand and breaking trade union resistance to excessive modernisation and automation on the other, which lead o labour displacement. Although, the policy statement does make good diagnosis, yet the therapy it suggests is not likely to prove very effective from the point of view of growth with equity.

Villages and Small Indistries in The Eighth Plan

The Eighth Plan allocated a sum of Rs. 6,334 crores (at 1991-92 prices) i.e., 1.5 percent of the total public outlay for the development of village and small industries. However, the actual expenditure (at current prices) was Rs. 7,094 crores i.e. 1.4 percent of the total outlay.

In terms of targets of production and the achievement of the Eighth Plan, it may be noted that but for raw silk production, in which there was shortfall in production, in all other areas the targets were achieved. Production of small scale industries reached a peak of Rs. 418,863 crores. Similarly, the production of powerloom cloth was of the order of 17,300 million sq. metres in 1996-97 as against the target of 15,240 million sq. metres. Even in the traditional industries - village industries, coir fibre, handloom cloth and handicrafts, the targets of production set for the Eighth Plan were achieved.

So far as employment is concerned, the village and small industries were able to provide employment to 575 lakh persons in 1996-97. This is really commendable. Out of this, the modern SSI sector provided employment to 228 lakh persons (i.e. nearly 40 percent of the total) and the traditional sector to 347 lakh persons (60 percent of the total). The growing share of the modern sector is indicative of the fact that higher productivity and higher earning areas in the village and small industries are getting strengthened. This is really welcome.

A highly praiseworthy achievement of the village and small industries is their contribution to exports to the tune of Rs. 52,230 crores in 1996-97 i.e. 44 percent of the total exports. This proves beyond doubt that V & SIs are very important in our effort to globalise the Indian economy.

Villages and Small Indistries in The Ninth Plan

Ninth Plan notes that the small sector is presently producing about 8,000 items, out of which 821 after the recent dereservation of 15 items are reserved for production in the small sector. However, out of the reserved items, it has been observed that as many as 200 are either not produced at all in the small sector or their production is insignificant. Besides this, the Ninth Plan mentions that during the last few years "the growth of SSI Sector in the non-reserved areas has been higher than in the reserved categories which is proof of their inherent strength and resilience of the small scale sector and its ability to respond to the challenge of the market forces."

To increase the flow of credit, the Government has started setting up specialised branches of banks exclusively meant for providing credit to SSIs.

To improve technology of SSIs, SIDBI has already set up a Technology Development and Modernisation Fund with a corpus of Rs. 200 crores. The Government has also set up Technology Trust Funds with contributions from State Governments and industry associations for transfer and acquisition of the latest technologies.

Under the scheme of Integrated Infrastructure Development Centres (IIDCs), infrastructure facilities are being developed in backward rural areas. 50 such IIDCs were to be set up during the Eighth Plan period, out of which 22 have been approved. This scheme would be continued during the Ninth Plan with more incentives and financial assistance in hilly areas and North Eastern States.

To provide technological support and training to small scale sector, tool rooms with German, Danish and Italian assistance are being sep up at Indore, Ahmedabad, Bhubneshwar, Jamshedpur and Aurangabad.

The credit provided to the SSI sector by the financial institutions is considered credit to 'priority sector'. By March 1996, the total credit provided by public sector banks stood at Rs. 29.842 crores. The cumulative disbursements by State Financial Corporations amounted to Rs. 12,704 crores upto March 1996.

The targets of production, employment and exports set for the Ninth Plan are given in table 8. It may be noted that the modern sector in SSI includes small scale industries and powerlooms. The traditional sector consists of handlooms, khadi and village industries (KVI), coir industries and handicrafts. From the data, it becomes obvious that production of small scale industries is expected to increase at an annual average growth rate of 12 percent. Similar is the increase in powerloom sector. Even in the traditional sector, production is likely to grow at the annual average rate of about 11 to 12 percent. This only underlines the vibrant nature of the SSI sector.

Regarding employment, total employment in the SSI sector will increase from 57.5 million to 66.6 million, indicating additional employment generation of the order of 9.1 million. Out of this, modern sector contribution will be 3.6 million and that of the traditional sector by 5.5 million. Overall, the rate of growth of employment will be of the order of 3.0 percent per annum which is higher than the rate of growth in any other sector of the economy visualized for the Ninth Plan.

But the most encouraging aspect of the SSI sector is the contemplated increase in exports which are expected to go up from Rs. 52,230 crores in 1996-97 to Rs. 104,000 crores in 2001-02, indicating an average annual growth rate of 14.7 percent. The most important contributors are small scale industries and handicrafts. These two account for 88 percent of the total increase in exports expected during the Ninth Plan. It may, however, be noted that out of total exports of SSI sector expected by 2001-02 of the order of Rs. 104,000 crores, the share of the modern sector will be Rs. 86,950 crores i.e. 83.6 percent. This underlines he need for strengthening the modern SSI sector with a view to increase exports. However, the traditional sector will continue of be a source of supplementary employment for the poor in the rural as well as urban areas.

From the above it becomes obvious that SSIs represent a very dynamic sector of the Indian economy and deserve all help, protection and encouragement.

S.P. Study Group on Development of Small Development of Small Enterprises

At the instance of the Deputy Chairman of the Planning Commission, a Study Group on Development of Small Enterprises (hereafter referred to as study Group) was constituted in May 1999. While constituting the Study Group, representation was given to SSI associations, economists. Indian Institute of Management, Ahmedabad, SSI entrepreneurs and secretaries of various departments like Ministry of small scale Industries and Agro and Rural Industries, (SSI & ARI), Reserve Bank of India, SIDBI, FICCI etc. The study Group submitted its Report in March 2001.

Main Recommendations of the Study Group are:

(a) Three-tier definition of tiny, small and medium sector:

Tiny units: up to Rs. 10 lakh to investment in plant and machinery.

SSI units: Rs. 10 lakhs to Rs. 1 crore investments in plant and machinery.

Medium units: Rs. 1 crore to Rs. 10 crores investment in plant and machinery

The supportive measures to be made available to the three sectors will have to be decided [illegible] Government from time to time. The endeavour will be to provide maximum support and protec[illegible] tiny units, somewhat lesser support to SSI units and no facilities/support to the Medium [illegible] except credit for modernisation from a separate fund.

Table 8 : Targets and Achievements of V & SSI in the Eighth Plan and the Ninth Plan

			1996-97		Ninth Plan 2001-[illegible]	
			Target	Anticipated Achievement	Target	Annual av[illegible] rate of growth
A.	**Production**					
Modern Sector						
1.	Small Scale Industries	Rs. crores	420,000	418,863	738,180	[illegible]
2.	Powerloom Cloth	msq.mtrs.	15,240	17,300	30,489	[illegible]
Traditional Sector						
3.	Khadi Cloth	msq.mtrs.	125	125	280	[illegible]
4.	Village Industries	Rs crores	4,120	4,120	7,261	[illegible]
5.	Coir Fibre	000' tonnes	276	271	375	[illegible]
6.	Handloom Cloth	m.q.mtrs.	7,000	7,000	2,336	[illegible]
7.	Raw Silk	tomes	16,250	14,000	20,540	[illegible]
8.	Handicrafts	Rs crores	29,620	29,620	52 201	[illegible]
B.	**Employment (lakhs)**		**231**	**575**	**666**	[illegible]
a. Modern Sector (1+2)			159	228	264	[illegible]
1.	Small Scale Industries		159	159	184	[illegible]
2.	Powerlooms		72	69	80	[illegible]
b. Traditional Sector (3 to 7)			61	347	402	[illegible]
3.	Khadhi & Village Industries		61	61	70	[illegible]
4.	Coir Industry		5	5	6	[illegible]
5.	Handlloms		149	149	173	[illegible]
6.	Sericulture – Raw Silk		61	151	[illegible]	[illegible]

7.	Handicrafts		78	71	82	3.0
C.	**Exports (1 to 16)**	**Rs. crores**	**20,201**	**52,229**	**104,000**	**14.7**
1.	Small Scale Industries		20,201	39,921	78900	14.5
2.	Powerlooms		n.a	3,970	8,050	15.2
3.	Coir Industry		211	208	400	15.9
4.	Handlooms		1,692	1,650	3,175	13.9
5.	Silk		1,500	880	1,525	11.6
6.	Handicrafts		5,400	5,600	11,950	16.3

Source: Complied and computed from Planning Commission, *Ninth Five Year Plan (1997-2002), vol.II.*

The investment ceiling should be revised upwards every three years, to account for inflation. For this purpose, the wholesale price index of the Government of India should be used.

Industry related service and business enterprises upto investment of Rs. 10 lakhs in fixed capital including land and building should also be included in the SSI sector and should be treated at par with tiny industries for priority sector lending except for financing truck operators, cars, heavy vehicles, taxis, autorickshaws and tempos.

The term small scale industry should be replaced by "Small Enterprises" which will consist of the following segments:

(i) Tiny industrial units,

(ii) Small Scale industrial units, and

(iii) Service and business enterprises.

The Study Group has the first time defined the investment ceiling for plant and machinery for medium scale units. This was felt necessary as this would ay down a direction for SSI units to graduate to medium scale units.

(a) Need of bringing awareness in small industries sector about WTO implications and its impact on SSI sector, particularly due to bringing more items under Open General Licence (OGL) as per WTO obligations. Setting up of a new cell in the office of DC (SSI) for matters relating to WTO and its implications on SSI sector.

(b) Need for a single comprehensive law for SSI sector

(c) This study Group has recommended that presently reservation should be continued for SSI sector. However, to enhance exports, the Study Group has recommended that non-SSI units can take up production of reserved items with 30 per cent export obligation to be completed over three years. Presently, this limit is 50 per cent.

(d) The Study Group has recommended to raise investment ceiling from Rs. 1 crore to Rs. 5 crore for plant and machinery for export oriented industries like leather products, garments, hosiery, hand tools, toys, packaging material, auto components, pharmaceuticals, food processing, etc.

(e) For infrastructure development, the Study Group has recommended a corpus to Rs. 2,000 crores so that adequate infrastructure facilities are available to the SSI sector.

(f) To encourage technocrat entrepreneurs in high-tech industries like electronics, information technology, bio-technology, pharmaceuticals, an Incubation Infrastructure Development Fund of Rs. 1,000 crores has been recover ided by the Study Group for sitting up of Incubation Centres (ICs) in the Tenth plan. These ICs would provide all facilities and finance, technical constancy, etc. to encourage technocrats and first generation entrepreneurs to success fully take up production on new technologies, not tried so far but having potential. Such incubation centres have given good results in developed countries as well as South East Asian countries.

(g) With a view to encourage large units to make prompt payment to SSI units against deliveries made by the SSI units as per order, the Study Group has recommended:

- Denial of MODVAT credit to defaulters in respect of payment to SSI units for more than [illegible] days' delay.
- Amendment of Income Tax Act to disallow unpaid SSI bills from business expenditure.
- Strengthening of factoring services, and
- Monitoring of implementation of Delayed Payments Act by Development Commissioner (Small Scale Industries) DC (SSI)

(h) To encourage better linkages between large and medium units, the Study Group has recommended:

- Foreign Direct Investment (FDI) to be encouraged in SSIs for better technology transfer
- Allowing excise exemption on SSI manufactured goods for other, large units under brand name in urban areas also which is presently allowed for rural areas.

(i) The Study Group has recommended enactment of Limited Partnership Act to bring [illegible] risk capital in SSI sector and the concept of limited liability. SAMADHAN scheme for one time settlement of dues of sick SSI units so that asset could be reutilised. Sick units should be required to make one time payment including interest not more than double of the credit/loan amount. This will provide an exit rout to entrepreneurs of sick units.

(k) To free the SSI sector from rigid and harassing regulatory laws applicable to the SSI sector and to reduce inspectors visits, the Study Group has recommended a number of measures, like (i) need for a single unified Act for small enterprises, (ii) replacement of inspection by self-certification, (iii) simplification of regulatory laws, etc.

(l) To enhance the data base for the SSI sector, the Study Group has recommended (i) a [illegible] census for SSI sector should be conducted since the last SSI census was held in 1987-88, (ii) collection of detailed data on clusters, (iii) sample surveys by the office of DC (SSI) to be conducted annually.

(m) The Study Group has made a number of recommendations for human resource development of SSI sector which includes inputs like training, skill upgradation, new management practices, etc.

(n) The Study Group has made recommendations on fiscal and financial measures covering:

- Setting up of targets for tiny and SSI units for credit from banks and FIs under priority sector lending.
- Setting up of more specialized bank branches for SSI sector.
- Measures for strengthening resource support to SIDBI and to make available cheaper resources for on lending at lower interest rates to SSI sector.

- Setting up of a special venture capital type fund of Rs.500 crore to be named as Laghu Udyog Nirman Nidhi for equity support.
- Standardisation of procedure and simplification of forms by banks.
- Statutory backing to State Level Inter-Institutional Committees (SLIICs).
- Raising of present excise exemption limit from Rs.50 lakh to Rs.100 lakh.
- Five per cent national MODVAT credit to large units buying components, etc. from SSI units.
- Extension of Credit Gurantee Fund Scheme with a corpus of Rs.2,500 crore.
- Allowing additional 10 percentage point abatement over and above the existing rate of abatement under Minimum Retail Price (MRP) based assessment to levy excise duty on SSI products. Presently large and small units are allowed 30 to 50 percentage point abatement on MRP for levying excise duty.
- Monitoring of credit flow to SSI sector by the Reserve Bank of India.
- To make available credit to SSI sector at a reasonable cost viz, Primelending Rate (PLR) plus three per cent.
- Raising of limit of composite loans from Rs.10 lakh to Rs.25 lakh to encourage tiny units.
- Not to cover all future fixed assets of assisted units for securing its existing advances.
- Need of restructuring of SFCs.
- Measures for time-bound disposal of loan applications and easy documentation.

(o) Measures for technology up-gradation and modernisation of SSI units:

- Setting up of Technology Bank for collection and dissemination of information about technology needed.
- A technology up-gradation & Modernisation Fund of Rs.5,000 crore with an interest subsidy of five per cent.
- Accelerated depreciation on plant and machinery installed for technology up-gradation and modernisation.
- Five per cent custom duty on capital goods with import obligation and five per cent interest subsidy as recommended for technology modernisation.

(p) To private higher marketing support to the SSI sector, the Study Group has recommended.

- Statutory backing and continuation of the Price Preference (up to 15 per cent to SSI products) under Government Purchase Programme and Purchase Preference Scheme in respect of 358 items on purchases made by government departments.
- Up to 33 per cent of government purchases may be done from SSI sector on the lines of USA.
- Industry status to all types of consortium industries so that they can avail finance from banks and FIs.
- Timely release of institutional finance for export orders of SSI units.

The recommendations made by the Study Group are very important. But it is more important that these are accepted and implemented in the best possible manner, so as to provide maximum possible benefits to SSI sector.

Assessment of the Report of the Gupta Study Group

SP Gupta Study Group has presented a very comprehensive report dealing with various aspects of the small scale sector and made detailed recommendations. In that sense, the Study Group Report is a landmark intended to strengthen the SSI sector. For the first time, it has introduced a definition of the Medium Sector so as to indicate the direction for the SSI units to graduate and abandon the crutches of reservations and other benefits specific for the SSI sector. Some of its recommendations such as the creation of Infrastructure Development Fund of the order of Rs.2,000 crores. Incubation Infrastructure Development Fund of the order of Rs.1,000 crores, raising the corpus of the Credit Guarantee Fund to Rs.2,500 crores and setting up of Technology upgradation and Modernisation Fund of Rs.5,000 crores have financial implications. The Government will have to find resources it is serious about strengthening the SSI sector, which has great potential for employment generation and export growth.

Some of its recommendations regarding the reduction of inspections by multiple agencies causing harassment to SSI units need detailed study so that in the atmosphere of liberalisation, SSI units are freed from unnecessary harassment. Moreover, the suggestion regarding the need for a single comprehensive law for SSI sector would require another study group to frame a comprehensive law and this requires the co-operation of the Ministry of Labour, Ministry of Environment, Social Welfare and Industry. Since the Government has created a separate ministry for Small Scale Industries, the Ministry should undertake this work of preparing comprehensive legislation for SSIs.

However, the critics have raised certain issues and pointed out some inconsistencies in the Report of the Study Group. The major issues raised are:

1. Raising the Investment Ceiling for Export-oriented SSIs from Rs.1 crore to Rs.5 crores – The Government of India, after receiving a large number of representations from various small industry associations reduced the investment ceiling of Rs.3 crores prescribed in 1997 to Rs.1 crore in 2000. The Study Group, in the name of export-oriented units, has recommended the raising of the limit to Rs.5 crores, far exceeding the Abid Hussain Committee recommendation. A number of industries like leather products, handtools, toys, packaging material, autocomponents, pharmaceuticals, food processing, etc. have been selected for the purpose. In this way, by a very clever move, quite a significant proportion of medium sector units have been pushed into the SSI units with technology and export intensity and having investment in plant and machinery upto Rs.5 crores will poach in the funds provided for the technology upgradation of the SSI sector. This recommendation is logically inconsistent and should be reviewed.

2. Reducing the export obligation on non SSI units undertaking production of SSI reserved items - At present, non-SSI units undertaking the production of SSI reserved items can do so only if they fulfill the export obligation of 50 per cent. The purpose of imposing this restriction on the non-SSI units was to protect SSI units from the large scale sector. By reducing the export obligation to 30 per cent, the Study Group defeats its objective of strengthening the SSI sector. It may be pointed out that reserved items contributed 38 per cent of employment and 28 per cent of turnover of SSI sector. The Government policy of withdrawing reservations from 14 very important items reserved for SSI sector has harmed the small sector. Recently, the Government has deserved the garment sector [illegible] along with such anti-SSI sector poaching in the SSI sector is also reduced from 50% to 30%, this will further threaten the SSI sector – a major source of labour absorption.

Policy Perspective to Help Small and Tiny Sectors Enterprises

Two major problems responsible for the sickness of small and tiny sector are lack of availability of adequate credit, especially working capital and problems associated with marketing of products. In this respect, small scale industry associations have highlighted certain facts:

1. 95 per cent of the S S Units are still below the Rs.5 lakh level of investment in plant and machinery.

2. Ironically, 95 per cent of S S Units accounting for nearly 33 per cent of the employment in the factory sector are not getting more than 3 per cent of their credit requirements.

3. Total credit available to SSI units as a percentage of production has come down from 7 per cent in 1991-92 to 6.5 per cent in 1995-96.

4. The SSI units are not able to effectively market their products, in the absence of brand names and superior advertising power of large units.

To overcome difficulties experienced in credit availability, the Reserve Bank of India appointed in December 1991 a Committee under the Chairmanship of Shri. P.R. Nayak, Deputy Governor, RBI. Later in December 1997, Mr. S.L. Kapoor, former Secretary, Small Scale Industries, Government of India was appointed as Chairman of another Committee to make recommendations pertaining to the persistent problems of untimely and inadequate availability of credit to SSIs.

The major recommendations of *Nayak Committee* are:

1. As against the availability of 8.1 per cent of credit available over the turnover, the Nayak Committee recommended 20 per cent credit over the production/turnover of SSIs. This recommendation has also been endorsed by the Abid Hussain Committee. RBI should monitor the flow of credit to this sector so that the target is achieved within the time frame of a decade.

2. "Collateral Security" and/or third party guarantee insisted by the banks should be dispensed with as a rule, irrespective of the amount of credit involved.

3. As per the recommendation of the Abid Hussain Committee, from the total credit of SSI Sector, 40 per cent is to be provided to units with less than Rs.5 lakhs investment in plant and machinery. 20 per cent to the units with Rs.5 lakhs to Rs.20 lakhs investment and the balance 40 per cent is to be provided to units with investment of more than Rs.25 lakhs. This recommendation should be implemented and monitored by the RBI.

4. Village industries, and the smaller tiny industries with credit limit upto 1 lakh should have the first claim on the priority credit to the SSIs.

At present, tiny sector gets credit equivalent to 2.7 per cent of its turnover, which is extremely low. Efforts should be made to raise it to 40 per cent level as recommended by the Ibid Hussain Committee.

5. Banks should ensure that there are not delays in sanctioning credit to SSI units.

6. Specialised bank branches for SSI are to be opened by the banks to facilitate operation of large number of SSI loan/credit account. Specialised branches are to be set up in clusters having concentration of SSIs.

Kapoor Committee subsequently made 128 recommendations to improve the availability and delivery of credit to SSIs. The RBI accepted 35 recommendations, and issued circulars to banks to implement them. Salient features of the accepted recommendations are:

1. Delegation of more powers to Branch Managers to grant as hoc limit.
2. Freedom to banks to decide their own norms of assessment of credit requirements.
3. Opening of more specialized branches for SSIs.
4. Enhancement of limit of composite loans to Rs.5 lakhs.
5. Strengthening of mechanism for recovery of loans.

6. Paying more attention to backward states.
7. Setting up Customers Grievance Redressal Machinery and making it more effective.
8. Simplifying procedures for sanctioning credit and handling complaints.
9. Disposal of loan applications upto Rs.25,000 within a fortnight and loans above Rs.2[illegible] within 8 to 9 weeks.

All these recommendations, if effectively implemented and monitored would certainly improve the flow of credit to this rather neglected sector.

Other Measures

To help the marketing of SSI products, Price Preference Policy was made a permanent measure to protect the interests of SSI units. A price preference of 10 per cent was accordingly permitted to the products of cottage and SSIs. States have withdrawn this permanent preference measure. This has adversely affected the marketing of SSI products. This was uncalled for and the need of the hour is to revive this measure.

The Government has decided to amend the interest payable on Delayed Payment to SSI & Ancillary Industrial Undertakings Act (1993) to make the provision of the law more stringent by raising it to 1.5 times the prime lending rate charged. Although the law has been given more teeth but its implementation has remained very weak. It is, therefore, held by critics that the Delayed Payment Act is a non-starter and a paper tiger. There is a compelling need to effectively use the power provided in the Act to save several SSI units form closure.

Action by the Government on the Gupta Study Group Recommendations

Prime Minister Atal Bihari Vajpayee announced a package of measures to strengthen small scale sector on August 30, 2000. They include:

1. Lowering the investment ceiling in plant and machinery for SSI sector from Rs.3 crores to Rs.1 crore.

2. Limit for composite loans to SSI units raised from Rs.10 lakhs to Rs.25 lakhs. Composite loans will include term loans and working capital from the same agency.

3. Industry-related service and business enterprises with a maximum investment of Rs.10 lakhs will qualify for priority lending. This will help employment creation in rural and semi-urban areas.

4. A capital subsidy of 12% for investment in technology in selected sectors.

5. A Group to recommend within three months ways and means to streamline frequent inspection of SSI units by multiple agencies.

6. A fresh census of SSI units to be conducted so as to update database for SSI sector.

7. To continue grant of Rs.75,000 for SSI units opting for ISO 9000 certification with a view to encourage quality management.

8. To help the SSI sector to improve its competitiveness, the limit for exemption from excise duty has been raised from Rs.50 lakhs to Rs.1 crore.

9. To help handloom sector, Government announced Deendayal Hathkarga Protsahan Yojana aimed at supporting the handloom sector through finance, design and marketing inputs. The scheme to be implemented of Rs.447 crores.

A change of policies from protectionism to liberalisation has helped large Indian industry and multinationals to enter in areas reserved for SSIs. This extreme path should be avoided since this has

done more harms than good. The country should move to a middle path and permit selective liberalisation with necessary safeguards.

Sickness in Indian Industry

"The fault dear Brutus is not in our Stars - but in ourselves."

-William Shakespeare

Dimensions of The Problem of Industiral Sickness

The incidence of industrial sickness has been growing in India during the last decade. Not only some of the traditional industries like cotton textiles, jute and sugar have been afflicted with sickness, but even some other important industries like engineering, chemicals, rubber, cement, electrical and paper have been affected.

Economic Survey (1989-90) lamenting the prevailing situation mentions: "Growing incidence of sickness has been one of the persisting problems faced by the industrial sector of the country. Substantial amount of loanable funds of the financial institutions is locked up in sick industrial units causing not only wastage of resources but also affecting the healthy growth of the industrial economy."

Table 1 : Overview of Industrial Sickness in India at the end of march 1997

		No. of Sick units	Total bank Credit Locked up (Rs. cores)	Per cent of total
1.	Non-SSI sick units	1,948	8,614	64.5
2.	Non-SSI weak units	420	1,564	11.3
3.	SSI-sick units	2,35,032	3,609	26.2
	Total	2,35,032	13,787	100.0

Source: Compiled from RBI, *Report on Currency and Finance* (1997-98).

The total bank credit locked up in sick/weak units increased from Rs.13,134 crores as at end of March 1993 to Rs. 13,787 crores as on 31st March, 1997. These included Non-SSI sick units, Non-SSI weak units and SSI-sick units. Out of the total bank credit locked-up in sick/weak units, Non-SSI sick units accounted for Rs.8,614 crores i.e. 64.5 per cent of total, Non-SSI weak units for Rs.1,564 crores (i.e. 11.3 per cent) and SSI-sick units Rs.3,609 crores (i.e. 26.2 per cent).

Table 2 provides data about non-SSI sick units and non-SSI weak units in India. The data reveal that 1,948 non-SSI sick units account for an outstanding bank credit of Rs.8,614 crores. Industry-wise analysis reveals that five industries viz., textile, engineering, iron and steel, electrical and chemicals account for about 56% of total outstanding bank credit by 31st March 1997.

Among the non-SSI weak units, five indusaries viz., textile, engineering, electrica[illegible] [illegible] and chemicals accounted for 58 per cent of total outstanding bank-credit as [illegible] the end of March [illegible]

If non-SSI sick and weak units are taken together, then the five industries viz. [illegible] engineering, paper, iron and steel and chemicals account for a total locked up bank credit of Rs 5,9[illegible] crores i.e. 58.5 per cent of the total outstanding bank credit to such units. Total bank credit locked [illegible] in [illegible] sick and weak units of the non-SSI sector was Rs.10,178 crores as at the end of March [illegible]

Statewise analysis of sick and weak units

Statewise analysis of sick and weak units (non-SSI and SSI) can be studied from the data [illegible] in table 3. As regards the non-SSI sick units, the largest number of these units (340) were in the state [illegible] Maharashtra, followed by West Bengal, Andhra Pradesh, Gujarat, Uttar Pradesh, Tamil Nadu [illegible] Karnataka. These seven industrially advanced states together accounted for 71 per cent of the total number of non-SSI units and 74.2 per cent of total outstanding bank-credit to such units as at the [illegible] of March 1997.

Table 2 : Industrywise classification of non-SSI weak sick units and non-SSI weak units as on 31 March 1997

	Units	Non-SSI Sick Units			Non-SSI Weak Units			Sick and Weak	
		Number	Outstanding Bank Credit (Rs. crores)	Per cent of total	Number	Outstanding Bank Credit (Rs. crores)	Per cent of total	Outstanding Bank Credit (Rs. crores)	Per cent Total
1.	Textiles	380	1,418	16.5	65	130	8.3	1,548	15.2
2.	Engineering	212	1,181	13.7	35	82	5.2	1,263	12.4
3.	Chemicals	190	838	9.7	42	157	10.0	995	9.8
4.	Iron and Steel	137	672	7.8	22	171	10.9	843	[illegible]
5.	Electrical	88	906	10.5	14	401	25.6	1,307	[illegible]
6.	Metals	75	429	5.0	21	96	6.1	525	[illegible]
7.	Paper	111	227	2.6	9	21	1.3	248	[illegible]
8.	Cement	52	300	3.5	14	45	2.9	345	[illegible]
9.	Sugar	21	99	1.1	7	12	0.8	111	[illegible]
10.	Jute	27	163	1.9	3	5	0.3	168	[illegible]
11.	Rubber	33	93	1.1	8	12	0.8	105	[illegible]
12.	Misc.	697	2,288	26.6	180	432	27.6	2,720	26.[illegible]
	Total	1,948	8,614	100.0	420	1,564	100.0	10,178	100.0

Source: Compiled and Computed from the data given in RBI, *Report on Currency and Finance (1997-98)*

As regards non-SSI weak units, statewise, the number of such units was the highest in Maharashtra (59 unit) with outstanding bank credit of Rs.220 crores, followed by Karnataka, Gujarat and Andhra Pradesh. Taking the seven industrially advanced state, it was revealed that they were

having 279 weak units out of a total of 420 weak units i.e., 66.4% of the total and the outstanding bank credit was Rs.1,116 crores i.e., 71.4% of the total bank-credit in such units.

As regard SSI sick units, seven industrially advanced states viz., Maharashtra, West Bengal, Gujarat, Tamil Nadu, Andhra Pradesh, Uttar Pradesh and Karnataka accounted for 1,34,813 sick small scale industrial units out of a total of 2,35,032 sick units. These units accounted for Rs.2,498 crores of outstanding bank credit out of the total outstanding bank credit of Rs.3,609 crores of such units. In other words, 57 per cent of the total sick SSI-units and 72 per cent of the total outstanding bank credit of such units was concentrated in the seven industrially advanced states of India.

It would be desirable to take overall outstanding bank credit in all three types of units (non-SSI sick units, non-SSI weak units and SSI sick units) and consider statewise the situation. Incidentally, the number of units can be a misleading indicator because the units involved in sickness may be of different sizes. Pooling together all the three categories revealed that out of a total outstanding bank credit of Rs.13,787 crores in all the sick units in the country, seven industrially advanced states accounted for Rs.9,952 crores i.e., 72.2 per cent of the total. The conclusion is obvious : industrial sickness is more concentrated in the industrially advanced states of India. Maharashtra was at the top with locked up bank credit of Rs.2,599 crores (18.8%), followed by West Bengal Rs.1,458 crores (10.6%), Karnataka Rs.1,423 crores (10.3%).

Growth of Industrial Sickness

It would be appropriate to study the growth of industrial sickness during the last decade. Data for the period prior to the passage of Sick Industrial Companies (Special Provisions) Act of 1985, classified sick units into large, medium and small units, but later the classification was made more scientific and units were grouped under non-SSI and SSI units. We have therefore, added the large and medium units and indicated them as non-SSI units for the earlier period (Refer table 4).

From the data, the following points emerge:

1. There has been fluctuations in the number of non-SSI sick units - there number rose from 1,401 in December 1980 to 1,832 in December 1984 and thereafter it rose to 2,374 in March 1996. Alongwith it, there is a continuous increase in the number of sick SSI units from 23,149 in 1980 to 2,62,376 in March 1996.

Table 3 : Statewise analysis of Industrial Sickness in India as on 31st March 1997

	State	Number of Units			Outstanding Bank Credit (Rs. crores)			Total	% of total
		Non-SSI Sick	Non-SSI Weak	SSI-Sick	Non-SSI Sick	Non-SSI Weak	SSI-Sick		
1.	Maharashtra	340	59	19,360	1,615	220	764	2,599	18.8
2.	West Bengal	216	27	53,451	1,033	53	372	1,458	10.6
3.	Uttar Pradesh	170	32	23,286	916	65	299	1,280	9.3
4.	Andhra Pradesh	225	39	15,460	1,061	126	214	1,401	103
5.	Gujarat	174	39	6,510	584	81	197	862	6.2
6.	Tamil Nadu	141	34	9,809	623	103	203	929	6.7
7.	Karnataka	110	49	6,937	556	468	399	1,423	10.3

Sub total (1 to 7)		1,376	279	1,34,813	6,388	1,116	2,448	9,952	[illegible]
		(70.6)	(66.4)	(57.3)	(74.2)	(71.4)	(67.8)	(72.2)	
8.	Kerala	64	17	8,908	409	84	168	661	[illegible]
9.	Haryana	66	12	2,574	304	24	64	392	[illegible]
10.	Bihar	55	9	22,702	117	74	121	312	[illegible]
11.	Madhya Pradesh	91	20	12,070	300	65	151	516	[illegible]
12.	Orissa	55	7	3,408	261	24	45	330	[illegible]
13.	Rajasthan	67	17	14,561	250	27	98	375	[illegible]
14.	Punjab	51	11	2,466	146	55	84	285	[illegible]
15.	Assam	38	3	10,133	166	1	54	221	[illegible]
16.	Others	85	45	23,397	273	94	376	743	[illegible]
	Total	1,948	420	2,35,032	8,614	1,564	3,609	13,787	[illegible]
		(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	

Note: Figures in brackets are percentage of the total of the respective column

Source: Compiled and Computed from the data given in RBI, *Report on Currency and Finance,(1997-98)*

2. The outstanding bank credit in non-SSI sick units increased from Rs.1,520 crores in December 1980 to Rs.10,026 crores in March 1996 - an increase of 660 percent during this period. As against it, outstanding bank credit in the SSI units rose from Rs.306 crores in December 1980 to Rs.3,722 crores in March 1996 - an increase of 1,216 percent during this period. Consequently the relative share of non-SSI units in outstanding bank credit declined from 83.2% in December 1980 to 72.9% in March 1996. Correspondingly, the share of SSI units increased from 16.7% to 27.1% during 1980-96. This indicates that the rate of growth of industrial sickness is faster in the SSI sector than in the non-SSI sector. This is due to the high mortality rate experienced in small units.

3. Average annual rate of growth of outstanding bank credit during 1980-96 in the non-SSI sector was 12.5 per cent and that of the SSI sector was 18.5 per cent.

4. Average bank credit per sick unit during 1980-95 in the non-SSI sector increased from Rs.108 lakhs to Rs.422 lakhs - more than three-fold increase. But as against it, the average bank credit per unit in the SSI units showed marginal increase from Rs.1.32 lakhs to Rs.1.42 lakhs. This implies that sickness in the SSI sector is more prevalent in the tiny sector, but is penetrating among bigger units in the non-SSI sector.

This survey of sick units is not comprehensive and there may be many more units, which have not been formally declared sick, but have become 'sickness prone'. The problem is assuming a serious dimension. The Sixth Plan commenting on the consequences of sickness mentions: "The phenomenon of industrial sickness not only tends to aggravate the problem of unemployment, but also renders anfractuous capital investment and generally creates and adverse climate for further industrial growth. While in advanced countries where there are adequate social security benefits, this is accepted as a normal feature of industrial scene, such sickness has much more serious economic consequences in a country where unemployment is a major problem and resources are scarce." The Working Group of Central Trade Unions set up by the Union Ministry of Industry also echoed similar sentiments on the problem of sick units: "whatever may be the causes, the consequence is always the same: loss of

employment and production to an economy already suffering from chronic unemployment and shortage. The workers are the worst victims of industrial sickness." Obviously, industrial sickness has both growth and welfare implications.

Factors Responsible for Industrial Sickness Stickiness in Large and Medium Scale Units

Two sets of factors are responsible for industrial sickness - exogenous and endogenous. The exogenous factors relate to such factors as government policies pertaining to production, distribution and prices; change in the investment pattern following new priorities in the plans, shortage of power, transport, raw materials, deteriorating industrial relations. Such factors are likely to affect all units in an industry. These factors can result in the sickness of the industry and thus deserve corrective action at the level of the State. One such instance is the controlled cloth scheme. The Planning Commission itself admitted: "A study of the economics of the production of controlled cloth shows that the cost of cotton alone is higher then the stamped prices in many of the varieties. Even after taking into account 35 per cent increase granted to mills on 1st January, 1977 not translated into the form of an increased consumer price, the uncovered cost of production has been found to be sizeable." When the Government itself is convinced that a particular policy is unjustifiable, it does necessitate remedial action on the part of the Government.

Another instance is that of the coal industry which had to face draconian price controls before nationalisation. Even the Railways, which were the principal buyers, refused to pay any more, but within 3 years of nationalisation, coal prices were raised by two and a half times. In case the Government could see the justification of price rise of coal after nationalisation, it could as well agree to the situation earlier.

Another important case of State inaction is its failure to evolve a suitable national income and wage policy. Instead the Government leaves the settlement of wage disputes to bilateral bargaining. As a consequence, the Reserve Bank, the State Bank, the Life Insurance Corporation and similar other high profit making concerns agree to pay high wages to their workers. These high wage islands become the envy of workers in other undertakings/industries. This sets in a chain reaction. Unless the principle of equal pay for employees with comparable or nearly comparable qualifications is accepted, industrial relations will remain in a state of turmoil, contributing to industrial sickness.

Listing the endogeneous factors, one can mention the following: mismanagement, diversion of funds, wrong dividend policy, excessive overheads, lack of provision for depreciation of machinery and other equipment, over-estimation of demand, etc. The Sixth Plan after making a careful analysis of the factors leading to sickness concludes: "However, perhaps the most important of all causes of sickness is the incompetence or the cupidity of the management."

In this connection, it would be of interest to mention the findings of the study made by Jayanti Ghosh of a firm manufacturing pottery and ceramics. The data reveal that the firm followed the policy of declaring an extremely high rate of dividend. As a proportion of net profit, the dividend was about 92 per cent in 1962-63 and reached the figure of 102 per cent in 1965-66 with the introduction of a new system of appropriation. The climax of this policy of milking the enterprise was reached in 1967-68 when the declared dividend was 242 per cent of net profit. Consequently, the firm totally ignored the need for making reasonably adequate provision for depreciation of general reserve, wither for the maintenance of plant or machinery or for its expansion. Jayanti Ghosh rightly observes: "The implications of such a policy in terms of building up reserves for further investment and expansion of production or overhauling of machinery and techniques are obvious. The main gainers from such a dividend policy were the primary shareholders, the large houses with the majority interest."

[illegible] same study brings out the interesting [illegible] selling expenses of the firm [illegible] combined [illegible] selling agents [illegible] expenditure rose to as high a proportion as [illegible] per cent of the total [illegible]. It was also the year in which the firm was declared a[illegible] of 242 per cent of the [illegible].

The case of the pottery firm is not the only case. It is only illustrative [illegible] prodigal [illegible] by the private [illegible]. The consequences of such policy [illegible] after making the enterprise dry declared its closure throwing out of employment [illegible].

[illegible] therefore incorrect to say that in all cases, Government [illegible] demanded by the workers are responsible for sickness. In a majority of [illegible] mismanagement and misconduct have been the factors responsible for the situation [illegible] mentioned. In fact as the take over [illegible] engineering units [illegible] what the Government has inherited is a load of [illegible] machinery [illegible] distraught workforce. Nationalisation in such circumstances has become [illegible] against the consequences of his misdeeds instead of punishing [illegible] enterprise dry, then hands it over to the Government for salvage.

George Fernandes had also the same story to tell. [illegible] Government to be a scavenger for the private sector. Look at the National Textile [illegible] NTC today has 111 textile mills. They were taken over after the private sector [illegible] their money and abandoned them and 1,50,000 workers employed in these [illegible] State [illegible] Jessops, Braithwaite, Burn Standard, Britannia Engineering [illegible] and [illegible] and other engineering units taken over by the Government [illegible].

It may also be mentioned that industrial sickness is much more [illegible] the financial institutions are called upon to pump more and more [illegible] down. The heavy outstandings of the sick units support this view. In this way, [illegible] to shoulder the huge burden of liabilities, which an extravagant management [illegible] principal shareholders [illegible] to salvage their capital by [illegible] shareholders and the worker who suffer later when the company is taken [illegible] of the Working Group of Central Trade Unions, therefore stated: "Instead of plugging [illegible] such wasteful expenditure, quite often the sick units so taken over, ask the workers [illegible] in wages, dearness allowance, fringe benefits, etc., and sometimes the workers who are [illegible] their only source of livelihood, are compelled to accept such unfavourable terms. [illegible] instances when the complement of a plant was reduced by the new management after [illegible] several workers had to lose their jobs."

Measures To Prevent Sickness/Revive Large And Medium Scale [illegible]

It has also been observed that the funds of the company are diverted to [illegible] owned by the business house, taking advantage of the legal loopholes. To check [illegible] Report of the Working Group of Central Trade Unions (1978) suggested [illegible] that whenever a company is taken over, all other concerns belonging to the same [illegible] taken over or recover the amount, so diverted or misappropriated, by the management [illegible] companies or the personal assets of the members of the Board of Directors."

In many situations, it has been found that the management [illegible] unit and wanting to close it down declares [illegible] in the hope that [illegible] will get compensation [illegible] and buildings, and equipment at the market [illegible]. With fabulous compensation, the management [illegible] set up new units. It is due to this reason that two approaches have been suggested [illegible] tackle the problem of sick units. The Working Group of Central Trade Unions recommended [illegible]

two relevant statutes, namely, the Industries (Development and Regulation) Act, 1951 and Companies Act should be amended to provide for:

1. Deterrent penalties to parties responsible for sickness of the units and for recovering all dues including compensation from their other corporate/personnel assets.

2. Expeditious takeover of the unit likely to become sick of already sick.

3. Simultaneous financial and management-restructuring of the units, safeguarding of workers' interests in respect of all dues.

4. Preparation and implementation of a revival plan for the unit with provision of the requisite funds. barring reversion of the unit to the erstwhile management.

The other approach was enunciated by late Professor Raj Krishna who did not favour take-over of sick units. In several cases, the Government discovered, at a very late stage that sickness was contrived, but the private business was successful in abandoning the sick child which had been deliberately starved by it in the lap of the State. In other words, for the sins of the private sector, the public sector was being called upon to pay. George Femandes, therefore, in a very angry comment remarked: "Profits should go to the private sector for them to sustain their five-star culture. Losses should be borne by the State - which means by the poor people of our country." Obviously, the question before the Government is: should the Government take over sick units of the private sector and thus revive and reconstruct these units by spending large sums of money? Or alternatively, should the Government start new public undertakings in these industries?

Late Professor Raj Krishna was of the opinion:

"After basics are nationalised public investment. A must not be wasted on the acquisition of old plants. There are scores of new plants waiting to be created in critical sectors. I would prefer public investment to be channelled for creating new capacity in crucial sectors rather than for buying old capacity."

The basic questions before the country are:

1. Whether the time and resources required for reviving and modernising sick mills are greater than those required for starting new mills?

2. Whether the workers who would be thrown out of employment could be absorbed so that the hardships to the working class can be minimized?

It is very difficult to pronounce a definite judgement in favour of either approach.

The advocates of takeover policy argue that this policy promises quicker results because it provides an infrastructure to work upon. Secondly, it involves less social cost in terms of retrenchment of workers and industrial unrest. It should however be ensured that the private sector is not allowed to gain both ways: Firstly, by milking the enterprises dry and secondly, by securing fabulous compensation and keeping its hold on the management of the nationalised concern.

Another suggestion which has been given by George Fermandes is to hand over the management of the sick units to workers with all the assistance which was so far given to the employers to be made available to the employees. The suggestion can become feasible if the following measures are also taken:

1. Not all units which are sick should be handed over to workers under government supervision, but only such units should be handed over which are capable of revival.

2. The past liabilities of the units should be reduced. This can be done by (a) writing [illegible] payment of past liabilities or phasing out the payment of statutory liabilities; (b) by re-scheduling the payment of loans; (c) by writing off of the whole or a part of the accrued interest.

3. The Government should grant loans to these units under the Soft Loan Scheme [illegible] concessional rate of interest and reduced margins.

4. The sick enterprises should be given priority in the supply of raw materials.

5. The Government should make available the services of technical/professional managers to sick units to help their recovery back to health.

6. The Government should exempt the sick units from the payment of excise duty, sales tax etc., for some period to enable them to recover.

A modified version of the suggestion of Mr. George Fernandes is that the management [illegible] units should be entrusted to workers and/or professional managers under government ownership [illegible] arrangement from a functional point of view appears to be more balanced because it reconciles on the one hand decentralised ownership with competent management and on the other, it harmonizes the individual interest of the employees with the growth of the enterprise. The proposal deserves a serious trial and if this model can be made operationally viable, it is likely to usher in a new era in corporate management.

Another way of revival of sick units is to merge them with a healthy public sector unit [illegible] private sector unit. Merger with a private sector unit has difficulties because no healthy unit would like to burden itself with the liabilities of a sick unit. In case, the State has to bear the past liabilities of the sick unit and is also called upon to provide all sorts of concessions in the name of revival of sick units there is a fear that such mergers may be used as a convenient tool for obtaining State concessions in the form of allocation of raw materials, supply of soft credit and remission of taxes. It would therefore, be prudent to hand over sick enterprises to private sector units.

Industrial Sickness in Small Scale Industry

Several studies have been made to determine the extent and the causes of sickness in small scale industry. A brief review of the various studies is given below.

Study Team Report of the State Bank of India

The Study Team of the State Bank of India headed by Shri J.S. Varshneya (1975) examined 120 small-scale units with aggregate borrowing in excess of Rs.2 lakhs. The study team found that 100 units were in the unsatisfactory group and barely 20 were in the success group. Among the factors which were responsible for extensive sickness, the most important was lack of management expertise and lack of adoption of sound business principles in running the enterprise.

Entrepreneurial Development Programme in Gujarat

The study covered 248 units in Gujarat which were considered to be performing unsatisfactorily. The study revealed the following:

(i) Performance of the enterprise is positively associated with the age of the entrepreneur. As the age of the entrepreneur improves, performance also improves.

63 per cent of the students performed very poorly as entrepreneurs. Performance of professionals covering managers, senior executives, professors, etc., was very commendable as the failure rate in this category was only 9 per cent.

(ii) Labour problems were the least important causes of failure in small-scale industries.

Survey of mortality of small-scale units in South India

P.K. Mazumdar and A. Nag of the Indian Institute of Economics, Hyderabad conducted a survey of the non-existing units in the States of Andhra Pradesh, Kerala and Karnataka to study the causes of mortality among the small-scale units. A sample of 150 units was surveyed for the period September 1974 and March 1975. The findings of the study revealed the following.

(i) More than 40 per cent of the dead units located in the States of Andhra Pradesh, Kerala and Karnataka did not have a life span of more than two years; that 25 per cent of the units died in the third year. In other words, the infant mortality rate was very high among the small enterprises.

(ii) Dead units are characterised by low employment levels and average employment in about 60 per cent of the dead units did not exceed five and in about 80 per cent of the units did not exceed nine.

(iii) The dead units suffered heavily on account of under-utilisation of capacity. This was a chronic feature since average utilisation of capacity was as low as 36 per cent. Three factors accounted for under-utilisation of capacity, lack of finance to meet working capital needs, lack of demand and non-availability of adequate raw material supply.

Haryana's Study of Small-Scale Units

The Haryana Unit of the All India Federation of the Small and Rural Industries in their memorandum submitted to the Union Minister of State for Industries on 14th April, 1979 pointed out that one of the basic factors responsible for sickness of small units was the fact that most of the 'principals' do not pay the ancillaries for six months or even longer after the purchase of goods. If the ancillaries dare protest against erratic payments, the principals threaten to stop purchasing from them. The *Memorandum drew attention to the blatant though sad reality: "Nearly 60 per cent of the 'sick'* small and rural units would not have gone sick had the principals not delayed the payments fro more than four months."

FICCI Survey on Sickness in SSIs (1988)

The FICCI survey 1988 showed that insufficient or delayed receipt of working capital and heavy dependence on other sources of finance was the most important cause of sickness. Finance as whole, both long-term and short-term accounts for as large as 43% of sickness.

The second factor which affects the viability of SSI units is their inability to sell because they cannot make expenditure on expensive advertisement and salesmanship. When the parents fall sick, the ancillaries inevitably suffer. The way-out suggested by FICCI survey is the policy of product reservations which can prevent sickness. FICCI survey has emphasized that measures to prevent sickness are much more important than efforts at rehabilitation.

Principal factors responsible for sickness of small units

A review of the various studies regarding small-scale units reveals the following:

(i) *Lack of management expertise* is a very important factor. Young entreneurs start enterprises with romantic ideas. They keep high overhead costs, borrow at high rates of interest and do not care for making economies in costs, more especially during the period of infancy. Thus, inexperienced management of small units is one of the important causes of sickness.

(ii) *Non-observance of the basic principles of business management* is another major contributing factor to sickness. To start enterprises with a low equity base, to make no effort to build internal financial resources during good years, to maintain high inventories to total production, to invest short-term borrowings in medium-term investments, etc. result in developing poor internal resilience to fight difficult times.

(iii) *Under-utilisation of capacity* caused by lack of working capital, lack of demand and non-availability of raw materials results in industrial sickness, leading to the death of small enterprises

(iv) *Easy approval of small-scale units by the state* without proper screening of project proposals also resulted in sickness. This only under-scores the fact that assessment of viability of the projects is not made with adequate care, more especially with regard to financial viability.

(v) The dead units depended mostly on their own funds, i.e., on their individual savings rather than on borrowed funds. Among the dead small units, own funds accounted for 89 per cent of gross investments. For working capital requirements, these units depended on nationalised banks or co-operative banks.

(vi) *Non-payment by the 'principals'* to the ancillaries has been noted as an important cause of industrial sickness.

Measures to prevent sickness in small units

The problem of industrial sickness in small units has to be treated differently from the problem of sickness of the large units. It is basically the problem of increasing the competitive strength and viability of the small units. For this purpose, the following measures deserve consideration:

(i) The Reserve Bank should issue guidelines for the operation of small units and thus make professional management expertise available for the guidance of small entrepreneurs. The management expertise should acquaint the small entrepreneur with the need for a better equity base, prescribe norms for allocation of their surplus to depreciation, retained profits and expansion programmes so as to build their internal financial strength.

(ii) Since a majority of sick units die in the second or third year of their existence, a programme of monitoring and nursing them during infancy is very essential. In this way, the misuse of funds for purposes other than specified, and the factors leading to low capacity utilisation can be examined and quick remedial action taken.

(iii) The Government can accord priority in allocation of scarce raw materials, extending marketing assistance and granting certain rebates and concessions to small units and more so to such units which show better record of performance.

(iv) Sickness of small units should be treated at par with scarcity/famine in agriculture and thus concessional rates of interest be charged at par with those loans, that are granted in scarcity/famine conditions in agriculture. The maximum rate of interest should be 7 per cent for small sick units to enable them to secure soft credit.

(v) The Government should take penal action against the principals for non-payment for the delivery of goods by small units.

Prevention Of Industrial Sickness And State Policy

A survey or industrial sickness in India reveals that the State did not take preventive action before the enterprises closed down or became so seriously sick that they had to be admitted to the 'emergency ward'. But it must be clarified that but for reasons of accident, natural calamity or some other very powerful external factor, sickness does not develop all of a sudden. But the fact of the matter is that we do not pay any heed to the danger signals till the day comes when the enterprise collapses. It is in this context that we may understand the warning signals.

It would, therefore, be desirable to understand the process of industrial sickness. For this purpose a definition of industrial sickness would be helpful.

According to the Reserve Bank of India, "a unit is considered sick if it has incurred cash losses for one year and, in the judgement of the financing bank, is likely to incur cash losses for the current as well as following year and/or there is an imbalance in the unit's financial structure that is, when the ratio of current assets to current liabilities is less than 1:1 and debt equity ratio (total liabilities as a ratio of net worth) is worsening." From this it follows that in the early stage of sickness, the unit is not able to meet its costs and depreciation. As a consequence, its net profits start declining. A stage comes when the losses mount further and the unit starts eating its capital and reserves. Mr. Sudarshan Lal in his definition of a sick unit has indicated two stages of sickness. According to him, "a unit can be considered as sick if it is operating at less than break-even point, that is, where it is unable to meet its costs and depreciation; the unit, which has eroded its capital and reserves, should be considered to have reached an advanced stage of sickness."

It is, therefore, necessary that sickness should be detected at an early stage and preventive measures be taken immediately. If sickness is controlled in the beginning, it will involve much less social costs-both in terms of financial burden on the State exchequer and in terms of displacement of labour, loss of production and its effect on other industries. Sickness in one industry affects all those industries which are connected with it on account of forward/backward linkages. Thus, the social cost of sickness in one or a few industries is not limited to them alone, but it retards the growth of other industries too. Thus from the point of view of the economy as a whole, preventive measures are more desirable and economical.

Warning Signals of Industrial Sickness

(i) *Shortage of Liquids funds to meet short-term financial obligations of creditors as also to meet statutory obligations.* The first sign of sickness can be noticed when an enterprise cannot pay for the purchase of raw materials, when it delays payment to its labour and when it is not in a position to meet the demand of short-term creditors for interest or repayment of loans. Besides this the industrial unit in all violation of legal provisions, stops meeting its statutory obligations, such as contributions to Employees Provident Fund, payment of excise and/or sales tax, etc. These signals foretell the development of a serious malady in future.

(ii) *Growth of excessive inventories.* Another warning signal is the growth of excessive inventories of raw materials, good-in-process and finished goods. The failure of the firm to sell the finished goods at the pace it was doing earlier results in higher inventory accumulation.

(iii) Non-payment of interest on term loans or non-payment of installments give another warning signal of impending sickness.

(iv) *Under-utilisation of capacity.* Every unit of production for its survival must cross the break-even point. It implies that the volume of production or sales of a firm are just adequate to cover the fixed costs, besides the variable costs which every production unit has to cover. If a firm operates below its break-even point, then it is incurring a loss and is bound to grow sick.

(v) *Return on investment.* After meeting its costs, a production unit should be able to make an adequate provision for depreciation. Besides this, the unit after making payment of interest on borrowed capital from friends, relatives and other creditors, should be able to generate a reasonable figure of net profits (before tax) for the enterprise. For obtaining a rate of return on investment, net profit as a proportion of the total investment in the enterprise has to be taken. Total investment should include equity capital and reserve. A comparison of the rate of return with the prevailing rate of interest is indicative of the health of the enterprise.

(vi) *Maintenance of certain financial ratios.* An enterprise is considered according to the Reserve Bank of India, as sick if the ratio of current assets to current liabilities is less than 1:1. In other words, it indicates cash losses and declining liquidity of the firm.

Similarly, debt-equity ratio (total liabilities to net worth) is another indicator of the state of financial health of a firm. A declining debt-equity ratio indicates movement towards sickness

However, the financial ratios cannot be treated as true indicators of the state of health of a firm. The firms, more especially sickness-prone firms, in order to put up a better image do a lot of a window dressing.

Government Policy on Industrial Sickness

Mr. George Fernandes, former Union Minister for Industry, made a policy statement on industrial sickness on 15th May, 1978 in the Parliament.

The main elements of the policy were as under:

1. The government should make suitable arrangements for monitoring and detecting industrial sickness at an early stage.

2. The financial institutions should jointly set up a group of professional directors who would be full time employees of the institutions and who could be nominated on the board of directors of the companies with doubtful management competence or integrity and in which the institutions have a substantial stake. In case, the group finds that the management has acted in a patently incompetent manner or has indulged in malpractices, the same management will not be extended financial assistance, until the management is changed.

3. The government should set up a screening committee to make recommendations relating to sick undertakings on the following lines:

(a) It may recommend the take-over of the management of a sick undertaking with the clear understanding that the units will not be handed back to the same management.

(b) In case, the financial institution or the State government recommended that the unit should be taken over, or where the takeover of the unit is considered necessary in national interest, the management should be taken over.

© After takeover of the management, the unit could be sold as a running concern or alternatively, a reconstruction of the undertaking could also be done. Such reconstruction will include writing down the share values, conversion of loans to equity, acquisition of shares by the Government, constitution of new board of directors etc.

(d) The merger of the unit with a public sector undertaking could also be considered.

The main thrust of the policy was to reduce the incidence of sickness in industry and dishonest management.

Following the announcement of the Government policy, a special cell on sick units in the RBI was formed to monitor the performance of sick units and to suggest corrective measures in regard to their rehabilitation. Similarly, regional monitoring cells were formed.

Since there is considerable scope for manipulation in the financial statements, it may be difficult to discover many of the manipulations from financial audit. It would, therefore, be appropriate to insist on cost audit which could reveal the malpractices in the manner of expenditure and thus indicate whether a particular unit was sound or not. The danger signals can be noted more easily in cost audit, rather than in financial audit. So far the vigilance of the Government has not been adequate.

TABLE 5 : Viability Position of Sick/Weak Units (as the end of March 1995)

		Viable	Non-viable	Viability not decided	Total
No. of Units		16,362 (6.0)	2,50,454 (92.4)	4,390 (1.6)	2,71,206 (100.0)
a.	SSI Units	15,539 (5.8)	2,49375 (92.8)	3,901 (1.4)	2,68,815 (100.0)
b.	Non-SSI Sick and Weak Units	823 (34.4)	1,079 (45.1)	489 (20.5)	2,391 (100.0)
Outstanding Bank Credit (Rs. crores)		**5,089** **(37.0)**	**5,464** **(39.8)**	**3,187** **(23.2)**	**13,739** **(100.0)**
c.	SSI Sick Units	598 (16.9	2,842 (80.1)	107 (3.0)	3,547 (100.0)
d.	Non-SSI Sick and Weak Units	4,491 (44.1)	2,621 (25.7	3,080 (30.2)	10,192 (100.0)

On the basis of the viability status, revised definitions of sick units have been framed. According to Sick Industrial Companies (Special Provisions) Act (1985) a 'sick industrial company' means a medium and large (i.e., non-SSI) industrial company (being a company registered for not less than 7 years) which at the end of any financial year accumulated losses equal to or exceeding its entire net worth and has also suffered cash losses in the financial year and the financial year immediately preceding such financial year. This definition does not cover, government companies, shipping companies and small scale industrial units/ancillary units.

To prevent weak industrial units becoming sick, the Reserve Bank of India has advised banks to take necessary remedial measures in respect of industrial units at the stage of 50 per cent erosion of their net worth. Such units, have been termed as 'weak' under SICA. An industrial unit is termed as 'weak' if at the end of any accounting year, it has (i) accumulated losses equal to or exceeding 50 per cent of its peak network in the immediately preceding five accounting years; (ii) a current ratio of less than 1:1 and (iii) suffered a cash loss in the immediately preceding year.

Further from the half year ending September 1989, the definition of sick SSI unit has been modified as follows: "A small-scale industrial unit should be considered as sick if it has, at the end of any accounting year, accumulated losses equal to or exceeding 50 per cent of its peak net worth in the immediately preceding five accounting years."

The same definition is applied also is the case of tiny and decentralised sector. However, in the case of such units where it is difficult to get the financial particulars, a unit may be considered as 'sick' if it defaults continuously for a period of one year in the payment of interest or installments of principa. and there are persistent irregularities in the operation of its credit limit with the bank.

The viability status of identified sick units as on 31st March 1995 shows that about 93% of the SSI sick units and 45% of non-SSI sick units were not viable. (Refer table 5). Bank credit locked up in non-viable sick units was as high as 80 per cent in the SSI sector and 26 per cent in the non-SSI sector

Sick Industrial Companies Act (1985) - a Critical Appraisal

More recently the government has come to the conclusion that it is not all desirable to devote resources to keep alive through a process of artificial respiration such non-viable units which are destined to die sooner or later. Economic Survey (1985-86) stated the Government policy in clearest terms: "The approach towards the rehabilitation of sick units has to be very selective and systematic There is no point in throwing away further resources in support of units, which are irretrievably sick Only such units as are found to be potentially viable need to be taken up for the formulation of rehabilitation packages to restore them to health."

In pursuance of the Government policy, the Sick Industrial Companies Act has been passed with the objective of carrying out early detection of sickness in an industrial unit and then to evolve a package of measures to remove uncertainty about the working of the sick unit.

Definition of sick unit: The sick unit has been defined to be a company where the accumulated losses at the end of any financial year result in erosion of 50% or more of its peak net worth during the immediately preceding five financial years. The net worth is the sum total of the paid-up capital and free-reserves. The free reserve means al reserves credited out of the profits and share premium account but does not include reserves credited out of revaluation of an asset write back of depreciation provisions and amalgamation.

Action suggested: The Act has made it mandatory for companies to report sickness at two levels:

(1) When the erosion of the net worth is of the order of 50%, the Board of Directors of the sick unit has been directed to bring this fact to the notice of the shareholders within a period of 60 days from the date of finalisation of the duly audited accounts of the company for the relevant financial year.

(2) When the erosion of the net worth is 100% and more, and the unit continues to show cash losses for the next two years, the management of the unit is required to report to the newly constituted board under the Act which would then take appropriate action which may involve merging, rehabilitation or even winding up after a fresh appraisal through an operating agency.

S.S. Srivastava and R.A. Yadav have made a study of 200 projects. The analysis shows that the working capital becomes negative to start with followed by cash loss. This is the first symptom of sickness.50% of erosion of net worth takes 7 to 8 years. This period is quite critical. The company enters at this stage in a state of grave sickness. The landslide from 50% erosion to 100% erosion is very quick. It is usually 1 to 2 years. The action recommended at 50% erosion would then merge with what is required at 100% erosion as there would be hardly much time in other words, the Sick Industrial Companies Act would declare an industrial unit sick when it is nearly dead or already dead From this, it follows that the definition of sickness at 50% erosion of its peak net worth will defeat the purpose of the Act and needs re-examination. (Refer table 6).

It would, therefore, be more desirable to adopt the RBI definition of a sick unit to be one which incurs cash losses for one year and in the judgement of the bank, is likely to continue cash losses for the current year as well as the following year and which has an imbalance in its financial structure Such a definition can help to provide early detection of sickness and from the warning signals so received, timely action to prevent the deterioration in sickness can be planned. The Government has revised the definition of sick units.

Another finding of several studies is that poor management is the principal cause of industrial sickness S.S. Srivastava and R.A. Yadav after an analysis of 223 projects which became sick between June 1970 and December 1983 came to the following conclusions about causewise sickness.

From the data given in table 4, it is obvious that management incompetence contributes about 44 per cent of industrial sickness. In some cases, fraudulent and dishonest managements suck certain units dry and then throw them in the lap of the Government policy towards policy is that although social considerations compel the Government to take over these units and make heavy investments on modernisation or renovation, the previous management is not held accountable for the lapses which impaired the economic viability of the units concerned. The policy for sick industrial units has, therefore, to provide, whenever necessary, for sanctions against inept or fraudulent management." The government has, therefore, become selective and discreet in takeover.

TABLE 6 : Causewise distribution of new projects in default

		No. of Projects	% of the Projects	% contri-bution
A.	Management incompetence	92	41.2	48.9
	(i) Lack of good management	36	16.1	22.2
	(ii) Poor implementation	56	25.1	21.7
B.	Production Problems	81	36.4	31.9
	(iii) Non-availability of raw materials	53	23.8	13.5
	(iv) Shortfall of working capital	3	1.4	7.2
	(v) Labour trouble	12	5.4	5.7
	(vi) Technical Operational problems	13	5.8	5.5
C.	Marketing and Misc. Problems	50	22.4	24.2

Source: Reclassified from S.S. Srivastave & R.A. Yadav, Management and Monitoring of Industrial Sickness, (1986), p.15.

To tackle the problem of industrial sickness, the Government has established the Board for Industrial and Financial Reconstruction (BIFR) under the Sick Industrial Companies Act of 1985. The BIFR has been vested with powers to institute the necessary enquiries to determine whether or not a company is sick. If the BIFR comes to the conclusion that the company has become sick, it can either give reasonable time to the Company concerned to make its net worth positive or it can devise suitable measures, including change of management, reconstruction of share capital, sale or leasing out a part or whole of an undertaking or its amalgamation/merger with a healthy unit. The Act also contains a provision that if the BIFR is satisfied that a person has been responsible for diversion of funds or for managing the affairs of a company in a manner detrimental to the interests of the company, then the BIFR shall direct the banks and financial institutions not to extend any financial assistance for a period of ten years to such a person or to a firm in which sung a person is a partner or to a company in which such a person in a director.

BIFR became operational from May 15, 1987. Public sector companies were brought within the purview of BIFR through an amendment of the SICA in December 1991. Since its inception, upto the end of November 1998, the BIFR has received 3,441 references under Section 15 of SICA.1,037 cases were rejected on scrutiny. Of the 2,404 references registered, 452 cases were dismissed as non-maintainable. Revival schemes were sanctioned or approved in 609 cases and 606 cases were recommended to the High Courts for winding up. A recent study of the revival schemes under implementation, reveals that about 22 per cent of the cases are on the road to revival, in about 20 per cent cases it is too early to form an opinion and the progress is not satisfactory in the remaining 36 per cent.

According to the Economic Survey (1998-99), 214 companies have been declared "no longer sick" on successful completion of the rehabilitation schemes sanctioned for them. This a heartening development. Moreover, the proportion of cases effectively decided to those registered by BIFR till the end of November 1998 has improved to 80.4 per cent.

According to the RBI, Report on Currency and Finance (1997-98), "The main reasons for industrial sickness in non-SSI sick/weak units, as reported by bands, were such internal factors as deficiencies in project management (44.8 per cent of the cases) and shortcoming in project appraisal (7.2 per cent of cases), as also such external factors, as non-availability of raw materials, power shortage, transport bottlenecks, financial bottlenecks, increase in overhead costs, change in Government policy, market situation, and fall in demand."

Lack of modernisation has been identified an important cause for industrial sickness. To help the revival of sick units in cotton textiles and jute industry, two funds viz., the Textile Modernisation Fund (TMF) and the Jute Modernisation Fund (JMF) have been set up in 1986. Under TMF, assistance of the order to Rs. 750 crores and under JMF of the order of Rs. 150 crores will be provided in the next 5 years. This shall provide substantial help in the revival of sick textile units.

CHAPTER-11: FOREIGN INVESTMENT IN INDIA

The flow of direct foreign investment to India has been comparatively limited because of the type of industrial development strategy and the very cautious foreign investment policy followed by the nation.

Direct foreign investment (private) in India was adversely affected by the following factors.

1. The public sector was assigned a monopoly or dominant position in the most important industries and, therefore, the scope of private investment, both domestic and foreign, was limited.
2. When the public sector enterprises needed foreign technology or investment, there was a marked preference for the foreign government sources.
3. Government policy towards foreign capital was very selective. Foreign investment was normally permitted only in high technology industries in priority areas and in export-oriented industries.
4. Foreign equity participation was normally subject to a ceiling or 40 per cent, although exceptions were allowed on merit.
5. Payment of dividends abroad, repatriation of capital, etc., as well as inward remittances were subject to stringent laws like the Foreign Exchange Regulation Act (FERA), 1973. These discouraged foreign investment.
6. Corporate taxation was high and tax laws and procedures were complex.

These factors either limited the scope of or discouraged the foreign investment in India.

Government Policy

The following paragraphs give a very brief account of Government of India's policy towards foreign capital and technology. First, the salient features of the policy followed till the economic liberalisation introduced July 1991 are given. This is followed by an account of the new policy.

India was following a very restrictive policy towards foreign capital and technology. Foreign collaboration was permitted only in fields of high priority and in areas where the import of foreign technology was considered necessary. In other areas, import of technology was considered on merits if substantial exports were guaranteed over a period of 5 to 10 years and if there were reasonable proposals for such exports. The government had issued lists of industries where :

(a) (i) Foreign investment may be permitted.

(ii) Only foreign technical collaboration (but no foreign investment) may be permitted.

(b) No foreign collaboration (financial or technical) was considered necessary.

The government policy on foreign equity participation was, thus, selective. Such participation had to be justified with regard to factors such as the nature of technology involved, whether it would promote exports which might not otherwise take place and the alternative terms

available for securing the same or similar technological transfers. Foreign equity participation was limited to 40 per cent, although exceptions were allowed on merit. The foreign share capital was to be by way of cash without being linked to tied imports of machinery and equipment or to payments for know how, trade marks, brand names, etc.

Technical collaborations were to be considered on the basis of annual royalty payments which were linked with the value of actual production. The percentage of royalty was dependent on the nature of technology. Whenever possible, the payment of fixed amount of royalty per unit of production was preferred. Royalty payments were limited to a period of 5 years.

The Foreign Exchange Regulation Act (FERA), 1973, served as a tool for implementing the national policy on foreign private investment in India. The FERA empowered the Reserve Bank of India to regulate or exercise direct control over the activities of foreign companies and foreign nationals in India. A foreign company was defined as one (other than a banking company) which was not incorporated in India or in which non-resident interest was more than 40 per cent or any branch of such a company.

According to the FERA, non-residents (including Indian citizens), foreign citizens resident in India and foreign companies required the permission of the RBI to accept appointment as agents or technical management advisers in India, of any person or company, or permit the use of their trade marks.

The trading, commercial and industrial activities in India of persons resident abroad, foreign citizens in India and foreign companies were regulated by the FERA. They had to obtain permission from the RBI for carrying on in India any activity of a trading, commercial or industrial nature; opening branches/offices or other places of business in India acquiring any business undertaking in India; and purchasing shares of Indian companies.

RBI had given general permission for certain matters. For example, general permission was granted to foreign companies to acquire or hold any immovable property in India which was necessary for, or incidental to, any activity undertaken by them with the permission of the RBI.

The New Policy

The Industrial policy statement of July 24, 1991, which observes that while freeing the Indian economy from official controls, opportunities for promoting foreign investment in India should also be fully exploited has liberalised the Indian policy towards foreign investment and technology.

As pointed out earlier, in the pre-liberalisation era, foreign equity participation was restricted normally to 40 per cent and foreign investment and technology agreements needed prior approval. As against this, the new policy has allowed majority foreign equity with automatic approval in a large number of industries.

The new policy has also made the import of capital goods automatic provided the foreign exchange requirement for such import is ensured through foreign equity.

Salient features of initiatives under the new policy includes the following.

Foreign investment in most of the industries is now eligible for automatic approval route (i.e., no prior approval of the government/RBI is required.)

Until December 1996, only 36 industries as mentioned in the Annexure III of the Industrial Policy Statement of July 1991 were eligible for automatic approval of FDI up to 51 per cent of the

total equity. The automatic route has subsequently been expanded very significantly and now there are different categories of industries on the basis of the ceiling of foreign equity participation, viz.

1. Industries in which FDI does not exceed 26 per cent.
2. Industries in which FDI does not exceed 50 per cent.
3. Industries in which FDI does not exceed 51 per cent.
4. Industries in which FDI does not exceed 74 per cent.
5. Industries in which up to 100 per cent foreign equity is permitted.

In February 2000, government took a major decision to place all items under the automatic route for FDI/NRI*/OCB (Overseas Corporate Bodies) investment except for a small negative list which includes the following : (1) items requiring no industrial licence under the Industries (Development & Registration) Act, 1951; (2) foreign investment being more than 24 per cent in the equity capital of units manufacturing items reserved for small scale units; (3) all items requiring industrial licence in terms of the locational policy notified under the industrial policy; (4) proposals having previous venture/tie-up in India with foreign collaborator; (5) proposals relating to acquisition of shares in existing Indian company by foreign/NRI/OCB investor; (6) proposals falling outside notified sector policy/caps or under sectors in which FDI is not permitted and/or applications chosen to be submitted through FIPB rather than automatic route by the investors.

Further, subject to sectoral policies and sectoral caps, the automatic route would be available to all foreign and NRI investors with the facility to bring in 100 per cent FDI/NRI/OCB investment. All proposals for investment in public sector units as also for EOU/EPZ/EHTP/STP units would qualify for automatic approval subject to the aforesaid parameters.

All other proposals which do not conform to the guidelines for Automatic Approval are considered by the Foreign Investment Promotion Board (FIPB). The FIPB considers those proposals in their totality and makes recommendations to the Government.

Foreign-owned India holding companies have been permitted to make downstream investments within permissible equity limits through the automatic route provided such holding companies bring in the requisite funds from abroad. Also the need to obtain prior approval of the FIPB for increasing foreign equity within already approved limits has been dispensed with in all cases where the original project cost was Rs 600 crore.

There are two procedural routes for approval of technical collaborations: (1) Automatic Approval by RBI is available for any proposal with lumpsum payment not exceeding US $2 million and royalty of up to five per cent on domestic sales and eight per cent on exports. (2) In all other cases, the Project Approval Board (PAB) considers the proposals and makes recommendations to the Industry Ministry regarding approval.

Other measures which encourage foreign investment include the following: ending the government monopoly in insurance; opening up of the banking sector; divesting public sector; divesting public sector enterprises; protection of international trade marks and patent by legislation; conclusion of bilateral investment treaties and double taxation treaties; and establishment of a Foreign Investment Implementation Authority (FILA) in order to ensure that approvals for foreign investments (including NRI investments) are quickly translated into actual investment inflows and the proposals fructify into projects.

India has also joined the Multilateral Investment Agency in 1994.

FII Investments

The Indian stock market was opened up to FII investment in 1992-93 and since then there has been a significant increase in the portfolio investment by FIIs.

The Regulations on Foreign Institutional Investors, which were notified on November 14, 1995, contains various provisions relating to definition of FIIs, eligibility criteria, investment restrictions, procedures of registration and general obligations and responsibilities of FIIs.

According to the Regulations, FIIs may invest only in:

(a) securities in the primary and secondary markets including shares, debentures and warrants of companies listed on a recognised stock exchange in India, and

(b) Units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed on a recognised stock exchange or not.

Joint ventures between a variety of domestic and foreign securities firms have been approved in the stock broking, merchant banking, assets management and other non-bank financial services sectors. The overall effect of FII investment and financial joint ventures has been the introduction of international practices and systems to the Indian Securities industry.

FIIs are permitted to invest in a company up to an aggregate of 24 per cent equity, which can be increased to 40 per cent subject to approval by the Board of Directors and a Special Resolution of the General Body.

In 1996-97, Government liberalised the FII investment policy, allowing the to invest in unlisted companies and in corporate and government securities.

FII investment has become an important determinant of the stock market trends in India.

Euro/ADR Issues

As mentioned earlier, since 1992-93, Indian companies satisfying certain conditions, are allowed to access foreign capital markets by Euro-issues of Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs).

"A Depository receipt is basically a negotiable certificate, denominated in US dollars, that represents a non-US company's publicly-treated local currency (Indian Rupee) equity shares DRs are created when he local currency shares of an Indian company (for example) are delivered to the depository's local custodian bank, against which the Depository Bank (such a the Bank of New York) issues DRs in US dollars. The Depository Receipts may trade freely in the overseas markets like any other dollar denominated security, either on a foreign stock exchange, or in the over-the-counter market, or among a restricted group such as qualified institutional buyers."

The prefix global implies that the DRs are marketed globally rather than in a specific country or market.

Companies with good track record of three years may avail of Euro-issues for approved purposes. According tot he revised guidelines issued in November 1995 companies investing in infrastructure projects, including power, petroleum exploration and refining, telecommunications, ports, roads and airports are exempted from the condition of three-year track record. It is expected to help companies in the infrastructure sectors to access cheap overseas funds.

Earlier companies had to keep the funds raised through Euro-issues in foreign currency deposits with banks and public financial institutions in India to be converted into Indian rupees as

and when required for expenditure on approved end uses up to 25 per cent of the Euro-issue proceedings for meeting corporate restructuring and working capital requirements. Companies are also permitted to raise funds through issue of Foreign Currency Convertible Bonds (FCCBs) and ADRs.

Table 1: FOREIGN INVESTMENT IN INDIA BY CATEGORY

(US $ millions)

	1991-92	1992-93	1997-98	2000-01
1. Direct investment	150	315	3557	2339
2. Portfolio investment	8	244	1828	2760
(i) FIIs	-	1	979	1849
(ii) Euroequities	-	240	645	831
Total	158	559	5385	5099

Source : Government of India, economic Survey, 1996-97 and 2001-02

An Evaluation of the New Policy

Although the liberalisation has increased the inflow of foreign capital to India, it has been much lower than several other developing countries have been receiving. After reaching a height of $3.57 billion in 1997, FDI inflow to India dropped to $2.16 billion in 1997 and marginally increased to $2.63 billion in 2000. India's share of global FDI flows is nowhere near the annual target of $10 billion set by the Government many years ago. This is because the infrastructural facilities are poor, several factors are costly and the policy and procedural environment in India in several respects are far from encouraging. Not only the foreign capital is shying away from India but also it is feared that there are signs of capital flight from India..

There are many ardent critics of foreign investment and technology. Foreign investment and technology is not without problems. However, the opening up of the economies of a number of nations for foreign companies and the several measures they have taken to woo foreign companies are clear indicators of the positive contribution foreign capital and technology can make.

The new policy of Government of India is, of course, much better than the old policy. However, in comparison with the business environment in many other countries, India still is not very attractive in the eyes of foreign companies, despite the large and growing Indian market. Now that many countries are competing to lure the foreign capital and technology, the choice is indeed very wide for the foreign firms. Further, many multinationals are keen to establish a foothold in the former 'communist' and 'socialist' countries which have now widely opened their doors for the foreign capital and technology, besides their interest in several other countries. Cultural factors also tilt the balance in favour of these countries vis-à-vis India. Again, sufficient clarity and simplicity are still conspicuous by their absence in the Indian policy. No miracles should, therefore, be expected from the belated awakening of India.

Although there is a log of talk about the procedural simplification, foreign companies still find the procedures very perplexing and unbearably time-consuming.

One important criticism of the liberalisation of foreign investment has been that foreign investment would take place mostly in non-priority sectors. However, about 80 per cent of the foreign investment in India since the liberalisation has gone to priority sectors. Now several of the priority industries, including the infrastructural sector, which were earlier exclusively reserved for the public sector, are opened to foreign investment. Foreign investment needs to be directed to priority sectors.

TABLE 2 : FDI AS PERCENTAGE OF GDP

Country	1989	1999
Argentina	4.0	11.3
Brazil	1.1	6.7
China	0.6	2.4
Indonesia	0.4	2.4
South Korea	3.3	9.1
Malaysia	4.2	7.1
Mexico	1.4	4.5
Pakistan	0.6	1.4
Thailand	3.8	4.9
India	**0.3**	**0.6**
USA	7.4	13.4
UK	37.6	66.1
Switzerland	34.4	139.2
Japan	11.1	30.9
Germany	10.4	36
Canada	7.8	15.1

Source : World Development Indicators, 2001 (Cited by "Fact File : India and the World"), The Hindu, September 10,2001.

Foreign Investment by Indian Companies

Until 1991, Indian companies made very little investment abroad. Although Government of India's policy had been one of encouraging foreign investment by Indian companies, subject to certain conditions, several factors like the domestic economic policy and the domestic economic situation were deterrents to foreign investment by Indian companies.

By restricting the areas of operation and growth, the government policy seriously constrained the potential of Indian companies to make a foray into the foreign countries through investment. Added to this was the attraction of the protected domestic market which was, in many cases, a seller's market and this made the Indian companies to ignore the foreign markets.

Indian companies have established subsidiaries and joint ventures in a number of countries in different manufacturing industries and service sectors.

The new economic policy of India is expected to encourage foreign investments by Indian companies. The curbs on growth, even by mergers and acquisitions, have been removed, financing restrictions have been eased, areas of business opened to the private sector companies have been substantially enlarged and foreign tie up policies have been liberalised. Further, domestic market is becoming increasingly competitive. All these factors should encourage the Indian companies to invest in other countries and take advantage of the economic liberalisation in many countries.

The investment limits for automatic clearance are too small and there is an urgent need for substantial upward revision.

In light of the economic liberalisation and the growing competition at home, many Indian companies have been planning for a major thrust abroad.

Recent reports indicate that many Indian companies are eager to invest abroad. Several companies have also been relocating production facilities abroad or prefer foreign countries to India for further expansion. This, perhaps, is an alarm bell.

Liberalising agricultural exports is concerned, Jalan favours moving cautiously in view of the importance of the agricultural sector in terms of GDP, employment, poverty levels and consumer welfare. For example, a sudden freeing of exports of foodgrains could lead to a sharp increase in domestic prices, reducing levels of real consumption of the poor, who are net buyers of good. Similarly, a sudden change in import policy for cotton or sugar might put millions of farmers out of work if, in that year, world prices are at a low level and there is glut in production. Moreover, extensive subsidies granted by the USA and the countries of the European Union to their agricultural exports further complicates the picture. On account of all these reasons, Jalan advocates that "trade liberalisation should first be introduced in regard to those non-food commodities which do not figure heavily in the consumption of the poor."

According to the Ninth Five Year Plan Document, the first, and possibly the most important, pre-condition for creating a more open economy is to create an expanding production base of tradeable goods and services which can not only withstand external competition, but can also create a surplus to generate sufficient export earnings for meeting the import requirements of the economy. The second pre-condition is to create the conditions under which the export market becomes increasingly more attractive so that there is both a shift from selling in the domestic marekt to exports and that capacities are developed to specifically target such export opportunities. According to the Plan, "both these conditions are inextricably interlinked, and involve the reduction and eventual elimination of the anti-export bias that had characterised the Indian economic system in the past and continues to exist to some degree even at present. There are two dimensions to this. First, the incentive structure has to be re-oriented towards investment in tradeable goods and services and away from non-tradeables. Second, the relative profitability of exports vis-à-vis domestic sales has to be improved."

Trade Policy of The Government of India

As indicated in the previous chapter, solution of the balance of payments problem of a country depends considerably on the policies it adopts in the import sector and export sector. In this chapter we propose to discuss the import policy and the export policy of the Government of

India. This discussion is best divided into two periods: (1) the pre-reform period (i.e., the period prior to 1991), and (2) the reform period (i.e. the period after 1991). During the latter period, massive liberalisation measures have been introduced in the industrial sector, the foreign trade, sector and the financial sector. As far as the foreign trade sector is concerned, the year 1991 is a 'watershed' as massive trade liberalisation measures adopted since this year mark a major departure from the relatively protectionistic trade policies pursued in earlier years. According to Rajesh Mehta, such a break stems from the change in the perception for the trade policy mind-set in the country. "While the objectives of self-reliance and self-sufficiency influenced the trade policy formulation in the 1950s and 1960s, the factors like export led growth, improving efficiency and competitiveness of Indian industries prevailed upon the trade policy-making during the late 1970s and the early 1980s. The current trade policy reforms, on the other hand, seem to have been guided mainly by the concerns over globalisation of the Indian economy, improving competitiveness of its industry and adverse balance of payments situation." We, accordingly, propose to discuss the two periods separately.

Import Policy: The Pre-Reform Period

The important policy of the Government of India in the pre-reform period had two important constituents: (i) import restrictions and (ii) import substitution. It was formulated keeping in view the limited foreign exchange reserves of the country, shortages of essential consumer goods in the economy, requirements of capital goods, machinery, spare-parts and components for the building up of heavy, basic industries, and the role and scope of import substitution in the country. The period of 1980s was characterised by massive import liberalisation – the desire being to enhance the export competitiveness of large sections of Indian industry.

During the immediate post-Independence period, the import policy was liberal and was designed to meet the pent up demand released after the Second World War. However, this resulted in heavy deficit in the balance of trade and the government was forced to impose restrictions on imports from hard currency areas. The rupee was devalued in September 1949. As a consequence of devaluation, restrictions on imports were considerably curtailed. Approach towards imports was liberal throughout the period of the First Plan as the government had substantial sterling balances to fall back upon.

Import Restrictions

The Mahalanobis strategy of development encouraging large-scale industrialization of the country was initiated in the Second Five Year Plan (which started in 1956-57). Under this strategy of development the government had to import capital equipment, machinery, components, spare-parts. Industrial raw materials, intermediate goods, technical know-how etc. in large quantities and this led to a substantial increase in foreign exchange expenditure. The government also had to resort to import of foodgrains from time to time to overcome the shortage of foodgrains. As against this, the export earnings continued to be stagnant. Thus the government had no option but to severely curtail import expenditure. Therefore the history of severe import restrictions in the country starts from the year 156-57. As the foreign exchange difficulties continued to mount up, more and more items were brought under import restrictions over a period of time. Imports were classified under the categories of banned items, restricted items, cancalised items and items under Open General Licence (OGL). Canalised items were those items that were canalised through the public sector agencies like State Trading Corporation (STC). Minerals and Metals Trading Corporation (MMTC), etc. Severe restrictions were imposed on the imports of non-essential

goods, so that foreign exchange resources could be released for the imports of capital good and other essential imports. The policy of import restrictions was rigorously pursued by the government for full two decades right upto 1977-78. However, there was a brief period of import liberalisation after the devaluation of 1966. Following the devaluation of the rupee by 36.5 per cent in terms of gold in June 1966, imports were somewhat liberalised. Such liberalisation was offered to 59 priority industries consisting of export industries, capital building industries, and industries catering to the needs of the common people (like sugar and cotton textiles). The year 1966 also saw the initiation of the new agricultural strategy and the government resorted to large scale import of fertilisers, seeds, pesticides and insectidies, etc., to implement the new strategy.

Import Substitution

The two broad objectives of the programme of import substitution in India were: (a) to save scarce foreign exchange for the import of more important goods, and (b) to achieve self-reliance in the production of as many goods as possible. The policy in India has gone through various phases. Broadly speaking, we can discern three distinct phases (i) in the earlier phase, import substitution mostly took the form of domestic production of consumer goods; (ii) in the second phase, emphasis shifted to the replacement of the import of capital goods and (iii) in the third phase emphasis was on reducing the dependence on imported technology by developing and encouraging the use of indigenous techniques. As a result of the policy of import substitution, the structure of imports has undergone significant changes. Many items which were previously imported are now being produced in the country itself. As a result of this policy, the country has been able to increase the production of many industrial products like iron and steel, automobiles, railway wagons, machine tools diesel engines, power transformers, etc., and in the case of many other products has achieved a stage of self-sufficiency. R.G. Nambiar has examined the progress of import substitution in Indian economy over the period 1955-56 to 1973-74. His study clearly shows how domestic production was successful in replacing imports in each category of manufactured goods. By 1955-56, imports of consumer goods had already shrunk considerably and the process of import substitution had been practically completed in this sector. Share of imports in consumer goods sector in 1955-56 was a meagre 3.7 per cent which further fell to 1.1 per cent in 1973-74. In intermediate goods I sector (raw material origin) the share of imports fell from 24.5 per cent in 1955-56 to 8.6 per cent in 1973-74. Over the same period, the share of imports in total supply fell from 31.7 per cent to 12.0 per cent in intermediate goods II sector (goods at higher level of fabrication) and from 15.2 per cent to 9.1 per cent in the case of all manufactured goods. As far as investment goods are concerned, the process of industrialization during the Second and Third Plans required their substantial import and consequently the share of imports in investment goods sector rose from 25.0 per cent in 1955-56 to 42.9 per cent in 1963-64. However, as domestic production of such goods increased, the share of imports gradually declined and stood at 23.6 per cent in 1973-74. From this analysis, Nambiar concludes that the import substitution strategy in India appears to have succeeded in its prime objective of altering the structure of imports and in generating an environment conducive to activating 'latent growth forces.'

Though the immediate aim of import substitution in his country was the conservation of foreign exchange, its long-term objective was to initiate structural changes of far-reaching significance in the economy. This objective was embodied in the large scale programme of industrialization adopted in the Second Five Year Plan. As a consequence of this, the industrial structure has achieved diversification and depth so necessary for future growth. Jaleel Ahmed has argued that import substitution not only helped in saving valuable foreign exchange for the

economy, it also contributed directly to the processes of economic (and industrial) growth. For example, over the 15 year period, 1950-51 to 1965-66, import substitution accounted for roughly one-fourth of the total growth of output, and for nearly one-half of the growth of output of the capital goods sector. Similar results were obtained by H.B. Chenery, S. Shishido and T. Watanabe in their econometric study of Japan's economy for the period 1914 to 1954. They found that during this period, import substitution accounted for nearly 40 per cent of the growth of manufacturing industry.

Import Liberalisation in 1980s

The import policy of the Government of India till 1977-78 varied in degrees of restrictiveness during different plans. It was rather light during the First Plan, intensely severe during the second, somewhat less so during the Third (except in the last two years): and perhaps equally so since then (right up to 1977-78). The year 1977-78 initiated a new era of *import liberalisation* in the country. This process was carried forward in 1980s. The annual import policies of 1980-81 to 1984-85 followed the liberal approach of providing necessary imported inputs for the industrial sector. However, the real thrust in the direction of liberalistion was provided from 1985 onwards when the system of formulating long term (three year) policies was adopted. Three long-term export-import policies were announced by the government. The first covered the period 1985 to 1988, the second covered the period 1988 to 1990 and the third covered the period 1990-9.

The export-import policy of 1980s was guided by the recommendation of the three official committees — the Alexander Committee (1978), Tandon Committee (1982) and the Hussain Committee (1985). These Committees had laid stress on export promotion and import liberalisation. Accordingly the major changes in export-import policies in the eighties (particularly in the three long term export-import policies) were in the following directions — a general move towards liberalisation of imports, especially of capital goods and raw materials, and the emphasis on export incentives. Indications were clear that henceforth the OGL (Open General Licence) list of imports would expand, both with inclusion of new items and with transfers from the licensed list. Thus the government mooted a general move to confine the quantitative restrictions t a narrower range of importables. Second, the policy measures sought to liberalise, on a priority basis, imports of capital goods and raw materials, by shifting these to the OGL list and via tariff reductions. The last two long term export-import policies paid more attention to exports with the last policy (1990-1992) being the most export oriented of all. The broad details of the import liberalisation measures enunciated in the three long-term export-import policies (1985-88, 1988-90 and 1990-92) are outlined below :

Policy for Import of Capital Goods. Since capital equipment is the basic requirement of the industrial sector, the approach in the three-year export-import policies was on providing easy access to imported capital items by progressively delinking them from licensing formalities. A large number of capital goods were placed under OGL (Open General Licence) category i.e. they could be imported without any import licence. To help exporters to compete in the world market, special facilities were provided to them for import of capital goods. Enterprises exporting 25 per cent or more of their production, subject to a minimum of Rs. 1 crore or units exporting a minimum of Rs. 10 crore were give the benefit of importing capital goods on price and delivery consideration,s notwithstanding the indigenous availability of such capital goods on price and delivery considerations, notwithstanding the indigenous availability of such capital goods, provided there is a direct nexus with the product exported. Moreover, Registered Exporters were

permitted to import capital equipment against REP (Registered Exporters Policy) licences. The 1990-92 policy incorporated a scheme for import of capital goods at concessional duty by manufacturer-exporters. Facility was also provided for the import of second-hand capital goods.

Policy for Import of Raw Materials. As in the case of capital goods, a large number of raw materials, components and consumables were placed under OGL in order to enable the actual users (industrial) to procure them without going through the licensing formalities. In addition to OGL imports, actual users (industrial) were extended the facility of importing raw materials, components and consumables under supplementary licences.

Import Policy for Registered Exporters. Because of the dire need for increasing the export earnings of the country, import policies in 1980s were given an 'export orientation'. The aim of these policies was to provide the Registered Exporters an assured, continuous and uninterrupted supply of the required production inputs, essential for expanding the exports on a sustaining basis. From early 1980s flexibility has been provided in the utilisation of REP licences. Duty free import of raw materials against REP licences was introduced. Registered exporters were provided with the facility to import capital goods against REP licences. The 1980-90 policy widened the scope of export products qualifying for import replenishment. An automatic facility was provided in all REP licences, for the import of raw materials and components. The 1990-92 policy further liberalised the import policy for Registered Exporters by making REP licences freely transferable. The benefit of REP licensing scheme was made available to all export products, except those that ere specifically identified in the policy.

The 1990-92 policy introduced the Blanket Advance Licence scheme in place of the earlier Pass Book scheme. Exporters with Rs. 10 crore exports on net foreign exchange earning (NFE) basis were allowed to procure 12 months' requirement of imported inputs duty free. This policy also gave recognition to the role played by service exports. Service exports were made eligible for grant of a Replenishment Licence at the rate of 10 per cent of the net foreign exchange earned.

Policy for Export/Trading House. Exporters who fulfill certain minimum export requirements for a specified period of time are granted the status of Export Houses, Trading Houses, Star Trading Houses or Super Star Trading Houses. The 1988-90 policy had fixed the eligibility limit for recognition as Export Houses Trading at Rs. 10 crore of net foreign exchange respectively. This was raised to Rs 5 crore for Export Houses and Rs. 2 crore and Rs. 10 crore of net foreign exchange earning respectively. This was raised to Rs. 5 crore for Export House and Rs. 20 crore for Trading Houses by the 1990-92 policy. The latter policy also introduced a new category of Star Trading Houses. These included those Trading Houses that had net foreign exchange export earning at Rs. 75 crore or above annually in the preceding three years.

In view of their special position in the field of exports, Export/Trading Houses were provided with a number of import benefits. These house were entitled to the benefits available under the Registered Exporters Policy. The 1985-88 policy introduced flexibility in the grant of renewals of export/trading house certificates. Allocation of foreign exchange for promotional activity by these houses was increased. The 1988-90 policy brought in further relaxations as additional licences so as to allow import of limited permissible items of raw material and cancalised items. In addition to the above, Star Trading Houses were granted added facility in the form of special additional licences.

Policy for Import of Technology. The government allowed liberal import of technology with a view to making export production of the country internationally competitive and also to

help in the country's technological advancement. However, the emphasis was on the absorption and adaptation of imported technology.

A Critical Evaluation of Import Regime

In this sub-section we present a critical evaluation of the import control regime, the policy of import substitution and the policy of import liberalisation of the pre-reform period.

According to Jagdish Bhagwati and Padma Desai, import policy had the following adverse economic effects : (1) delays; (2) administrative and other expenses; (3) inflexibility; (4) lack of co-ordination among different agencies; (5) absence of competition; (6) bias towards creation of capacity despite under utilisation; (7) anticipatory and automatic protection afforded to industries regardless of costs; (8) discrimination against exports; and (9) loss of revenue.

Delays occurred, according to Bhagwati and Desai, because of the following [illegible] reasons : (i) because of a scarcity of foreign exchange, the definition of priorities [illegible] exceptionally difficult and attempts to meet demands on an equitable basis are made [illegible] frequently requires collecting 'more information' to scrutinize applications and take [illegible] decision; (ii) large bureaucratic apparatus results in wastage of time; and (iii) widespread corruption at all levels of the administrative hierarch frequently creates obstacles [illegible] movement of files.

Because of a rigid itemization of permissible imports, and element of inflexibility [illegible] pattern of utilisation of imports was introduced. Not only transferability of licences [illegible] different industries but even transferability of licences among units within the same industry was not permissible. This gave rise to an expanding black market in import licences. There was [illegible] lack of coordination among the multiplicity of agencies dispensing imports and this [illegible] various bottlenecks and difficulties in procuring desired imports on the part of applicants. The import allocation system was so designed as to eliminate the possibility of all competition, whether domestic or foreign. If an item was available in the country, it could not be imported even if domestic costs were much higher than the foreign supply price in the domestic market. Undoubtedly, this gave a boost to import substitution but, at the same time, eliminated all incentives to reduce costs per unit output. Protected market reduced the 'cost-mindedness' of domestic producers. Not only this, protected market gave the wrong signals to industry as domestic production of banned and restricted goods became more profitable than those of permissible items.

Bhagwati and Desai note that the tendency to relate equity in allocations of import licences to installed capacity prompted many entrepreneurs to build up capacity for in excess of [illegible] requirements even in those cases where there was already under-utilization of existing installed capacity. Protection was automatically granted to all industries regardless of cost, efficiency and comparative advantage in the Indian import policy. According to Bhagwati and Desai, this served to divorce market-determined investment decisions from any guidelines that international opportunity costs (with suitable modifications) might have otherwise provided'. The import policy until late 1964, was formulated with a substantially inward looking bias and thus proved unfavourable to manufacturing exports. Since the import control system was designed to [illegible] the profits on scarce imports to the private sector, it resulted in inevitable loss of revenue to the exchequer.

2. The Policy of Import Substitution

As stated earlier, import substitution enabled the country to achieve diversification and depth so necessary for further growth. However, many economists have argued that the indiscriminate extension of import substitution to a wide range of sectors in India without regard to costs, was not the 'best', or the 'most efficient' policy. In this context Jaleel Ahmed states, "Valuable resources could have been saved if the process of import substitution had been more selective with a limited number of strategically chosen sectors and industries, where a concentration of effort and resources could have maximised the gains in efficiency. In the heavy industry sector, in particular, simultaneous development of a plethora of manufacturing activities may have deprived the economy of the advantages of large-scale production and of meeting the minimum critical thresholds." Another important criticism is that since under the policy of import substitution, the import of most luxury consumer goods was restricted by prohibitory tariffs, the profitability of their domestic production automatically increased. This factor, coupled with the political pressure of the affluent to satisfy their demand, let to the establishment of a wide range of import-substituting consumer goods industries catering to the demand of the affluent few for sophisticated and highly diversified products, totally out of line with the average per capita income in the country. The demand tended to fall off after a certain point (because of the general poverty of the masses), resulting in unutilised capacity and higher average costs in these luxury goods industries.

In addition to the above, the import substitution strategy is criticised on various other counts as well. On the basis of various studies conducted for numerous countries, G.M.Meier argues that the import substitution strategy in these countries "was not targeted according to systematic economic criteria but instead was pursued in a chaotic, inefficient manner and for too long a time. At the micro level too many plants produced too small an output; quality was inferior; capital was underutilised; and the industrial structure became increasingly monopolistic or oligopolistic... Although the sheltered firm's profits in local currency could be high, the domestic resource cost was excessive, and the cost increased per unit of foreign exchange saved. Given high effective rates of protection, the domestic value added in some cases was actually negative at world prices... Further, policy induced price distortions – negative real rates of interest, excessively high wages for unskilled labour, and undervalued foreign exchange were pervasive. As the import substitution process continued from the easy first stage of replacing non-durable consumer goods, it entailed production that was increasingly high cost and less economic; the incremental capital/output ratio increased; the rate of growth in aggregate output slowed down; and employment lagged as further import substitution became more difficult".

3. The Policy of Import Liberalisation

The policy of import liberalisation pursued with a vigour in the 1980s resulted in a substantial increase in the volume of imports. For instance, the volume index of imports was 212.3 in 1986-87(base 1978-79 = 100), i.e., in a period of eight years, it had more than doubled. In 1990-91, it stood at 237.7.

Studies conducted by different economists show that import liberalistion led to a significant increase in the import intensity of exports. In his study covering the period 1970-85, Deepak Nayyar has shown that the import-intensity of exports increased from 6.9 per cent in 1972-73 to 23.5 per cent as a proportion of total exports in 1984-85 and from 10.4 per cent to 35.5 per cent as a proportion of exports eligible for REP facilities (excluding gems and jewellery for which the import content was very high). Some data for the later period are available in Reserve Bank's

study on Finance of Public Limited Companies which covers 1942 public limited companies. This study shows that the import intensity increased by almost 25 per cent over a three year period (194885 to 1986-87) which is quite substantial.

While the impact of the policy of import liberalisation in increasing the import-intensity is thus fairly well established, its impact on promoting exports is a bit difficult to judge particularly because there a number of factors affecting the export performance and import liberalisation is just one of them. However, Deepak Nayyar notes that while the average import content of Indian exports rose from 13.7 per cent during 1977-78 to 23.5 per cent in 1984-85 (excluding gems and jewellery), the average annual rate of growth in export earnings was only 11 per cent during 1977-78 to 1984-85 as compared to a much better average annual rate of growth of 20.3 per cent during 1970-71 to 1977-78 (the rates of growth are in terms of rupee values). Whereas the volume of exports had increased by 58 per cent and unit value of exports by 122 per cent during 1970-71 to 1977-78, export growth during 1977-78 to 1984-85 was marked by a sharp declarations as the volume of exports grew by only about 30 per cent and the unit value of export by 68 per cent. Thus during the earlier period of liberalisation, import liberalisation did little for export promotion. On the other hand, as the import content of exports increased, the proportion of net foreign exchange earnings in gross f.a.b. value of exports actually declined.

Export Policy: The Pre-Reform Period

The Three Phases of Export Policy

Bimal Jalan classifies the export policy of the Government of India in the pre-reform period into three distinct phases : Phase I (upto the first oil shock of 1973), phase II (covering the period from 1973 upto a decade or so), and phase III (the period after the above and covering roughly the latter half of the Sixth Plan and the whole of the Seventh Plan). Phase I was characterised by export pessimism as, following Prebisch, Singer and Nurkse, it was believed that exports from developing countries faced a stagnant world demand and nothing much could be done to increase them. It was also believed that the terms of trade of these countries were destined to deteriorate over time *regardless of the policies* of developing countries. According to Bimal Jalan, "this was a crucial assumption as it firmly established a case for discouragement of exports and for policies which encouraged production for the domestic market." However, the 'export pessimism' thesis was not borne out of by post-War developments in international trade. In fact, trade in the 1950s and 1960s grew faster than world income and several developing countries showed a sharp increase in their share in world trade. Exports of manufactures from developing countries grew twice as fast as the developed countries' income in the 1960s and four times as rapidly in the 1970s.

The period of Phase I can be divided into two sub-periods : (a) 1952-66, and (b) 1966-73. The first sub-period covers the first three five Year Plans and was characterised by an essentially passive export policy though some steps to increase exports were undertaken in the Third Plan. Except for a few items such as iron ore, stagnation of export earnings in this period is to be largely attributed to domestic policies which often led to the falling share of India's traditional exports and insufficient expansion in the case of non-traditional exports. Some of these policies as underlined by Bhagwati and Desai were as under;

(i) Export controls which wee started during the Second World War and carried over for much of the early part of the decade in the case of important foreign exchange earning

commodities like jute, tea, cotton textiles, oilseeds and vegetable oil, raw cotton, hides and skins etc;

(ii) Export duties which affected several export commodities through most of the decade; and

(iii) The growing strength of domestic demand accentuated in some cases by government's promotional activities.

The second sub-period in Phase I starts with the devaluation of rupee by 36.5 per cent in terms of gold in June 1965. The government expressed the hope that the devaluation would lead to expansion in export earnings as Indian goods would now be cheaper in international markets. On the other hand, imports will decline as the prices of imported goods would increase. In addition, many foreign investors would feel encouraged to invest capital in those fields where we required foreign capital earnestly. Devaluation would encourage foreign tourists into India and discourage Indian tourists abroad. These developments would have a favourable effect on India' balance of payments situation.

Since devaluation was accepted in place of export subsidies as the means of keeping down the prices of exports, the post-devaluation period was accompanied by a substantial elimination of export subsidies and a marked reduction of the tariffs. However, the failure of export earnings to increase soon made the reintroduction of subsidization schemes inevitable. Export subsidies were introduced for some non-traditional goods in 1966 itself and by 1967 they covered the bulk of engineering goods, chemicals, sports goods, paper products, steel scrap, prime iron and steel, cotton textiles and some other products.

Phase II can be considered to have begun in 1973 and lasted for about a decade. "In this phase, although this was not explicitly stated, it was recognized that import substitution policies by themselves could not bring about a viability in India's balance of payments... In this second phase exports were, therefore, accorded a high priority." The government, accordingly, undertook a number of steps to increase exports. Moreover, as pointed out by Deepak Nayyar, the nominal effective exchange rate (NEER) of the rupee depreciated continuously in the 1970s. Given the lower rate of inflation of home as compared to the outside world, this also meant a sharp downward movement in the real effective exchange rate (REER) of the rupee. In fact, the REER declined from 107.83 in 1974 to 82.66 in 1979(1975=100). As a result, the relative profitability of exports increased. These policy measures coincided with some favourable external factors. Nayyar particularly highlights three such factors : "First, there was remarkable expansion in world trade, which was associated with an increase in world import demand for most of India's exportables. Second, there was a boom in the prices of primary commodities, which led to a sharp increase in average unit values realized for exports. Third, the oil price increases led to the emergence of new markets in the oil exporting countries which constituted a net addition." Thus export growth picked up considerably in Phase II. In fact, it was 'quite robust' in the second half of 1970s. However, this could not last long as export promotion policies continued to be pursued as 'exceptions' to normal development policies.

Phase III saw a more positive approach to export promotion strategy. While incentives for export production were enhanced on the one hand, exports themselves were now being seen as an integral part of industrial and development policies. Export policy in Phase III emphasized 'technological upgradation, increase in the size of plants free imports and domestic and international competition for the entire industrial sector as being essential for export promotion."

According to Deepak Nayyar, it is also possible to discern the beginning of a new long-term perspective about trade policies and industrialization in this phase, which provided a contrast with the approach of the earlier planning era. The objectives of export promotion and import substitution are realised in the performance of the economy as a whole rather than the external sector alone. Thus, there is a close nexus between trade policies, industrial policies and the economic policies in the monetary and fiscal sphere.

Export Promotion Polices: An Overall View

Important export promotion measures undertaken by the Government of India during the pre-reform period were as follows :

Case Compensatory Support (C.C.S.). This was introduced in 1966 [illegible] designed to provide compensation for unrebated indirect taxes paid by exporters on inputs, higher freight rates and market development costs. The rates varied from product to product, and often from exporter to exporter. The scope of CCS was steadily extended over the years and the proportion of [illegible] exports eligible for CCS rose from a level of about 20 per cent in the early 1970s to a little more than 40 per cent in the early 1980s. The CCS involved the largest single budgetary outlay for exports. After the devaluation of the rupee in July 1991 and substantial trade liberalisation, it was felt that CCS had become redundant. It was, accordingly, abolished in July 1991.

Duty Drawback System. The object of the duty drawback system is to reimburse exporters for tariff paid on the imported materials and intermediates and central excise duties paid on domestically produced inputs which enter into export production. This is a world-wide practice and the rationale is straight forward. Custom duties and excise duties on inputs raise the cost of production in export industries and thereby affect the competitiveness of exports. Therefore exporters need to be compensated for the escalation in their costs attributable to such customs or excise duties.

Replenishment Licences. In order or provide the export sector of the economy with access to importable inputs that enter into export production, at international prices, the import policy allowed special import facilities for registered exporters. In 1957, the government introduced the Import Entitlement Scheme (IES) to help the exporters in procuring imported raw materials and other components necessary for export production. Exporters were granted import licences, fetching high import premia, pro rata to the value of exports effected. Average premium on these import licences varied from 70 to 80 per cent and therefore IES proved to be the most important measure of subsidization. By 1965-66, IES extended to nearly 80 per cent of Indian export earnings. IES was withdrawn on devaluation of the Indian rupee in 1966 but was soon reintroduced in another garb in a revised form. The new name of the scheme was Import Replenishment Scheme (IRS). The system of import replenishment licences which are related to the f.o.b. value of exports is, for most part, a facility in so far as it enables exporters to import inputs where the domestic substitutes are not adequate in terms of price, quantity or delivery dates. It is also an incentive in so far as there is a premium on those REP licences which are transferable. An REP licence makes it possible for exporters to obtain items that are either canalised or restricted in the import policy, subject to the limits and conditions specified.

Advance Licence and Duty Exemption Scheme. Advance licences facilitate imports of specified raw materials without payment of any customs duty. Such licences are available only against confirmed export orders and/or letters of credit. Under the Intermediate Advance Licensing Scheme, duty free advance licences are granted to Registered Manufacturer exporters

for the supply of intermediate product to an exporter holding a duty-free advance licence. This scheme enables manufacturer exporters of an export product to obtain the supply of intermediate inputs from the indigeneous sources rather than resorting to import.

EPZs and 100 per cent EOUs. With a view to giving impetus to export drive, the government set up Export Processing Zones (EPZs) which provide almost free trade environment for export productioniso as to make Indian export products competitive in the world market. The scheme of 100 per cent Export Oriented Units (EOUs) was introduced in December 1980 to provide duty free access to imports of raw materials, intermediate goods, capital goods and technology on OGL. These units have also been exempted from normal licensing provisions in the domestic tariff areas and restrictions implicit in MRTP and FERA. Their production is bounded for exports and the units can be established anywhere in the country. However, because of complex procedures and infrastructural problems these schemes have not been very successful in promoting exports.

Subsidies on Domestic Raw Materials. The most important scheme in this category is the International Price Reimbursement Scheme (IPRS) for steel, which equalizes the difference between international and domestic prices of steel obtained from domestic sources.

Fiscal Concessions for Exports. *Special fiscal treatment granted to exports takes two* forms, that which relates to the payment of indirect taxes, and that which relates to the payment of direct taxes. The first type of concession is incorporated in the duty drawback system and the regime of cash compensatory support which seeks to reimburse indirect fares that are not refunded through the former. He second type of concession is incorporated in income tax provisions where earning from exports are either partially exempted from income tax, or taxed at a lower rate. Such income tax rebates have been provided to exporters in India in one form or another since the early 1960s.

Export Credit and Assistance to EPCs. Assistance is granted in the form of grant-in-aid to the Export Promotion Councils and approved organisations, export houses, consultancy organisations and individual exporters to undertake (a) market research, commodity research, area survey etc, (b) export publicity and dissemination of information, (c) trade delegations and teams, (d) participation in trade fairs and exhibitions, (e) establishment of offices and branches in countries abroad, (f) research and development schemes etc., and (g) any other scheme that would promote the development of market for Indian goods abroad.

Blanket Exchange Permit Scheme. A Blanket Exchange Permit Scheme was introduced by the government in June 1987. The scheme aimed to give a major thrust to the country's export promotion drive. Under the scheme exporters were allowed, barring a few products, to utilise 5-10 per cent of their foreign exchange earnings for undertaking export promotion activities.

Organisational Structure for Promotion of Exports

The organisational structure for promotion of exports includes a number of councils and organisations set up during the post-Independent period. These include (i) Export Promotion Councils, (ii) commodity Boards, (iii) Agricultural and Processed Food Products Export Development Authority, (iv) Export House, (v) The central Advisory council on Trade, (vi) The *Federation of India Export Organisations, (vii) The Trade Development Authority, (viii) The* Indian Institute of Packaging, (ix) Export Credit and Guarantee Corporation of India, (x) The Export Inspection Council, (xi) Trade Fair Authority of India, (xii) Public sector agencies like State Trading corporation of India, Minerals and Metals Trading Corporation, Handicrafts and

Handloom Export Corporation, Indian Motion Pictures export Corporation etc. and (x) the Indian Institute of Foreign Trade. At present 5 Commodity Boards (dealing with tea, coffee, rubber, spices and tobacco) and 20 Export Promotion Councils are functioning. Export House specialise in export trade. In addition, there are trading House, Star trading Houses and Super Star Trading Houses. The Central Advisory Council on Trade advises the government on matters relating to export and import policy and programmes, the operations of import and export controls etc. The Indian Institute of Packaging undertakes research on raw materials for the packaging industry. Proper packaging of export goods is necessary to protect the products and attract the consumers. The primary objective of the Export Credit and Guarantee Corporation of India is to promote exports from India by providing export credit insurance and guarantee facilities to Indian exporters and commercial bankers. The purpose of Export Inspection council is to enforce quality control and compulsory pre-shipment inspection of various commodities. Trade Development Authority (TDA) has been merged with the Trade Fair Authority of India (TFAI) to form a new organisation under the name of India trade Promotion Organisation (ITPO) in January, 1992. The main objectives of the organisation are to develop and promote exports, imports and upgradation of technology through the medium of fairs to be held in India and abroad. The Federation of Indian Export Organisations co-ordinates and supplements the export promotional activities of various organisations and institutions. State Trading Corporation (STC) was set up primarily to deal in trade with socialist countries. It exports a wide range of products such as sugar, tea, tobacco, coffee, castor oil, etc. and bulk commodities like cement and salt, textiles and manufactured products. Minerals and Metals Trading Corporation (MMTC) was set up specifically for dealing with exports of mineral oils and metals from the country.

A Critical Evaluation of Export Policy

1. Absence of a Long Term Export Strategy

As noted earlier, phase I (i.e. the period from the beginning of the planning to the first oil shock of 1973) was characterised by export pessimism. In the first two plans, estimates were more in the nature of expected earnings rather than of firm targets and no definite programme of expanding export earnings was adopted. Indeed, the Second Plan took the position that only when industrialization had proceeded some way that increased production of home would get reflected, in large-export earnings. Some measures of export subsidization were indeed started in the Third Plan yet the overall mode of pessimism persisted. In phase II (covernign the period from 1973 upto a decade or so) more attention was paid to the export sector as it was realised that import substitution, in itself, would not be able to bring about a viability in India's balance of payments. Accordingly, a number of steps (outlined earlier) were adopted to increase exports. Even then, the criticism remains that we lacked a long tern export strategy. In most of the crucial areas affecting the export sector ad-hocism persisted. In the third phase, there was anew emphasis on exports and many steps were initiated to increase them. However, the 'linkages' of the exports of different industries to the domestic economy not were explored. Accordingly, the task of 'integrating' export planning with the overall planning could not to be accomplished.

2. Problems Confronting Primary Exports

For a long period of time, primary products contributed a major portion of India's export earnings. However, prospects of increasing exports of these commodities were limited on account of a number of external and internal factors. The external factors included (i) steady deterioration in the terms of trade for primary products in the international market; (ii) severe fluctuations in international product prices; (iii) growth of synthetic substitutes; (iv) changes in technology which

have reduced the amount of material used in manufacturing; (v) pattern of consumption in developed countries which makes for a low propensity to consume such products; and (vi) tariff and other restrictions imposed by industrial countries on some primary products. International demand for most of the primary products exported by India had remained stagnant while it had to face serious competition from some other underdeveloped countries interested in increasing their exports of these goods. Therefore, it became continuously more and more difficult for India to maintain its share in world export of these products. For example, India has to face tough competition from Sri Lanka and East Africa in tea and its share in tea exports declined from 50 per cent in 1950-51 to 21 per cent in 1969-70. Competition from Bangladesh (previously East Pakistan) in the field of jute led to reduction of India's share in world exports of jute manufactures from 95 per cent in 1950-51 to 45 per cent in 1969-70.

These tendencies were observed in all those primary commodities where India was a major supplier and hence had to operate in oligopolistic market conditions. However, in commodities where India held either a near monopoly or was a marginal supplier, domestic policies also contributed their mite in keeping India's export earnings low. The most important factor in this context was probably the rising domestic consumption of exportables either as raw materials for the domestic industry (for example, raw cotton, raw tobacco, raw hides and skins, etc.) or as final goods (like cotton textiles, tea, coffee, vegetable oils, etc.) To met domestic demand of oilseeds and vegetable oil in the economy, the government banned the exports of most oilseeds in 1952 (this has to be seen in the light of the fact that in pre-war days, India used to supply 40-50 per cent of world exports of groundnuts and groundnut oil). Because of the serious inflationary pressures operating in the economy profit margins on domestic sales rose considerably in relation to export sales and this worked as a disincentive to export primary products. In addition to these two factors operating in the domestic economy (increased domestic demand and inflation), export controls introduced by the government from time to time and export duties levied on primary exports may also have contributed to a fall in India's share of world exports of primary products.

3. Problems confronting Non-Traditional Exports

Government of India had recognized quite early, and rightly so, that possibilities of increasing export earnings through expansion of primary exports are severely limited. Therefore, it placed an increasing emphasis on the development of non-traditional exports. World trade of most of these commodities was expanding rapidly and it was not difficult to increase India's share. Moreover, India was a marginal exporter of these commodities and its export-promotion efforts were not likely to invite serious countermoves from major exporting countries. Thus India's domestic policies could play a crucial role in increasing export earnings from non-traditional products and engineering goods). Various export subsidization policies were specifically introduced and oriented with the purpose of increasing the exports of manufactured products. Therefore, it is no mere accident that the share of engineering goods exports in total exports rose from 2.1 per cent in 1960-61 to 12 per cent in 1960-61 to 12 per cent in 1990-91. Import entitlement schemes and import replenishment schemes, duty drawback scheme, cash assistance, provision of finance for exports, provision of raw materials to export-oriented units at international prices, direct tax concessions, etc, all helped the country in enlarging its export earnings.

However, exports of manufactured products also suffered on account of serious trading and production problems, faulty domestic policies and insufficient efforts.

(i) Trading Problems. Among the 'trading problems' one can mention external impediments which pose a problem of "entry" for the Indian manufactures (and manufactures of

other developing countries) in markets of industrialized countries. The most important factor inhibiting exports of manufactured products from less developed countries to developed countries is the system of tariffs adopted by the latter. The characteristic feature of this system is that tariff rates become increasingly higher as one moves from raw material to manufactured product. For example, as one moves from iron ore to raw steel and then to machine goods. the tariff rates in industrialized countries frequently increase. Such tariff system makes it difficult for less developed countries to complete in the world market for manufactures. This discriminatory tariff system is accompanied by a plethora of quota restrictions and other non-tariff barriers. Another external impediment is that the process of import substitution in other countries encompasses virtually the same rang eof goods which India is trying to export. The most glaring example in this context is of the cotton textile industry which many less developed countries have developed successfully in the post war period.

During recent years, international agencies like the IMF and World Bank have been pressuring the developing countries to open up their economies. as, according to these agencies, globalisation will help them in improving the economic efficiency of their industrial sector and compete in the international markets. In fact, such 'opening up' has been made a pre-condition for granting economic assistance under the structural adjustment programme. The IMF World Bank conditionalities have obviously been dictated by the developed countries who are interested in finding new markets in the developing countries for their ever increasing rang eof products. However, they themselves continue to impose restrictions on imports from the developing countries.

(ii) Production Problems. The most serious problem in this field is the lack of 'technological dynamism' in Indian industry. In spite of changes in the industrial and trade policies, most Indian firms continue to produce outdated products with inefficient production technologies. The continued technological stagnation of industry is shown by its low expenditure on technology acquisition activities (for instance, in the decade 1981-91, the public and private sector firms in India spent less than 0.8 per cent of their sales on R& D). Not only this, a very large number of firms continue to use plants which are more than 20 years old. These plaints suffer from frequent breakdowns, poor and uneven product quality, and high rejection rates. They have also become inefficient users of energy. Furthermore, these plants embody obsolete production technologies which have been replaced by more advanced and efficient technologies in the developed countries. Since the advanced processes and plants of the developed countries are highly computerized the production quality is far superior and uniform. In this global competitive environment, if India is to increase its earning from manufactured exports, it will have to update its technological capabilities continuously. This calls for massive investment in R & D and plant modernisation.

New Trade Policy: The Reform Period

As stated earlier, the period after 1991 has been marked by a substantial liberalisation of the trade policy. While some liberalisation measures were the result of the conviction among government circles that they were necessary to make exports competitive in the international market, some were undertaken programme (as we shall discuss in the chapter on 'India and the World Economy'). Moreover, with India joining the WTO (World Trade Organisation) in 1995 as a founder member, it is under an obligation to strike down all quantitative restrictions on imports and reduce import tariffs so as to 'open up' the economy to world trade and the forces of

globalisation. The main features of the new trade policy as it has evolved over the years since 1991 are as follows :

Freer Imports and Exports. In the pre-reform period, India's trade policy regime was complex and cumbersome. There were different categories of importers, different types of import licences, alternate ways of importing etc. Substantial simplification and liberalisation in all these respects has been carried out in the reform period. The tariff-line wise import policy was first announced on March 31, 1966 and at that time itself 6,161 tariff lines were made free. Till March 2000, this total had gone up to 8,066. Quantitative restrictions in respect of 1,429 tariff lines remained till this date. The Exim Policy 2000-01 removed quantitative restriction on 714 items and the Exim Policy 2001-02 removed quantitative restrictions on the balance 715 items. Thus, in line with India's commitment to the WTO, quantitative restrictions on all import items have been withdrawal

Rationalisation of Tariff Structure. In its Final Report published in January 1993, Chelliah committee had advocated drastic reductions in import duties. The Committee expressed the opinion that the rupee had depreciated considerably in the 1980s and the early 1990s, pushing up the level of protection to Indian industries considerably. For instance, the Committee pointed out that in the seven year period 1985-86 to 1992-93, the real exchange rate of the rupee had depreciated by 57.45 per cent. This had pushed up the cost of the imports considerably leading to very high levels of protection to the Indian industry. The Committee, therefore, recommended that the prevailing import duties be rationalized and drastically lowered by 1998-99 so that parity in prices of goods produced domestically and internationally can be establishment. Acting on the recommendations of the Committee, the Finance Minister announced substantial cuts in import duties in the 1993-94, the 1994-95 and the 1995-96 Budgets. The 1993-94 Budget reduced the maximum rate of duty on all goods from 110 per cent to 85 per cent except for a few items including passenger luggage and alcoholic beverages. The 1994-95 Budget further brought town the maximum rate of duty from 85 per cent to 65 per cent. This was brought down to 50 per cent in the 1995-96 Budget and further to 40 per cent in the 1998-99 Budget. The 2000-01 Budget reduced the peak rate of basic customs duty to 35 per cent. However, a surcharge of 10 per cent was imposed in the Budget which was withdrawn in the 2001-02 Budget. As a result, the peak customs duty rate declined from 38.5 per cent to 35.0 per cent. The Union Budget for 2002-03 reduced the peak customs duty rate to 30 per cent which was brought down further to 25 per cent in the Union Budget for 2003-04.

Decanalisation. A large number of exports and imports used to be canalised through the public sector agencies in India. The supplementary trade policy announced on August 13, 1991 reviewed these canalised items and decanalised 16 export items and 20 import items. The 1992-97 policy decanalised imports of a number of items including newsprint, non-ferrous metals, natural rubber, intermediates and raw materials for fertilisers. However, 8 items (petroleum products, fertilisers, edible oils, cereals, etc.) were to remain canalised. The Exim Policy, 2001-02 put 6 items under special list — rice, wheat, maize, petrol, diesel and urea. Imports of these items were to be allowed only through State trading agencies.

Convertibility of Rupee on current Account. The exchange rate policy in India has evolved from the rupee being pegged to a market related system (since march 1993). The exchange rate is largely determined by the market, i.e., demand and supply conditions. "The objective of exchange rate management has been to ensure that the external value of the rupee is realistic and credible as evidenced by a sustainable current account deficit and manageable foreign

exchange situation. Subject to this predominant objective, the exchange rate policy is guided by the needed to reduce excess volatility, prevent the emergence of destabilizing speculative activities, help maintain adequate level of reserves, and develop an orderly foreign exchange market."

Prior to the devaluation of 1966, one US dollar was equal to Rs. 4.76 (this was the rate during 1961-65). After the devaluation in 1966, one U.S. dollar became equal to Rs. 7.50. The system of fixed exchange rates (also known as the Bretton Woods System) was abandoned by the most countries in 1973. The Government of India also abandoned it and pegged Indian rupee to a basket of currencies of the countries which are her major trading partners. Under this floating exchange rate system, the rupee started to slide against the dollar and other major currencies of the OECD countries. By the end of 1990, one US dollar had become equal to Rs. 18.07. The rate, Rs per SDR, was 7.58 in 1970 and reached Rs. 25.71 by the end of 1990. The Government devalued the rupee in early July 1991 which led to a depreciation in the value of the rupee against the five major international currencies by roughly 22 per cent.

(i) **Partial convertibility of rupee.** The finance Minster announced the liberalised exchange rate mechanism system (LERMS) in the Budget for 1992-93. This system introduced partial convertibility of rupee. Under this system a dual exchange rate was fixed under which 40 per cent of foreign exchange earnings were to be surrendered at the official exchange rate while the remaining 60 per cent were to be converted at a market determined rate. The foreign exchange surrendered at official rate was to be used for the import of essential items (like crude oil, petroleum products, fertilisers, life saving drugs, etc.) and the foreign exchange converted at the market rate was to be used to finance all other imports. Since the official exchange rate was lower than the market rate, this system meant taxing the exporters to subsidize the government's bulk imports. The implicit export tax was between 8-12 per cent and was highly resented by exporters.

(ii) **Full convertibility on trade account.** The 1993-94 Budget introduced full convertibility of the rupee on trade account. As a result, the dual exchange rate system was dispensed with and a unified exchange rate system introduced. Under the unified exchange rate regime, the 60:40 ratio was extended to 100 per cent conversion. This 100 per cent conversion was extended for (i) almost the entire merchandise trade transactions (i.e. export and import of goods); and (ii) all receipts, whether on current or capital account of balance of payments (BOP), but not all payments. Side by side, the official RBI rate also stayed on for the conversion of items not permitted under the unified market rate i.e., more than half a dozen of invisible items of current account as well as capital account. In addition, various exchange control norms of the Reserve Bank remained in operation all along, albeit with some relaxation of provisions.

(iii) Full convertibility on current account. Current account convertibility is defined as the freedom to buy or sell foreign exchange for the following international transactions : (i) all payments due in connection with foreign trade, current business, including services, and normal short-term banking and credit facilities; (ii) payments due as interest on loans and as net income from other investments; (iii) payments of moderate amount of amortization of loans or for depreciation of direct investments; and (iv) moderate remittances for family living expenses. In February 1994, the Reserve Bank undertook several steps towards achieving such convertibility when it announced relaxations in payment restrictions for a number of invisible transaction and liberalisation of exchange control regulations upto a specified limit relating to (a) Exchange Earners' Foreign Currency (EEFC) Accounts; (b) basic travel quota; (c) studies abroad; (d) gift remittances; (e) donations; and (f) payments of certain services rendered by foreign parties.

India achieved full convertibility on current account on August 19, 1994 when the Reserve Bank further liberalised invisible payments and accepted obligations under Article VIII of the IMF, under which India is committed to foresake the use of exchange restrictions on current international transactions as an instrument in managing the balance of payments. Many other relaxations of restrictions on current transactions were announced in subsequent years. These include major relaxations in exchange control; more liberal indicative ceilings for release of foreign exchange by authorised dealers (Ads) for basic travel quota, studies abroad, medical expenses, casual (gift) remittances, donations, release of exchange for persons proceeding on employment abroad; greater flexibility in the Exchange Earner Foreign Currency (EEFC) accounts held by exporters; greater flexibility for remittances for purchase of foreign services by residents, etc.

After the country moved to a single market-determined exchange rate system in March 1993, the rupee exhibited good stability and for over two years after March 1993, the rupee-dollar exchange rate

Multinational Corporations, Fera and Fema

Multinational Corporations (MNCs) are huge industrial organizations which extend their industrial and marketing operations through a network of their branches or their Majority Owned foreign Affiliates (MOFAs). MNCs are also known as Transnational Corporation (TNCs). Instead of aiming for maximization of their profits from one or two products, the MNCs operate in a number of fields and from this point of view, their business strategy extends over a number of products and over a number of countries. There are now 40,000 TNCs whose tentacles straddle the international economy through some 2,50,000 overseas affiliates. They posses staggering of 24.2 per cent of the world's GDP and have risen to 28.3 per cent of the word GDP in 1998. This show that 200 top MNCs now control over a quarter of the world's economic activity. In fact, the combined sales of these 200 MNCs estimated at $ 7.1 trillion in 1998 surpass the combined economies of 182 countries. If we subtract the GDP of the big nine economies:- the united state of America, Japan, Germany, France, Italy, the United Kingdom, Brazil, Canada and China – from the world GDP, the GDP of the remaining 182 countries of the world comes to $ 6.9 trillion in 1998 which is less than the sales o the 200 top MNCs. An idea of the giant size of these MNCs can also be had from the revelation made in a study conducted by the Washington based institute of Policy Studies (IPS) that of the 100 largest economies in the world, 51 are corporations; only 49 are countries.

The above data show the massive control exercised by the MNCs on the world economy. In fact, because of their huge capital resources, latest technology and worldwide goodwill. MNCs are in position to sell whatever product they choose to manufacture in different countries. The fact is that people in underdeveloped countries are 'crazy' for the products of these corporations and prefer their products to the products produced indigenously.

Reasons for The Grwoth of MNCs

Reasons for the growth of multinationals are manifold, the important ones being as follows:

1. **Expansion of market territory.** As the operations of a large-sized firm extend and as its international image builds up, it seeks more and more extension of its activities beyond the physical boundaries of the country in which it is incorporated.
2. **Marketing superiorities.** A multinational firm enjoys a number of marketing superiorities over the national firm: (a) It possesses a more reliable and uptodate market information system; (b) It

enjoys market reputation and faces less difficulty in selling its products; (c) It adopts more effective advertising and sales promotion techniques; and (d) It has efficient warehousing facilities due to lower inventory requirements.

3. **Financial superiorities.** A multinational firm enjoys the following financial superiorities over the national firm : (a) It has huge financial resources with which it can easily turn all circumstances in its favour; (b) It maintains a high level of funds utilization by generating funds in one country and using them in another: (c) It has easies access to external capital markets; and (d) Because of its international reputation it is able to raise more international resources. Even investors and banks pf the host country are eager to invest in it.

4. **Technological superiorities.** The main reason why MNCs have been encouraged by the under-developed countries to participate in their industrial development is on account of the technological superiorities which these firms possess as compared to national companies. The underdeveloped countries regard transfer of technology from MNCs useful on account of the following reasons; (a) Industrialization represents the most important way out of underdevelopment and the resources of these countries are insufficient to sustain the industrial progress on their own; (b) Local manpower, materials, local capital equipment etc. have to be optimally exploited and these countries are unable to accomplish this; (c) Depending totally on local companies would require heavy imports of raw materials, capital equipments, machinery and technical knowledge whereas MNCs bring these on their own; and (d) The underdeveloped countries have to face stiff competition for selling their products in international markets. Unless their goods meet international standards and quality specifications, they cannot sell. MNCs help them in producing such goods.

5. **Products innovations.** MNCs have Research and Development Departments engaged in the task of developing new products and superior designs of existing products. Therefore their productions opportunities are far greater as compared to national companies.

Domination of MNCs

MNCs have a strong hold over the Indian economy. In fact, even two decades ago, these corporations controlled 53.7 percent of the assets of the giants sector in India. According to the Industrial Licensing Policy Inquiry Committee, there were 112 companies in India in 1966 with assets worth Rs.10 crore or more. Of these , 48 were either foreign branches or Indian subsidiaries of foreign companies. In addition, 14 Indians companies had extremely heavy loans and equity capital and ,therefore , were virtually foreign controlled. These 62 companies had Rs. 1,370 crore worth of assets which constituted 54 percent of the total assets of India's giant sector. According to Dalip S. Swamy , a number of other companies were also under foreign domination in one way of the other. In return for technical assistance, they had promised an assured market of machines and spares to their foreign associates. Some companies were heavily dependent on international financial institutions for economic assistance. Thus, western foreign capital dominated the country's big business and controlled the apex of India's industrial pyramid in the mid-1960s.

An interesting thing about the operation of MNCs in India is that they have raised a major part of investment resources from within the Indian economy. A study on the sources of finance of MNCs was conducted by Sudip Chaudhuri for the period 1956-75. The sample selected for study include 50 largest foreign subsidiaries. His analysis revealed that for the period 1956-75 as a whole, foreign sources (in the form of foreign share capital and foreign loans) contributes only 5.4 percent of the financial resources of these companies, 94.6 percent being contributed by the domestic sources. Directly comparable data are not available for the period after 1975. However, table 5.4 of John Martinussen's study shows that the amount of capital issues consented with

foreign participation declined from 61.5 percent of al consent to public limited companies in 1976 to a mere 29.5 percent in 1980. John Martinussen indicates that 20 TNC affiliated companies even reduced their foreign funding. Several of these companies obtained no foreign funds at all during the period from 1974 to 1983. This fact about the financing behaviour of MNCs explodes the myth that they bring in large amounts of foreign capital with them. The real position is that MNCs collect most of the capital from within the country itself but repatriate large amounts of the profits to their home countries.

Foreign Collaboration and MNCs

A common form of MNCs participation in Indian industry is through entering into collaboration with Indian industrials. Foreign collaboration agreements are made between Indians companies and foreign parties, involving sale of technology, as well as use of foreign brand names for the final products. The enormity of foreign collaboration entered into by the Indians companies would be clear from the fact that in nearly all of the new industries in the large or medium size group, privately or publicly owned, set up after independence, some collaboration agreement was present. Trends of liberalization in the 1980s gave a substantial spurt to foreign collaboration. This would be clear from the fact that of the total 12,760 foreign collaboration agreements approved in 40 years between 1948 and 1988 , as many as 6,165(i.e.48.3 percent) were approved during the eight years between 1981 and 1988 . As a result of liberalized foreign investment policy announced in July-August 1991, there has been a further spurt of foreign collaborations. For instance, over the period August 1991 to August 2002, the government approved 7,464 foreign technology collaboration and 15,998 foreign direct investment proposals. The total amount of foreign investment approved in the process amounted to a mammoth Rs.2,84,812 crore. However, the actual inflow was only Rs.1,29,838 crore.

The policy of the government in the field of foreign collaboration has been criticized on the following counts:

(i) A large number of agreements were concluded for the manufacture of products which are nonessential or which could be produced with the help of local technology. Theses items included vacuum flasks, lipstick, toothpaste, cosmetics, ice-crème, biscuits, dry batteries, readymade garments etc. Clearly such collaboration were directed to serve the needs of high income groups and to take advantage of a foreign brand name;

(ii) The government permitted multiple collaboration, i.e. repetitive import of the same or similar technology. This resulted in repetitive payments without adding to the stock of technical knowledge in the country;

(iii) The terms of agreements were mostly weighted in favour of the foreign collaboration and were against Indian interests. This arose on account of the lack of bargaining power in the Indian side and the government's eagerness to acquire foreign participation in the face of foreign exchange shortage;

(iv) Since the responsibility of specification and supply of equipments was entrusted to the foreign collaboration, there was close tie-up between the designers resulting not only in price mark up but also in over-import of equipment. Sometimes equipments were imported even when they were available locally, sometimes they remained idle for want of spares, and often the process were more highly mechanised and sophisticated than was desirable or necessary. At times, obsolete technology was imported;

(v) The terms of payments were also drawn up so as to squeeze out the maximum payment under one head or other. Generally 5 percent of the annual turnover fro 10 years as royalty plus 5 percent of the imported plant cost as technical fees in the case of royalty-cum-technical fees, or 10

percent of the issued capital as lumpsum payment for technical fees alone, were the limits of official policy. However, these tended to become routine;

(vi) The most important part related to the presence of various restrictive clauses in the agreements. Some restrictions imposed were: (a) the technology cannot be passed on any one else, in some cases even after the expiry of the agreement; (b) manufacturing is to be carried out according to the specifications laid down by the collaborator and no local adaptations can be made; (c) control over overseas purchase was exercised through the provision that it had to be made directly or indirectly through the collaborator, (d) production was tightly controlled at times through the posting of foreign techniques; (e) controls over the pricing and marketing of the products were exercised by requiring that a part of the production was to be made the sole selling agents; and (f) right to export was also restricted by the provision that exports could be done only to specify countries or on certain preconditions; and

(vii) Foreign collaborations have helped the growth of monopolies and concentration. They joined hands with the big business houses and the latter were only too eager to enter into understand with them since the presence of foreign links often conferred certain strategic advantages (patent, resources, foreign exchange, etc.) enabling the big business house to diversify and expand.

Harmful Effect of The Operatios of MNCs on Indian Economy

The operations of MNCs open up the possibilities of interference in the industrial (and other) activities of the recipient country and are thus resented by the 'nationalist' thinkers. Their arguments against the operations of MNCs can be summed up as follow:

1. **Payment of dividends and royalty.** A large sum of money flows out of the country in terms of payment of dividends, profits, royalties, technical fees and interest to the foreign investors. A study by N.K.Chandra shows that over three-fifths of private corporate, or about two-fifths of factory sector dividends were paid out by the foreign firms in the mid-1980s.
2. **Distortion of economic structure.** MNCs can inflict heavy damage on the host country in various forms such as suppression of domestic entrepreneurship, extension of oligopolistic practices (such as unnecessary product differentiation, heavy advertising, or excessive profit taking), supplying the economy with unsuitable technology and unsuitable products, worsening of income distribution by distorting the production structure to meet the requirements of high-income elites, etc. Modern , Marxist economists (Paul Baran, for example) argue that foreign investment (especially through multinational corporations) opens up the doors of 'neoimperialism' and 'exploitation'.
3. **Political interference.** Because of their immense financial and technical power, the MNCs have gained the necessary strength to influence the decision making processes in underdeveloped countries. Though they do help in transferring technology to underdeveloped countries, it has been often found that models and patterns of industrial development and technologies transferred are nor in harmony with the interests of the host countries. The governments of underdeveloped countries have also felt threatened by the direct and indirect interference of MNCs in their internal affairs. The autonomy and sovereignty of the host countries is in danger. Because of these reason, the governments of various countries have sought to restrict the activities of MNCs in their economies through a battery of administrative controls and legal provisions.
4. **Technology transfer not necessarily conducive to development.** As far as transfer of technology to underdeveloped countries is countries is concerned, the behaviour pattern of MNCs reveals that do not engage in R and D activities within underdeveloped countries. Their R and D

efforts are concentrated in laboratories in the home country or in other industrialized. Though R and D activities continue to be centralized in the parent country, the host countries have to bear the bulk of their costs since the affiliates of the MNCs in these countries remit payments on this account generally in relation to their sales volume. Such payments by the affiliates ate generally over and above those remitted in the form of royalties and technical fees to the parent firm. The satisfaction expressed on technology transfer is partly misconceived also on account of the fact that MNCs which generally command a semi-monopolistic position in their products lines do not transfer their first-line or most advanced technology until foreign firms compel them to do so. In many cases, the technology transferred is of a capital-intensive nature with is not useful from the point of view of a labour surplus economy. In fact, continued insistence on the import of such technology can have serious consequences for the economy of the host country since unemployment will increase. Also, market will fail to grow and this constraint alone would suffice to restrain the rate of growth from increasing.

Control over Multinatiopnal Corporations

The responsibility of controlling the activities of multinational corporations in India rests on different government agencies. These agencies are: (i) the Ministry of Company Affairs, (ii) the Reserve Bank of India, (iii) the Ministry of Industrial Development, and (iv) the Ministry of Finance. However, these agencies do not work in close cooperation with each other. As a result, there is no coordination in their functioning. Each case is discussed on its own merits by the authorities. There are no objective criteria for approving applications and the procedure resorted to by the various ministries is lengthy and cumbersome.

As a result of a study by Michael Kidron entitled Foreign Investment in India published in 1965 (and the follow-up discussions in which many economists participated) and the appearance of the Industrial Licensing Policy Inquiry Committee Report in 1968, the belief got strengthened that imports of foreign technology were overpriced and were designed to perpetrate dependence. As a consequence, the government policy was progressively tightened in the following directions. (1) Some industries were not allowed to import technology at all, the underlying principles of the policy being that (a) no 'inessential' article should be produced with fresh imports of technology (this gave the existing domestic and foreign producers automatic protection against fresh imports of technology) and (b) where domestic capacity was 'adequate' to technology should be imported; (2) Among industries where technology imports were allowed, the maximum rate of royalty was laid down; (3) In some designed industries, foreign investment was allowed in principle, but sanction in individual cases was a matter of administrative decision; (4) The normal permissible period of agreements was reduced from ten years to five, and renewals were generally frowned upon; (5) Exports and other marketing restrictions were generally not allowed, and often an obligation to export a certain proportion of the output was insisted upon; (6) A clause was often inserted in the agreements granting permission to the importer to sub-licence the technology; (7) the CSIR was allowed to look at applications for approval of technology imports, and if it expressed willingness to supply the technology, approval was withheld or at least delayed.

The most effective curb on the activities of foreign companies, especially MNCs, was supposed to come with the passing of the Foreign Exchange Regulation Act (FERA) in 1973 to which we now turn.

Foreign Exchange Regulation Act (FERA), 1973

Foreign exchange regulation act (FERA) was promulgated in 1973 and it came into force on January 1,1974. Section 29 of this act referred directly to the operations of MNCs in India According to the section, all non-banking foreign branches and subsidiaries with foreign equity exceeding 40 per cent had to obtain permission to establish new undertakings, to purchase shares in existing companies, or to acquire wholly or partly any other company. Guidelines for administering this section of FERA were announced in 1973 and later amended in 1976.

According to these guidelines, the principal rule was that all branches of foreign companies operating in India should convert themselves into India companies with at least 60 percent local equity participation. Furthermore, all subsidiaries of foreign companies should bring down the foreign equity share to 40 percent or less. Exempted from these rules were, however, companies exporting a substantial part of their production, and companies engaged in core sectors and priority industries. In these cases, the guidelines provided for higher levels of foreign equality. According to Martinussen, "these exceptions to the general rule reflected the government's endeavours to induce TNCs to use their superior access to global distribution and marketing system, with a further view to improving India's balance of payments position. Beside, they reflected a desire on the part of the Indian government to channel TNCs away from certain industries and into core sectors and high priority industries. The latter included primarily basic intermediates and capital goods, where as the former comprised mainly consumer goods. As a rule, the manufacture of priority items required sophisticated technology not available from indigenous source".

Implementation of FERA. There were substantial delays in implementing FERA. According to Martinussen , by June 1979, only about half the companies directed to dilute the foreign holding had carried out the process as stipulated. Most of the companies directed to dilute the foreign holding had carried out, at that time, yet to initiate the process. Not until 1892, i.e eight years after FERA came into force, did the last group of 28 companies receive final directions pursuant to the act. Moreover, upto the end of 1985, a total of 252 foreign controlled companies were exempted from the general rule stipulating a maximum of 40 percent non-resident interest.

In regard to the companies that did not comply with FERA regulations, Martinussen observes a certain pattern. For instance, he found that almost all these companies belonged to only three groups. They were either engaged in tea plantation activities or in the manufacture of drugs and pharmaceuticals, or they were affiliated with particularly large TNCs. The special treatment to tea companies was due to the importance of tea in India's foreign trade. As far as the drugs and pharmaceuticals industry is concerned, India's heavy dependence on MNCs for bulk drug came in the way of compliance of FERA regulations. As far as the third category of powerful MNCs in concerned, Martinussen gives in detail the experience with regard to Hindustan Lever Ltd. This company managed to secure concessions from the government on flinisy grounds. For instance, it succeeded in getting 60 percent of its toiletries manufacturing classified by government as high technology activity as it helped in 'import substitution'.

The general conclusion that emerges from a review of FERA is that it did any significant way restrict the expansion and activities of TNCs affiliated companies in general. In fact, "the overwhelming majority of large, well-established and experienced TNC affiliated companies were able to extract sizeable benefits from the working of the approval system, not necessarily in keeping with government policy. In other words, the approval system proved ineffective as a regulatory framework in relation to resourceful TNCs that chose to come to terms with the system."

New Concessions for FERA Companies

In line with the liberalisation measures announced in the new industrial and trade policy in 1991 and the subsequent period, the government announced major concessions to FERA companies in November 1991 and January 1992. On January 8, 1993 the government promulgated an Ordinance to amend FERA with immediate effect. The Ordinance removed a large number of restrictions on companies with more than 40 per cent non-resident equity, removed FERA controls on Indian firms setting up joint ventures abroad and allowed Indians to hold immovable property abroad, subject to certain conditions. Important concessions announced in November 1991, January 1992 and January 1993 were as follows:

(1) Companies with foreign shareholding were allowed to increase foreign equity to 52 per cent by remittances in foreign exchange in specified high priority industries; (2) section 26, sub-section 7, which required the FERA companies to get Reserve Bank's permission before raising working capital or accepting deposits was revoked; (3) Sections 28 and 29 were revoked. This meant that FERA companies could now use their trademarks in India and could carry on in India any activity of a trading, commercial or industrial nature; (4) Section 31 was revoked. This allowed FERA companies to deal in immovable property in India; (5) Section 27 which restricted Indian companies setting up joint ventures abroad and resident Indians associating themselves with or taking part in overseas concerns was scrapped; (6)Restrictions regarding assets held in India by non-residents were removed; (7) Indians were allowed to keep foreign currency upto 500 or Rs. 15,000; (8) Import and export in gold and silver was exempted from FERA implying that these commodities were now to be governed by Exim policy; (9)Section 17 which conferred powers on the government to regulate uses of imported gold and silver was deleted; (10) restrictions on transfers of any security from a register in India to a register outside India were removed; (11) Restrictions on transfers of shares by a non-resident to another non-resident were removed; (12) The provision allowing the government to acquire foreign securities for purposes of strengthening foreign exchange position had never been invoked and was unlikely to be invoked. Since this provision could cause avoidable apprehensions and fears in foreign investors, it was deleted; (13) Foreign nationals were exempted from obtaining prior permission under FERA before taking up employment in India; (14) A FERA provision which provided that the Government could direct certain payments to be made by FERA companies in a special account, was deleted.

The above list of concessions shows that FERA was made redundant and efforts was made to place FERA companies at par with Indian companies. In fact, the Union Budget, 1998-99, advocated repealing FERA and replacing it with FEMA (Foreign Exchange Management Act) as, according to the government, FERA was out of tune with the changing times. Since the country has moved to full current account convertibility and there is opening up of foreign exchange markets and transactions, "it is no longer appropriate to deify foreign exchange as something special and maintain a burdensome and highly regulatory structure around this deity." Consequently, the government adopted FEMA in 1999. Under FEMA, the emphasis is on 'management' rather than 'regulation.'

Foreign Exchange Management Act (FEMA), 1999

The Foreign Exchange management Bill (FEMA) was introduced by the Government of India in Parliament on August 4, 1998. The Bill aims "to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India." It was adopted by the Parliamentary in 1999 and is known as Foreign Exchange Management Act, 1999. Chapter II of FEMA deals with the regulation and management of foreign exchange. Section 3

states that except as otherwise provided in this Act, no person shall in any manner deal in or transfer any foreign exchange of foreign security to any person not being at authorised person. Section 4 states that except as otherwise provided in this Act, no person resident in India shall acquire, hold, own possess of transfer any foreign exchange, foreign security or any immovable property situated outside India.

Current Account and Capital Account Transactions. Sections 5 and 6 deal with current account and capital account transactions. According to Section 5, any person may sell or draw foreign exchange to of from an authorised person if such sale or drawal is a current account transaction. However, the Central government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed. According to Sub-section 1 of Section 6, any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction subject to provisions of Sub-section2. Sub-section 2 states that Reserve bank may, in consultation with the Central government, specify –(a) any class or classes of capital account transactions which are permissible; (b) the limit upto which foreign exchange shall be admissible for such transactions. However, the Reserve Bank shall not impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business. Sub-section 3 of Section 6, nevertheless, lays down that without prejudice tot he generality of the provisions of Sub-section 2, the Reserve Bank may prohibit restrict or regulate specified transactions in foreign exchange/foreign securities etc.

Sub-section 4 of Section 6 states that a person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India. Sub-section 5 states that a person resident outside India may hold, own, transfer or invest in India currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

Realisation and Repatriation of Foreign Exchange. Section 8 lays down that save as otherwise provided in the Act, where any amount of foreign exchange is due or has accrued to any person resident in India such person shall take all reasonable steps to realise and repatriate to India such foreign exchange within such period and in such manner as may be specified by the Reserve Bank.

Section 9 provides the following exemptions from realisation and repatriation of foreign exchange: (a) possession of foreign currency or foreign coins by any person up to such limit as the Reserve Bank may specify (b) foreign currency account held or operated by such person or class of persons and the limit up to which the Reserve Bank may specify; (c) foreign exchange acquired or received before the 8th day of July, 1947 or any income arising or accruing thereon which is held outside India by any person in pursuance of permission granted by the Reserve Bank; (d) foreign exchange held by a person resident in India upto such limit as the Reserve Bank may specify, if such foreign exchange was acquired by way of gift or inheritance from a person referred to in clause (c), including any income arising there from; (e) foreign exchange acquired from employment, business, trade, vocation, services, honorarium, gift inheritance of any other legitimate means upto such limit as the Reserve Bank may specify; and (f) such other receipts in foreign exchange as the Reserve Bank may specify.

Contravention and Penalties. Chapter IV deals, with the issue of contravention and penalties. Section 13 says that if any person contravenes any provisions of this Act he shall, upon adjudication, be liable to a penalty upto thrice the sum involved in such contravention where such amount is quantifiable, or upto two lakh rupees where the amount is not quantifiable, and where such contravention is a continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues. Section 14 says that if the person concerned fails to make full payment of the penalty imposed on him within a period of ninety days, he shall be liable to civil imprisonment.

'**Adjudication and Appeal.** Chapter V deals with the issue of adjudication and appeal. Section 16 states that the Central government may appoint Adjudicating Authorities for holding an inquiry in the manner prescribed after giving the accused person a reasonable opportunity of being heard for the purpose of imposing any penalty. Section 17 provides for the appointment of one or more Special Directors (Appeals) to hear appeals against the orders of the Adjudicating Authorities. Section 18 says that the Central government shall, by notification, establish and Appellate Tribunal to be known as the Appellate Tribunal for Foreign Exchange to hear appeals against the orders of the Adjudicating Authorities and the Special Director (Appeals) under this Act. The Appellate Tribunal shall consist of a Chairperson and such number of Members as the Central government may deem fit. Sub-section 2 of Section 28 deals with the powers of the Appellate Tribunal and the Special Director (Appeals). It says that they shall have, for the purposes of discharging their functions under this Act, same powers as are vested in a civil court under the Code of Civil Procedures, 1908.

Directorate of Enforcement. Chapter VI deals with the establishment of the Directorate of Enforcement and its powers, etc. Sub-section 1 of Section 36 states that the Central government shall establish a Directorate of Enforcement with a Director and such other officers or class of officers as it thinks fit, who shall be called Officers of Enforcement, for the purpose of this Act. Sub-section 3 of Section 37 states that the Director of Enforcement and other officers of Enforcement shall exercise the like powers which are conferred on Income-tax authorities under the Income-tax Act, 1961 43 of 1961) and shall exercise such powers, subject to such limitations laid down under the Act.

Miscellaneous. The last chapter, Chapter VII consisting of Sections 39 to 49 deals with miscellaneous issues Sub-section 1 of section 40 empowers the Central government in the public interest and by notification to suspend or relax the provisions of the Act in certain circumstances. Sub-section 3 provides that notification issued there under shall be laid before each House of Parliament. Section 41 empowers the Central government to give general cr special directions to the Reserve Bank. Section 42 provides that where contravention of any of the provisions of this Act is committed by a company, the person responsible for the conduct of its business shall be deemed to be guilty of the contravention. Section 44 bars the prosecution of legal proceedings against the officers of the Central government or the Reserve Bank or any other person exercising any powers or discharging any functions of performing any duties under the provisions of this Act for anything done in good faith. Section 45 empowers the Central government to remove the difficulties in giving effect to the provisions of the Act. Section 46 empowers the Central government to frame the rules and section 47 empowers the Reserve Bank to make regulations to carry out the provisions of this Act and the rules made thereunder. Section 48 provides for laying before Parliament the rules and regulations made under this Act. Section 49 provides for repeal of the Foreign Exchange Regulation Act, 1973 and for dissolution of the Appellate Board constituted under Section 52 of the said Act. Sub-section 3 of this Section says that notwithstanding anything

contained in any other law for time-being in force, no court shall take cognizance of an offender under the repealed Act and no adjudicating officer shall take notice of any contravention under Section 51 of the repealed Act after the expiry of a period of two years from the date of commencement of this Act. According to sub-section 4, subject to the provisions of Sub-section . all offences committed under the repealed Act shall continue to be governed by the provisions of the repealed Act as if that act had not been repealed.

FEMA: A Major Departure from FERA

As is clear from the name of the Act itself, the emphasis under FEMA is on 'exchange management' whereas under FERA the emphasis was on 'exchange regulation' or exchange control. Under FERA it was necessary to obtain Reserve Bank's permission, either special or general, in respect of most of the regulations thereunder. FEMA has brought about a sea change in this regard and except for Section 3 which relates to dealing in foreign exchange, etc., no other provisions of FEMA stipulate obtaining Reserve Bank's permission. The demand for new legislation was basically of the following counts: (i) FERA was introduced in 1974 when India foreign exchange reserve position was not satisfactory. Accordingly, stringent controls were required on the use of foreign exchange position, it is argued that such stringent controls are not now required; (ii) India had given notice to the IMF in August 1994 that it had attained Article VIII status. This notice meant that no restrictions will be imposed on remittances of foreign exchange on account of current account transactions; and (iii) the private corporate section had been complaining for long against, what it termed, the 'draconian provisions' of FERA which gave unbridled powers to the Enforcement Directorate to arrest any person, search any premises, seize documents and start proceedings against any person for contravention of FERA or for preparations of contravention of FERA. The contravention under FERA was treated as a criminal offence and the burden of proof was on the guilty.

FEMA has changed all this. As stated earlier, the purposes of FEMA is not 'facilitate external trade and payments' and 'promote the orderly development and maintenance of foreign exchange market in India.' As far as the promotion of orderly development and maintenance of foreign exchange market is concerned, FEMA is silent. However, a far as facilitating external trade is concerned, Section 5 removes restrictions on drawals of foreign exchange for the purpose of current account transactions. As external trade, i.e., import and export of goods and services, involves transactions on current account, there will be no need for seeking the permission of Reserve Bank of India in connection with remittances involving external trade. However, Section 5 confers powers on the Central Government to impose reasonable restrictions on current account transactions, in consultation with the Reserve Bank. But this seems to be just an 'enabling provision' added keeping in view the experiences of some East Asian countries during the 1997-98 crises which required stricter exchange controls. As far as the 'draconian provisions' are concerned, FEMA has reduced their rigour significantly. For instance, unlike in the case of FERA, violations of FEMA will not attract criminal proceedings. The contravention will now be treated as a civil offence. Thus FEMA removes the "threat of imprisonment" which businessmen abhor. Now they will either compound their illegal acts by paying a fine if it is not too high, otherwise they will pay lawyers to engage in lengthy (and mostly inconclusive) litigation with the government.

According to Biswajit Dhar and Mritunjay Mohanty, FEMA represents major departures from the past policies in tow other important respects : "First, it can be seen as an initial step towards capital account convertibility. Secondly, by removing the FERA from the state book and

replacing it with the FEMA, the government seems to have finally decided to give up even the bare intention of regulating foreign capital in the country." The latter is an important message coming at a time when the international institutions, under the leadership of developed countries, are putting a multilateral investment regime in place that would free foreign investors from any controls which host countries might feel the need to impose. Although India has maintained that it would preserve its sovereign rights to regulate foreign investment, the absence of FERA is likely to pose serious difficulties in this effort.

As far as the issue of capital account convertibility is concerned, Section 6 of FEMA introduces some elements in this respect. As mentioned earlier, Sub-section 2 of this Section states the "Reserve Bank shall not impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business."" This leaves out an important set of capital account transactions outside the Reserve Bank's ambit. In this context, there are two points worth noting: "First, as the above quote makes clear, international investors have been assured that their interest will be protected : a matter of no small importance given the current state of multilateral negotiations aimed at deregulating foreign investment. Second, in a world where loans are fungible, the above could well be the thin end of the wedge which expands the scope for convertibility."

The relaxation of foreign exchange controls and the move towards convertibility have been justified by the Finance Minister on grounds of improvements in external account. However, facts speak otherwise. During recent years, pressure on India's current account have been quite perceptible. Greater openness of the economy is likely to push up the current account deficit further and create foreign exchange difficulties. The turmoil that the global financial markets faced in recent times has already forced many governments who were previously advocating relaxation of foreign exchange controls to beat the retreat and once again impose foreign exchange restrictions.

CHAPTER-12: INTERNATIONAL MONETARY FUND, WTO & WORLD BANK

A landmark in the history of world economic cooperation is the creation of the International Monetary Fund, briefly called IMF.

The genesis of the Fund lies in the breakdown of *Gold Standard,* which created a vacuum in the field of international trade. With the abandonment of gold standard in the 'thirties all countries realised the need for international cooperation in economic affairs, as veritable chaos had resulted in the system of foreign exchange rates and international trade after the end of the gold standard system. As a result, each country tried to secure its own interest at the cost of others. Each deliberately undervalued its currency to secure an advantage for its exports. They started following 'beggar-my-neighbour' policies in currency matters as well as in matters of international trade. Competitive exchange depreciations, exchange controls, import and export regulations and bilateral trade pacts were the of the day, and world trade as a whole declined to a great extent. International investments also suffered very much as a result of the uncertainly created by the frequently changing exchange rates. In short, international trade and investments passed through the worst period in the 'thirties.'

It was then recognised that the monetary disorder of the world could be corrected only by mutual agreement between nations having international economic relations. International monetary cooperation became the dire need of the day. Since it was not possible to revive the gold standard, a new system had to be devised, a system which would provide sufficient flexibility through international assistance without affecting the internal economic order of the country, as also an efficient payments mechanism which would permit and foster high and stable levels of world trade. Different nations put forward different plans in this respect. In 1943, the United States Treasury published a proposal for the establishment of an International Stabilisation Fund of the United and Associated Nations. In the same period Great Britain also proposed the establishment of an International Clearing Union. The American proposal is known as 'White Plan', and the British proposal is known a 'Keynes Plan', after their principal authors Mr. White and Lord Keynes respectively. In 1944, a joint plant plan in the shape of a "Joint Statement by Experts on the Establishment of International Monetary Fund of the United and Associated Nations" emerged, which became the basis for the United nations Monetary and Financial Conference at Bretton Woods, New Hampshire, from July 1 to July 22, 1944.

The purpose of the Bretton Woods Conference was to devise means for assuring a system of international trade and payments consistent with the dual objectives of high world productivity and trade and domestic employment and income with economic stability. At this meeting, it was decided that an 'International Monetary Fund' (IMF) be organised embodying a working mechanism for the smooth settlement of international payments in order to achieve the objectives.

However, the IMF itself was organised in 1946, and commenced operations in March, 1947.

Objectives

The fundamental objective of the IMF was the avoidance of competitive devaluation and exchange controls that had characterised the era of 1930. It was set up to administer a "code of

fair practice" in the field of foreign exchange and to make short-term loans to member nations experiencing temporary deficits in their balances of payments, to enable them to meet these payments without resorting to devaluation or exchange control, while at the same time following internal policies to maintain domestic income and employment at high levels. Thus, basically there are three general objectives of the IMF: (1) the elimination of reduction of existing exchange controls, (2) the establishment and maintenance of currency convertibility with stable exchange rates, and (3) the widest extension of multilateral trade and payments.

In essence, the Fund is an attempt to achieve the external or international advantages of a gold standard system without subjecting nations to its internal disadvantages.

More precisely, the objectives of the Fund are stated in Article 1 of the Fund Agreements as follows :

1. To promote international monetary cooperation through a permanent institution which provides machinery for consultation and collaboration on international monetary problems.

2. To facilitate the expansion of balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as the primary objectives of economic policy.

3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation

4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

5. To lend confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

Evidently, Article 1 forms the cornerstone of the Fund Agreement because all decisions are to be guided by the purposes stated in this Article.

Functions

From the objectives outlined above, it is easy to see that :

1. The Fund functions as a short-term credit institution.

2. It provides machinery for the orderly adjustment of exchange rates.

3. It is reservoir of the currencies of all the member countries, for which a borrower nation, can borrow the currency of other nations.

4. It is a sort of lending institution in foreign exchange. However, it grants loans for financing current transactions only and not capital transactions.

5. It also provides machinery for altering sometimes the par value of the currency of a member country. Thereby it tries to provide for an orderly adjustment of exchange rates, which will improve the long-term balance of payments position of member countries.

6. It also provides machinery for international consultations.

In fine, the Fund contributes to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all member nations.

Organisation And Structure

The Fund is an autonomous organisation affiliated to the U.N.O. It main office is in Washington. At present the Fund has 116 members (nations). However, former Soviet bloc nations are not members of the Fund. In fact, the Fund represents all the countries outside the centrally controlled economics, except Switzerland, thus greatly widening the area of international monetary cooperation.

The ruling body of the Fund is a Board of Governors, consisting of one representative and one alternate representative appointed by each member nation. Normally, the Board meets once a year and exercises its power in such important matters as admission of new members, revision of quotas, election of directors, etc. But it has delegated working authority to the Board of Executive Directors. Thus the Board consists of 20 executive directors of whom 5 are nominated, one each by the five largest quota-holding countries, U.S.A., U.K., West Germany, France and India. Of the remaining 15, three are elected by Africa, 3 by Latin America, 5 by the Far East and Pacific area and 4 by Continental Europe. The Chairman of the Board of Executive Directors is the Managing Director – who is the head of the Fund. The executive board meets two or three times each week to consider problems brought before the Fund.

Quotas

IMF's constitution represents a departure in the formation of international organisations. It is financed by the participating countries, with each country's contribution fixed in terms of quota Quotas were fixed on the following basis :

(i) 2 per cent of national income;

(ii) 5 per cent of gold and dollar reserves;

(iii) 10 per cent of average annual imports;

(iv) 10 per cent of maximum variation in annual exports;

(v) the sum of (i), (ii), (iii) and (iv) increased by the percentage ratios of average annual exports of national income.

It goes without saying that the quotas of all the countries taken together determine the major financial resources of the Fund. The borrowings from member countries and income from operations and investments constitute another form of resources of Fund. Moreover, the contributed quota of a country determines its borrowing rights and voting strength. Each member nation of the IMF is required to subscribe its quota partly in gold and partly in its own currency Specifically, a member nation must contribute gold equal to 25 per cent of its quota, or 10 per cent of its gold stock and U.S. dollar holdings, whichever is less. The portion of subscription paid in a nation's own currency is generally paid in the form of a deposit balance in favour of the IMF held

in the nation's central bank. Thus, the Fund gets a pool of foreign currencies to lend, together with gold, which enables it to acquire additional amounts of currencies whenever its initial supply of some currencies becomes depleted.

Table1
Quotas of Selected Member Countries of IMF
(As on December, 31, 1972. Amounts expressed in millions of SDRs* or Old U.S. Dollars)

Country	Quota	Gold subscription
U.S.A	6,700	1,672
U.K	2,800	700
Germany	1,600	400
France	1,500	375
Japan	1,200	300
Canada	1,100	275
Italy	1,000	250
India	940	162

* 1 SDR = 0.888671 gram of fine gold.

Source : IMF, International Financial Statistics, Feb., 1973.

The quotas are reviewed every five years and adjusted from time of time by the Fund. In fact, the enlargement of quotas from time to time reflects the Fund's appraisement of the increase in need for international liquidity. After the third revision of quotas in 1970, the total member countries' quotas stand at present at about $29 billion. India's quota is about $940 millions. India is thus the eighth largest quota-holder today. In Table 1 above, we have enlisted the quotas of first eight IMF member countries in order of their rank.

Operations

Following points may be enlisted for discussing the operations of the IMF :

1. The lending operations of the Fund technically take the form of sale of currency. Any member nation running short of foreign currency may buy the required currency from the Fund, paying for it with its own currency. Since each member contributes gold to the extent of 25 per cent of its quota, the Fund freely permits a member to draw up to the amount of its gold contribution. Additional drawings are permitted only after certain careful and strict scrutinise. Since the purpose o the fund is to make temporary and short-term loans, it expects repayment of loans within 3 to 5 years. It thus assists its borrowing members temporarily to restore equilibrium in their payments position, thereby maintaining the revolving character of its resources and seeking the establishment of a liberal system of international payments by helping the members to avoid imposing restrictions on payments or trade (imports) during balance of payments difficulties.

2. The Fund has also laid down provisions relating to exchange stability. At the time the Fund started functioning, members were required to declare the par values of their currencies in terms of gold as a common denominator or in terms of U.S. dollars. Thus under the IMF arrangements, gold retains its role in determining the relative values and currencies of different

nations. And once the par values of different currencies are fixed, it is quite easy to determine the exchange rate between any two member nations.

However, if at any time a member country feels there is a 'fundamental disequilibrium' in its balance of payments position, it may propose a change in the par value of its currency i.e. its devaluation. But devaluation is allowed or even advised by IMF for the purpose of correcting a fundamental disequilibrium and not for undue competition or other advantages. Thus, the decision to devalue should not be taken unilaterally by the member concerned, but only after consultation with the Fund.

The Fund has been laid down that member countries should not adopt a system of multiple exchange rates. That is to say, there should not be two or more rates between the currency of one member country and that of any other member country. This was necessary to prevent countries from departing from the principle of fixed exchange rates.

Secondly, it was also laid down that a member country should not purchase or sell gold internationally at prices other than those indicated by the par values.

In essence, these provisions were laid down in order to secure the chief advantage of gold standard system, viz., exchange stability. At the same time, the exchange rates were not rigidly fixed as in the case of gold standard, and exchange depreciation or devaluation was permissible only for correcting a fundamental disequilibrium in the balance of payments of a country. Similarly, the Fund might ask a member enjoying a persistent surplus position to revalue its currency and set things right.

3. With a view to eliminate or minimize exchange control operations, the Fund laid down that in ordinary trade and other current transactions, there should be no restrictions. Although the fund laid down that exchange controls and other restrictions should not be used for normal current transactions, it allows their use at all times to control international capital movements, especially 'capital flight.' Moreover, exchange controls are expressly permitted in the case of currencies which may be declared 'scare' by the Fund. It is also permitted during the 'transition period.' Thus, the elements of exchange control have been incorporated in the provisions of the Fund.

4. In fine, the IMF may be described as a bank of central banks of different countries, because it collects the resources of the various central banks in the same way in which a country's central bank collects cash reserves of all its commercial banks and assists them in times of emergency. However, while a central bank can control the credit policy of its member banks, the Fund cannot so control the domestic economic and monetary policies of member nations. It only seeks to maintain a multiple payments system through an orderly adjustment of the exchange rates.

Role Of Gold In Imf Arrangements

We have seen that under the provisions of the Fund, the par values of the currencies of member nations are determined either in terms of gold or the U.S. dollar. Gold is thus assigned a key role in the Fund's monetary arrangements. It is regarded internationally as the most liquid asset, and a common denominator of the values of all the currencies. This has led to some economists like Prof. J.H. Williams to declare the plan of the Fund as 'essentially a gold standard plan.' Lord Keynes, on the other hand, stated that the Fund's plan is 'exactly opposite of gold standard.' These two extreme views came to be expressed about the similarities and differences of the Funds' monetary arrangements from the old international gold standard system.

IMF's Resemblance To Gold Standard

Prof. Williams has pointed out that the Fund's monetary mechanism is not different from the gold standard system. Apparently the Fund seems to resemble the gold standard in the following respects :

1. Gold occupies an important place in the scheme of the Fund, as the par values of the currencies of member countries are expressed in terms of gold.

2. Gold is designed to operate as a common denominator of the currencies of member nations.

3. The Fund's charter requires that a certain minimum of the quota subscribed by the member country must be paid in terms of gold.

4. Member countries are prohibited from buying and selling gold at prices other than those corresponding to the par values of their currencies.

5. Under the IMF scheme, gold continues, the serve as a reserve of international currency. It is regarded internationally as the most liquid asset.

6. Thus the Fund may purchase the currency of any country by making payment in gold.

7. Moreover, there is a standing offer from the Fund to purchase gold at official parties. A permanent international market for the gold is created by this offer of the Fund.

8. Under the gold standard, every country balances its external account with rest of the world and not with the countries individually. Similarly, the IMF also encourages multilateral convertibility of currencies at fixed parties. Briefly thus under both the systems multilateral payment system exists.

9. When looked at from the manner in which the members conduct their transactions with the Fund, there also appears to be an analogy between the gold standard system and the Fund's plan. Under the gold standard, a deficit country meets the deficit by export of gold. Under IMF arrangements, quota takes the place of gold, and the deficit country is required to borrow – purchase the foreign exchange required from the Fund and its borrowing capacity is determined by the quota subscribed.

In fact, transactions that are made by the members with the Fund are of an extraordinary nature; comparable to gold (or short-term capital) movements under the gold standard. They influence bank reserves and the internal credit phenomenon of the country in precisely the same way as movements of gold did under the gold standard. That is to say, the deficit countries will automatically experience deflation and the surplus countries will experience inflation. .This happens because when a deficit country purchases foreign currency from the Fund, the volume of its international currency would contract. Moreover, when the purchasers (importers) of foreign exchange from the central bank in the country will have to pay local currency in exchange for it, they may draw cheques on their commercial banks' demand deposit accounts in favour of the central bank. As a result, the commercial banks' cash reserves decrease and ultimately there will be a contraction of credit leading to deflation in the deficit country. This is what also happens in the case of a deficit country under the gold standard system. Similarly, in the case of a surplus country, when its domestic currency is received as payment, the currency circulation is likely to expand. Moreover, exporters will sell their earnings of foreign exchange to the central bank and get the local currency in exchange, which may be deposited with commercial banks. As a result

the commercial banks' cash reserves will increase and credit expansion may be effected. This process will tend to serve to bring about a correction in the disequilibrium (deficit of surplus) of a country's balance of payments. Thus, the Fund's equilibrating mechanism is as good or as bad as the gold standard mechanism.

IMF–A Better Scheme Than Gold Standard

According to Keynes, the IMF scheme is quite the opposite of the gold standard system in several respects.

1. Though gold retains its place as the ultimate standard of reference as per the IMF Charter, the operations of the Fund do not, however, represent a return to the gold standard. Moreover, gold is not the basis of currency under the IMF scheme in the way in which it used to be under the gold standard. The value of the currencies is not rigidly fixed in terms of gold and once for all. Alterations in the exchange rates or par values are allowed by the Fund within certain limits.

2. The basic principles underlying the working of the international gold standard was that the countries following it should adjust their internal price levels and income levels in order to maintain the rigidly fixed exchange rates. On the other hand, the Fund emphasises that orderly adjustment of exchange rates should be undertaken in order to bring the exchange rates in parity with the structure of internal prices and incomes. Thus IMF holds that *de facto* exchange depreciation must be made *de jure* by devaluation.

In short, gold in the IMF schemes serves as a faithful servant and not as a wayward master as was typical of the gold standard.

3. Unlike the gold standard system, under the Fund's arrangements a deficit country is under no compulsion to induce deflation in its economy. It can easily counter-balance any deflationary influence, so arisen on account of international payments, through the action of the central bank. Thus, deflation is not a logical outcome of the IMF arrangements.

4. Under the game of gold standard, exchange control is not permitted, whereas the IMF allows the use of exchange restrictions together with exchange rate adjustments in certain circumstances.

5. Rules of gold standard emphasised external stability, even at the cost of internal stability, whereas the IMF arrangements give greater importance to the achievement and maintenance of internal stability.

6. International gold standard required compulsory coordination if domestic economic policies of the participating countries in accordance with the rules of the gold standard game. Under IMF arrangements, member countries can follow their independent economic policies.

7. Under the gold standard system there was no international currency reserve which could help the deficit countries to meet their temporary disequilibrium in the balance of payments. The Fund, however, keeps a pool of such reserves, assists in meeting a temporary shortfall in the balance of payments and tries to minimise the ugly consequences (depression and unemployment) of the gold standard.

It thus goes without saying that the IMF scheme is a definite improvement upon the gold standard. It contains the advantages of gold standard and carefully eliminates its disadvantages. Today almost all the countries are on the paper standard. But under it direct convertibility of he

currencies of different nations would be difficult. IMF therefore suggested to express the par values of all currencies in terms of gold so that conversion would be easier. In short, by restricting the right of the country to change the exchange rate beyond a prescribed limit, by prohibiting exchange restrictions in normal circumstances, and by facilitating convertibility of the currency through gold the IMF has preserved the advantages of the gold standard and avoided the disadvantages of the paper standard

Achievements of The IMF

Undoubtedly the IMF has made a remarkable success in achieving most of its principal objectives :

1. The primary goal of the IMF was to promote stability in exchange rates. The measure of exchange stability that the world has witnessed in the IMF era is remarkably superior to what was seen during the inter-war period or gold standard regime. Under IMF arrangements, stable exchange rates do not imply rigid exchange rates. IMF's object is to combine the merits of stability with flexibility in exchange management. It is aimed at avoiding competitive exchange depreciations by requiring members to declare the par values of their currencies fixed in terms of gold or the U.S. dollar. However, it permitted an orderly adjustment or exchange rates when this was needed for correcting fundamental disequilibrium in a country's balance of payments. The recent devaluation of the Indian rupee (in 1966) and that of pound-sterling were justified by the IMF.

2. The IMF also served as an expert institution for consultation and guidance in international monetary matters. It serves as an excellent forum for discussions, practically on a day-to-day basis, of the economic, fiscal and financial policies of member nations, with particular reference to their balance of payments impact. The Fund has created a feeling among the member nations that their economic problems are not their exclusive concern but of the whole international society.

3. The Fund has contributed in certain ways to the expansion of world trade. By providing credit facilities to member countries, the IMF has reduced the need for their imposing import quotas and resorting to exchange controls. It assists the deficit countries in meeting their temporary disequilibrium in the balance of payments. It also works for facilitating multi-lateral payments and trade, promoting thereby international trade as a whole.

4. In recent years the Fund has achieved some success in bringing about a simplification of the multiple exchange system at least in countries that have sought financial assistance from the Fund.

5. The Fund has been instrumental in ensuring steady progress in the establishment of a multilateral system of payments in respect of current transactions. However, little success has been achieved in this direction due to agencies and organisations out of the Fund's purview.

6. In the beginning, the Fund pursued a conservative credit policy, refusing loans for any purpose other than correcting a fundamental disequilibrium in the balance of payments. Moreover, the IMF credit was of short-term duration only. Lately, however, the Fund has changed its attitude by accepting a more liberal credit policy. Today the Fund grants development loans, too. Hence, the quantum of borrowings from the Fund has shown a marked increase in recent years.

7. In a nutshell, the fund has thus been able to secure all the advantages of managed paper standard by maximizing employment and accelerating the pace of economic development and of the gold standard by maintaining comparative economic stability, while carefully avoiding the disadvantages of either.

8. Moreover, the Fund has been particularly interested in the newly developing countries of the world and has been liberally assisting them to maintain a healthy balance of payments and monetary stability at home. In recent years, however, underdeveloped countries have started looking to the Fund to assist them in their economic development programme also. Furthermore, most of the new member countries who have acquired independence recently are facing difficult problems in organising their monetary, fiscal and exchange systems. These countries, thus require Fund's growing assistance in constructing a solid monetary and exchange base for their economic growth. The Fund has been already providing technical assistance to its members in this respect, but now its activity is substantially widened to meet this challenge. In many of these countries, the Fund's experts have assisted in the formulation of appropriate monetary, fiscal and exchange policies or in the implementation for stabilisation programmes. Besides, the Fund has organised, since 1964, a Fiscal Affairs Department whose officers advise member countries on matters relating to tax policy, tax systems, tax administration, budgeting etc. The Fund has also organised the Central Banking Advisory Service to provide technical advice to newly developing countries to establish or improve their central banks. An IMF Institute is also started by the Fund in 1964 to train the officials of member nations.

Above all, to solve the current international liquidity problem, the IMF has succeeded in establishing the SDR scheme.

Mr. P.P. Schweitzer rightly expressed his strong conviction that the Fund is ideally and flexibly constructed to perform the new tasks and to provide the new facilities that may be needed in the course of the continuing evolution of the international monetary system.

The IMF and India

Till recently, India's official economic policy during the planning era has been to assign a commanding position to the public sector in the mixed economy, with a view to preventing the concentration of economic power into a few hands in the private sector, and to check the inflow of foreign capital as well as imports in order to provide protection to the domestic industries. As a matter of fact, India's economic policy uptil now was largely at odds with the free enterprises, free market, and free trade philosophy of the IMF and the World Bank.

Though the socialist pattern-oriented plan strategy did not allow free flow of foreign capital into the country, Indian industrial strategy has always remained dependent on foreign capital inflows. This is because India has never made any serious efforts in developing indigenous technologies.

India's economic policies led to a control-permit raj in the Nehruvian era and thereafter Following the Soviet model planning, with due Indianisation, however, the country had tended to become a closed economy. This was never appreciated by the IMF and World Bank authorities. Hence, these international institutions have always tried to press their views at every opportune moment. Whenever India experienced a foreign exchange crisis, these international authorities tried their level best to dilute Indian industrial and trade policies. In 1966, for instance, when India had a served problem of BOP deficit, the World Bank insisted on a degree of import liberalization as a *quid pro quo* for its financial support for BOP adjustments. In the seventies and onwards.

India had to change her èconomic policies quite often. Most of such changes were towards the process of liberalisation, attributed to the IMF pressure. The imposition of emergency rule in June 1975 is also attributed to crush the political opposition against the IMF programme and strategy. In fact, Smt. Indira Gandhi was heavily pressured to abandon her quasi-socialist policies and accept the ideology of the West. A very patent, calculated and long-term campaign was authorised by the IMF and the World Bank to see it that India opens up its door to western private investment, western technology and western exports on a growing scale in due course of time. To quote Prof. S.L.N. Sinha in this context, "In the last 2-3 years, the IMF and the World Bank have laid a great deal of emphasis on measures of economic liberalisation, much less on controls and artificial props and much more free play of the market forces. A lot of stress has also been laid on going very slow on the setting up of public sector enterprises, including financial intermediaries. This attitude reflects partly the ideology preference for free enterprises and a market-oriented economy but primarily dissatisfaction with the general performance of economies which were based on planning, regulation and public enterprises in a big way, in the light of experience of over three decades.

These international authorities went on giving financial help to the country on such conditions. In 1981, India received 5 million on SDR loan under the pretext of development assistance. In 1991, when India was confronted by a severe foreign exchange and financial crisis, the IMF and World Bank came to her rescue not with sympathy but to fulfil their long-cherished objective. India was forced to accept all conditions of the IMF for such assistance. She was asked to globalise her economy very rapidly with an open door policy of free trade. The country had no change the planning strategy and to redesign it on market-friendly approach. The New Economic Policy with all its dimensions towards liberalisation was chalked out under the IMF's direction. In effect, trade and exchange liberalisation are imposed upon the Indian economy at a very faster rate which probably the country had never expected. Under the zeal of globalisation of the Indian economy, less attention was paid to its age-old problems of poverty, inequality and chronic unemployment. Developing countries including India must realise that some policy changes in the right direction are inevitable for their own benefit. There should be no scope left for the politicians to raise wrong issues or false ideas of prestige or outworn ideologies. Nonetheless, no country should consider itself to be weak enough to mortgage its sovereignty in right decision-making. When countries like India need to borrow from the international sources, they must be alert to discourage overt and covert attempts on the part of officials of the IMF or World Bank from doing propaganda for only those proposals and reforms which they think as the only best for the country's improvement, especially when they are unduly dogmatic, biased and unreasonable. India's main problem uptil now has been the government's incapacity to act rightly, firmly and effectively in time, on account of being more emotional to set ideologies and compromising attitude to safeguard the party's interest more than the national interest.

Short Comings of The Fund

In its working, the Fund has revealed several inadequacies in its structure and provisions.

1. Some economists like Prof. Williams pointed out that in the post-war situation when the Fund was started, it was practically useless. For the post-war situation was characterised by serious international payment maladjustments. Such a situation required long-term aid and loans for reconstruction, and not temporary ones as the Fund proposed.

2. It has been pointed out that the Fund's choice of the par values in terms of gold or the dollar was ill-advised, since the original members fixed their exchange rates at a time when overvaluation of currencies was most common.

3. Certain provisions of the Fund seemed to be destructive rather than constructive. For instance, when fundamental disequilibrium results from international inflation as a result of the domestic policy of the country, the Fund will justify devaluation because of the domestic economic policies of the member country proposing the change. But it should be noted that devaluation cannot be effective unless internal inflationary spiral is checked. Here the Fund is helpless. as it has no authority to interfere with the country's internal economic policy except through persuasion and consultation.

As a matter of fact, in fixing exchange rates, both initially and subsequently, the Fund has followed a weak and passive policy. Often countries have disregarded the Fund's rules relating to alterations in the par values of their currencies. In 1949, for instance, there was devaluation of currencies by more than 23 countries which was of course competitive in nature which the Fund could not prevent. The passive attitude on the part of the Fund may be considered as its inability to rise to its level of responsibility. Nevertheless, it must be said that the exchange stability achieved during the Fund's era is more appreciable than the chaos in the inter-war period.

4. The Fund has failed to prevent dollar shortage. Despite the acute dollar shortage felt by the Sterling area, the Fund failed to declare the dollar as 'scarce currency' and to adopt the necessary measures to make the dollar freely available.

5. The Fund was also blamed for granting purchasing rights to certain members without taking into account their creditworthiness.

6. The Fund has totally failed to solve the problems of the underdeveloped chronically debtor countries. In these countries the remedy is to stimulate economic growth by long-term international lending. But in view of its limited resources the Fund primarily aimed at short-term accommodation only. However, this deficiency has been overcome to an extent in recent years by raising the capital of the Fund.

7. The Fund is also criticised because its executive membership has been so devised as to safeguard U.S. interests.

8. During last 10-12 years most of the reforms were undertaken by the IMF just in order to relieve the U.S.A. from the balance of payments difficulties.

9. The Fund could not remove the trade restrictions employed by some countries to safeguard their interests. Advanced nations are keen on removal of trade controls by member nations so that their economic interest may brighten. But this may harm the newly developing countries who therefore strongly oppose the move. The Fund has thus become a medium for exerting rival claims.

10. On certain important issues, IMF did not take timely measures. For instance, during the 1971-72 dollar crisis, IMF did not bring immediate pressure upon the U.S. Government to devalue the dollar till the end of 1972, and during the same period, it also allowed Japanese Yen and German Mark to float indefinitely. In the Articles of Agreement of the IMF there is provision for declaring a currency as "scarce currency", which as remained meaningless due to the Fund's inactiveness in this regard.

11. Another major weakness of the IMF has been that it has failed to evolve a stable international monetary system. In fact, the present international monetary system under the IMF is a "gold exchange standard" which may even be described as a "dollar exchange standard system", in which member countries set par values of their currencies in terms of gold and have to maintain fixed exchange rates by preserving international reserves containing gold and key currencies in which the U.S. dollar is of prime importance. The problem today is, however, of the inadequacy or gold supply and incapacity of the United States to continue huge balance of payments deficit which she is experiencing at present. Further, the ratio of U.S. gold reserves to U.S. dollars is steadily declining due to increasing demand for converting dollars into gold by the dollar-holding nations. The United States is thus facing a "short-term confidence problem" which can become a long-term problem in due course of time. The speculation against U.S. dollar and the consequent heavy drain on U.S. gold-reserves has eventually rendered the present international monetary system unstable, thereby steadily weakening the international position of the United States.

Concluding Remarks

Despite its various shortcomings, the Fund has achieved striking success in the field of international monetary cooperation. If it has not proved more successful than it did, it is because of the various inherent difficulties faced by the Fund is solving the various problems. It cannot be denied that the Fund has proved to be of use in promoting its main objectives of growth of international trade, reduction of restrictive practices and easy convertibility of currencies, and managed stability of exchange rates. The Fund is a truly international institution and has demonstrated dynamism and adaptability to the growing and changing requirements of world economy. It tries to harmonize more effectively the economic relations of advanced and poor nations.

In short, the Fund has shown capacity for good work and purposes and many bold ideas have been emanating from it. In view of the improvements and changes in operations, we can hope that in the years to follow, it will play a more dynamic and comprehensive role in achieving its objectives and maintaining better international economic and monetary relations.

Suggested Reforms in The IMF

The IMF is the pillar of the edifice of the international monetary system. The world is changing very fast with dynamism to embrace the 21st century. Over 50 years old institution like the IMF need reformation to meet the emerging challenges and tackle the new problems in the modern global finance system. Time has ripped to undertake certain reformatory measures immediately in the interest of the new economic order of the world economy and its progress, beside wiping out the tarnished image of the IMF in its working as a financial institution.

Power relationship within the IMF structure of the monetary system need a change. The SDRs scheme is a substitution for gold. SDRs should be made more significant in the international monetary system. SDRs should play the role of the main denominator in determining parties of different currencies and the exchange rate instead of the US dollar. Nowadays, there is *de facto* dollar standard in the global monetary system. Instead of dollar, the SDRs should become the principle reserve asset, then only one can hope for the minimization of the American dominance into the global monetary system. The IMF should become more strong, fair and neutral. This requires restructuring of its power relationships. With adoption of the SDR standard and its equitable distribution with due consideration for the liquidity need of developing countries, the power relationships can hopefully be rationalized.

International Financial Institutions

The World Bank (IBRD)

The International Bank for Reconstruction and Development (IBRD), better known as the World Bank, was established at the same time as the International Monetary Fund to tackle the problem of international investment. Since the IMF was designed to provide temporary assistance in correcting balance of payments difficulties, an institution was also needed to assist long-term investment purposes. Thus, IBRD was established for promoting long-term investment loans on reasonable terms.

The World Bank (IBRD) is an inter-governmental institution, corporate in form, the capital stock of which is entirely owned by its member-governments. Initially, only nations that were members of the IMF could be members of the World Bank; this restriction on membership was subsequently relaxed.

Functions

The principal functions of the IBRD are set forth in Article I of the Agreement as follows

1. To assist in the reconstruction and development of the territories of its members by facilitating the investment of capital for productive purposes.

2. To promote private foreign investment by means of guarantee of participation in loans and other investments made by private investors and when private capital is not available on reasonable terms, to make loans for productive purposes out of its own resources or from funds borrowed by it.

3. To promote the long-term balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members.

4. To arrange loans made or guaranteed by it in relation to international loans through other channels so that more useful and urgent projects large and small alike, will be dealt with first. It appears that the World Bank was created to promote and not to replace private foreign investment. The Bank considers its role to be a marginal one, to supplement and assist private foreign investment in the member countries.

A little consideration will show that the objectives of the IMF and IBRD are complementary. Both aim at increasing the level of national income and standard of living of the member nations. Both serve as lending institutions, the IMF for short-term and the IBRD for long term capital. Both aim at promoting the balanced growth of international trade.

Bank's Organisation

Like the Fund's, the Bank's structure is organised on a three-tier basis : a Board of Governors, Executive Directors and a President. The Board of Governors is the supreme governing authority. It consists of one governor (usually the Finance Minister) and one alternate governor (usually the governor of the central bank), appointed for five years by each member. The Board is required to meet once every year. It reserves to itself the power to decide important matters such as new admissions, changes in the Bank's stock of capital, ways and means of distributing the net income, its ultimate liquidation etc. For all technical purposes, however the Board delegates its powers to the Executive Directors in the day-to-day administration.

At present the Executive Directors are 19 in number, of which five are nominated by the five largest shareholders – U.S., U.K., Germany, France and India. The rest are elected by the other members.

The Executive Directors elect a President who becomes their ex-officio Chairman holding office during their pleasure. He is the chief of the operating staff of the Bank, and, subject to the direction of the Executive Directors on questions of policy, and is responsible for the conduct of the ordinary business of the Bank and its organisation.

Capital Resources

The World Bank, like any other corporation, has an authorized capital of $21 billion divided into, 2,10,000 shares, each having a par value of $100,000. Initially, however, its authorized capital was $10 billion. Of the present authorities authorized capital, $20.48 billion are subscribed by issue of 204,848shares. However, only 10per cent of the par value, viz., $ 2.04 billion have been called in as paid-up capital. The capital stock of the Bank can be increased if a 3/4th majority of the total voting power is cast in favour. Of the paid-up capital 2% has to be subscribed in gold or U.S. dollar the remaining 98% has to be paid in the currency of the member.

Lending Operations

Loans are granted to member countries only after the Bank is fully satisfied about the economic position of the borrowing country as well as the soundness of the specified projects for which assistance is sought. In granting loans, the Bank is prepared to take reasonable risks but insists that funds obtained from it should be used for purposes which are constructive and practical. The Bank has powers of supervision and control to ensure that funds are used for the purposes for which the loan is granted. Normally the Bank makes medium or long term loans, the term being elated to the estimated useful life of the equipment or plant being financed.

The Bank makes or facilitates loans in any one or more of the following ways :

(a) by making or participating in direct loans out of its own funds; or

(b) out of the funds raised in the market of a member, or otherwise borrowed by the Bank; or

(c) by guaranteeing, in whole or part, loans made by private investors through the investment channels.

The total outstanding amount of the loans made or guaranteed by the Bank is not to exceed 100% of its total unimpaired subscribed capital resources and surplus. The interest rate charged by the Bank on its loans is the estimated cost of the Bank of borrowing money for a comparable term in the market and is uniform without distinction among borrowers. In addition to the rate of interest, the Bank charges on all loans a commission of 1% for the purpose of creating a special reserve against losses and ½ per cent for administrative expenses.

In recent years, the Bank has made loans mainly for specific development projects in the field of agriculture, power, transport and industry. Most of the loans have been made to the underdeveloped countries. India is the Bank's largest individual borrowers.

Technical and Advisory Assistance

In addition to providing financial assistance to member countries, the bank has been rendering signal service to its members by providing them suitable technical assistance to assess their total economic resources and to set up priorities to be followed in their development programs. Technical assistance on a broader scale has also been provided, for instance in development programming, through Survey Missions, which make intensive studies of national resources and formulate recommendations to serve as the basis of long-term development programmes.

In addition to the training programme, the Bank with financial assistance from the Rockefeller and Ford Foundations, has set up in Washington an Economic Development Institute to provide an opportunity to selected groups of senior officials from the less developed countries to participate annually in an international course of studies designed to give them new perspective of the problems of economic development and to increase their efficiencies.

Criticisms

The modus operandi of the Bank has been criticised on various counts from different quarters:

1. It is alleged that the Bank charges a very high rate of interest on loans. For example some of the loans which India has received in recent years bear an interest of 5 [illegible] per cent including the commission at 1% which is created to the Bank's special reserve.

2. The Bank's insistence, prior to the actual grant of loan, on the country having the capacity to transfer or repay, is open to criticism. The Bank should not apply orthodox standard to judge the transfer capacity of any borrowing country. Transfer capacity follows rather than precede the loan.

3. The financial help give by the Bank does not amount to more than a drop in the big ocean of financial requirements so essential for various development projects.

Conclusion

It may be said that the World Bank has not come upto the expectations of many nations. Nevertheless, it has been instrumental to a very large extent in initiating and accelerating the [illegible] of economic reconstruction and development in different countries. No doubt, India has derived immense benefit from the world Bank. The Bank may have failed to France most of the development projects, but it should be remembered that it has financed quite a large number of them which have proved a notable success. The bank has also played a significant role outside financial matters by serving as a mediator between different countries on major economic and political issues. For instance, its help in the solution of the Indus Waters dispute between India and Pakistan and the Suez Canal dispute between the U.K. and U.A. R. has been invaluable.

International Finance Corporation (IFC)

The International Finance Corporation was established in July, 1956, with the specific object of providing finance to the private sector. Though it is affiliated to the World Bank it is a separate legal entity with a separate fund and functions. Members of the World Bank are eligible for its membership.

Objectives : IFC's objective is to assist economic development by encouraging the growth of productive private enterprises in its member nations, particularly in the underdeveloped areas. Thus, it laid down the following objectives :

1. To invest in productive private enterprises, in association with private investors and without government guarantee of repayment, in cases where sufficient private capital is not available on reasonable terms.

2. To serve as a clearing house to bring together investment opportunities, private capital (both foreign and domestic) and experienced management.

3. To help in stimulating the productive investment of private capital, both domestic and foreign.

The IFC considers only such investment proposals whose objective is establishment, expansion or improvement of productive private enterprise which will contribute to the development of the economy of the country concerned. Industrial, agricultural, financial, commercial and other private enterprises are eligible for IFC financing, provided their operations are productive in character.

The IFC is authorised to invest is funds in any form it deems appropriate, with the exception of capital stocks and scares. It does not have a policy of uniform interest rates for its investments. The interest rate is to be negotiated in each case in the light of all relevant factors, including the risks involved and any right to participation in profits etc.

IFC makes investments only when it is satisfied that the enterprise has or will have experience and competent management and it looks to that management to conduct the business of the enterprise. It does not itself assume responsibility of managing the enterprise.

In India the IFC has so far made six investment commitments totaling over $7 million.

However, the actual working of the IFC has been rather slow. That there is great scope for its work is quite evident from its resources and investment portfolios.

It may be hoped that IFC will in future be more fully able to play a dynamic investor's role in the economic development of the poor nations.

International Development Association (IDA)

The International Development Association (IDA) was established in 1960, affiliated to the world Bank. It was started to provide finance to less developed members on a "soft" loan basis, that is on terms imposing a lower servicing charge on loans than what the conventional bank charges.

Objectives : Following are the principal objectives of the IDA:

1. To provide development finance on easy terms to less developed member countries.

2. To promote economic development, increase productivity and thus raise standards of living in the underdeveloped areas.

Thus IDA is viewed as a means of furthering the development activities of the World Bank and as a supplement to the Bank's activities. Under its charter, the IDA is to support projects which are calculated to contribute to the development of the country concerned, whether they are directly productive or not. The IDA credits would be called development credits to distinguish

them from conventional loans, and these would be repayable mostly in the currency lent rather than in the currency of the borrower. Since IDA charges nominal rates of interest on its loans, it has also been nicknamed the "Soft-Loan Window."

IDA has granted a number of credits to India for her development schemes. The grant of credits for development projects given by IDA to India has been in the nature of a continuous flow. But for the funds that have been made available by IDA to India, our development pace would have been considerably slower.

World Trade Organisation (WTO)

The World Trade Organisation (WTO) was established on 1st January 1995. Governments had concluded the Uruguay Round negotiations on 15th December 1993 and Ministers had given their political backing to the results by signing the Final Act at a meeting in Mrrakesh, Morocco in April 1994. The '*Marrakesh Declaration*' of 15th April 1994, affirmed that the results of the Uruguay Round would '*strengthen the world economy and lead to more trade, investment employment, and income growth throughout the world.*' The WTO is the embodiment of the Uruguay Round results and the successor to the General Agreement on Tariffs and Trade (GATT).

To WTO has larger membership than GATT, the present number of members stands at 135. India is one of the founder members of the WTO. How the membership benefits India is worth examining. This chapter is devoted for the purpose. Before this, it is useful to understand more about the WTO itself.

Functions

WTO is based in Geneva, Switzerland. Its functions are:

- administration and implementing the multilateral and plurilateral trade agreements which together make up the WTO;
- acting as a forum for multilateral trade negotiations;
- seeking to resolve trade disputes;
- overseeing national trade policies and
- cooperating with other international institutions involved in global economic policy-making.

The WTO Agreement contains some 29 individual legal texts-covering everything from agriculture to textiles and clothing, and from services to government procurement, rules of origin and intellectual property. Added to these are more than 25 additional ministerial declarations, decisions and understandings which spell out further obligations and commitments for WTO members.

Trade Without Discrimination

The main principle that guided the erstwhile GATT and directs the present incumbent WTO is to promote trade without discrimination. For almost 50 years, key provisions of GATT outlawed discrimination among members and between imported and domestically produced merchandise. According to Article 1, the famous 'most-favoured-nation' (MFN) clause, members are bound to grant to the products of the other members treatment no less favourable than that accorded to the products of any other country. A second form of non-discrimination known as 'national treatment', requires that once goods have entered a market, they must be treated no less favourably than the equivalent domestically produced goods. This is Article III of the GATT

Apart from the revised GATT (Known as 'GATT 1994'), several other WTO agreements contain important provisions relating to MFN and national treatment. Intellectual property protection by WTO members provides for MFN and national treatment. The General Agreement on Trade in services (GATS) requires members to offer MFN treatment to services and service suppliers of other members. Other WTO agreements with non-discrimination provision include those on rules of origin; pre-shipment inspection; trade-related investment measures and the application of sanitary and phytosantiary measures.

The case for open trade, ceaselessly sought to be achieved by the GATT and WTO, is based on pure commercial sense. All countries, including the poorest, have assets-human, industrial, natural, financial-which they can employ to produce goods and services for their domestic market or to compete overseas, means that countries prosper by taking advantage of their assets in order to concentrate on what they can produce best. Bigger markets, domestic as well as overseas, will help these countries produce more and reap economies of scales. Liberal trade policies which allow unrestricted flow of goods and services will result in expanded markets.

On the other hand, protection and perpetual government subsidies lead to bloated, inefficient companies supplying consumers with outdated and unattractive products. Ultimately, factories overseas, markets contract and world economic activity is reduced. Hence, the need for open trade is emphasized upon.

WTO, contrary to popular belief, is not a 'free-trade' institution. It permits tariffs and other forms of protection but only in limited circumstances. It is a system of rules dedicated to open, fair and undistorted competition.

Differences Between Gatt And The WTO

The WTO is not a simple extension of GATT. On the contrary, it completely replaces its predecessor and has a very different character. The major differences between the two bodies are the following:

- The GATT was a set of rules, a multi-material agreement, with no institutional foundation, only a small associated secretariat which had its origins in the attempt to establish an International trade Organization in the 1940s. The WTO is a permanent institution with its own secretariat.
- The GATT was applied on a 'provision basis' even if, after more than 40 years, governments chose to treat it as a permanent commitment. The WTO commitments are full and permanent.
- The GATT rules applied to trade in merchandise goods. In addition to goods, the WTO coves trade in services and trade-related aspects of intellectual property.
- While GATT was a multi-lateral instrument, by the 1980s, many new agreements had been added of a plurilateral, and therefore, selective nature. The agreements which constitute the WTO are almost all multilateral and thus, involve commitments for the entire membership.
- The WTO dispute settlement system is faster, more automatic and thus much less susceptible to blockages, than the old GATT system. The implementation of WTO dispute findings will also be more easily assured.

'GATT 1947' continued to exist until the end of 1995, thereby allowing time for all GATT members to accede to the WTO and permitting an overlap of activity in areas like dispute settlement. Moreover, GATT lives on at 'GATT 1994', the amended and updated version of GATT 1947, which is an integral part of the WTO Agreement and which continues to provide the key disciplines affecting international trade in goods.

The WTO Structure

The structure of the WTO is dominated by its highest authority-the Ministerial Conference. This body is composed of representatives of all WTO members. It meets atleast every two years and is empowered to make decisions on all matters under any of the multilateral trade agreements.

The day-to-day work of the WTO is entrusted to a number of subsidiary bodies, principally, the General Council, also composed of all WTO members, which is required to report to the Ministerial Conference. The General Council also convenes in two particular forms-as the Dispute Settlement Body and the Trade Policy Review Body. The former overseas the dispute settlement procedures and the latter conducts regular reviews of trade policies of individual WTO members.

The General Council delegates responsibility to three other bodies-namely the Councils for Trade in Goods, Trade in Services and Trade-Related Aspects of Intellectual Property Rights. The Council for Goods oversees the implementation and functioning of all the agreement covering trade in goods, though many such agreements have their own specific overseeing bodies. The later two Councils have responsibility for their respective WTO agreements and may establish their own subsidiary bodies as deemed necessary.

Three other bodies are established by the Ministerial Conference who report to the General Council. The Committee on Trade and Development is concerned with issues relating to the developing countries and especially, to the 'least-developed' among them. The Committee on Balance of Payments is responsible for consultations among WTO members and countries which resort to trade restrictive measures in order to cope with their balance of payments difficulties. Finally, issues relating to WTO's financing and budget are dealt with by a committee on Budget, Finance and Administration.

Each of the plurilateral agreements of the WTO-those on civil aircraft, government procurement, dairy products and bovine meat-establish their own management bodies which are required to report to the General Council.

The Final Act

Ever since the GATT was established after the Second World War, it has been striving hard (along with the World Bank and the International Monetary Fund) to achieve international economic cooperation. Towards this objective, GATT has been conducting several trade rounds (see Box 5.1), the latest being the Uruguay Round which is the most expensive. The Uruguay Round involved tow thousand, six hundred, and thirty one days of negotiations and thousands of controversies and debates. Consensus was finally arrived and the agreement, called the Final Act, was signed in April 1994 at Marrakesh, Morocco.

Box 1

GATT Trade Rounds

Year	Place	Nature of Negotiation	No. of participating Countries
1947	Geneva	Tariffs	23
1949	Annecy	Tariffs	13
1951	Torquay	Tariffs	38
1956	Geneva	Tariffs	26
1960	Geneva	Tariffs	26
1961	(Dillon Round)		
1964	Geneva	Tariffs and	62
1967	(Kennedy Round)	Anti-dumping measures tariffs, non-tariff measures and	
1973	Geneva	"framework"	102
1979	(Tokyo Round)	agreements Tariffs, non-tariff measures, rules, services,	
1986	Geneva	intellectual property	123
1993	(Uruguay Round)	rights, dispute settlement, textiles and clothing, agriculture WTO, etc.	

The major provisions of the Final Act (reportedly implemented by the WTO) release to agriculture, sanitary measures, helping least developed countries, clothing, TRIPS, GATS and anti-dumping measures. A brief description of each of these follows is given below.

Agriculture

The agreement relating to agriculture is made up of several elements which seek to reform trade in agriculture and provide the basis for market-oriented policies, thereby improving economic cooperation for importing and exporting countries alike. It establishes new rules and commitments in market access, domestic support and export competition and includes provisions that encourage the use of less trade-distorting domestic support policies to maintain the rural economy. It also allows actions to be taken to ease adjustment burdens and provides some flexibility in the implementation of the commitments. Specific concerns for developing countries are addressed including those of net-food importing developing countries and less developed economies.

Health and Safety Measures

The Agreement on the Application of Sanitary and Phytosanitary Measures concerns the application of food safety and animal and plant health regulations. It recognises government's rights to take sanitary and phytosanitary measures but stipulates that they must be based on

science, should be applied only to the extent necessary to protect human, animal or plant life or health and should not arbitrarily or unjustifiably discriminate among members where identical or similar conditions prevail.

Helping Least Development and Food Importing Countries

It is recognised that during the reform programme, least developed and net food-importing developing countries may experience negative effects with regard to giving food supplies on reasonable terms and conditions. Such countries need assistance. Therefore, a special ministerial decision calls for appropriate mechanisms related to the availability of food and the provision of basic foodstuffs in full grant from and aid for agriculture development. It also refers to the possibility of assistance from the International Monetary Fund (IMF) and the World Bank with respect toe he short-term financing of commercial food imports. The Committee on Agriculture holds responsibility to monitor the follow up to the decision.

Textile and Clothing

The objective of this agreement is to secure the integration of the textiles and the clothing sector-where much of the trade is currently subject to bilateral quota negotiations under the Multi-Fibre Agreement (MFA) into the main stream of WTO. The integration, however, shall take place in stages (see box 5.2 for the stages). Al MFA restrictions in force on 31Ist December 1994 would be carried over into the Final Act and maintained until such time as the restrictions are removed or the products integrated into WTO.

TRIPS

The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) recognises that widely varying standards in the protection and enforcement of intellectual property rights and the lack of multilateral disciplines dealing with international trade in counterfeit goods have been a growing source of tension in international economic relations. With this end in view, the agreement addresses the applicability of basic GATT, principles and those of relevant international intellectual property agreements; the provision of adequate intellectual property rights; the provision of effective enforcement measures for those rights; multilateral dispute settlement and transitional implementation arrangement.

Textiles and Clothing-Integration Stages	
• On Ist January 1995, each party integrated from the specific list in the agreement products accounting for not less than 16% of its total value of textiles and clothing imports in 1990. • On Ist January 1998, products accounting for not les than a further	17% of 1990 imports will be integrated • On Ist January 2002, products accounting for not less than a further 18% of 1990 imports will be integrated. • On Ist January 2005, all remaining products will be integrated.

The TRIPS agreement contains three parts : Part 1 sets out the provisions and principles Part 2 addresses different kinds of intellectual property rights and Part 3 concern enforcement.

GATS

The General Agreement on Trade in Services (GATS), negotiated during the Uruguay Round, is the first step of multilaterally-agreed and legally enforceable rules and disciplines ever negotiated to cover international trade in services. The agreement contains three elements : a framework of general rules and disciplines, annexes addressing special conditions relating to individual sectors (the sectors covered are : movement of natural persons, financial services, telecommunications and air transport service) and national schedules of market access commitments.

A Council for Trade in Service oversees the operation of the agreement.

Anti-dumping Measures

GATI allows members to apply anti-dumping measures. Such measures can be imposed on imports, if such dumped imports cause injury to a domestic industry in the territory of the importing members. More detailed rules governing the application of such measures-which take the form of either duties or undertakings on pricing by the exporter, were negotiated during the Tokyo Round and the same was revised in the Uruguay Round.

The WTO Agreement provides for greater clarity in the method of determining that a product is dumped. It sets out additional criteria for determining the injury caused to a domestic industry by the dumped product and the procedure to be followed in initiating and conducting anti-dumping investigations. Rules on implementation and duration of anti-dumping measures are also part of the agreement. In addition, it clarifies the role of dispute settlement panels in disputes relating to anti-dumping actions taken by he WTO members.

Implications for India

India was one of the 76 governments that became a member of the WTO on its first day. Divergent views have been expressed in support and against our country becoming a member of the WTO.

Arguments for Joining WTO

1. Ours is one of the few developing countries which has succeeded in implementing liberalisation programmes. Over three-quarters of WTO members are developing countries in the process of economic reform from non-market systems. These countries have chosen to join WTO after careful deliberations in their respective countries. Obviously, they have perceived economic gains for themselves by becoming members. India should not be an exception.

The criticism that the WTO exists only for industrialised countries is not all that valid. During the seven-year course of the Uruguay Round-between 1986 and 1993, over 60 developing countries implemented trade liberalisation programmes. Some did so as part of their accession negotiations to GATT while others acted on an autonomous basis. At the same time, developing countries and transition economies took a much more active and influential role in the Uruguay Round negotiations than in any previous round.

With the end of the Uruguay Round, developing countries showed themselves prepared to take on most of the obligations that are required of developed countries. They were, provisions-particularly so far the poorest, 'least developed' countries. In addition, a ministerial decision on measures in favour of least-developed' countries. In addition, a ministerial decision on measures in favour of least-developed countries give extra flexibility to those countries in implementing WTO agreements; calls for an acceleration in the implementation of market access concessions, affecting goods of export interest to those countries; and seeks increased technical assistance for

them. Thus, the value to development of pursuing open market policies, based on WTO principles, is widely recognised and appreciated. So is the need for some flexibility with respect to the speed at which these policies are pursued.

2. The real importance of the WTO to India lies in the role that a dynamic export industry can play in the country's development. Both in terms of job creation, skill development and technological evolution, an opening up to the outside world is essential. The semi-autarkic earlier system resulted in a major leap forward in the development of indigenous industry and agriculture. But it lacked an internal dynamic. There were no incentives to improve technology and productivity. In short, it was closed system that left no room for evolution. It is only by forcing industries to sell outside the country and compete for export markets that they will have an incentive to evolve.

There is another reason why India needs to search for external markets. This is the crucial dependence on imports for survival. The country has for long believed that it is a self-sufficient independent economy. But, infact, from petroleum and fertilizers to capital goods, raw materials and life saving drugs, the Indian economy is vitally dependent on imports. As long as it dependent on imports, it needs to export to pay for these imports.

As long as India needs to export and import, it makes for more sense to be part of the multilateral trading system than stay out of it. That is why even country like China, despite its fiercely-guarded sovereign and its status as the world's last major socialist power, has been desperately trying to get into the WTO.

3. By being a member of the WTO, India can benefit from the International Trade Centre jointly operated by the WTO and the United nations, the latter acting through UNCTAD (the UN Conference on Trade and Development). The International Trade Centre was earlier set up by GATT in 1964 at the request of the developing countries to help them promote their exports.

The Centre responds to requests from developing countries for assistance in formulating and implementing export promotion programmes as well as import operations and techniques. It provides information and advice on export markets and marketing techniques, and assists in establishing export promotion and marketing services and training personnel required for these services. The Centre's help is freely available to the least developed countries.

4. Estimates have been made by the World Bank, OECD and the GATT Secretariat, which show that the income effects of the implementation of the Uruguay Round package will add between 213 to 274 billion US dollars annually to world income. The GATT Secretariat's estimate of the overall trade impact is that the level of merchandise trade in goods will be higher by 745 billion US dollars in the year 2005, than it would otherwise have been. The GATT Secretariat further projects that the largest increases will be in the areas of clothing (60%), agriculture, forestry and fishery products (20%) and processed food and beverages (19%). Since India's existing and potential export competitiveness lies in these product groups, it is logical to believe that India will obtain large gains in these sectors. Assuming that India's market share in world exports improves from 0.5% to 1%, and that we are able to take advantage of the opportunities that are created, the trade gains may conservatively be placed at 2.7 billion US dollars extra exports per year. A more generous estimate will range from 3.5 to 7 billion US dollars worth of extra exports.

5. Another advantage of WTO membership stems from the fact the India (any member-country for that matter) is saved from entering into multiple bilateral trade negotiations with other countries. In the absence of WTO, India, for example, would be required to enter into as many bilateral agreements as the country desires to have trade links. With the WTO membership, our country

has the advantage of having trade links with all other member countries without the need for bilateral agreements. The role of WTO is like that of a telephone exchange in this context.

6. WTO provides for a multilateral set of rules which are beneficial to a country like ours. Such rules provide grater protection against bilateral pressure or against trade restrictions that cannot be justified under a multilaterally agreed framework. Further, the system of multilateral rules imparts greater predictability and stability to the international trading system. If the system of rules is not followed, the ensuring chaos and uncertainty will result in a trading system dominated by might rather than right.[1]

7. There are several areas in the Uruguay Round package the relate to market access. The more important ones are tariffs, textiles and agriculture. India's position in all these sectors is advantageous to her and the provisions are favourable to the country

Arguments Against Membership

Arguments against India's membership in WTO are equally strong. The major ones are stated below:

1. The claim that the world trade would increase substantially and that India's exports will expand considerably is not acceptable to many. The estimates relating to world trade (as shown above) may prove to be suspect. Flow of goods and services across the globe depends not much on trade restrictions but on factors like infrastructure, political environment, technology assured supply of exportable goods and quality consciousness of producing countries. It may, be observed that India is short, to some extent, in all these requisites. Removal of trade barriers will not guarantee expansion in world trade.

2. India and other developing countries have blindly walked into the trap laid by the developed countries. WTO, alongwith IMF and World Bank, represents the interests of developed countries. Rhetoric and platitudes notwithstanding, WTO will not ensure open trade for goods produced by developing countries. It ensure necessary climate for domination and hegemonisation by the consortium of the capitalist countries. Infact, the Uruguay round negotiations were motivated by the needs of the United States and Western Europe to discover new markets for their industries, especially in sectors like services and finance.

3. It is claimed that there are several areas in the Uruguay Round package that relate to market access and India would, therefore, gain substantially in the long run because of the market access. Figures demonstrating the gains from market access are do doubt praiseworthy. But the gains, if any, in tariff concessions or removal of quotas could easily be lost because of the new rules and disciplines and potential for trade harassment.

4. The worst fears expressed about the WTO agreement relate to the steep hike in prices of drugs and agricultural inputs. Table 1 shows how select drug prices will be costlier across the globe

Box 1 gives the balance sheet of the WTO for India

International Comparison of Selected Drugs Prices

Table 1

DRUG	INDIA	PAKISTAN	TIEMS COST LIER*	USA	TIES COST LIER*	UK	TIMES COST LIER*
Anti- Bacterials	73.04 33.61	151.26 161.94	2.07 4.82	192.39 613.77	2.63 18.26	178.77 290.88	2.45 8.65

Ofloxacin Norfloxacin Tobramycin	16.43	150.98	9.13	387.50	23.58	86.66	5.27
Anti-inflammatory Diclofene	5.67	72.00	12.70	234.74	41.40	110.29	19.48
Anti-Ulcerants Ranitidine	30.03	336.00	11.57	729.93	25.14	553.88	19.08
Cardiovasculars Atenolol Diltiazem	7.86 19.29	111.78 96.00	14.22 4.98	223.85 161.84	28.48 8.39	118.76 90.90	13.11 4.73
Anti-Viral/Fungal Ketaconazole	43.00	286.40	6.66	660.36	15.36	287.85	6.69
Anti-Histamine Aztemizole	6.00	156.00	26.00	427.74	72.29	115.14	19.19
Anti-Anxiolytics Buspirone	4.05	115.73	28.58	147.62	36.45	193.92	47.88
Anti-Cancer Mitoxantrone vincreistine	446.35 28.00	N.A. 416.98	- 14.48	14876.65 1047.26	33.34 36.36	9116.06 624.79	20.43 21.69
Anti Depressant Pluoxetine	29.00	798.40	27.53	507.60	17.50	647.21	22.32

Conclusion

All things considered, it may be concluded that the WTO membership will prove advantageous to us in terms of the global market thrown open to our goods and services. To take advantage of the world market, we must improve the quality of our goods and services, cut down costs and wastages, and improve our competitive strength. Only then we will be in a stronger position to sell our products abroad and survive in the competitive global market.

Agenda for The Next Millennium

The agenda for the next millennium before the World Body is on the following lines :

1. Agricultural products
2. Services
3. Tariffs on industrial products.
4. TRIPS, textiles, and anti-dumping duties and subsidies.
5. New issue-foreign investment, competition policies, transparency in government procurement, e-commerce.
6. Non-trade issues linkage between trade and environment, linkage between trade and labour.

Items 1 to 4 have already been covered under previous negotiations but require reviews, but five and six are new areas.

The agenda is heavy and the member countries are sharply divided over the inclusion or exclusion of items for finalization at the proposed ministerial conference slated to be held at Seattle (US). The Seattle Conference ended in a fiasco as member countries clashed with each other on several issues.

India's Commitments to WTO

1. As a member of the WTO, India has bound about 67% of its tariff lines whereas prior to the Uruguay Round, only 6% of the tariff lines were bound. For non-agricultural goods, with a few exceptions, ceiling, bindings of 40% ad valorem on finished goods and 25% on intermediate goods, machinery and equipment have been undertaken. The phased reduction textiles, where reduction will be achieved over a period of 10 years, India has reserved the right to revert to duty levels prevailing in 1990, if the integration process, envisaged under the Agreement on Textiles and Clothing, does not materialise in full or is delayed. Under the Agreement on Agriculture, except for a few items, India's bound rate ranges from 100% to 300% and no commitments have been made regarding market access, reduction of subsidies or tariffs.

2. Quantitative Restrictions (QRs) on imports are currently being maintained on balance of Payments (BoP) grounds for about 2,300 tariff lines at the eight digit level. In view of the improvement in the BoP, the Committee on BoP restrictions has asked India for a phase out plan for the QRs. Based on presentations before this committee and subsequent consultations with trading partners, an agreement was reached with these countries, except USA, to phase out the QRs over a period of six years beginning 1997.

3. The Government of India is committed to amend the Patents Act for meeting its obligations under the TRIPs Agreement. The ruling of the two WTO Dispute Settlement Panels following the complaints made by the USA and the European Union that India had failed to meet its commitments under article 70.8 (requiring the setting up of the Mail Box System) and Article 70.9 (granting of Exclusive Marketing rights) made it obligatory for the Government.

Balance Sheet for India	
Advantages • benefits from reduction of tariffs on the products of export interest to India. • Improved prospects for agricultural exports as a result of likely increase in the world prices of agricultural products due to reduction in domestic subsidies and barriers to trade. • Likely increase in the export of textiles and clothing due to the phasing out of the MFA by 2005. • Advantages from greater security and predictability of the international trading system due to the revamped dispute	• We will lose policy options in several areas because of - The extensive bindings undertaken by us. - Prohibition of certain types of subsidies and making certain other types actionable. - Giving up the option of granting process patents only in some sectors. - Limitations put on our ability to apply restrictions on balance-of-payments ground. • Increased outflow of foreign exchange due to commitments undertaken in the field of TRIPS, TRIMs and services. • Technological dependence on foreign firms

settlement procedures, and the agreements on Safeguard, Subsidies and Anti-Dumping Measures.

Disadvantages

- Tariff reductions on goods of export interest to India are very small. On the other hand, there will be erosion of the preferences enjoyed by India and India will most probably be graduated out of the generalised System of Preferences (GSP).
- Meagre prospects of increase in agricultural exports due to the very limited extent of agricultural liberalisation.
- There will be hardly any liberalisation of our textile exports during the next 10 years, with most of the liberalisation expected to come at the end of this period.
- We will be put under tremendous pressure to liberalise our services industries.
- There will be only marginal liberalisation to the movement of labour services in which we are competitive.

will increase as the R & D required to take advantage of the Uruguay Round may not be undertaken on an adequate scale due to paucity of resources.

- Concentration in market structure whereby only a few large firms or transnational corporations may benefit and smaller and tiny firms may disappear.
- Increasing intrusion in our sovereign domestic space in TRIPs, TRIMs, Services and Agriculture.
- The Uruguay Round had paved the way for similar other intrusions in future through linkages between trade and environment, trade and labour standards, and a new regime for the treatment of foreign capital.
- Trend towards neo-protectionism in developed countries against our exports.
- Possibility of cross-retaliation against our report of goods and services.[2]

of India to make appropriate amendments to the Patents Act 1970 by April 19, 1999. Accordingly, the government introduced a Bill to amend the Patents Act during the 1998 winter session of Parliament which was passed by the Rajya Sabha on December 23, 1998. This was followed up by a President Ordinance on January 8, 1999, bringing the domestic legislation in conformity with India's obligations under Articles 70.8 and 70.9 of the TRIPs Agreement. The Patents (Amendment) Bill was finally approved by the Parliament on march 13, 1999.

4. Under TRIMs, India has already notified the TRIMs maintained by it. These have to be eliminated by January 1, 2000. Under the Information Technology Agreement (ITA), tariffs have to be brought down to zero on 95 lines by the year 2000, on 4 tariff lines by 2003, on 2 tariff lines by 2004 and on balance 116 tariff lines by the year 2005. India is also committed, under the Agreement on technical Barriers to Trade and Sanitary and Phytosanitry measures, to establish and administer national standards and technical regulations, keeping in view the basic precepts of MFN, National Treatment and transparency.

5. Under the General Agreement on trade in Services (GATs), India has made commitments in 33 activities. Foreign service providers will be allowed to enter into these activities. According to the Government, the choice of the activities has been guided by considerations of national benefit (viz., the impact on capital inflows, technology and employment).

6. India's legislation on customs valuation, the Customs Valuation Rules, 1998, has been amended to bring it into conformity with the provisions of the WTO Agreement on implementation of Article VII of GATT 1994 and the Customs Valuation Agreement.

Review of Performance

During the last four years of its existence, the WTO has proved to be totally different from its predecessor-GATT. GATT was toothless but WTO has been armed with adequate power by the way disputes between trading countries have been settled. It is to the credit of the WTO that even the mighty US was brought to book on more than one case. Secondly GATT negotiating rounds took place once in a decade or so. But at Singapore, just two years after the conclusion of the Uruguay round, the WTO virtually concluded an information technology agreement, and launched studies on investment, competition policy, transparency in government procurement and trade facilitation. Thirdly, the old leisurely pace of GATT is gone. Instead, there is enormous pressure to compress into the next few years what used to take decades to complete. Fourthly, the agenda of the WTO is expanding and the US is trying to push everything possible under the ambit of the WTO. This would facilitate smooth flow of trade across the globe. Finally, the most favoured nation rule is advantageous to all member countries. This means that even when the US uses its muscle to take advantage of the Japanese market for beef and autoparts, the benefits are available not only to the US but for all members including India.

However, liberalism is ultimately about freedom of choice, and nobody can argue that such freedom is expanded by bringing new items onto the WTO agenda and forcing these down unwilling throats under the threat of trade retaliation. The US argues that a multilateral agreement on investment will be good for developing countries, even those opposed to it, since it will make them more attractive foreign investors. But the logic of this argument itself is that countries which fail to liberalise foreign investment rules will suffer any way, so why subject them to further penalties through trade sanctions? WTO serves a major purpose as a rule-making body of trade liberalisation. It should not be expanded into a sort of world government covering every economic.