

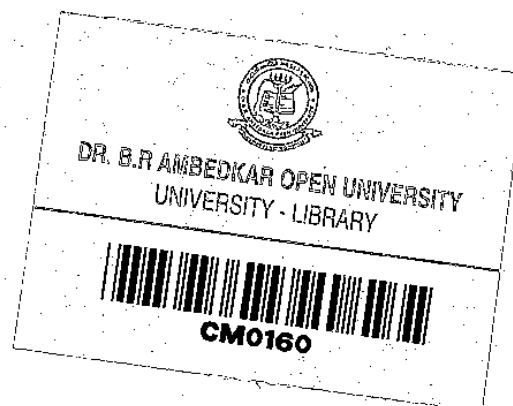


**DR. B.R. AMBEDKAR  
OPEN UNIVERSITY**

**MBA-1 :  
BUSINESS  
ENVIRONMENT**

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CM-0160  
31-3-97

DR. B.R. AMBEDKAR OPEN UNIVERSITY

**COURSE DESIGN AND PREPARATION TEAM**

Prof. J. Satyanarayana (Editor)  
Professor Emeritus  
Department of Commerce  
Osmania University  
Hyderabad

Prof. V. Nageswaran  
Department of Management &  
Entrepreneurship  
Anna University  
Madras

Prof. D. Amarchand  
Professor and Head  
Department of Commerce  
University of Madras  
Madras

Prof. G. Prasad  
Department of Commerce  
& Business Administration  
Nagarjuna University  
Nagarjuna Nagar  
Guntur

Prof. S. Kishan Rao  
Department of Economics  
Osmania University  
Hyderabad

Prof. V. Venkaiah  
Department of Business Management  
Dr. B.R. Ambedkar Open University  
Hyderabad

**Editor (Language) :**

Prof. G. Sambasiva Rao  
Department of English  
Dr. B.R. Ambedkar Open University  
Hyderabad

**Cover Design :** Sri M. Chandra Sekhar  
Artist - cum - Designer  
Dr. B.R. Ambedkar Open University, Hyderabad

**Printer's Name :** Boys Town Industrial Training Centre,  
Jahanuma, Hyderabad

# BLOCK - I: INTRODUCTION TO BUSINESS ENVIRONMENT

Now-a-days, the organisation and management of any business enterprise is controlled and conditioned by the environment where it exists. Present day's environment is consisting a number of complex factors and forces, which are becoming more and more dynamic.

In this context, an attempt has been made in this block to introduce you the subject of environment of business of India. The environmental factors have been divided broadly into three categories, viz., economic, political-legal, and socio-cultural and are discussed in four units. Economic environment of business in India is discussed in first unit, whereas the second unit is devoted for discussion on political and legal environment. The socio-cultural environment is analysed in third and fourth units.

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# UNIT - I : ECONOMIC ENVIRONMENT OF BUSINESS

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## Objectives

After studying this unit, you should be able to :

- identify the components/factors in the economic environment relevant to a business;
- examine the key-components/significant forces contributing to the economic environment like budget of the Government, its financial position, external trade and international developments; and
- assess the overall economic environment of business in India.

## Structure

- 1.1. Introduction
- 1.2 Business Environment and its Constituents
- 1.3 Economic Issues under the Directive Principles of State Policy
- 1.4 Growth Rates of the Economy
- 1.5 Budgetary Position
- 1.6 Indebtedness - Internal and External
- 1.7 Exports and Imports
- 1.8 Deficit and Imbalance
- 1.9 Industrial Growth Rate
- 1.10 World Trade Organisation
- 1.11 Changing World Economic Scenario
- 1.12 Summary
- 1.13 Further Readings
- 1.14 Self-Assessment Test

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## 1.1 INTRODUCTION

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Just as human beings live in a climate, business operates in a certain environment. This environment is complex, changing, and not easily predictable. The environment sends out signals of threats as well as opportunities to the business. The business must be on the look out for the changes in the environment and adapt itself to survive and grow. The business responds to environmental forces and by this interaction process, the business can also influence the constituents of environment. The business, for example, designs and produces goods/services to meet the norms of a particular culture. But in course of time business, by its innovations and effective advertisement appeals may be able to change at least a part of those cultural norms. It is for this reason that an understanding of the environment is worth an attempt.

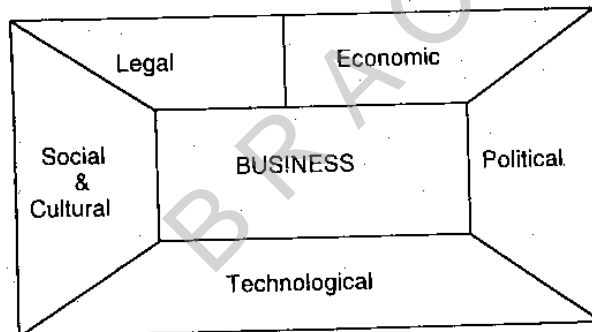
Environmental factors can only be described but one can be neither precise by measuring nor certain about the complexity. In fact understanding or assessment depends on how one perceives the environment - the threats and opportunities in it. Besides, the future course of the environment remains uncertain. All these features make the study articulate even though less precise.

One should be alert to the environmental forces. It also means, say in the case of a business leader, to keep widening the horizon of awareness, observing and listening to the signals from the environment. For example even at the time when the Government of India started a discussion on communications policy, MNCs from Japan and USA started advertising on the Indian TV screen!

## 1.2 BUSINESS ENVIRONMENT AND ITS CONSTITUENTS

Environment of a business may consist of several things - visible and non-visible, internal and external, immediate and distant elements. Considering the components or forces in the external environment, it is conventional to classify them into Economic, Legal, Technological, Political, Social and Cultural components. Diagrammatically this can be presented as follows :

Fig. 1  
Constituents of the External Environment of a Business



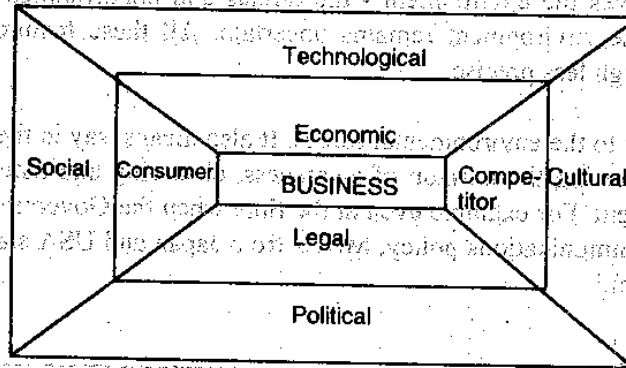
(Note : Economic Environment may also include the competitors, suppliers and the consumers, depending on one's purpose of analysis.)

Each one of these components has a direct or indirect effect on the functioning of the business. A new legislation, tax policy, change of the ruling party, an invention and behaviour of social or cultural groups - each one is meaningful to some business if not to all businesses.

The intensity of the influence of these forces on the environment may differ from firm to firm and one can present this idea in a graphic form as follows :

Fig. 2

**Forces in the External Environment - Differing-Intensity**



As may be seen from Fig. 2 the economic and legal forces on the one hand and the competitors as well as consumers on the other, are very close to a certain business. These forces in the environment are often in a state of flux and send out signals about the change. If the business can decode the signals - by scanning the environment and analysing it in a systematic way, it will be better prepared for its future.

The study of economic environment may be taken up first, for many firms this has more direct impact. The environment with its implications for the economy is examined under economic environment. So, the economic goals of the Government, the taxes, the trade etc., are the most important segments of the economic environment. These may now be considered one after another.

### 1.3 DIRECTIVE PRINCIPLES OF STATE POLICY

The economic environment in India emerges out of the political and legal foundation laid by the Constitution of India. The Constitution makers might have adopted a capitalistic or socialistic economic frame for our country and if they had done so, a different economic environment might have prevailed now. They were not rigid about any such ideology. But, the Constitution recommended certain "Directive Principles of State Policy" to be adopted for a new social and economic order. These principles got evolved during discussions in the course of the freedom movement, and were drawn from the experience of industrially advanced countries. The Directive Principles were to be considered "fundamental in the governance of the country and it shall be the duty of the State to apply these principles in making laws". However, the Directive Principles do not lay down the process of economic development to be followed even in broad terms. All that is said in this respect is that:

"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. Further, concentration of wealth and means of production to the common detriment should be avoided and the ownership and control of material resources of the community are to be distributed as would subserve the common good".

The concept of economic justice stated in these principles is subject to different interpretations as it is stated in broad terms only and no specific steps are stated to secure it. Thus, though planning was accepted in principle, the nature and type of planning or

economic policy in general were shaped by different sources, agencies and people over a period of time.

"Economic Justice" can be provided by State regulations. The Public Distribution System for some essential commodities, distribution of credit through government owned banking system, provision of primary education, health care etc., were done by the government on a fairly large scale so that "Economic Justice" could be rendered. No one questions the need for economic justice but questions have arisen about the need for monopoly of the government in providing them - since such monopolies have made the service too costly (to the Public Exchequer) and not available to many.

The Directive Principles have no legal compulsion and as such, their violation cannot be challenged in a court as is possible in the case of fundamental rights guaranteed by the same Constitution. There are also no physical targets to be fulfilled, no time span, no financial commitment but there is only a moral commitment on the part of the government to implement the policy in word and spirit.

#### Activity - A

to describe the changes that are taking place in a particular  
ment

Change in the environment	Changes in the Business
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roduction of satellite T.V.	
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economic justice"? What is "social justice"? Try to describe the  
are practised. Are they different from "justice" without the

**TABLE 1.1  
KEY INDICATORS**

	1991-92	1992-93P	1993-94P	1994-95P	1991-92	1992-93P	1993-94P	1994-95P	
	ABSOLUTE VALUES				PERCENT CHANGE OVER PREVIOUS YEAR				
	1	2	3	4	5	6	7	8	9
<b>Gross National Product</b> (Rs. thousand crore)									
At current prices	542.0	615.8	695.3 Q		15.2	13.6	12.9 Q		
At 1980-81 prices	209.8	218.7	228.7 Q	240.9 E	0.6	4.2	4.6 Q	5.4 E	
<b>Gross Domestic Product</b> (Rs. thousand crore)									
At current prices	552.0	627.6	707.1 Q		15.5	13.7	12.7 Q		
At 1980-81 prices	214.2	223.4	233.0 Q	245.3 E	0.9	4.3	4.3 Q	5.3 E	
<b>Agricultural</b> <b>Production (1)</b>	145.5	151.5	154.8	158.2 A	-2.0	4.1	2.2	2.2 A	
<b>Foodgrain production</b> (million tonnes)	168.4	179.5	182.1	185.0 A	-4.5	6.6	1.4	1.6 A	
<b>Industrial</b> <b>Production (2)</b>	213.9	218.9	227.8	232.8 (3)	0.6	2.3	4.1	8.0 (3)	
<b>Electricity generated</b> (Billion KWH)	287.0	301.1	323.5	257.9 (8)	8.6				
<b>Wholesale Price Index (4)</b>	217.8	233.1	258.3	284.3 (5)	13.1				
<b>Exchange Rate</b> a b (Rs / US \$)	24.65	28.96	31.37	31.38 (8)	27.1				

Note : Gross National Domestic Product figures are at factory cost.

A - Anticipated; P - Provisional; Q - Quick Estimates; E - Advance

a - Percent change indicates the rate of depreciation of the Rupee

b - Composite rate from March 1992 to February 1993.

1. Index of agricultural production (Principal crops) with base 1981-82 = 100.
2. Index of Industrial production 1980-81 = 100.
3. Average index for April-October, 1994
4. Index with base 1981-82 = 100. Percentages relate to change over the year.
5. As on February 18, 1995 for 1994-95 and for the last two years.
8. April-January 1994-95.
9. As on February 13, 1995 for 1994-95.
10. As on January 20, 1995.

been increasing at about 10-11% which is expected to come down only after production level goes up still further. The external value of the Indian Rupee seems to have depreciated very much but further depreciation has been halted which shows a comparatively stronger position in the last year of Table 1.1.

## 1.5 BUDGETARY POSITION

The budget of the government indicates the magnitude or the financial activities of the government, the composition of the government's income and expenditure. A summary of the latest budget is therefore presented in Table 1.2. The Revised Budget Estimates (of the Central Government) for 1994-95 had placed the total expenditure at Rs. 1,62,272 crore and the budget estimate for 1995-96 Rs. 1,72,151 crore.

Net tax revenues accruing to the centre were estimated at about Rs. 65,000 crore and Rs. 74,500 crore in 1994-95 and 1995-96, respectively.

External loans, net of repayment, are placed at Rs. 3,947 crore compared to the Budget Estimates.

The fiscal deficit was originally budgeted at Rs. 54,915 crore or six per cent of GDP. The fiscal deficit in the revised estimates comes to Rs. 61,035 crore which is about 6.7 per cent of GDP. However, nearly three quarters of this deterioration is due to the extraordinary rise in small saving collections, 75 per cent of which is passed on to the States. Thus the bulk of the deterioration in the fiscal deficit is not on account of increased expenditure of the Central Government.

Various receipts if examined as percentage of the total receipts during this period are as follows :

1.	Excise Duty	21 %
2.	Customs Duty	15 %
3.	Income-tax	7 %
4.	Corporate Income Tax	8 %
5.	Other taxes	1 %
6.	Non-tax revenue	13 %
7.	Non-debt Capital Receipts	7 %
8.	International Borrowings	24 %
9.	External Borrowings	2 %
10.	Borrowings from Reserve Bank of India (91 days treasury bills)	2 %
		100 %

**TABLE 1.2**  
**BUDGET OF THE CENTRAL GOVERNMENT AT A GLANCE**

	1993-94 Actuals	1994-95 Budget Estimates	1994-95 Revised Estimates	1995-96 Budget Estimates
(in crores of rupees)				
1. Revenue receipts	75453	86084	88770	100787
2. Tax revenue (net Centre)	53449	62742	64988	74374
3. Non-Tax revenue	22004	23342	23782	26413
4. Capital receipts	55440	59615	67502	66364
5. Recoveries of loans	6191	6700	6700	6730
6. Other receipts	- 48	4000	5767	7000
7. Borrowings and other liabilities	49297	48915	55035	52634
8. Total receipts (1 + 4)	130893	145699	156272	167151
9. Non-Plan expenditure	98998	105117	113511	123651
9.1 On revenue account on which	83545	90749	93965	106998
9.1.1 Interest payments	36695	46000	44000	52000
9.2 On Capital account	15453	14368	19546	16653
10. Plan expenditure	42855	46582	48761	48500
10.1 On revenue account	24624	28062	28937	29330
10.2 On capital account	18231	18520	19824	19170
11. Total expenditure (9 + 10)	141853	151699	162272	172151
12. Revenue expenditure(9.1+10.1)	10169	118811	122902	136328
13. Capital expenditure (9.2 + 10.2)	33684	32888	39370	35823
14. Revenue deficit (1 - 12)	32716	32727	34132	35541
15. Budgetary deficit (8 - 11)	10960	6000	6000	5000
16. Fiscal deficit [(1+5+6)-11=7+15]	60257	54915	61035	57634
17. Fiscal deficit adjusted for small savings loans to State and Union Territory Govts.	55257	49763	51386	50634
18. Primary deficit (16 - 9.1.1)	23562	8915	17035	5634

## 1.6 INDEBTEDNESS (INTERNAL AND EXTERNAL)

Government borrows both from within the country and from external sources. Both the borrowings affect the level of inflation in one way or the other but the borrowings add to the expenditure of the Government by way of interest payments or debt servicing. The total internal public debt of the Union Government as on March 31, 1993, was Rs.1,99,100 crore of which 30.3 per cent was to back currency notes.

The overall debt position is provided in Table 1.3.

**TABLE 1.3**  
**SOME ASPECTS OF THE PUBLIC DEBT OF THE CENTRAL GOVERNMENT**

	Rs. in Crores As on 31st March 1993
1. The rupee debt of the Union Government under the consolidated fund :	199100
Market loans	81679
Treasury Bills and connected securities issued to Reserve Bank	91614
Treasury Bills etc. held by others	25807
2. The rupee debt under the public account (of this bearing interest = 149907)	160554
3. Total rupee debt	359654
4. External debt at historical cost	42269
5. Total Government debt at historical cost	401923
6. Interest paid in 1992-93	31075
(On Market loans (rupee debt) 8147)	
(On External debt 3529)	

Source : The CAG Report for 1994.

The forex reserves also indicate the economic strength of a nation. Table 1.4 provides a historical perspective of forex reserves from 1950-51 onwards. The figures in Table 1.4 show the increase in reserves since 1992-93 - even though the composition of the reserves not be ignored while judging this reserve position.

**Activity - C**

How are the growth rates of agriculture and industry in the economy during the last four years? What transformations have taken place in your region or state during the last five years?

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How does the growth rate of National Domestic Product compare with the growth rate of industry during the last four years? Which industry has recorded the fastest growth in your region?

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**TABLE - 1.4**  
**FOREIGN EXCHANGE RESERVES**  
**HISTORICAL PERSPECTIVE**

(US \$ million)

Years	Forex Reserves	Import cover 2 (No. of months)	Current 3 payments cover 2 (No. of months)
1950-51	1614	16.8	14.6
1951-56	1648	12.2	10.6
1960-61	390	2.0	1.7
1965-66	383	1.6	1.3
1970-71	584	2.9	2.2
1975-76	1657	3.3	2.9
1980-81	5850	4.5	4.0
1985-86	5972	4.2	3.5
1990-91	2236	1.0	0.8
1991-92	5631	3.3	2.3
1992-93	6434	3.4	2.5
1993-94	15068	7.5	5.3
4 1994-95	19604	8.2	5.9

1. Excluding gold and SDRs.
2. Based on foreign exchange reserves of respective year and levels.
3. Current payments cover is estimated on the basis of the aggregate of merchandise imports and outflows on account of invisible.
4. End January 1995.

**Activity - D**

Give examples of Revenue Receipts and Capital Receipts in the Budget.

**Capital Receipts**

**Revenue Receipts**


What are the implications of a budgetary deficit? (Refer to books on "Public Finance")

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How much of a rupee income to the Union Government consists of all taxes? How does it compare with your State Government?

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How much of a rupee receipt by the Union Government consists of borrowings? How does it compare with your State Government?

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What is meant by cost of debt servicing?

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Referring to relevant literature, explain the meaning of 'debt trap'.

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## **1.7 EXPORTS AND IMPORTS**

International Trade can be the 'engine' of the growth for a country. When opportunities for import and export are open, all countries try to import goods which were not available locally. Imports are available at competitive prices. Similarly goods that are available in surplus and cannot be absorbed in the domestic market can be exported. In both ways production and trade, increase and result in the growth of employment and income in the nation. However, maintaining a balance between imports and exports is an act of prudence because, ultimately a country has to pay for its imports only through its exports. The trade deficit (excess of imports over exports) of India in 1990-91 was estimated at Rs.10,640 crore.

The economic environment can be better understood if we look at the composition of Exports and Imports which are provided in Table 1.6 and 1.7 respectively. A summary of top ten products exported from India given in Table 1.5 shows the trends in the composition of exports.

You should note that the change in composition of exports indicates that the "manufacturers" are taking a higher proportion of our exports, as also the increase in the "value added" exports. The term - value added - indicates the extent to which we add value to the raw material by processing it and manufacturing finished products. Higher

composition of value added exports is indeed a welcome development. At the same time, you should also note that our exports are concentrated in a few products only. In 1990-91, only ten products accounted for almost 70% of India's exports.

The striking feature of India's exports has been the distinct change in its composition. Over the last two decades, the share of eight major traditional products in India's total exports has gone down from 42% in 1970-71 to just 16% in 1993-94. During the same period, the share of seven major non-traditional products got doubled from 31% in 1970-71 to 63% in 1993-94.

If we consider all the traditional and non-traditional products we can observe that the ratio of traditional versus non-traditional exports has changed drastically from 72:28 in 1965-66 to 16:84 in 1986-87.

The other significant change in the composition of the exports is in the extent to which the individual products contributed to the total exports. If we take a span of four decades, we find that in 1950-51, the top three products were Cotton Fabrics, Jute Manufactures and Tea, the traditional trio, accounted for 51.3% of India's exports. In 1993-94 these three items accounted for less than 10%. The first three products in order of importance in 1993-94 were Gems & Jewellery, Engineering Goods and Readymade garments which accounted for 40.1% of total exports.

You should note that the change in composition indicates that the "manufactures" are taking a higher proportion of our exports, as also the increase in the "value added" exports. The term - value added - indicates the extent to which we add value to the raw material by processing it and manufacturing finished products. However, exports are concentrated in a few products only. In 1993-94, only ten products accounted for almost 74.2% of India's exports.

## **DIRECTION OF EXPORTS**

The top five countries which figured in our exports prominently over the last decade have been - the USA, Russia, Japan, the UK and West Germany. These countries together took 42.7 % of India's exports in 1993-94. These five countries took more or less around half of total exports in earlier years as well. However, the relative importance of these countries has changed over the years. Here too, heavy concentration of exports in a few countries can be observed. As a result of this concentration, the disintegration of USSR later dealt a heavy blow to the Indian exports. Other important trading partners of India around 1990 were Belgium, United Arab Emirates, Saudi Arabia, Hong Kong, Italy and France.

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## **1.8 DEFICIT AND IMBALANCE**

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Budgetary deficit not provided by new borrowings or taxes are normally filled by increased (currency) note issues and this can add to the money supply with its own multiplier effect. The budgetary deficits of the recent past are given in Table 1.8.

Another deficit which must be kept in mind is the trade deficit or Balance of Payments position. The trade deficit (excess of imports over exports) was about Rs.10,640 crore in

1990-91 - the Gulf Crisis at that time necessitated higher import and loss of export markets and remittances.

During 1990-91 the foreign exchange reserves got reduced to Rs.1382 crore net - of revaluation of gold. This was despite borrowings from the IMF (Rs.3,334 crore). A further erosion of Rs.2,073 crore occurred between April-June 1991 notwithstanding considerable compression in imports. The new government took office on June 21, 1991 and two remedial actions (a) devaluing the external value of the rupee by about 18% in July 91 (taking it further to 23% in 1992); and (b) reduction of the fiscal deficit which brought to halt a serious imbalance in the financial position of the economy.

**TABLE 1.5**  
**TOP TEN PRODUCTS EXPORTED FROM INDIA**

1950-51	% of Total Exports	1970-71	% of Total Exports	1990-91	% of Total Exports	1993-94	% of Total Exports
1. Cotton Fabrics	19.3	1. Jute Manufacturers	12.4	1. Gems & Jewellery	16.1	1. Gems & Jewellery	17.9
2. Jute Manufacturers	18.8	2. Iron Ore	7.6	2. Readymade Garments	12.3	2. Engg. Goods	13.6
3. Tea	13.2	3. Engg. Goods	7.5	3. Engg. Goods	11.9	3. Readymade Garments	11.6
4. Leather & Manufactures	4.3	4. Leather & Manufactures	5.7	4. Leather & Manufactures	7.9	4. Chemicals	8.1
5. Spices	4.1	5. Cotton Fabrics	4.9	5. Chemicals & Allied products	7.2	5. Cotton fabrics	6.9
6. Tobacco	2.2	6. Tea	3.7	6. Tea	3.3	6. Leather & Manufactures	5.8
7. Cashew kernels	1.4	7. Cashew kernels	3.4	7. Iron Ore	3.2	7. Marine products	3.6
8. Engg. goods	0.6	8. Gems & Jewellery	3.0	8. Marine products	2.9	8. Oil cake	3.3
9. Marine products	0.4	9. Spices	2.5	9. Cotton	2.6	9. Iron Ore	1.9
10. Coffee	0.2	10. Tobacco	2.0	10. Oil cake	1.9	10. Tea	1.5
Top Ten together	64.5	Top Ten together	52.7	Top Ten together	69.3	Top Ten together	74.2

Source : RBI Reports on Currency and Finance, R.B.I. Bulletins

**TABLE 1.6**  
**INDIA'S EXPORTS BY COMMODITY GROUP**

(US \$ MILLION)

Commodity Group	1992-93	1993-94	Apr-Sep 1993-94	Apr-Sep 1994-95	Apr-Sep 1993-94	Apr-Sep 1994-95
					Per cent change	
1	2	3	4	5	6	7
I. Agriculture & allied, of which	3135.8	3994.8	1847.7	1863.2	27.4	0.3
1. Tea	337.2	311.9	184.7	-141.3	-7.5	-14.2
2. Coffee	129.9	177.1	60.9	187.7	36.3	206.4
3. Cereals	343.9	423.6	193.9	160.8	23.2	-17.1
4. Unmanufactured tobacco	122.6	118.0	81.0	34.2	-3.0	-44.0
5. Spices	135.8	178.9	85.7	78.4	31.7	-8.4
6. Cashew	257.2	332.1	159.3	204.5	29.1	28.3
7. Oil Seeds	533.5	736.2	303.4	254.1	38.0	-18.2
8. Fruits & Vegetables	107.9	133.4	60.8	86.8	23.6	10.0
9. Marine products	601.9	808.8	310.5	438.3	34.4	41.2
10. Raw cotton	62.8	210.2	163.6	30.2	235.0	-81.5
II. Ores and Minerals of which	737.8	888.0	402.7	435.1	20.4	8.0
11. Iron ore	381.2	432.7	211.5	188.7	13.5	-10.8
12. Processed minerals	143.0	195.0	88.8	109.1	36.3	22.8
13. Other Ores & Minerals	188.0	232.9	93.7	129.1	23.9	37.8
III. Manufactured goods of which	14015.9	16789.0	7810.0	9059.6	19.8	16.0
14. Leather & Manufactures	867.3	830.9	410.9	472.4	-3.2	15.0
15. Leather Footwear	410.2	479.6	202.3	219.4	17.0	8.5
16. Gems & Jewellery	3071.7	3094.4	1875.0	2016.3	30.0	7.5
17. Drugs, Pharmaceuticals & Fine Chemicals	529.3	642.1	289.1	346.2	21.3	19.7
18. Dyes, Intimidies & Coal Tar Chemicals	330.6	386.5	165.5	214.2	10.9	29.4
19. Manufactures of Metals	560.2	603.3	313.8	323.3	23.8	3.0
20. Machinery & Instruments	541.6	636.4	304.9	325.8	17.5	6.9
21. Transport equipment	533.7	586.7	252.9	338.6	9.9	33.9
22. Primary & Semi-finished Iron and Steel	164.4	432.1	222.7	174.0	162.9	-21.9
23. Electronic goods	212.3	311.8	137.9	172.1	46.9	24.8
24. Cotton yarns, Fabrics, Madeups etc.	1350.5	1542.3	713.4	1004.9	14.2	40.8
25. Readymade garments	2393.0	2579.6	1217.4	1325.4	7.8	8.9
26. Handicrafts	865.2	928.7	437.4	481.5	7.3	10.1
IV. Crude & Petroleum Products	476.2	397.8	236.7	217.4	-16.5	-8.1
V. Others & Unclassified Items	171.6	103.9	47.9	55.4	-39.4	15.7
<b>GRAND TOTAL</b>	<b>18537.2</b>	<b>22236.6</b>	<b>10345.0</b>	<b>11620.8</b>	<b>20.0</b>	<b>12.3</b>

Source : DGCI&S, Calcutta.

**TABLE 1.7**  
**INDIA'S IMPORTS BY COMMODITY GROUP**

(US \$ MILLION)

Commodity Group	1992-93	1993-94	Apr-Sep 1993-94	Apr-Sep 1994-95	Per cent change	
					Apr-Sep 1993-94	Apr-Sep 1994-95
					6	7
I. Food & allied, of which	721.0	550.4	212.8	814.1	-23.7	282.6
1. Cereals	333.5	84.9	66.6	20.6	-74.5	-69.0
2. Pulses	115.5	18.9	60.9	87.0	56.7	42.9
3. Cashew nuts	129.9	153.9	44.9	111.7	18.4	148.6
4. Edible oils	57.6	52.2	15.1	77.4	-9.4	413.5
II. Fuel of which	6396.1	6221.5	3298.6	3097.4	-2.7	-10.5
5. Coal	477.6	465.0	216.1	338.8	-2.6	56.7
6. POL	5918.6	5756.5	3082.5	2758.6	-2.7	-10.5
III. Fertilisers	977.7	831.2	387.5	394.2	-15.0	1.7
IV. Paper board manufactures & Newsprint	177.2	222.1	85.4	103.0	25.3	20.6
V. Capital goods of which	4531.0	6040.0	2533.0	3243.4	33.3	28.0
7. Machinery except elec. & machine tools	1652.6	2190.7	823.5	1159.7	32.6	40.8
8. Electrical machinery	826.2	794.4	475.4	547.8	-3.8	15.2
9. Transport equipment	481.8	1266.8	503.6	517.7	174.3	2.8
10. Project goods	1278.5	1401.0	577.5	826.9	9.6	43.5
VI. Others of which	6067.0	8377.5	2962.9	3142.8	5.1	6.1
11. Chemicals	2017.5	1986.3	827.5	1323.7	-1.5	60.0
12. Pearls, Precious & Semi-precious stones	2441.9	2641.2	1429.6	780.0	8.2	-45.4
13. Iron & Steel	711.4	781.8	302.7	484.9	9.9	60.2
14. Non-ferrous metals	394.5	474.9	210.2	349.3	20.3	66.1
15. Professional instruments Optical goods	501.4	493.4	192.9	204.9	-1.6	6.2
VII. Unclassified items	3011.5	3064.0	1316.2	2056.2	1.7	56.2
GRAND TOTAL	21881.6	23306.7	10796.4	12861.1	6.5	19.0

Source : DGCI&S, Calcutta.

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**TABLE 1.8**  
**BUDGETARY DEFICIT**  
(Rs. in crores)

1990-91	11,347
1991-92	6,855
1992-93	12,312
1993-94	10,960
1994-95 (R)	6,000
1995-96 (B)	5,000

R - Revised Estimate

B - Budget proposals

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## 1.9 INDUSTRIAL GROWTH RATE

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Economic reforms since July 1991 have had a positive impact on the investment climate in the country. They have also evoked a strong positive response from foreign investors and portfolio managers. The conventional indicators suggest that both the investment climate and the capital market remained buoyant. The buoyance is reinforced by an increasing number of capital issues by Indian companies in both the domestic market and abroad, and the upgrading of Indian sovereign rating by international credit rating agencies such as the Japan Bond Research Institute (JBIR) and Moody's Investors Service.

There has been an encouraging trend in domestic investment, as is evident from sanctions and disbursements of term loans by All India Financial Institutions and capital market operations.

While the sanctions recorded an increase of 26.8 per cent in 1993-94, disbursements went up by 15.1 per cent. The financial assistance sanctioned by these institutions in April-December 1994 recorded an impressive growth of 59.2 per cent, but the disbursements showed a lower growth of 26.3 per cent mainly because of the availability of alternative cheap funds through Euro issues of convertible debentures and GDRs. The increase in financial assistance was supplemented by the buoyance in the capital market.

The Five year plan targeted around 5.5 per cent growth per annum in industrial products. The overall growth rate in 1993-94 is estimated at 4.1 per cent. The growth rates vary between different categories. This is not sign of a stagnant economy but that of a growing economy, perhaps in the midst of a transition phase. A broad indication of the growth of a few selected industries may be obtained from Table 1.9. There are more than 200 types of industries and most of the service sector (air-passenger service, for example) are not included here. In spite of this, the Table should help one to give a bird's eye view of the growth rates in absolute terms. Growth rates in terms of percentages are available in a summary form in Tables 1.10 and 1.11.

## 1.10 WORLD TRADE ORGANISATION

The Uruguay Round of GATT negotiations was formally concluded at the Ministerial Conference held in Marrakesh, Morocco, from 12-15 April 1994. India, along with 110 other countries authenticated the results of the Uruguay Round by signing the Final Act. In addition, 104 countries also signed the Agreement establishing the World Trade Organisation (WTO). The WTO Agreement has come into force from 1 January 1995 and India has become a founder member of the World Trade Organisation, by ratifying the WTO Agreement on 30 December, 1994.

**TABLE 1.9**  
**INDIAN INDUSTRY - SOME GROWTH RATES**

	Unit	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93
1. Coal (including lignite)	(mn. tonnes)	175.2	190.9	207.0	213.7	225.1	243.9	253.3
2. Iron Ore	( " )	52.7	51.0	49.5	50.6	53.7	53.9	52.3
3. Aluminium	(1000 tonnes)	257.3	278.1	357.3	427.1	451.1	511.5	481.1
4. Jute Textiles	( " )	1394	1192	1389	1304	1430	1378	1310
5. Sugar	( " )	8502	9110	8752	10989	12047	13277	10589
6. Aluminium conductors	( " )	58.0	40.9	29.5	57.8	67.6	56.9	24.1
7. Tea	(mn kg.)	618	678	690	700	705	715	715
8. Bicycles	(Rs. mn thousand)	6119	6676	6703	6802	7804	7150	6963
9. Electricity generated	(billion KWH)	187.7	202.1	221.4	245.4	264.2	286.7	301.1
10. Automobiles (total)	(Rs. million thousand)	235.8	291.6	317.6	350.7	366.3	341.9	330.7
11. Paper & paper board	(1000 tonnes)	1569	1662	1726	1823	2088	2122	2152

Source : The Hindu Survey of Indian Industry 1994

**TABLE 1.10**  
**GROWTH RATES OF INDUSTRIAL PRODUCTION (IN PERCENTAGES)**  
**USE BASED CLASSIFICATION**

Industrial Sector	Weight	1991-92	1992-93	1993-94
1	2	3	4	5
Basic Goods	39.4	6.5	2.6	5.9
Capital Goods	16.4	-8.6	-0.1	-5.3
Intermediate Goods	20.5	-2.2	5.4	11.4
Consumer Goods	23.6	1.5	1.8	3.1
Consumer durable	2.6	-10.7	-0.7	15.2
Consumer non-durables	21.0	4.7	2.4	0.5

**TABLE 1.11**  
**GROWTH RATES OF INDUSTRIAL PRODUCTION BY**  
**BROAD GROUPS OF MANUFACTURING INDUSTRIES**

(Per cent)

Sectors	Weight	1991-92	1992-93	1993-94
1	2	3	4	5
Food Products	5.3	4.8	- 1.6	- 8.4
Beverages & Tobacco	1.6	2.4	5.9	21.3
Cotton Textiles	12.3	9.8	8.0	5.0
Jute Textiles	2.0	-10.6	- 4.2	18.6
Other Textile products	0.8	- 5.8	- 22.0	- 3.2
Wood & Wood products	0.5	- 6.2	3.0	4.3
Paper & Paper products	3.2	2.6	3.9	6.6
Leather & Fur products	0.5	- 6.7	3.5	6.6
Rubber & Petro products	4.0	- 1.1	1.5	0.9
Chemical products	12.5	2.8	6.0	7.6
Non-metallic min. products	3.0	6.2	1.8	3.4
Basic metals & alloys	9.8	5.7	0.4	15.0
Metal products & parts	2.3	7.0	- 6.4	1.4
Non-electrical machinery	6.2	- 1.9	- 1.2	4.2
Electrical machinery	5.8	- 12.4	- 2.0	- 6.8
Transport equipment	6.4	- 0.7	5.0	5.2
Other mfg. industries	0.9	- 16.1	4.2	- 5.7

Estimates have been made by the World Bank, OECD and the GATT Secretariat, which show that the income effects of implementation of the Uruguay Round package will add between 213 to 274 billion U.S. 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 U.S. dollars in the year 2005, than it would otherwise have been. The GATT Secretariat further projects that the largest increases will be in the area of clothing (60%), agriculture, forestry, and fishery products (20%) and processed foods 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 would be able to take advantage of the opportunities that are created, the trade gains may conservatively be placed at 2.7 billion U.S. dollars in extra exports per year.

There are several areas in the Uruguay Round package that relate to market access. The more important ones are tariffs, textiles and garments and agriculture.

The Uruguay Round Agreement has also strengthened multilateral rules and disciplines. The most important of these relate to anti-dumping, subsidies and countervailing measures, safeguards and dispute settlement. For example, on subsidies countries with a per capita income of less than U.S. dollars 1000 have been exempted from the general phasing out of

export subsidies on industrial products. Regardless of the level of per capita income, all countries will have to phase out export subsidies on products where they have a share of 3.25% or more of the world market in two consecutive years. But this only affects India's exports of diamonds.

The Agreement on Trade Related Investment Measures (TRIMs) prohibits investment measures that are inconsistent with national treatment (Article IH). Developing countries have been allowed a five year transition period to phase out inconsistent TRIMs. The Agreement does not impose any obligation to provide access to all or any particular sectors for foreign investments.

The General Agreement on Services (GATS) has two major across-the-board requirements. The first is non-discrimination on the basis of the most favoured nation (MFN) clause and the second is transparency. There is no requirement for an across-the-board opening up of the services sector. India has made an offer on the basis of the country's self-interest. India's interest in the negotiations on services was primarily in the delivery of services through the modality of cross border movements of neutral persons. The negotiations on services will come to an end six months after the entry into force of the agreement establishing the WTO.

The Agreement on Trade Related Intellectual Property Rights (TRIPs) provides norms and standards for copyrights and related rights, trademarks, geographical indicators, industrial designs, patents, lay out designs of integrated circuits and protection of undisclosed information. On copyrights and related rights, the Agreement requires compliance with the provisions of the Berne-Convention. India is already a signatory to the Berne Convention and the new Copyright Act already meets the requirements of the TRIPs Agreement. A Bill to amend the Trade and Merchandise Marks Act of 1958, so as to provide for the protection of service marks, was introduced in Parliament in 1993. A new law will have to be enacted, but there is a five year transition period under the Agreement before this needs to be done. On industrial designs, the Designs Act of 1991 will have to be updated, but there is a five-year transition period that is allowed.

On patents, the basic obligation is that product and process patents must be permitted in all areas. However, specific exceptions from patentability are permissible for selected areas. Countries that do not provide products patents in certain areas now, can delay the provisions requiring products patents for another five years, beyond the five years that are granted as a general exemption. But exclusive marketing rights will have to be provided for products which obtain patents after 1, January 1995. The Patents (Amendment) Ordinance of 1994 has accordingly been promulgated on 31 December 1994. On plant varieties, there is an obligation to provide for protection by patents or by an effective *sui generis* system or by a combination.

The W.T.O. is to implement the international trading rules. Provisions are there for binding arbitration and appeals, with quick dispute settlement procedures for all areas. The threat of unilateral actions is considerably reduced.

## 1.11 CHANGING WORLD ECONOMIC SCENARIO

Trade liberalisation and the opening up of avenues for foreign investment together have led to positive economic benefits during the last three years. The first of these benefits has been the improved access to external sources of supply of raw materials and components as well as intermediate products for Indian Industry. This has liberated many industrial units from the conventional constraint of inadequacy of domestic supplies of raw materials and other maintenance items required for sustaining manufacturing operations at reasonably high levels of capacity utilisation.

Second, with the improving forex reserves position consequent on substantial inflows of capital, the policy makers have been able to improve supply management of critical bulk consumer items such as sugar and edible oils through imports and to that extent moderate the inflationary trends in the economy.

Third, the intangible benefit of a regime of liberalised imports is the quality upgradation in Indian industry made possible by the improved access to imports unhindered by bureaucratic decisions which used to circumscribe the importer's choice of quality. Besides for the large companies in India access to funds from global markets at much reduced costs has increased.

Recent years have seen the formation of a number of major trade blocks some of which are very strong and well known. A short list is as follows :

Name	No. of countries
1. The European Communities (EU)	12
2. European Free Trade Association (EFTA)	7
3. Economic Cooperation Organisation	3
4. The Arab Common Market	7
5. Latin American Integration Association	11
6. Association of South Asian Nations (ASEAN)	5
7. North American Free Trade Agreement (NAFTA)	3

(There are 24 such regional trade blocks)

Regional blocks agreement, which is in fact goes against the Principle of GATT pose hurdles to other countries. There can be trade diversion away from these countries to those within the block. The motivations to form such blocks may not be economic alone but may be political and cultural.

### Activity - E

Explain the meaning and implications of the following - Use the latest data from RBI's or other publications.

Trade Deficit :

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Forex Reserves :

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Traditional  
Export items :

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**Activity - F**

Find out from the newspaper the current exchange rate between :

	As on 30th Sep.	As on 31 st Dec.	As on 31st Mar.
US \$ and Rupee			
German Mark and Rupee			
Japanese Yen and Rupee			
British Pound Sterling and Rupee			

**Activity - G**

What do you know about Uruguay Round, Marrakesh, GATT, WTO?

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**Activity - H**

What do you know about TRIPS, TRIMS and GATS? Give examples.

TRIPS \_\_\_\_\_

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TRIMS \_\_\_\_\_

GATS \_\_\_\_\_

### Activity - I

What are the countries which have formed into a strong trade block/union as listed below?

EU \_\_\_\_\_

EFTA \_\_\_\_\_

ECO \_\_\_\_\_

NAFTA \_\_\_\_\_

## 1.12 SUMMARY

The data in the different tables gives a bird's-eye-view of the Indian Economy. Based on this the business in India may take the environment as stable for the past few years, the financial position of the Government is conducive for controlling the inflation and the position of trade and industrial production shows clear signs of growth. This can be confirmed by referring to the Industrial Policy of the Government in a later unit.

## 1.13 FURTHER READINGS

1. D. Amarchand, Government and Business, New Delhi, TMH 1994 Edn.
2. Government of India, The Economic Survey, Publications Division, 1995.
3. Glueck William F., Business Policy and Strategic Management, 1980  
(Tokyo, Mc Graw-Hill)
4. A. Das Gupta and N.Sen Gupta, Government and Business, Sultan Chand & Sons, Delhi, 1994.

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## 1.14 SELF-ASSESSMENT TEST

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1. "Broadening the horizon of your awareness" - is a message applicable to spiritualism and business leadership. Explain what does it mean to a business leader?
2. "Directive Principles of State Policy" have not changed. But there is a sea of change in the economic policy pursued in the country in the recent past. How do you reconcile these two? Have we violated this part of the constitution?
3. Discuss India's Export trade pattern in recent times.
4. Government's indebtedness has some serious implications to the economy in general and business in particular. Discuss.
5. Briefly describe the changes that are expected in the near future since the agreement with WTO has become operational.
6. What are the prospects of India joining a Trade block? What advantages may be expected if it happens?

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## **UNIT - 2 : POLITICAL AND LEGAL ENVIRONMENT**

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### **Objectives**

After reading the unit, you should be able to :

- understand the impact of political and legal environment on business;
- the concept and components of democratic socialism in India;
- the legal framework in India with special reference to socio-economic legislation relevant to industry; and
- overview the functioning of some economic administrative bodies in India.

### **Structure**

- 2.1 Introduction
- 2.2 Economic, Social and Secular Ideologies
- 2.3 Democratic Socialism in India
- 2.4 Components of Political System
- 2.5 Legal Environment
- 2.6 Important Economic and Industrial Legislations
- 2.7 Securities and Exchange Board of India
- 2.8 Summary
- 2.9 Further readings
- 2.10 Self-Assessment Test

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### **2.1 INTRODUCTION**

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Business and politics are closely related to each other. Every business has to function within the political framework of the country. Business cannot survive and prosper without a clear understanding of the dynamics of politics and without the support of public opinion.

Political environment consists of the type of government, its stability, its actions and its control over the people. Political ideology of the government determines the role of business firms. Political stability improves the confidence of the investors in the business. Rules and regulations enforced by the government and the public reaction to them provide necessary direction to the growth of the business. Honesty in Government improves the

morale of the people and prevents spreading of corruption in the society. Corrupt government corrupts the business and society.

A political system which is stable, honest, efficient and dynamic and which ensures political participation of the people, and assures personal security to the citizens, is a primary factor for economic development. The rich countries of today owed their success mainly to the political systems they richly enjoyed. "There is today", comments John Kenneth Galbraith, "no country with a stable and honest Government that does not have or has not had a reasonably satisfactory state of economic progress". He further argues that "In all these countries, the early emphasis was not on capital investment but on political and then on cultural development. In the United States, Western Europe, and more recently in Japan, a secure political context was stressed in both thought and action on economic development; it was considered the first requisite for economic progress".

For instance, multinational companies like Coca Cola and IBM discontinued their activities in India in the late seventies because of the government policy of restricting the growth of multinational companies in the country. In 1989, the Government allowed another multinational company, Pepsi Cola, to enter the Indian market to give boost to the food processing industry. Recently, the Coca Cola Company again entered the Indian market. Stability of the Government is also an important factor from the point of view of growth of business. Businessmen prefer to start new units in those states where there is political stability and where rule of law prevails.

A business can succeed in the accomplishment of its goals only if it is able to properly foresee the changes in the policies and programmes of the Government and adjust its activities accordingly. Changes in the Government policies and programmes may be and lasting (a) long term or (b) short term and contextual or (c) of cyclical nature. At times, regional factors may also influence these policies and programmes.

Long-term changes reflect a basic shift in the attitudes and viewpoints of the voters. Thus, in a country like ours, these are aimed at reduction in unemployment, industrial hazards, economic insecurity and to afford protection to the consumers. Quick changes in the policies and programmes of the Government may be caused by unforeseen factors such as outbreak of war, calamities like earthquake, drought, etc. Cyclical changes in Governmental policies and programmes take place when elections to the legislatures are round the corner and the Government is relatively more responsive to popular opinion. Uncertainty as regards who may win the elections may also cause instability and business houses may prefer to wait and watch what changes may be made by the new leadership. Regional factors will influence Governmental policies such that a leadership with rural orientation may place greater emphasis on agricultural and industries based on agriculture.

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## **2.2 ECONOMIC, SOCIAL AND SECULAR IDEOLOGIES**

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Business is a sub-system of the economic system of the country and it is composed of innumerable inter-locking sub-systems known as industrial and commercial firms. Each firm has further sub-systems such as production, marketing, finance and personnel. The economic system of the country exerts the most pervasive influence on the structure, organisation and operations of these firms. Therefore, the business system of a country cannot be studied without reference to the economic system of which it is a part. The economic system of the country provides economic environment of business. Business is

influenced by the overall economic, fiscal, commercial and industrial policies of the Government etc.

Under a capitalist economy, business is largely operated by entrepreneurs for private profit. Decisions relating to production, distribution and consumption are made through market forces of demand and supply without much interference by the Government. But in a communist or socialist economy, all business decisions are dictated and regulated by the central agencies of the Government. The business cannot take independent decisions here. However, in a mixed economy like India, the businessmen have freedom of choice and action in certain industries. Some industries are reserved exclusively for the public sector. The private sector business enterprises have to be guided by the Governmental budgetary, industrial and commercial policies. They are also expected to pursue their social responsibilities as they operate under the socio-economic environment.

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### **2.3 DEMOCRATIC SOCIALISM IN INDIA**

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The classical basis of socialism was provided by Marx and Engles who believed that to end exploitation from the world, it was necessary to abolish private ownership of the means of production. Marx and Engles considered private property to be the cause of all social levels. The tremendous progress achieved by the Soviet Union, which followed Marx and Engles Model, has an impact on the capitalist countries of the world also. Although the countries that followed capitalism did not lose faith in private property and individual freedom, yet they were convinced that the Government could play an effective role for faster economic development.

Jawaharlal Nehru, the first Prime Minister and the architect of Indian Planning, greatly admired the achievements of Soviet economic system. He borrowed the concept of socialism from socialist societies and democratic values of the capitalist societies to take advantage of the virtues of the two extreme societies. This type of mixed economy followed by India is described as "democratic socialism".

Under the Directive Principles of the Indian Constitution, it has been laid down that the State should strive "to promote the welfare of the people by securing and protecting as effectively as it may be a social order in which justice, social, economic and political, shall inform all the institutions of national life".

While following the mixed economic system, the successive Governments in India since Independence accorded distinctive role to the public sector for faster development of the economy and egalitarian distribution of national income. Although the private sector is permitted to base its activities on the profit motive, exploitative character of this motive was effectively curbed by the Government. The Government played an important role in the economic sphere and it tried to ensure that the fruits of economic development are as widely distributed as possible.

The mixed economic system practised in India during the last four decades has been able to create social and economic infrastructure. It provided industrial base by fostering the development of heavy and basic industries and enlarged educational opportunities. But it failed to increase the employment facilities as was expected. It also failed in eliminating

poverty and reduction in concentration of income and wealth. Moreover, the economy was over regulated leading to stagnation in many fields of economy.

The disintegration of Soviet Russia and Political and economic upheavals in other East European Socialist countries resulting in the introduction of market-based economy made India also to realise the need for liberalising its economy by reducing government controls and regulations. In this context, the economic reforms initiated by the Government of India in June 1991 aimed at unshackling the Indian industrial economy from the cobwebs of unnecessary bureaucratic controls.

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## 2.4 POLITICAL INSTITUTIONS

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The political system in India under democratic socialism comprises three vital institutions. They are (i) legislature, (ii) executive or government and (iii) judiciary.

(i) **Legislature** : Legislation exercises more influence on the business activities and its impact is considerable. The legislature decides such vital aspects as the type of business activities; growth, regulation and control of business, size of operations, employment and working conditions etc.

(ii) **Executive or Government** : The Sovereignty of the Indian Republic rests with the people who elect their representatives to govern themselves. The Parliament/Assembly makes laws for the country/state and the executive enforces them. The executive includes the head of the state, his/her ministers and all other officers of the Government who are concerned with the execution of laws and running of administration.

(iii) **Judiciary** : Judiciary determines the manner in which the work of the executive has been fulfilled. The main function of judiciary is to see that the authority of the executive conforms to the general rules laid down by the legislature. The Indian constitution establishes an integrated judiciary with the Supreme Court at the apex.

As discussed above, Government is a political institution with a social purpose. The intensity of Government - Business relationship depends upon the form of Government; the ideology of the ruling party; the strength of the opposition parties; the role and responsibility of bureaucracy; socio-economic legislations; velocity of government policies, plans and programmes; and the political stability. All these critical elements of political-legal environment will have heavy impact on the functioning and growth of business organisations. For example, successful operation of business depends upon operation and co-ordination among a number of Government departments like Company Law Board, SEBI, Department of Industrial Development etc. When the political institutions work efficiently business prospers without constraints; otherwise it results in red-tapism, procedural delays, excessive centralisation and lack of dedication leading to frustration among businessmen.

### **Political Stability and Change**

There is a close nexus between political stability and business growth. There is evidence to state that business grows in a region which is politically stable. Political uncertainty is the main reason for the fall of business investment and ultimately the economic growth in

countries like Afghanistan, Bangladesh, Hong Kong, Kuwait, Nigeria, the Philippines, Poland, South Africa, United Arab Emirates.

Even in our country political instability resulted in decline in business investment from time to time. Within the country also, business prospered whenever and wherever there is political stability. Maharashtra, Gujarat and even West Bengal today provided political stability and the businessmen naturally preferred these regions. Businessmen were affected so much in states like Assam, Bihar, Jammu and Kashmir, etc., due to continuous political agitations and hence, they are preferring to stay away from these states.

Political stability of a country is considered not only in terms of physical events and happenings but also in terms of the stability of Government machinery and policies in relation to business. Government formulates and executes a number of policies and programmes. If the Government frequently changes its industrial policy, fiscal policy, monetary policy or trade policy and the like, it unnerves the business sector and thereby adversely affects business investment and related activities. If policies and programmes are stable then business can plan out its activities; otherwise it faces a tremendous amount of what is called 'non-market' risk and uncertainty. Stable policies build up business confidence and help corporate planning. Further, whenever a country becomes politically stable, there would be inflow of foreign capital making heavy investments. Since 1991 many multi-national companies have been in our country and this is mainly due to change in the ideology of the Government and political stability. On the other hand, foreign enterprises in the recent past have started rethinking on the investment in India due to political uncertainties (e.g. Enron's Power Project, KFC retail outlet, etc.).

### Activity A

State the relation between political environment and business.

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### Activity B

Explain the type of changes in Government Policies and Programmes in the recent past with specific examples.

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## Activity C

List out some of the instances where change in governments affected the survival and growth of specific business undertakings.

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## 2.5 LEGAL ENVIRONMENT

Legal environment is an important offshoot of political environment but it reflects long-term objectives of the public and the political leadership chosen by it. Thus, influenced by its own ideology or popular pressure, the Government may enact laws to regulate and control business activities and any violation of these laws may invite severe penalties and punishment for the offenders.

Important among the laws within the framework of which a business is required to operate in India are as follows :

- a. The Contract Act
- b. The Companies Act.
- c. The Factories Act.
- d. The Industrial Disputes Act.
- e. The Workmen's Compensation Act.
- f. The Essential Commodities Act.
- g. Tax laws, dealing with excise and customs duties, Central and local sales-taxes, income-tax, surtax and so on.
- h. Industrial (Development and Regulation) Act.
- i. Monopolies and Restrictive Trade Practices Act.
- j. The Foreign Exchange Regulation Act.

Let us now discuss some of the important economic legislations in India having considerable impact on industry.

## 2.6 IMPORTANT ECONOMIC AND INDUSTRIAL LEGISLATIONS

### 1. Industries (Development and Regulation) Act, 1951

The Industries (Development and Regulation) Act, 1951 is a very important piece of economic legislation affecting the industrial sector. The Act came into force from May 8, 1951 and it extends to the whole of India. The Act seeks to secure planned industrial

development of the country by regulating, controlling and developing industries that are included in the First Schedule of the Act.

**Objectives of the Act :** The following are the important objectives of the Act :

1. To implement the Industrial Policy : The primary object of the Act is to provide to the Central Government the means of implementing its industrial policy.
2. Regulation and development of important industries : The Act brings under the control of the Central Government the development and regulation of certain industries.
3. Planning and development of new undertakings : A system of licensing is introduced under the Act to regulate planning of future development of new undertakings on sound and balanced lines as may be deemed expedient in the opinion of the Central Government. In view of the liberalised industrial policy, only 18 industries have been subjected to compulsory licensing, which were subsequently reduced to 15.
4. Protection of Small-Scale Industries : This is sought to be achieved by reserving certain items exclusively for small scale sector.
5. Improving working of the industry, promoting arrangements for better marketing, standardisation of products etc., through Development Councils.

**Scheme of the Act :** The Act is divided into two parts. Part I deals with development aspects and Part-II deals with regulatory aspects of scheduled industries.

The development of the Scheduled Industries is sought to be secured primarily through the agencies of Central Advisory Council and Development Councils as well as by offering certain special facilities.

Regulation of scheduled industries is sought to be done by means of a system of registration of existing undertakings, licensing of new undertakings for producing new articles or for substantial expansion or change of location of existing undertakings.

Control over the industries is sought to be exercised by causing investigation into the working of these industries and in appropriate cases taking over of direct management and control.

The Act, however, empowers the Central Government to grant exemptions to any undertaking or a scheduled industry or class of undertakings or scheduled industries from all or any of the provisions of the Act, Rules or Orders made thereunder. Exemptions are granted having regard to the smallness of, or the number of workers employed in, or the amount invested in, any industrial undertaking or the desirability of encouraging small undertakings generally or the stage of development of any scheduled industry.

1. **Registration of Undertakings** : Every existing industrial undertaking was required to be registered after the Act came into force, provided it was included in the schedule to the Act. The Central Government shall register the scheduled industries and issue to the owner of the undertaking so registered a certificate of registration containing the production capacity of the industrial undertaking and other prescribed particulars.

2. **Licensing of Undertakings** : All new undertakings covered by the schedule must obtain a license from the Central Government before being established. The license may contain conditions regulating the size, location, manufacturing programme, and expansion or addition of a new product.

3. **Investigation** : The Central Government enjoys wide powers of control by investigation into the scheduled industrial undertakings. The Central Government may order investigation to be made of any scheduled industry or industrial undertaking if it is of the opinion that in the case of such undertaking there has been substantial fall in the volume of production, or marked deterioration in the quality of any product, or any unjustifiable rise in price, or if the undertaking has been managed in a manner detrimental to the public interest.

4. **Directions** : On completion of the investigation, the Central Government may issue directions regulating the production. It may require the industrial undertaking to stimulate development of industry, or prohibit the undertaking from reducing its production capacity or economic value, or control the prices, or regulate the distribution of product(s). The Central Government is also empowered to revoke the registration or license if it deems it necessary or justified in public interest.

5. **Taking over of Undertakings** : If the Central Government is of the opinion that an industrial undertaking in respect of which directions were issued has failed to comply with such directions, or it is being managed in a manner highly detrimental to the scheduled industry concerned or to public interest, it may take over the management of such undertaking. It may also take over an industrial undertaking, if the persons in charge of such undertaking have, by reckless investments, or creation of encumbrances on the assets, or by the diversion of funds, brought about a situation which is likely to affect the production, or if it has been closed for a period of not less than three months.

**Administration of the Act** : The Act provides the establishment of three bodies to implement its provisions. These bodies are described below :

a) **Central Advisory Council** : The Act requires the Government to establish a Central Advisory Council consisting of the representatives of industry, labour, consumers and such other class of persons as the Central Government may consider suitable. The Council has been created to consider the general problems of industries and the specific problems of registration and licensing and to advise the Central Government on regulation and development of scheduled industries.

b) **Development Councils** : The Act provides for the setting up of a development council for each major industry group covered by the Act to suggest improvement in quality of service, management and productivity and to recommend targets of production, measures of rationalisation and modernisation and for increase in efficiency.

c) **Licensing Committee** : The Act required the setting up of Licensing Committee to regulate industrial development in conformity with the priorities laid down in the Five Year Plans. It grants licenses for setting up new enterprises in the private sector after considering their capital, location, plant capacity proposed to be installed, technical and managerial personnel, foreign collaboration, etc. The Licensing Committee follows the licensing procedure laid down by the Government from time to time.

## **2. Companies Act, 1956**

The first Indian Companies Act providing for the registration of Joint Stock Companies was passed in the year 1850 on the lines of English Companies Act, 1844. Later the Indian Companies Act, 1913 was enacted after many amendments to the first legislation. The present legislation i.e., Companies Act, 1956 came into force on April 1, 1956. Later the Act had undergone amendments sixteen times before the introduction of the present Companies Bill in May, 1993.

The Companies Act, 1956 is one of the biggest legislations with 658 sections, 6 Tables and 13 Schedules and a large number of rules, forms, guidelines and clarifications given by the Company Law Board. The Act applies to the whole of India and applies to all classes of companies. It also contains provisions relating to companies incorporated outside India, but which have an established place of business in India.

**Objectives of the Act** : The main objects of the Act are stated below :

- i) To regulate private investments
- ii) To protect the legitimate interests of shareholders in view of the separation of ownership from management in the case of a joint stock company
- iii) To safeguard the interests of creditors in view of limited liability of the Company
- iv) To help the development of companies in India on healthy lines
- v) To prevent misconduct and malpractices on the part of company management
- vi) To help attain the social and economic objectives contained in the directive principles of the constitution
- vii) To establish an appropriate authority for administration of the Act and enforcement of its provisions.

**Scheme of the Act** : The entire Act may be conveniently divided into following four parts :

**I. Incorporation of a company (Part II to IV of the Act) : This part covers :**

- i) Nature and kinds of companies
- ii) Formation of a company and matters incidental thereto
- iii) Form and contents of Memorandum and Articles of Association etc.
- iv) Prospectus
- v) Issue of share capital

II. Registration of Charges

III. Management and Administration including :

- a. Membership in the company
- b. Meetings and Resolutions
- c. Managerial personnel and managerial remuneration
- d. Accounts and Audit, Dividends
- e. Investigation
- f. Supremacy of majority and prevention of oppression and mismanagement
- g. Compromise, arrangement, reconstructions and amalgamations

IV. Winding up covering such aspects as modes of winding up, conduct of winding up and dissolution of the company.

**Administration of the Act :** The Central Government is the supreme authority responsible for the administration of the Companies Act through the Department of Company Affairs. The day-to-day administration has been vested in the Company Law Board.

**Company Law Board :** Set up in 1964, it has been constituted as an autonomous organ by virtue of the Companies (Amendment) Act, 1988. It discharges such judicial and quasi-judicial functions as were being exercised by the court. The Board shall consist of not more than nine members, one of whom shall be the chairman. The Board has a three-tier administrative set-up as follows :

1. Central Office at Delhi
2. Four Regional Offices at Bombay, Calcutta, Madras and Kanpur headed by a Regional Director
3. Registrar of Companies in every state to carry out registration of companies and other administrative duties.

### 3. MRTP Act, 1969

This is the most important legislation in India which aimed at prevention of concentration of economic power when it is to the common detriment as well as prohibition of monopolistic, restrictive and unfair trade practices. The Act came into force from 1st June, 1970 and applies to all companies in the country, except Jammu and Kashmir.

The MRTP Act, 1969 underwent amendments in 1974, 1980, 1982, 1984, 1986 and 1988 before the recent amendment in 1991. The 1991 amendment brought far-reaching changes when the philosophy of the Act underwent a total change.

**Objectives of the Act :** The principal objectives of the Act, as spelt out in the Preamble, were :

- i) Prevention of concentration of economic power to the common detriment
- ii) Control of monopolies
- iii) Prohibition of monopolistic trade practices
- iv) Prohibition of restrictive trade practices.

After the 1991 amendment, the first objective has become irrelevant as the relevant provisions to achieve the objectives have been deleted. The objectives of the Act now are :

- i) Control of monopolistic trade practices;
- ii) Control of restrictive and unfair trade practices.

**Applicability of the Act :** After the 1991 amendment, the Act is applicable to all undertakings and financial institutions (including the government undertakings) except the following:

- i) any trade union or other association of workmen or employees formed for their own reasonable protection ;
- ii) the undertakings owned and controlled by a Government company or the Government engaged in the production of arms and ammunition and allied items and units;
- iii) all banking companies and insurance companies for which corresponding provisions exist in respect of these companies in the special statutes governing them.

**Scheme of the Act :** The Act deals with monopolistic trade practices indulged in by any undertaking. It defined the concept of monopolistic trade practices in terms of unreasonableness of the prices charged, unreasonableness in preventing or lessening competition in the market, increasing prices, profits and limiting technical development to the common detriment etc. The remedy for dealing with monopolistic trade practice is an inquiry at the instance of the Central Government by the MRTP Commission or *sua motu* by the Commission and suitable orders being passed by the Central Government thereafter to prevent the mischief resulting from such practices. The Act also deals with matters relating to restrictive trade practices. Briefly stated, a restrictive trade practice is one which prevents, distorts or restricts competition for goods and services in any manner. The Act provides for scheme of registration of certain agreements relating to restrictive trade practices.

The MRTP (Amendment) Act, 1984 introduced new provisions relating to unfair trade practices with a view to promoting the interest of consumers. An unfair trade practice means a trade practice which for the purpose of promoting the sale, use or supply of any goods or for provision of any services adopts any unfair method or unfair or deceptive practice. It is essential to note that the MRTP Commission has been given full powers to regulate restrictive and unfair trade practices by means of an inquiry and pass final orders thereon. The MRTP Commission may inquire into restrictive and unfair trade practices at the instance of the Central Government, State Government, Director General of Investigation and Registration, registered consumer associations, individual consumer and on its own.

**MRTP Commission** : The MRTP Commission set up under this Act is an independent quasi-judicial body and has power similar to a Civil Court under the Code of Civil Procedure, 1908 on some matters. The Commission shall consist of a chairman and not less than 2 and not more than 8 other members, to be appointed by the Central Government. The powers and functions of the Commission are :

- i) Power to order for preliminary investigation
- ii) Power with respect to trying of suits, etc.
- iii) Power to grant temporary injunction
- iv) Power to grant compensation
- v) Power to enforce orders
- vi) Power to cause investigation in certain cases
- vii) Power to punish for contempt
- viii) Power to make regulations
- ix) Power to grant exemption

**Director General of Investigation and Registration** : The Director General of Investigation and Registration is an important wing of the enforcement machinery meant for implementing the provisions of the MRTP Act. The Director-General is appointed by the Central Government. In addition to the Director-General, the Central Government may appoint as many Additional, Joint, Deputy, or Assistant Directors-General as it may think fit. The Director-General enjoys certain powers and performs functions required of him under the provisions of the Act. He acts independently of the MRTP Commission.

#### **4. Foreign Exchange Regulation Act, 1973**

The Foreign Exchange Regulation Act, 1973, came into force on 1st January, 1974. The Act applies to the whole of India and applies :

- i) to all Indian citizens in or outside India;
- ii) branches and agencies abroad of companies or bodies corporate registered or incorporated in India.

**Objectives of the Act** : The objectives of the FERA are as follows :

- i) To regulate certain payments
- ii) To regulate dealings in foreign exchange and securities
- iii) To regulate the transactions indirectly affecting foreign exchange
- iv) To regulate import and export of currency and bullion
- v) To conserve the foreign exchange resources of the country and to utilise the same in the interest of the economic development of the country
- vi) To regulate holding of immovable property outside India
- vii) To regulate employment of foreign nationals
- viii) To regulate acquisition, holding, etc., of immovable property in India by non-residents
- ix) To regulate foreign companies

The Preamble to the FERA, 1973 as amended in 1993, states the objects of the Act as 'consolidating and amending the law regulating certain payments, dealings in foreign exchange and securities, transactions indirectly affecting foreign exchange and the import and export of currency for the conservation of the foreign exchange resources of the country and the proper utilisation thereof in the interests of the economic development of the country.

**Administration of Exchange Control :** Exchange control is administered by the Reserve Bank in accordance with the general policy laid down by the Government in consultation with the Reserve Bank. Much of the routine work of exchange control is delegated to certain commercial banks which act as authorised dealers.

Prior to the new Industrial Policy, 1991 foreign equity upto 40 per cent of the issued capital was allowed to be raised in respect of foreign collaborations with the approval of RBI. Any Indian company with more than 40 per cent foreign equity would be termed a FERA company to which a great deal of restrictions imposed by this Act were applicable. The new Industrial Policy has announced liberalised measures to attract foreign investment. Accordingly, a list of high-priority industries have been specified in which automatic approval would be granted for - (i) foreign technology agreements subject to certain conditions; (ii) direct foreign investment upto 51% foreign equity subject to certain conditions and (iii) and direct foreign investment of more than 51% in listed forty industries subject approval by Empowered Board/Foreign Investment Promotion Board. In case of other industries, foreign equity participation would be allowed upto 40%. All other proposals for direct investment in India would require specific approval under the general procedures.

**Transactions Regulated by Exchange Control :** The following are the transactions that are regulated under this Act :

1. Purchase and sale of, and other dealings in, foreign exchange and maintenance of branches at foreign centres
2. Procedures for realisation of proceeds of exports
3. Payments to non-residents or to their accounts in India
4. Transfer of securities between residents and non-residents and acquisition and holdings of foreign securities
5. Foreign travel with or without exchange
6. Export and import of currency, cheques, drafts, travellers' cheques and other financial instruments, securities, jewellery, etc.
7. Trading, commercial and industrial activities in India or foreign firms and companies and foreign nationals as well as acquisition of business undertakings and acquisition and holding of shares in Indian companies by such companies/firms and persons
8. Investment, including portfolio investment in India by non-resident Indians
9. Appointment of non-residents and foreign nationals and foreign companies as agents in India
10. Occupation or profession undertaken in India by foreign nationals
11. Acquisition, holding and disposal of immovable property in India by foreign nationals and foreign companies
12. Acquisition, holding and disposal of immovable property outside India by persons resident in India

**Enforcement Agencies** : The Act is desired to ensure effective enforcement and implementation of the provisions. The scheme of enforcement envisages appointment of enforcement officers, adjudication of proceedings for levy of penalty by an adjudicating officer (the orders of whom are appealable to the Appellate Board and High Court), and prosecution proceedings for offences under the Act by the Court.

The Act provides for appointment by the Central Government of the Director, Additional Directors, Deputy Directors and Assistant Directors of Enforcement and such other class of Enforcement as the Central Government may think fit to appoint.

## **5. Industrial Disputes Act, 1947**

The Act was designed to provide a self-contained code to compel the parties to resort to industrial arbitration for resolving existing or apprehended disputes without prescribing statutory norms for varied industrial relations norms so that the forums created for resolution of disputes may remain unhampered by any statutory control and devise national norms keeping pace with improved industrial relations reflecting and imbibing socio-economic justice.

### **Extent of the Act**

The Act extends to the whole of the India. It applies to all industries whether they be carried on by private owners or by the Government. The Act has been amended from time to time. The latest amendment to the Act was made in August, 1984.

### **Objectives of the Act**

The Act makes provision for the investigation and settlement of industrial disputes and for certain other purposes. It ensures progress of industry by bringing about harmony and cordial relationship between the employers and employees. The following are objectives of the Act :

- i) Promotion of measures of securing and preserving amity and good relations between the employers and workmen;
- ii) Investigation and settlement of industrial disputes between employers and employees, employers and workmen, or workmen and workmen with a right of representation by registered trade union or federation of trade unions or an association of employers or a federation of associations of employers;
- iii) Prevention of illegal strikes and lockouts;
- iv) Relief to workmen in the matter of lay-off and retrenchment;
- v) Promotion of collective bargaining.

### **Definitions under the Act**

**Industry** : According to new Section 2(j) as substituted by the Amendment Act of 1982, 'industry' means any systematic activity carried on by cooperation between an employer and his workmen. The workmen may be employed by the employer directly or by through any agency, including a contractor. The employment should, however, be for the production, supply or distribution of goods or services with a view to satisfying human

wants or wishes (not being wants or wishes which are merely spiritual or religious in nature). It makes no difference whether or not -

- i) any capital has been invested for the purpose of carrying on the activity referred to above, or
- ii) such activity is carried on with a motive to make any gain or profit.

**Industrial Dispute** : Industrial Dispute means any dispute or difference between -

- i) employers and employees
- ii) employers and workmen, or
- iii) workmen and workmen, which is connected with
  - (a) the employment or non-employment,
  - (b) the terms of employment, or
  - (c) the conditions of labour of any person.

### **Machinery for Investigation and Settlement of Industrial Disputes**

The Industrial Disputes Act provides an elaborate and effective machinery for bringing about industrial peace by setting-up various authorities for the investigation and settlement of industrial disputes. These authorities include :

(i) **Works Committee** : Constituted at the unit level, this machinery is a bi-partite one, comprising representatives of employers and employees. It is required to be constituted in case where the number of workmen employed, presently or on any day during the preceding 12 months, is 100 or more. Works Committee is required to perform the following functions :

- a) to promote measures for securing and preserving amity and good relations between the employers and workmen;
- b) to achieve the above object, it is its duty to comment upon matters of common interest or concern of employers and workmen;
- c) to endeavour to compose any material difference of opinion in respect of matters of common interest or concern of employers and workmen.

ii) **Conciliation Officer** : The Act empowers the appropriate Government to appoint as many conciliation officers as it thinks fit. These officers are charged with the duty of mediating in and promoting the settlement of industrial disputes. The following are the duties of conciliation officers :

- a. To hold conciliation proceedings
- b. To investigate the dispute and all matters affecting the merits and right settlement thereof

- c. Send a report of the settlement to the appropriate Government or the authorised officer together with a copy of the memorandum of settlement signed by the parties to the dispute.
- d. In case no settlement is arrived at, send to the Government a report on reasons thereof.

iii) **Board of Conciliation** : The provision for appointment of Boards of Conciliation is made under the Act to bring the two parties to a dispute to sit together and thrash out their difference and to find out ways and means to settle them. The Act provides that the appropriate Government may constitute a Board of Conciliation. The following are the duties of the Board :

- a) Investigate the dispute and all matters affecting the merit and the right settlement thereof and do all such things that are considered necessary for inducing the parties to come to a fair and amicable settlement of the dispute.
- b) Send a report of the settlement or otherwise of the settlement of the dispute or any of the matters therein to the appropriate Government. The report shall be made within two months of reference or within such shorter period as may be fixed by the appropriate Government.

iv) **Court of Inquiry** : The appropriate Government may at any time constitute a Court of Inquiry for inquiring into any matter appearing to be connected with or relevant to an industrial dispute. A Court may consist of one independent person or of such number of independent persons as the appropriate Government may think fit.

A court shall inquire into the matters referred to it and report thereon to the appropriate Government ordinarily within a period of six months from the commencement of its inquiry.

v) **Labour Courts** : The appropriate Government may constitute one or more Labour Courts for the adjudication of industrial disputes relating to any matters specified in the Second Schedule and for performing such other function as may be assigned to them under this Act. Second Schedule lists the following matters :

- a. The propriety or legality of an order passed by an employer under the standing order.
- b. The application and interpretation of standing order.
- c. Discharge or dismissal of workmen including re-instatement of or grant of relief to workmen wrongly dismissed.
- d. Withdrawal of any customary concession or privilege.
- e. Illegality or otherwise of a strike or lock-out.
- f. All matters other than those specified in the Third Schedule.

vi) **Industrial Tribunals** : The appropriate Government may constitute one or more industrial tribunals for the adjudication of industrial disputes relating to any matter, whether specified in the Second Schedule or the Third Schedule and for performing such other functions as may be assigned to them under this Act. These tribunals need not follow the strict technicalities of law in adjudication of industrial disputes. The Tribunal shall consist of one person only, who shall be appointed by the appropriate Government.

vii) **National Tribunal** : Unlike other authorities under the Act, the National Tribunals can only be constituted by the Central Government. The Central Government may constitute one or more National Tribunals for adjudication of industrial disputes which in its opinion involves :

- i) questions of national importance ; or
- ii) are of such a nature that the industrial establishments situated in more than one state are likely to be interested in or affected by such dispute.

A National Tribunal shall consist of one person only to be appointed by the Central Government.

## 6. Consumer Protection Act, 1986

A number of laws have been enacted in India over the years to safeguard the interest of consumers. These include :

- a. The Indian Contract Act, 1872;
- b. The Sale of Goods Act, 1930;
- c. The Dangerous Drugs Act, 1930;
- d. The Agricultural Produce (Grading and Marketing) Act, 1937;
- e. The Drugs and Cosmetics Act, 1940;
- f. The Indian Standards Institution (Certification Marks) Act, 1952;
- g. The Prevention of Food Adulteration Act, 1954;
- h. The Drugs and Magic Remedies (Objectionable Advertisements) Act, 1954.
- i. The Essential Commodities Act, 1955;
- j. The Standards of Weights and Measures Act, 1976;
- k. The Trade and Merchandise Marks Act, 1958;
- l. The Patents Act, 1970;
- m. The Hire Purchase Act, 1972;
- n. The Prevention of Black Marketing and Maintenance of Supplies of Essential Commodities Act, 1980;
- o. The MRTP Act, 1969.

### The Consumer Protection Act

But under all these legislations the ordinary consumer had no other remedy but to initiate action by way of a civil suit which involved lengthy legal process proving to be too expensive and time consuming. As such it became necessary to evolve a law directed at protecting lay consumers. The Consumer Protection Act, 1986 was passed providing for

simple, quick and easy remedy to consumers under a three-tier quasi-judicial redressal agency at District, State and National levels. The Act was amended in June, 1993.

**Scope of the Act :** The Act extends to the whole of India except Jammu and Kashmir. It applies to all complaints with respect to goods (as designed in Sale of Goods Act, 1930), services and unfair trade practices, with a very wide and all-comprehensive definition of services. It includes the provision of facilities in connection with banking, financing, insurance, transport, processing supply of electricity, and other energy, board or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal services.

**Objectives of Act :** According to the Preamble, the Act is to provide for better protection of the interest of consumers and for that purpose to make provision for the establishment of consumer councils and other authorities for the settlement of consumers' disputes and for matters connected therewith. The following are the specific objectives of the Act for protecting the rights of consumers :

- 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, purity, standard and price of goods, or 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 and services at competitive prices;
- d. the right to secure redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers; and
- e. the right to consumer education.

**Consumer :** As per this Act 'consumer' means any person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, but does not include:

- i) a person who obtains such goods for resale or for any commercial purpose; or
- ii) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised; or
- iii) under any system of deferred payment, when such services are availed of with the approval of the first mentioned person.

## **Lodging of Complaints**

Complaints can be lodged and compensation can be claimed with respect to any of the following matters :

- i) any practice adopted by any trader or manufacturer falsely representing to consumers that the goods or services are of a particular standard, quality, type, mode, grade, usefulness and has sponsorship, approval or affiliation, or gives any guarantee or warranty about the life of the product, or materially misleads the public about the price of goods, or gives misleading information about competitive goods/services available in the market;
- ii) goods purchased for non-commercial purposes if they are defective;
- iii) deficiency of any services hired by him or her, which may be of the nature of a fault, imperfection, shortcoming and inadequacy in the equality, nature, and manner of performance which is required to be maintained by law.

## **Machinery to deal with grievances and disputes**

The Act has provided for a three-tier quasi-judicial machinery to deal with consumer grievances and disputes : District Forums, State Commissions, and the National Commission at the apex. The District Forums constituted under the Act are vested with jurisdiction to deal with all complaints where the value of the goods or services or the compensation claimed does not exceed Rs. 5 lakh. The State Commissions are empowered to entertain cases where the value or claim for compensation exceeds Rs. 5 lakh but does not exceed Rs. 20 lakh. The State Commissions are also to act as appellate bodies against orders of the District Forums. The National Consumer Disputes Redressal Commission (i.e., the National Commission) at the apex level has original jurisdiction to take up all claims and grievances exceeding the value of Rs. 20 lakh. It has also appellate and revisional jurisdiction over orders passed by the State Commissions and District Forums.

**Filing of Complaints :** Complaints may be filed by any of the following categories of persons for redressal and compensation :

- (i) any individual consumer, (ii) any voluntary consumer organisation registered under the Societies Registration Act, 1860, or the Companies Act 1956, or any other law in force, (iii) the Central Government, (iv) State Governments and Union Territory Administrations.

The redressal bodies at all levels (District, State and National) are endowed with powers and sanctions as in the case of Civil Courts. These bodies are required to observe the basic rules of natural justice and are not bound by any rules involving complicated or elaborate procedures. No court fee or any other charge is payable in respect of any complaint or petition or appeal or revision, however high may be the value of the subject matter. The complainant need only set out the grievance in simple form and furnish the name and address of the opposite party. Appearance may be by the complainant or any authorised agent and it is not obligatory to engage any lawyers. Orders of the National Commission can be preferred as an appeal with the Supreme Court.

The redressal forums are invested by the Act with powers to direct the respondent :

- a. to remove the defects pointed out by the appropriate laboratory from the goods in question;
- b. to replace the goods with new goods of similar description which shall be free from any defect;
- c. to return to the complainant the price, or as the case may be the charges paid by the complainant;
- d. 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 the negligence of the opposite party;
- e. to remove the defects or deficiencies in the services in question;
- f. to discontinue the unfair trade practice or the restrictive trade practice or not to repeat them;
- g. not to offer hazardous goods for sale;
- h. to withdraw hazardous goods from being offered for sale;
- i. to provide for adequate costs to parties.

The remedies that can be granted by the redressal agencies are therefore wide enough. The relief available to consumers depends on the nature of relief sought and facts. However, the redressal agencies have not been granted power to order injunctions.

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## **2.7 SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)**

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The stock market regulation in India remained scattered among different legislations and authorities, with little or poor coordination among the agencies intended to protect the market and investors. The recent stock market scam (1992) exhibited the fragility of the system and threw a number of challenges to the policy makers and even raised doubts regarding their capacity to book the culprits under the existing legal framework.

### **Constitution of Securities and Exchange Board of India**

Under these circumstance, there arose a need to constitute a comprehensive body which can act as a unifying force in bringing together the scattered legislation and offer better protection to the investors in India. Eventually, the Securities and Exchange Board of India (SEBI) was set up on April 12, 1988. The timing of constitution is considered more appropriate in a fast deregulating economy to bring about an orderly growth of capital market. To start with, SEBI was set up as a non-statutory body with the following functions:

- i) To protect the interest of investors in securities and to promote the development of and to regulate the securities market by such measures as it thinks fit;
- ii) Without prejudice to the generality of the foregoing provisions; the measures referred to therein may provide for the following :

- a. regulating the business in stock exchanges and any other securities markets;
- b. registering and regulating the working of stock brokers; sub-brokers, share transfer agents, bankers to 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;
- c. registering and regulating the working of collective investment schemes including mutual funds;
- d. promoting and regulating self-regulatory organisations;
- e. prohibiting fraudulent and unfair trade practices regulating to securities market;
- f. promoting investors' education and training of intermediaries of securities market;
- g. prohibiting insider trading in securities;
- h. regulating substantial acquisition of shares and take over of companies;
- i. calling for information for undertaking inspection, conducting inquiries and audits of the stock exchanges and intermediaries and self-regulatory organisations in the securities market;
- j. performing such functions and exercising such powers under the provisions of Securities Contracts Regulation Act, as may be delegated to it by the Central Government;
- k. levying fees or other charges for carrying out the purposes of regulation;
- l. conducting research for the above purposes; and
- m. performing such other functions as may be prescribed.

It took almost four years for the government to bring out a separate legislation in the name of SEBI Act, 1992 conferring statutory powers. Even without these powers, SEBI started its work in right earnest. The following are some of the important areas that engaged the attention of SEBI so far :

- i) Registration of brokers and sub-brokers by stock exchanges
- ii) Authorisation of Merchant Bankers;
- iii) Control over Mutual Funds;
- iv) Issue of Insider Trading Regulations;
- v) Issue of Portfolio Managers Regulations;
- vi) Issue of guidelines for disclosure and investor protection.

Besides the above, SEBI could extend its arm to the activities like inspection of stock exchanges, protection for debentureholders, stopping misuse of promoter's quota, free pricing for public issues, entry rules for foreign institutional investors, rules for securities of development financial institutions, lead managers, bankers to the issue, underwriters and guidelines for flotation of public sector bonds, bonus shares and stock invests.

#### **Guidelines for the Issue of Securities**

The guidelines issued by SEBI provide for compulsory subscription by the promoters of companies. In case of new companies established by individual promoter and entrepreneur, the promoter's contribution should be at least 25 or 20 per cent of the total issued capital, as the case may be, depending on the size of the issue. In case of new companies set up by

existing companies with a 5 year track record of consistent profitability, a minimum of 50 per cent of total issued capital should be contributed by the promoters. There is a lock in period of 5 or 3 years for these contributions.

The Securities and Exchange Board of India (SEBI) recently modified the proportionate allotment system by reserving 50 per cent of the net public offer for allotment to individual investors applying for less than 1,000 shares or securities.

The remaining 50 per cent of the offer to the public could be set apart for individual investors applying for more than 1,000 securities and corporate bodies. Unsubscribed portion in either of these two categories would be added to the other category interchangeably.

In both the categories, the allotment would continue to be made on the basis of proportionate method of allocation separately. These changes in allotment procedure would come into effect for issues where acknowledgement cards are to be issued on or after June 1, 1995.

### **Evaluation of the Working of SEBI**

Notwithstanding the fact that SEBI's functioning has come under severe criticism, it is able to make a dent into the jungle of stock market. In spite of the hesitant attitude of the Government of India in tackling the situation, SEBI started its activity with a firm note. The constituents, which enjoyed the degree of freedom more than permitted levels, would normally be unwilling to curtail their activities. Even the stock exchanges have come into conflict with SEBI regarding the exercise of powers relating to calling for periodical returns, prescribing maintenance of certain documents, approving bye-laws, and licensing of dealers in securities in certain areas. As a matter of fact, Central Government has the authority to exercise these powers under the Securities Contracts Regulation Act, 1956. These are now sought to be transferred to SEBI through the new legislation.

To make SEBI perform and act on the lines of Securities Exchange Commission (SEC) of USA, the Government should provide powers to penalise and debar the wrong-doers. Further, the Government should also consider granting powers for *suo motu* action on any matter connected with the capital market. SEBI could not prevent or at least unearth a scam, primarily because it had no more power than urging the government to take suitable action to curb the speculative bursts in stock prices. Thus, if the SEBI is to be successful in its role as a regulator, it needs to have more powers to prosecute the errant members of the system.

In the recent past, SEBI is considerably disturbed over the developments in the primary market since the emergence of the M.S. Shoes scandal and CBI raids on the officers of SEBI and SBI Capital markets. The cancellation of several public issues, heavy undersubscriptions leading to withdrawals of commitments by underwriters have jolted the primary market. As such a SEBI in future may be required to play a crucial role in regulating, controlling and developing the stock market in India.

### Activity D

As a manager what are the important legislations you have to consider for incorporation, expansion and operation of your organisation nationally and internationally?

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### Activity E

Assuming yourself as a consumer, what procedure would you follow in safeguarding your interest when you are cheated by a trader by giving a defective product to you?

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## 2.8 SUMMARY

The viability of business depends upon the ability with which it can meet the challenges arising out of the political and legal environment. The political and legal environment of a country is influenced by political organisations, political stability, Government's interaction with business, constitutional provisions affecting business, foreign policy, etc. A stable and dynamic political environment is indispensable for growth. A successful manager is one who takes stock of the relevant politico-legal environment of his business and then capitalise on the opportunity available in that environment.

## 2.9 FURTHER READINGS

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Relevant Bare Acts.

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## **2.10 SELF-ASSESSMENT TEST**

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Treat each one of the objectives given as a separate question and try to answer it briefly.

BRAOU

## **UNIT - 3 : SOCIO-CULTURAL ENVIRONMENT - I**

### **Objectives**

After reading this unit, you should be able to :

- understand how a society is organised
- explain the social forces that contribute to social groups and social order
- trace the emergence of social values
- describe the process of social change.

### **Structure**

- 3.1 Introduction
- 3.2 Social Organisation and Social Order
- 3.3 Emergence of Culture
- 3.4 Social Strata and Classes
- 3.5 Women and Society
- 3.6 Summary
- 3.7 Further Readings
- 3.8 Self-Assessment Test

### **3.1 INTRODUCTION**

An understanding of the society in which the business operates is as important as any other aspect of business environment. A society in which there is order (and not chaos), peace (not endless wars between groups), support to individual initiative, democracy, rationality etc., may be an ideal society and the importance of all these are felt only in their absence. A market system which is essential for the operation of free business is not possible in a society whose members do not encourage individual freedom, initiative, and success. Similarly, individual behaviour of workers, entrepreneurs, and bureaucrats are influenced by the socio-cultural values of the society to which they belong. Changes also occur in a society and the businessman must be responsive to these changes. Culture reflects the crystallised ideas and shared values of the members of a society. Since these two are closely related to each other it is socio-cultural environment that is considered for the present purpose.

## 3.2 SOCIAL ORGANISATION AND SOCIAL ORDER

In our every day affairs we normally may not observe the common characteristics of organisations with which we deal. To analyse and explain social life, we must seek to identify the most general and fundamental characteristics of any social organisation.

Second, the process of social organisation may be identified with an explicit purpose and planned or may be with an implicit purpose and may be loosely planned.

As social relationships become increasingly patterned and recurrent, social life begins to evidence predictable regularities. Thus social order emerges from social interaction. These patterns of social order exhibit numerous characteristics that are not properties of the individuals comprising them. Although social order is continually being created and changed, observers constantly isolate specific instances of this process and describe the structural forms they display. Social ordering and social structure therefore refer to two complementary ways of analysing social life: the first perspective stresses dynamic processes while the second emphasizes static forms. Finally, collective social life always gives rise to shared symbolic ideas, which become associated with established social arrangements. Thus culture emerges from social ordering. Cultural ideas such as values, norms, rules and beliefs in turn influence and help to perpetuate patterns of social order. This overall process is social organisation.

Social relationships provide the threads of social life, but separate threads do not by themselves constitute a fabric. Countless on-going relationships of numerous hues and textures must be endlessly interwoven in complex patterns to create the continually flowing material of social organisation. Sociologists use the term social ordering to refer to this process, in which social relationships become arranged into multi-dimensional patterns that are relatively stable over time.

The absence of social order is sometimes called social anarchy.

Illustrations of social ordering can be drawn from all areas of human life. To cite a few common examples : most adults live together in pairs consisting of one member of each sex, and year after year share countless daily activities with their partner; store clerks smoothly carry out numerous exchange transactions with streams of customers, most of whom are total strangers to them; traffic flows primarily into a city in the morning, but out of the city in the evening; the members of a social organisation gather at a specified location on a particular day of the week at a certain time, and then engage in predictable and ritualised interactions; members of audiences at lectures remain quietly seated, rather than running about or shouting at each other; children usually progress through school at the rate of one grade per year; in most communities, stores and offices tend to be located in some areas, factories in other areas, and residences in still different areas; we deposit a letter in a Post Box with the confidence that it will reach its destination fairly quickly, regardless of where it is going or what information it contains; individuals who violate legal statutes are judged and punished through established, impersonal procedures, rather than by the persons whom they have harmed.

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### 3.3 EMERGENCE OF CULTURE

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As individuals interact with each other in recurrent social relationships to form patterns of social order, they generate ideas about these collective endeavors which they share with their fellow participants. As they communicate about common activities, exchange attitudes, values and beliefs develop common standards of action, and adopt similar ways of doing things, they create a culture. In short, cultural ideas emerge from shared social life. These cultural ideas in turn become associated with particular patterns of social order. If one seeks to become a member of an ongoing social organisation, he must not only engage in established relationships but must also acquire its associated cultural ideas. This does not mean that all members of a given social organisation necessarily think alike, but over time these participants will come to share a body of common ideas.

An example to illustrate this idea is that the development of capitalism as a form of economic order led to the creation of a "business ideology" and laissez-faire philosophy of government.

Cultural ideas, therefore, largely reflect and express their underlying patterns of social order. Although discrepancies often exist between ideas and practices, these differences cannot become too great without imposing severe strains and conflicts on both the social order and its accompanying culture.

Many pioneer sociologists borrowed this anthropological conception of culture as "the total way of life of a people" and rather uncritically applied it to all behavioral, social and symbolic phenomena.

Subsequently, the concept of culture has been used to refer include bodies of ideas that are shared by the members of a society.

As an illustration, some of the most commonly suggested list of the major value configurations in American society may be cited here as follows :

1. **Materialism.** Americans are prone to evaluate things in material and monetary terms ... they tend to get quite excited about things as opposed to ideas, people, and aesthetic creations.
2. **Success.** ... Part of the American faith is that "There is always another chance" and that "If at first you do not succeed, try, and try again".
3. **Work and Activity.** ... Work and activity are exalted in their own right; they are not merely means by which success may be realised; in and of themselves they are valued worthwhile.
4. **Progress.** A belief in the perfectibility of society, man, and the world has been a kind of driving force in American history. ... Americans tend to equate "the new" with "the best".

5. **Rationality.** Americans almost universally place faith in the rational approach to life. They continuously search out more "reasonable", "time-saving", and "effort-saving" ways of doing things.

6. **Democracy.** "Democracy" has become almost synonymous with "the American way of life". ... and they insist that "all men are created equal" and "governments [derive] their just power from the consent of the governed".

7. **Humanitarianism.** ... Philanthropy and voluntary charity have been a characteristic note of America. More attention has been given to numerous programs for social welfare, with government playing an active role.

One can examine the Indian society on these lines and may find that the priorities, the extent of sharing of these ideals, the very strength of these ideas are certainly different here.

An attempt may be made in this direction. (It is difficult to generalise and so what could be presented here is relevant to the core segment of the society. This is just as we generalise about human nature even though each human is unique.) Spirituality, rather than materialism must be at the heart of the typical Indian. So also a life centering around nature (as opposed to exploitation of the nature) and fine arts particularly the music, paintings and dance are valued. Secondly, a sense of collectivism, rather than individual's success prevails in the typical Indian social groups. They may not be so much persistent, and may give up if not successful in the first or second attempt. Thirdly, work and activity are secondary when compared with contemplation, leisure and sometimes a feeling that hard work (not necessarily the work one likes to do) is a sort of God-sent Punishment for the bad deeds done in the previous birth may also prevail. Fourthly, members of the Indian society probably believe that progress does not come from new alone, there has been only degeneration as mankind moves from one "Yuga" (millennium) to another. They also may not like to control the progress of events and prefer to leave things to forces or events themselves. Fifthly, the parallel value here may be reliance on intuition or on one's "inner voice", rather than rigid analytical thinking. Sixthly, a benevolent dictatorship or a materialistic leadership is more at the root rather than democracy as such. Even today it is true that the democracy that works here is different when compared with that in the West. Finally, in the Indian Society the concept of man itself is that human beings are transpersonal; each one is divine in a certain sense and even though poverty may be considered as a curse, there is an equally important concern for the welfare of the other.

Definition of a social organisation as an entity is a continual process. It is accomplished primarily through the development of boundaries, structural stability and a specific culture.

A few common types of organisational boundaries are described below, although this list is far from complete :

(1) Formal membership rosters, on which the names of all members of the organisation are listed. Formal membership status is frequently contingent upon some action by the individual, such as paying dues, professing a certain belief, or undergoing an initiation ritual.

(2) Interpersonal identification of members with each other, as in the case of most small friendship groups. One becomes a member of such a group when he is tacitly accepted by the other members.

(3) Geographical location, or physical presence in a specified area such as a neighbourhood or a community.

(4) Self-identification by a person with an organisation, as employed by some political parties and religious bodies.

(5) Limitations on social relationships, based on observations or prescriptions concerning who interacts with whom in what ways on a regular basis.

(6) Willingness to defend the organisations against disruptive forces - "if you're with us, stand and fight for us".

(7) Shared cultural values and norms, as in the case of ethnic classes and professional associations.

These types of organisational boundaries are not mutually exclusive, and many organisations use several of them simultaneously or under differing conditions. But all of them do serve to delineate the organisations from its environment.

The second step in delineating organisations as concrete entities involves the maintenance of structural stability.

Strong resistance to change in the social order of an organisation might result in lengthy persistence, as occurs in many primitive societies, which frequently endure practically unaltered for hundreds of years. But if such a society encounters disruptive social forces too powerful for it to resist - such as economic pressures from Western societies - its inability to change with shifting conditions will likely mean its destruction. The more highly interrelated an organisation is with its social environment, the more frequently it must change in many small ways if it is to preserve its fundamental patterns of social order.

The third and last step in the delineation of an organisational entity is the creation of a unique culture associated with that organisation. The concept of cultural uniqueness, whether in terms of the content or the arrangement of its component ideas must be recognised and need not be elaborated here. The main point is that any organisation tends over time to acquire a culture that differs in some way from the cultures of all other organisations, even though it may share many specific ideas with numerous other cultures.

## **NATURE OF SOCIAL CHANGE**

Conflict often produces changes in social organisation, conflict frequently accompanies change and becomes an integral part of this process, and change in one area of social life can in turn stimulate additional conflict in other related activities.

For analytical purposes, all sources of conflict and change can be divided into two broad categories: (a) sources external to an organisation, or stresses; and (b) sources internal to an organisation, or strains.

The major sources of external stresses are the four factors comprising the setting of all social organisations - the natural environment, population, the human being, and material technology - plus the social environment within which an organisation exists.

Internal strains constitute the second category of sources of conflict and change. Because strains originate within a social organisation, they will inevitably produce disruptions and tensions in that organisation.

## **SOCIAL POWER**

An inevitable outcome of any social organisation, whenever and wherever it (organisation) occurs, is the creation of social power. By ordering their social interactions and infusing their relationships with common meanings, participants in social organisations collectively exercise power that none of them could exert individually. Whether these organisations be small groups, families, communities, formal associations, functional networks, or total societies, their actions and activities always involve the wielding of power in social life. Social power is generated through the process of social organisation and is inseparable from it.

### **Activity A**

A foreigner is interested to know about 'Indian Society', with particular reference to Indian Business Community. List the points of observation you would like to share with him.

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## **3.4 SOCIAL STRATA AND CLASSES**

In describing patterns of stratification, sociologists commonly speak of social strata and social classes. Both are outcomes of the process of social stratification, and both help us explain the effects of this process on other aspects of social life.

Class organisation frequently develops around common concerns and living conditions that members of a society share as a result of their similar amounts of power, privilege, and prestige. As a class becomes delineated and acquires organisational unity, stability, and effective power, it tends to come into conflict with other classes and organisations.

Ancient Hindu society was organised on the basis of one's role and duty in the society, which in course of time developed into caste and community. Caste and community are not based on choice but by one's birth. Some became upper and some lower and these demarcations created more disadvantages to learn and grow to the lower strata of the

society. This disadvantage is being removed now so that all can become equals by virtue of their birth. But it is the irony of the situation that in the process of removing the caste barriers, the higher or lower status castes and communities are recreated, reconfirmed and used for several purposes.

As a society industrializes and thus expands its available resources, several interrelated trends begin to occur, all of which tend to promote considerable amounts of absolute upward mobility - though this is never inevitable. These social trends include: (a) a shift in the occupational distribution resulting from a decline in the number of unskilled manual jobs and a growth in the number of skilled and non-manual jobs available, which forces many people to be upwardly mobile in order to find work; (b) an expansion in the number of goods and services available to all persons, as a consequence of continually rising economic productivity; (c) expanding educational opportunities of all kinds, which provide routes for upwards mobility to many people; (d) declining birth rates, especially among higher-status families, which necessitates recruitment from below for many higher positions; and (e) creation of organisations such as labour unions through which less privileged persons can exert pressures upon elites to share the expanding benefits more equally among all persons. None of these trends is an imperative consequence of industrialisation, but to the extent that they do occur, they make possible more extensive opportunities for social mobility than have ever existed in the past.

Finally, as social mobility occurs in an organisation, it can take one or two basic forms: (a) career mobility, in which a person significantly changes one or more of his statuses during his own lifetime; and (b) generational mobility, in which a person's major statuses are noticeably different from those of his parents.

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### **3.5 WOMEN AND SOCIETY**

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All major social reforms may be found to be closely associated with the status of women. Hence understanding of a society will be incomplete without understanding the status of women in that society. Women have been given, in India, the highest status - that of the 'Sakthi', of a mother-god and the repository of cultural values and traditions. But this remains in mythology and in the higher levels of thinking. In day-to-day social life too they are praised that 'there is a woman behind every successful man' - the place given is always 'behind' and not on the side. Such subordinate, subservient and slave positions are even praised. Crime, especially the sexual abuse, is also a manifestation of their status - of her being used as a property meant for use/exploitation. Education and exposure to other societies have brought about significant changes in the social thinking in India. There is a gradual change. Women as a customer or purchase-decision maker and employee makes a lot of change in the business environment.

With the recently acquired socio-economic and politico-legal rights and privileges, women in India have achieved a new status which, with the addition of the role of working women to their already existing roles, is liable to bring about changes in their ways of looking at things. Various studies have shown that the attitudes of educated women, particularly of educated working women, have considerably changed, especially with regard to marriage and family, and with regard to their own status.

Ideas, beliefs and values are affected by and in turn affect the socio-cultural and politico-economic atmosphere of the country and in the democratic society of India. Words and expressed opinions become even more important. Though some of them might change certain attitudes before overt behaviour occurs, others would not, and this will give a picture of the expected patterns of their social behaviour.

Many psychological studies have revealed that women and girls are still more dependent on social approval than men. That is why it is difficult for them to break the traditions or to go against old customs and social mores, even at the attitudinal or thought level. The tendency to break away from tradition, even at the attitudinal level is obviously the result of several important social, personal and psychological factors.

As on other social institutions, so on the institution of marriage as well, economic, socio-political and legal forces have made their impact. Women's education, her rights of citizenship and other legal rights and ideas, including her outlook on conjugal relationship and attitudes towards marriage are also affected by the kind of cultural ethos of a particular society, because a real culture consists of the sum total of the behaviour of a society's members in so far as these behaviours are learned and shared.

The modern urban culture, especially that of the big urban centres, even in India, tends to accentuate and stimulate one's sexual susceptibilities. All the mass media, right from advertisement to the themes of popular literature are calculated to arouse erotic thoughts and desires.

The fourth World Conference on Women held in September '95 in Beijing crystallizes the world opinion. Accordingly, the World community, today, accepts that discrimination against women begins at birth, that it is not enough to plan to raise the status of women without ensuring that girls are allowed to be born, and that if that happens then they are educated and raised with a sense of self-worth.

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### 3.6 SUMMARY

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Social order emerges from social interaction when it takes place according to certain norms. Social relationships create social life and countless on-going relationships constitute social organisations. Cultural ideas largely reflect the underlying patterns of social order - although discrepancies often exist between ideas and practices. An examination of the socio-cultural phenomenon shows that each society may have its own system of values.

Social segregation on the basis of caste and community - as it turned out - is not acceptable to a modern society and the leaders are now more fully determined to remove this grey mark in the otherwise bright culture. The role of women is closely associated with all measures of social reform and change. The women's position, though taken to dizzy heights by calling them as 'Sakthi', mother-god, paradoxically is not so high in the present day society. Social norms are still harsh towards women and the legal support along with the educational and economic opportunities made available now may lead to definite improvement in the social status and role in the economy.

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### 3.7 FURTHER READINGS

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### 3.8 SELF-ASSESSMENT TEST

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1. "Society has different groups, and social conflict is nothing but a struggle to gain control over the society and its resources". Explain.
2. Describe socio-cultural environment in India.
3. What are some of the 'values' that social and cultural patterns support and sustain? Give a few examples.
4. How may changes occur in the social organisation and order?
5. Examine the role of different social strata and comment on the need for the methods intended to establish social justice.
6. Explain how social conflicts may affect the stability of business and the economy.

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## UNIT - 4 : SOCIO - CULTURAL ENVIRONMENT - II

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### Objectives

After reading this unit, you should be able to :

- understand the emerging issues of environmentalism
- explain the implications of consumerism
- discuss the growth of and limits to professionalism; and
- understand the role of (trade) unionism in the context of business environment.

### Structure

- 4.1 Introduction
- 4.2 Environmentalism
- 4.3 Consumerism
- 4.4 Professionalism
- 4.5 The Corporate Family Business Today
- 4.6 Trade Unionism
- 4.7 Summary
- 4.8 Further Readings
- 4.9 Self-Assessment Test

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### 4.1 INTRODUCTION

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In the concluding part of the discussion about the socio-cultural environment, certain residuary issues are considered. These issues, though not connected with each other, nevertheless form part of the overall environment. They reflect certain emerging trends in isolated areas but are quite relevant to the business environment. These specific issues range from environmentalism to trade unionism as may be seen in the next few pages. For example, environmentalism is a new awareness and the citizens who are committed to this may scrutinize a business decision from this point of view and raise objections, if any. As the awareness increases, many new dimensions of the environmental angle come to be recognized and the business may be forced to respond for the well-being of the society.

## 4.2 ENVIRONMENTALISM

Environmentalism is an organised movement of concerned citizens and government to protect and enhance man's living physical environment. Environmentalists, in so far as business is concerned, focus on the impact of modern production and marketing practices on the surrounding environment and the costs that are borne by this society in this regard. Environmentalists, in specific terms, are concerned with strip mining, forest depletion, factory smoke, billboards and litter; with the loss of recreational opportunities, and with the increase in health problems due to bad air, water and chemically sprayed food.

Whereas consumerists are concerned about need satisfaction, environmentalists are worried about the social costs of this satisfaction. Environmentalists are not against marketing and consumption; they simply want them to operate on more ecological principles. They think of the goal of marketing not as the maximization of consumer satisfaction but as the maximization of life quality. They feel that mass advertising leads people to buy more than they need, whereas consumerists worry more about deception in advertising; environmentalists dislike the proliferation of shopping centres, whereas consumerists welcome new stores and more competition.

Environmentalists want environmental costs formally introduced into the decision calculus of producers and consumers. They favour the use of tax mechanisms and regulations to impose this attitude. Requiring business to invest in anti-pollution devices, taxing non-returnable bottles, banning high-phosphate detergents are a few.

### **Implications and Issues for Business**

Environmentalism has a host of issues to be dealt with by the industries. The fragility of the environment must be a key concern for the manager of our times.

A study conducted by Global Environment Monitoring System found that residents in Tokyo had the lowest levels of lead in their blood. Petrol in Tokyo has been lead-free since 1976. In contrast, Mexico City contained the highest lead content and people there have the highest levels of lead in their blood. India has the dubious distinction of ranking the third highest, after Belgium, with 130 micrograms of lead per litre of blood. Tokyo had 60 as a comparative figure. The unleaded petrol from Indian Oil Refineries should hope to bring relief.

In 1991, Tata Risk Management Services (TRMS), a division of Tata Sons, conducted mock drills in Baroda. The drills revealed that some of the worst industrial disasters could catch the managements unprepared. There were no guidelines for an emergency plan.

The absence of a regulatory body is a lacuna in the system. The recent introduction of an environment audit may help solve this problem to some extent. But again laws are not the solution to the problem. It is here that the top management and the business have to be self-disciplined.

Average temperatures around the world today are higher by 0.3 to 0.6 degree Celsius than in pre-industrial times. As the globe gets hotter, the polar ice caps could melt, submerging

low-lying coastal areas and pushing thousands of people to the hinterland. Reversal strategies to check the mercury rise must be given top priority. These can include banning CFCs, stopping deforestation, reforestation, switching from oil and coal to gas, and inculcating the attitude of conserving energy. India can contribute its mite if the industries switch from coal to gas and solar power, according to the latest report of the Tata Energy Research Institute. And even if this results in a mere 0.1 per cent fall in temperature, it would be an achievement.

### **Emerging Opportunities due to the Emerging Movement**

Due to all this, the business stands to gain, due to the emerging opportunities they throw up. For instance, Consultancy, a market which is comparatively very small, at just Rs. 12 crore, is slated to increase to Rs. 100 crore by the year 2000 as demand in the country for specialized knowledge in pollution control grows. Another area, Auto Emission Control, depends on the seriousness of the government in implementing emission standards. International companies like AVL List GmbH, Austria, a world leader in engine development and instrumentation, has formed a joint venture with AVL India to make high quality portable automatic smoke meters that are used to measure smoke emissions from diesel vehicles.

Waste management is a market which involves the eco-friendly disposal of industrial wastes by specialized firms. Some signs of this business are visible in the thermal power plant sector, where small operators are converting fly-ash into bricks. Besides this, firms offering common effluent treatment plants and technology could find lots of clients in the small sector. Government-run common effluent treatment plants are already doing well in Madras and Hyderabad. The use of bio-technology to treat polluted water is increasing, especially in distillery effluents. New entrant Western Paques, a Pune based company that was one among the first to introduce anaerobic digestion technology for organic effluent treatment, has been growing fast since 1989-90. The future should see more of such advanced effluent treatment plants and tertiary treatment of water, which makes sewage water potable.

Toxic Waste Management, a largely ignored sector, has a high growth potential, specially after passing of the Public Liability Act, which holds promoters responsible for any harm to human life resulting from the generation of waste. Thermax of Pune has set up a Waste Management Division to make high-tech incineration systems for toxic chemical wastes. Flakt too is looking at this area seriously.

**Indian Pollution Control Equipment Market :** A research report prepared by Business International, the research wing of the Economist : 'Indian firms selling air and water pollution control equipment have a capacity in basic forms of technology, but lack expertise in hi-tech areas'. For example, in air pollution control, most bag filters still use polyester for the fabric filter, whereas firms abroad use glass fiber that takes care of high-temperature, chemical-laden gases. But the issue here is the cost and not technology. The cost of using glass fibre is 10 times higher than the cost of polyester. The Indian business, if concerned about the environment, has to make substantial investments in this direction. Environmentally aware firms, like Gujarat Ambuja Cements, have already moved to hi-tech by using Fiberglas bag filters. Also right now, there are no rules for controlling emissions of sulphur di-oxide from coal-fired thermal power plants.

And finally, the control of noise pollution. This is currently an area ignored by industry, but as awareness about the noise menace grows, so will business prospects for items such as industrial silencers and noise-absorbing building material.

The gloomy predictions of the environmentalists that mankind would use up the earth's natural resources at an alarming rate took on an air of frightening reality in 1973. Today in 1993, only a mere one-tenth of industries have undertaken measures to halt this. This points to the urgency and enormity of the issue.

The debate on protection of the environment is continuing. Included in its scope are suggestions for pollution control measures, designing products that do not generate pollution and making an environment-friendly lifestyle.

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### 4.3 CONSUMERISM

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Starting in the 1960s, American business firms found themselves the target of a growing consumer movement. Consumers had become better educated; products had become increasingly complex and hazardous; and Ralph Nader organised and led a very powerful consumer group and created world-wide awareness about consumerism.

Consumerism is an organized movement of concerned citizens and government to enhance the rights and power of buyers in relation to sellers. Apart from the available contractual rights, under various laws, these people wanted the following specific rights :

1. the right to be adequately informed about the more important aspects of the products;
2. the right to be protected against questionable products and marketing practices;
3. the right to choose from a variety of products and services; and
4. the right to be heard, to register their complaint and get their complaints heard for necessary redressal.

On the whole, these rights are intended to influence products and marketing practices in directions that will enhance the quality of life.

Each of these proposed rights leads to a whole series of proposals by consumerists. The right to be informed includes such things as the right to know the true interest costs of a loan, the true cost per standard unit of competing brands, the basic ingredients in a product, the nutritional content of foods, the freshness of products, the true benefits of a product, the name of the manufacturer, etc.

The proposals related to additional consumer protection include the strengthening of consumers' position in cases of business fraud, the requiring of more safety to be designed into products, and the conferring of greater powers to government agencies.

The proposals relating to the quality of life considerations include regulating the ingredients that go into certain products (detergents, gasoline, soft drinks, noodles) and packaging, reducing the level of advertising and promotional 'noise', and providing consumer representation on Company Boards to introduce consumer welfare considerations into business decision making.

### **Implications of consumerism**

A number of business concerns/firms/undertakings at first resented this rise of the new movement called Consumerism as it appeared to increase business costs more than the benefits it delivered to the consumer. They felt that most consumers would not pay attention to unit pricing or ingredient labeling and that the doctrines of advertising substantiation, corrective advertising, and counter advertising would stifle advertising creativity. But on the whole most of the business firms went about "their" own way. There seems to be not much change in view of consumerism.

At present, consumerism has made business realize that it is actually the ultimate expression of the marketing concept. It compelled the top management to involve itself. It forced them to consider things from the consumers' point of view.

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## **4.4 PROFESSIONALISM**

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The great majority of managerial positions in India till the 1980s were held by first generation businessmen. The wide growth of professional management as a career in the form we know it today is entirely a post-war phenomenon. It began to be abundantly clear that industry had forged ahead and was able to make rapid strides with indigenous management. At the same time, the wave of management education originating in Britain and America reached our shores. Expatriates and Indians returning from Harvard spread the message around. This saw the growth of management associations in major cities and the laying of foundations of management education courses. Even the established organizations of trade and commerce, and the managing agencies, began to take active interest in management education and began to revise the values looked for in applications for managerial positions.

The opening of this new channel of employment created a tremendous impetus to seek jobs in industry. This is the background of professionalism in India.

Ours is an age of specialization. We respect the authority of the expert. We reward it, often handsomely, and allow the expert's writ to run through most of those areas which directly affect our private lives also. The 112-year-old family-run Dabur India-known for its conservative, hands-on style - has initiated a process of restructuring. It is increasingly looking to professionals to pole-vault it into the next century. Engaged in such a complex area, there is now available a set of knowledge and experience based guidelines which attempt to narrow down the uncertainty of the factors which confront one in decision-making. The professional is trained to evaluate systematically and assess the scope and limitations of every dimension of the problem with which he is confronted.

In a strict legal sense, management is not a profession but professionalism is something different. What is emphasised under professionalism is doing a work in a professional way - with competence, commitment and with a sense of accountability.

### **Limits to Professionalism**

It is a fact that professionalism is yet to acquire discipline and character. The style of professional management, outside the traditional business families, is basically the style of the bureaucrat. Its reaction to the changing environment is therefore slow and not ruthless enough. Also, professional management is defeated by labour, because through the years of affluence no such attempt was made to curb the we-they attitude. The real challenge to professional management will come from the owner-manager or entrepreneurial class. This owner-manager class may be a small one, but members of the business families are large enough in number to fill important management positions in their enterprises. Increasingly, the next generation heirs and relatives are receiving professional training in modern management and science and economics and when they enter business they have all the advantages of the career manager and a lot more through heredity and stake in capital. All those who are groomed like this may have an edge over many of the managers who are first generation professionals.

For most organisations we can think of three broad types of decisions that have to be taken at various times by somebody or other connected with and concerned about the organization's welfare. These three levels of decision making are - Strategic planning, Management control, Operational control. These decisions have two dimensions - the levels and number of people involved in decisions, and the practices, methods, systems used for making decisions.

Organizations that recognize the basic logic of differentiation in decision making and seek practices to uphold the logic are likely to move towards greater degrees of professionalisation. A professional in management today is one who has trained his mind in a manner that uses all available evidence and tools with a scientific outlook to narrow down the risks of decision-making for the present and for the future; to sense the direction in which today's effort must be made. Today nobody can make a success of his business in isolation either from the public at large or from those whose livelihood depends on the business. The professional manager is not incidental in business - he is there because he feels he has earned the right through a deliberate choice of career, through an acquisition of knowledge and a training of mind which success in business will demand from one who has no stake in the capital.

For a long time there were no challenges which only competition could offer. Except for technical and financial experts in the production area and in the interpretation of accounts, little need was felt for professional managers in either functional areas or in the general administration or in managing the environment. Relatives, friends, ministers and bureaucrats were obliged by business magnates. 'Whom you know' rather than 'What you knew' mattered more. Blood tie was the only consideration, and loyalty is more important than capacity, since some business is engaged in malpractices, secrecy was felt essential.

In the public sector organizations, which had to operate in the glare of parliamentary publicity, some rules and procedures were followed, sowing the seeds of professionalism (though it ended up in bureaucracy!). But despite this head-start of being theoretically

excellent, the effectiveness of these organizations were low and finally they floundered because of powerful pulls and pressures and corruption and political interferences.

There was an evaluation in perspective from 'the firm as me' through 'the firm as our family', to the firm as itself. In the non-family firm, the separation of authority between management and ownership provides a built-in objectivity. Management must justify itself to ownership, and there are mechanisms for reporting on performance and discussing the future - the annual report, the stockholders meeting, and the board of directors. The family firm need observe no such.

### **Family Business and Professional Corporate Enterprises**

In the traditional family business scene of yesteryear, opportunities for employment in industry and commerce were limited. Significant business houses, like Tatas, the Walchands, Birlas, Dalmias, Shrirams and other textile magnets, were not only few, they were also family managed ones. Industry itself was in an elementary stage, because India was treated as a dumping ground for the products from U.K. Given this scenario, very few businesses bothered about being professional!

#### **Activity A**

Read magazines like Business World, Business India, etc. regularly and try to get some latest facts and figures concerning developments of some selected companies within Indian Corporate world.

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#### **Activity B**

Make a list of professionally managed companies in India and also state the reasons for treating them as professionally managed.

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## 4.5 THE CORPORATE FAMILY BUSINESS OF TODAY

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The corporate business houses are evolved either from the family businesses of yesterday or the new breed of entrepreneurs of today. But one common feature of these enterprises is that they are professional or at least strive to that end.

The current business scenario is particularly different for family businesses. Business families are brandishing a new strategic weapon - the cleaved corporation. But unlike the past, however, today's break-ups are characterized by harmony - not hatred. With the cultural change in business, the families want to avoid the consequences of competitive greed, and in the process preserve their image. So instead of fighting over the spoils, families are systematically apportioning their businesses among their members on the following principle : allow each of the inheritors to focus on his/her competence. As the families themselves prefer to call it the present scenario is one of "reorganization", "not split".

What are the forces behind this reorganization? The answer is competition. Defending a diversified empire against focused corporations attacking each of their enterprises is testing the abilities of the business families. Their set-ups are unwieldy in terms of size, and unmanageable due to sheer diversity. Hence dividing businesses along competence makes them competitive. Secondly, aspirations of every member cannot be met under joint ownership. Finally, peaceful sharing of assets is more strategic than messy squabbles.

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## 4.6 TRADE UNIONISM

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Trade Unionism is a movement, traditionally begun for championing the underdog. Unions have consistently 'fought' for the rights of the so called 'under-privileged' in the organization.

Every union has certain institutional needs that must be met if it is to retain its members loyalty. If the management ignores the union, the only way the union can preserve its status is by opposing the management. In practice, the role of the trade unions vary from outright opposition to complete participation.

### **Unionism in Action**

Take the case of introduction of new equipment that will require workers to learn new jobs and assume new responsibilities. The typical approach in some companies is for the industrial engineer to make all the necessary plans, perhaps in consultation with the supervisor. When the equipment arrives, the supervisor assigns the people to the new jobs and the personnel department computes their revised pay scales. Almost inevitably, the union will find something wrong with the change and file a grievance - perhaps even sponsor a slowdown or wildcat strike. Why? Were the union to accept the management's action passively, it would be abandoning what it regards as its proper role. The way out to save face is to oppose the proposed changes.

In other companies the union/s status is preserved, and management customarily informs the union about the changes, asks for suggestions and bargains over the new pay scales. Bargaining implies a willingness to talk things over and to make compromises in an effort to get the group's approval to proposed changes. Collective bargaining is difficult with non-unionized groups as there is no established mechanisms to rely on. Ofcourse, management is under no obligation to bargain over every change it wants to initiate.

### **Some Issues of Contention**

There are quite a few traditional areas of contention between the unions and the management.

Union's attitudes towards job evaluation vary greatly. Union's objections to this centre around the charge that job evaluation is a management tool used to restrict or eliminate collective bargaining. By its very nature, some unions argue, job evaluation prevents a realistic consideration of market forces or bargaining strength, and it makes it impossible to work out adjustments suited to individual needs. Nevertheless, it gets to be introduced in most companies due to the union's insistence that something be done to eliminate wage inequities.

Many organizations use merit rating to determine which employees should receive merit increases that raise their salaries above a minimum set by the job evaluation. Occasionally, merit rating is also used to determine who is to be promoted. As such it is akin to performance evaluation at the management level. This practice gives rise to some special problems, like having to promote a junior employee, overlapping rate ranges and in developing a scale for job classifications. Unions in general oppose merit rating, insisting that it opens the door to rivalry and ill-feeling among the employees and to favoritism on the part of supervisors. They would prefer that all employees receive the same rate, and feel that movement upwards should be based on seniority.

Salary administration for executives involves another area of dispute. Since individual differences are larger in this group, most companies rely on performance appraisals, than job-evaluation. These companies also permit a certain amount of flexibility in this evaluation system to provide for individual bargaining - that is, to make it possible to grant a special raise to keep a good manager who has had a better offer from another organization. Then those who fail to get this 'increase' feel discriminated.

Bonuses relate reward to performance and are generally allocated according to a predetermined formula. The unions usually haggle over this formula till a mutually agreed rate is worked out.

### **Towards a Healthy Union-Management Relationship**

There is little doubt that the introduction of a union may prove to be a traumatic experience for the management. At the outset, the union may try to dramatize every company mistake, and the early days may be spent in destructive warfare. In some cases this period may drag on for months, with both sides trying to capitalize on the other's mistakes. While grudgingly accepting the existence of the union, the management may seek to limit its influence, and they may compete actively with the union for the loyalty of the membership.

Yet, of late, most companies develop a harmonious relationship and admit that the presence of union can have a beneficial effect on the organization.

### Activity C

What are the Trade Unions functioning at national level in India. Name the political parties to which they are affiliated.

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### Activity D

Read carefully the 'Chairperson's speech' of any two 'India's most excellent companies', for the latest year. Now, try to write atleast two paragraphs on each of the following :

- a) Socio-cultural Environment in India.
- b) Political-Legal Environment in India.
- c) Economic Environment of India.

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## 4.7 SUMMARY

The socio-cultural environment consists of certain specific forces which are the developments of the very same socio-cultural environment. Environmentalism is one such movement, a force, a new awareness and a new compulsion towards which the business must show a better understanding. Along with what is sometimes known as public interest litigation in India, the public awareness (about harmful effects of business decisions) seems to be developing fast. Similar is the case with 'consumerism'. Both try to enhance the quality of life. Business thinking has to be holistic and not shareholder or management-oriented alone. Professionalism is an internal development - the management is not a full-fledged profession but it is clear that management must be done in 'professional way'. The family - owned business too need such an approach. The true unionism is another force - the attitude of employees to take all grievances to the union and use the collective force -

has been supportive to the working class, sometimes at the cost of consumers. This force, though has a justification, needs to reorient itself to broaden its vision and to include in its force the interests of consumers and the rights along with duties.

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#### **4.8 FURTHER READINGS**

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Nehru, Jawaharlal, The Discovery of India, Calcutta : The Signet Press, 1946.

Prabhu, P.N., Hindu Social Organisation, Bombay : Popular Book Depot, 1954.

Madan, T.N., Family and Kinship, Bombay, Asia Publishing House, 1965.

Mandelbaum, D.G., Society in India (2 Vol.) Berkely:University of California Press, 1970.

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#### **4.9 SELF-ASSESSMENT TEST**

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1. Environmental debate is going on at the global level. What are issues under discussion?
2. What are the environmental issues which are directly relevant to the business and its manager?
3. How may the consumer rights be satisfied by a manufacturer of consumer goods?
4. Do you feel that 'consumerism' and the modern consumer-oriented 'marketing concept' are one and the same? Justify your answer with examples.
5. "A degree in management will not make a person professional. Professionalism refers to a different set of traits and competencies". Discuss.
6. The manager coming from a family - based business has many advantages and some limitations. Explain.
7. "Unionism" is a weakness of the employee which he wants to tackle by becoming a unionist. Explain. Is there much more than the individual gaining the strength of a large group?
8. Unionism is not confined to blue collar jobs. Why?

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## **BLOCK - II : POLITICAL ECONOMY**

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The relationship between Government and Business is a complex one. In a mixed economy like India, the interference of the Government may effect the business in either ways. Hence, there is every need for analysing the impact of government policies on business organisations, both public as well as private, carefully.

In this context, an attempt has been made in this block (in Unit - 5) to explain the relationship between Government and Business.

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# UNIT - 5 : GOVERNMENT AND BUSINESS

## Objectives

After studying this unit, you should be able to :

- understand the role of the Government in the economic affairs of a country, particularly in business activities.
- examine the policies of the Government of India in respect of public sector industries, large and small-scale industries in the private sector; and
- describe the policy and recent developments in respect of foreign direct investments in India.

## Structure

- 5.1 Introduction
- 5.2 Government - Business Interface
- 5.3 Government and Public Sector
- 5.4 Government and Private Sector
- 5.5 Government and Other Sectors
- 5.6 Government and Foreign Direct Investment
- 5.7 Summary
- 5.8 Further Readings
- 5.9 Self-Assessment Test

## 5.1 INTRODUCTION

Political economy, in essence, refers to the role of the Government in the economic affairs of a country. Since the nature of politics and political orientation (capitalistic, socialistic, communistic - genuine or moderated or fake) of the ruling party very much determines the economic affairs, these are assumed under Political Economy. Basically, the ruling Political Party defines the role of the state - whether it should be a "Police State" as in the olden days or it should be a 'Welfare State' as most of the modern Governments like to call themselves. When a state calls itself a 'Welfare State', obviously it is supposed to do all that is necessary for the welfare of its people. Whether the state itself should do it or it can arrange (through non-government sources) for doing it is an equally important question. Government - Business interface is one such wide area where political orientation determines the role of

the Government as far as it relates to business. In principle, the Government can run all or some of the businesses, keep all or some of the businesses under its direct control or assist all or some of the businesses to operate domestically and internationally. What is the ideal method is an un-settled issue. However, the new realisation emerging world over is that the dominant role of a Government is counter productive in the long-run.

Three major factors have contributed to the growth of government: (1) a demand for more government services, by current and would-be recipients of the service; (2) a desire to supply more government services, by the producers of the services; and (3) increased inefficiency, which results in more government spending to provide the same service. Hence, a more realistic balance for the government's role in the economic affairs is suggested.

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## **5.2 GOVERNMENT - BUSINESS INTERFACE**

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The Government's role sets the most significant part of the external environment of business. By and large, the role of the Government that concerns the private enterprise is in the regulations imposed, the incentives made available and the public sector investment and operations - in other words, the role can be explained in terms of entrepreneurial regulation, support and substitution. The common terminology used to describe all these activities is 'state intervention', obviously, in the context of a capitalistic economy. In a country like India, it may be through the central, state governments and through the municipal corporations. The laws imposed and the administrative action taken by these institutions can affect the functioning of private business. A better understanding of these laws and administrative actions as well as the rationale behind them is essential to those who want to understand business in the private sector.

The various measures of intervention are manifestations of the state's desire to achieve a designed direction or pattern in investment, production, distribution or consumption. The objectives behind such intervention are many. The most important among them are : (i) to conserve and channelize scarce national resources; (ii) to meet the basic consumption needs of the people, specially the weaker sections; (iii) to reduce the harmful effects of concentration of economic power and industrial wealth; (iv) to encourage widely dispersed industrial growth; (v) to protect or to encourage small-scale industries; (vi) to safeguard the economy from dominance by foreign investors; (vii) to conserve and to improve foreign exchange reserves; (viii) to protect or preserve the environment from the polluting industrial activities; and (ix) to protect the consumer from harmful or injurious articles and business practices. 'Public interest' is given as the underlying motive for recourse to these measures.

The Government today has assumed the role of a welfare state (by whatever name it is called) even though there is no generally accepted set of norms to define a welfare state. What is not open to serious question (by many) is that a welfare state must be democratic. Basically, it is a state in which public policy is predominantly concerned with the welfare of its members. The policy of the welfare state has different dimensions. Providing social services is a major segment of this policy. Social services aim at establishing a minimum standard of life. This is done by measures like : (i) protection of personal and economic rights; (ii) rehabilitation of injured, derelict or handicapped persons; (iii) publicly financed

education; (iv) prevention and cure of sickness, and other health services; (v) fostering the arts and the provisions of recreational facilities; and (vi) the provisions of social security, including housing, town and country planning. As far as economic policy is concerned, the wide range of thinking has not developed into a consensus as to what should be the nature of government intervention in the economic life of a nation. These have been changing depending upon the politico-economic philosophies of the parties in power.

The problem is that economic policy is essentially a matter of choice. The scope of economic policy includes the three conventionally recognized basic economic criteria of resources allocation, income distribution and the determination of the aggregate levels of income, output, employment and prices. But the scope of economic policy also encompasses, the fourth and more fundamental problem of structuring of the economic decision-making process itself, which influences the former three. But "the problem of structuring and restructuring the economic decision-making process - the problem of the organization and control of economic activity - is essentially a problem of the distribution of power in the society". In this sense, economic decisions can be explained only in terms of the ideologies of powerful groups in a democratic society.

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### 5.3 GOVERNMENT AND PUBLIC SECTOR

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Government owned companies (51% or more of equity owned by government) engaged in business activities are referred to as the public sector. On a deeper analysis, one can find that there can be only two basic reasons, viz., (i) ideology; and (ii) efficiency which justify the existence of the public sector. Resources allocated to the public sector as against the private sector can be justified only when the former is a more efficient way of resource allocation. Even pure ideology cannot ignore the efficiency criterion in resource allocation.

The reasons that justified the growth of the public sector are many. The public sector was expected to fulfill a number of functions and attain, often simultaneously, several social objectives. In many cases, they were created to promote those social objectives or externalities that, in general, would be inconsistent with private profit maximisation.

Basically, the state may either provide entrepreneurial support (by way of promotional and assistance policies) or entrepreneurial substitution (state ownership). Scarcity of capital in general and the difference in the attitudes towards risk between the private and public sector are the important reasons that favoured entrepreneurial substitution. The second objective has been to takeover the monopolies rather than regulate them in order to ensure that the monopoly profits accrue to the state than to the private sector. Incidentally, it was believed that the undesirable effects of monopolies may be avoided when the monopolies are owned by the State. The third objective was to control the 'commanding heights' or the 'key sectors' of the economy and this was based on socialistic ideology and the belief that state control of the 'commanding heights' is a necessary condition for equitable growth. Fourthly, public ownership has also been resorted to because of failure of initiatives by the private sector - usually by the taking over of 'sick' units to improve efficiency in particular. Then there are cases which are outside the 'traditional' fields where the private sector was said to be not endowed with the required managerial or technical capability. There are many more objectives which may be inferred by referring to one or more public enterprises. The 'other' objectives may be to:

1. provide public services
2. increase employment
3. reduce income inequality
4. promote regional development
5. stabilize prices
6. subsidise essential commodities
7. earn / save foreign exchange
8. promote exports in new markets
9. increase national self-sufficiency
10. promote national security
11. offset multinationals
12. earn profits for further investment

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 due to insufficient growth in productivity, poor project management, over-manning, inadequate attention to R & D and human resource development. Deterioration in work ethics, mismanagement, corruption and other evils in most of the enterprises have made a mockery of the objective of 'model employer'. In addition, public enterprises have earned a very low rate of return on the capital invested. This has inhibited their ability to regenerate themselves in terms of new investments as well as technological development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government.

Government therefore has been forced to adopt a new approach towards the public enterprises. The new policy states that a greater support will be given to public enterprises which are essential for the operation of the industrial economy to make them more growth oriented and technically dynamic. Units which may be faltering at present but are potentially viable will be restructured and given a new lease of life. The priority areas for growth of public enterprises in the future will be the following :

- a) Essential infrastructure goods and services;
- b) Exploration and exploitation of oil and mineral resources;
- c) Technology development and building of manufacturing capabilities in areas which are crucial in the long-term development of the economy and where private sector investment is inadequate; and
- d) Manufacture of products where strategic considerations predominate such as defence equipment (eight categories already referred to) may continue to be dominated by the public sector.

Competition will also be induced in these areas by inviting private sector participation. In the case of selected enterprises, part of Government holdings in the equity share capital of these enterprises will be disinvested in order to provide further market discipline to the

performance of public enterprises. This is a process known as privatization under which either some public sector units are sold to private sector or private enterprises are allowed to operate and compete with public enterprises. In postal services and television, privatisation has already come in a big way. Attempts have been made to bring in air transport, handling some shipment activities in ports. Private sector manufactured telephones are also in use as against the ones manufactured by the government owned Indian Telephone Industries (ITI). There are a large number of chronically sick public enterprises incurring heavy losses, operating in a competitive market and which seem to serve little or no public purpose in the present context. These need to be attended to and perhaps may have to be closed down if economic criterion justifies.

As on March 31, 1994 there were 240 Central Public Sector Undertakings (PSUs), excluding nine companies with Central Government investment but without direct responsibility for management, six insurance companies and three financial institutions. Of these, six were in the construction sector, 74 in service and 166 in manufacture. The total investment in central and state owned enterprises in 1993-94 was Rs. 63,000 crore (CAG Report).

Out of 240 operating PSUs, as many as 120 were profitable during 1993-94 as compared to 131 during the previous year. Profits of these profit-making enterprises went up from Rs. 7,384 crore in 1992-93 to Rs. 9,722 crore in 1993-94, an increase of 31.7 per cent. But the losses of the remaining loss-making companies increased from Rs. 4,113 crore to Rs. 5,287 crore, an increase of over 28.5 per cent, during the same period. The overall rate of return over capital employed in the PSUs increased from 2.33 per cent during 1992-93 to 2.78 per cent during 1993-94. But the gross margin (i.e., before depreciation, interest and taxes) of PSUs as per cent of capital employed declined from 18.01 in 1992-93 to 17.33 in 1993-94. The heavy capital investment in the past combined with a massive interest burden is reported to have reduced the gross margins of PSUs. Since July 1991, the Government has also been disinvesting a part of its equity held in selected PSUs. The Central Government has disinvested Rs. 4,950 crore in equities in 35 selected public sector enterprises, until the end of March 1994.

In order to establish a system of rehabilitation and restructuring of PSUs without Government having to bear the whole financial burden, the PSUs have been brought under the purview of the Sick Industrial Companies Act. By the end of 1994, 52 Central PSUs have already been registered (as sick) with the Board of Industrial & Financial Reconstruction (BIFR).

#### Activity - A

1. Consider a Small-Scale industrial unit in your neighbourhood. List out its interaction with the Government. For what decisions this business unit requires prior permission of the Government?

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2. At what stage the following laws become applicable to a business?

1. Excise Duty at the full-rate \_\_\_\_\_
2. Sales Tax \_\_\_\_\_
3. E.S.I. Act \_\_\_\_\_
4. P.F. Act \_\_\_\_\_
5. Factories Act \_\_\_\_\_
6. Shops and Establishment Act \_\_\_\_\_

**Activity - B**

1. Find out from a neighbouring big/medium business firm, and a public sector bank, about how much their mail (letters and telegrams, parcels) are sent through Department of Posts and how much through private courier services? And why?

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**Activity - C**

1. Distinguish the implications of the following terms :

Public Sector

Public Sector Industrial Undertaking

State Owned Enterprise

Government Company

Social Sector

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2. What are considered to be the "strengths" of public sector? Consider one company in your state and list out its weaknesses. (Don't give financial performance records)

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3. Profits cannot measure the performance of a public sector unit. Why?

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#### 5.4 GOVERNMENT AND PRIVATE SECTOR

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The private sector industries, excluding the small-scale industries, have been largely under government's regulations of various nature since 1951. The Industries (Development and Regulation) Act, 1951 introduced a licensing system which required these industries to obtain a licence for establishing a new undertaking, for subsequent expansion, to produce a new article, etc. Thereafter, concentration of corporate wealth and dominant market power also required a licence or clearance under the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act). Raising capital required a separate permission under the Capital Issues (Control) Act, 1947. The growth of large-scale units in the private sector, thus, for a long time, was considered not in the interest of a socialistic society.

Industrial licensing administered under the Industries (Development and Regulation) Act, 1951 has been abolished for all industries, except a few which are specified, irrespective of the levels of investment. These specified industries (15 categories) will continue to be subjected to compulsory licensing for reasons related to security and defence of the country; and certain important environmental (ecological) issues.

The MRTP Act was aimed at regulating expansion, establishment of new industrial undertakings, mergers, amalgamations and take-overs and the number of directorships one can hold.

These requirements under the MRTP Act have been removed since July, 1991.

Now, the remaining provisions of the MRTP Act enable the Monopolies and Restrictive Trade Practices Commission to inquire into and to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices. The Companies Act, 1956 is another legislation which regulates the private sector companies, particularly the organisation and management.

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## 5.5 GOVERNMENT AND OTHER SECTORS

The small-scale industries and the rural industries, though belong to the private sector, have been given a favourable and protective treatment by the government for a long time.

A small-scale industrial undertaking is one in which the investment in fixed assets in plant and machinery, whether held on ownership terms or by lease or by hire purchase, does not exceed Rs. 60 lakh.

An ancillary industrial undertaking is one which fulfills the following two conditions:

- (a) the investment in fixed assets in plant and machinery, whether held on ownership terms or by lease or by hire purchase, does not exceed Rs. 75 Lakh; and
- (b) the undertaking is engaged or is proposed to be engaged in the manufacture or production of parts, components, sub-assemblies, tooling or intermediaries or the rendering of services, and the undertaking supplies or renders at least 30% of its production or services, as the case may be, to one or more industrial undertaking.

Besides, industrial units were expected to be neither owned nor controlled by any other (Indian or foreign) undertakings. Under the new policy, however, the Government would allow upto 24 per cent equity participation in the small-scale sector by both domestic and foreign managed companies in India.

It would now be possible for big units to produce items reserved for SSIs, through their equity participation in the latter. The idea has been to provide access to the capital market and also to encourage modernisation of SSIs by their association with the larger units.

According to the new policy package for SSIs, the primary objective during the nineties would be to induce such units to contribute their mite to the economy in terms of higher output, employment and exports. Though this sector had been significantly delicensed, further efforts would be made to repose greater faith in young entrepreneurs. (All other statutes, regulations and procedures have to be modified wherever necessary, to ensure that these did not hit the interests of small and village units). The licensing system having been abolished for all practical purposes and foreign investment given a more or less free entry, the reservation policy for the small-scale industry (more than 800 products) may not make much sense and the protection may slowly wither away.

The policy on small-scale industries is implemented by state governments and it is here that conditions may make their establishment as lengthy a process as that of industrial licensing. The SSI unit in order to get registered need the permission of the State Director of Small-Scale Industries who scrutinises their applications and then their recommendations are necessary for allotment of raw material, power, water connections etc. The Employees State Insurance Act, Factories Act, The Provident Fund Act, Central Excise, etc., are applicable in most of the cases and the intervention by the bureaucrats under these laws is a regular feature. Though the Central Government has stated that visits of bureaucrats will be reduced, this takes quite some time to change the bureaucratic attitudes. One can easily find the element of arbitrariness if the organisation of the Department of the Director of Industries in the State administration is closely examined. A handful of administrators have

the authority to determine the raw material and other requirements for all types of small-scale industries.

A new scheme of integrated infrastructural development including Technological Back-up Services for SSIs is proposed for implementation with the help of State governments to induce industrialisation of rural and backward areas. The details are to be worked out. A Technology Development Cell would be set up by the Small Industries Development Organisation (SIDCO) to provide technology inputs to improve productivity and competitiveness of SSIs.

The number, employment, output and exports in the small-scale sector as estimated by the office of the Development Commissioner, Small-Scale Industries are given in Table-5.1.

**TABLE - 5.1**  
**SMALL-SCALE INDUSTRIES :**  
**NUMBER, OUTPUT, EMPLOYMENT AND EXPORTS**

Year	No. of units (in lakh) (As on 31st December)	Output at current prices (Rs. Crore)	Employment (in lakh)	Exports (Rs. Crore)
1	2	3	4	5
1991-92	20.52	178699	129.80	13883
1992-93	22.35	209300	134.06	17785
1993-94	23.84	241648	139.38	24000

Source : Government of India, Economic Survey 1994-95.

In real terms, the small-scale sector recorded a growth rate of 7.1 per cent in 1993-94, as against 5.6 per cent in 1992-93, and 3.1 per cent in 1991-92. These rates were significantly higher than the growth rates achieved by the industrial sector as a whole.

The small-scale sector contributes 40 per cent to the gross turnover in the manufacturing sector and 35 per cent of total exports. Several policy initiatives have been undertaken to assist the small scale sector and enhance its competitive strength. The measures include:

- A new scheme of Integrated Infrastructural Development was launched recently in 50 centres in rural and backward areas.
- The concessional rate of excise duty available for units with a turnover of Rs. 30 to 75 lakh per annum was extended to the non-registered sector also.
- A Quality Certification Scheme was launched in 1994 to improve the quality standards of SSI products which are to be assisted by awareness programmes and financial support to acquire ISO 9000 or similar international quality standards.

Modifications were effected in the 'Single Window Scheme' operated by SIDBI. The project outlay under the scheme was raised from Rs. 30 to Rs. 50 lakh as a whole, removing sub-limits for working capital and term loan components.

### **Cottage and Village Industries**

An industrial undertaking will come under 'tiny sector' when the investment does not exceed Rs.5 lakh. The village or rural or cottage industries are tiny units which are registered with the Khadi and Village Industries Board. The tiny units are eligible for additional marketing support on a continuing basis including access to institutional finance, priority in Government purchase programme and relaxation from certain Labour Law provisions.

In 1993-94 Khadi and Village Industries produced output valued at Rs. 3,490 crore and provide employment to 55.50 lakh persons. The Government of India has been extending infrastructural and input support to this sector. The policy package consists of supply of raw materials at reasonable prices, upgradation of technology and productivity through research programmes, training for artisans, flow of concessional and adequate institutional credit.

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## **5.6 GOVERNMENT AND FOREIGN DIRECT INVESTMENT**

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Inflows of foreign direct (Private) investment can potentially influence the host country's development objectives. The impact of such investments is often widespread. It can, according to a World Bank Staff Working Paper :

- affect the generation of income, foreign exchange, tax revenues and other related areas at the macro-economic level;
- affect employment and manpower skills in both the modern and the traditional sectors;
- change socio-cultural institutional values;
- have dynamic effects on competition, industrial efficiency, technological development and product innovation;
- have an impact on the 'control potential' of the host country's central government, other public authorities, domestic organisations and firms.

A great deal of literature has developed on these issues. The main findings point out the following problems :

1. The products produced by the private foreign investors cater mainly to the higher income groups.
2. The technology employed is often not suitable to the factor endowments of the host countries.

3. Sometimes, it is not within the capacity of the host country to adopt or absorb the technology.
4. Foreign firms engage in restrictive business practices and conceal profits mainly by transfer prices which cannot be easily known or taxed.
5. Large foreign firms have privileged access to local capital at the expense of local firms.
6. Policy stability is extremely important. Sound general economic policies help to build a good image for the host country and its economic development and create confidence. These factors are more effective in attracting foreign investors than the most favourable tax incentives.

The Foreign Exchange Regulation Act, 1973 which restricted the foreign direct investment in selected areas and to 40% of the paid-up capital of a company has been in operation till the new economic policy was introduced.

The new economic policy has made the foreign direct investment much easier to the investor. Accordingly, when conditions relating to ceilings on equity ownership, royalty, machinery and raw material are fulfilled the proposals are cleared almost automatically.

According to the new policy statement, approvals will be given for foreign investment up to 51 per cent of equity in high priority industries (34 as listed under Annexure III of the Policy Statement). These approvals will be available if the foreign equity covers the foreign exchange requirement for import of capital goods. The import of components, raw materials and intermediate goods and payment of know-how fees and royalties will be governed by the general policy applicable to other domestic units.

Other foreign equity proposals including proposals involving 51 per cent equity but which do not meet any or all of the criteria mentioned above will continue to require specific clearance.

### **Foreign Technology Agreements**

With a view to bringing in significant technological dynamism in Indian Industry, Government will provide automatic approval for technology agreements related to high priority industries within specified parameters. Similar facilities will be available for other industries as well if such agreements do not require the expenditure of free foreign exchange counterparts according to their own commercial judgement.

Automatic permission will be given for foreign technology agreements in high priority industries (a fairly long list of items listed under Annexure III of the government's notification) up to a lump sum payment of Rs.1 crore, 5 per cent royalty for domestic sales and 8 per cent for exports, subject to total payments of 8 per cent of sales over a 10 year period from date of agreement or 7 years from commencement of production. The prescribed royalty rates are net of taxes and will be calculated according to standard procedures. All other proposals will need specific approval under the general procedures in force. No permission will be necessary for hiring of foreign technicians, foreign testing of indigenously developed technologies.

## Foreign Direct Investment

Foreign investment inflows were the major factors behind the surge in capital inflows to the country from 1993-94. Total capital inflows (including IMF transactions) more than doubled from about \$4.3 billion in 1992-93 to \$9.2 billion in 1993-94, of which the share of foreign investment inflows rose from \$585 million (14 per cent) to \$4.1 billion (45 per cent). The contribution of foreign investment to capital inflows is expected to rise further in 1994-95 with an inflow of about \$3.9 billion already under this account in the first three quarters of the year.

The response of foreign investors to the liberalisation of the foreign investment regime has been very encouraging. Portfolio investment, including GDRs, has responded swiftly, to rise from under \$100 million in 1992-93 to nearly \$3.5 billion in 1993-94 and could be of the same order in 1994-95. There have been sharp increases in approvals of direct investment proposals, the value rising to \$2.9 billion (Rs. 8,957 crore) in 1994 from \$235 million (Rs. 534 crore) in 1991. The total DFI proposals approved during 1991 and 1994 amounts to \$ 7.2 billion (Rs. 22, 238 crore), against just under \$1.0 billion (Rs. 1,274 crore) approved during the whole of the previous decade (1981-90). It takes time for all these proposals to fructify into actual inflows, but there are already signs that the actual inflows are picking up.

### Activity - D

1. In a country like Thailand a highway / long bridge has been constructed by a Japanese firm and the price of construction and (excellent) maintenance is collected by the firm by way of a toll fee paid by the user. After a certain period the highway will become the property of the government. Do you find parallel provisions in India?

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2. What is meant by the reservation policy for the Small-Scale Sector?

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### Activity - E

1. Find out the impact of reduction in import (Customs) duties on the Small-Scale industries. Take one example and find out the facts.

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2. Has the above reduction taken away the benefits of protection (from competition from large units)? Illustrate.

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**Activity - F**

1. The new technology has necessitated a large increase in the economic life of an industrial unit. Write down two examples and justify.

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2. The demand for handicrafts has certainly increased but it is not so the plight of the craftsmen. Do you agree? Write one or two crafts and craftsmen. Find out the reasons.

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**Activity - G**

1. Foreign direct investment brings with it foreign exchange and technology. What else are the major advantages?

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2. If a US computer manufacturer wants to invest in India, what potential advantages he may expect here?

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3. What is the meaning of "level playing ground" that is often referred to in the context of competition between Indian business and foreign enterprises?

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## 5.7 SUMMARY

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While examining the inter-relationship between Government and business it is found that the Government would like to confine itself to a limited number of business activities in the future. The entrepreneurs of private sector, (Indian and foreign) then, will find that the economy has opened up and new opportunities can be used to enrich themselves as well as the country. The government may then play a watchdog's role and reduce the level of its direct intervention.

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## 5.8 FURTHER READINGS

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E.S.Savas, Privatization: The Key to Better Government, New Delhi : Tata McGraw Hill (1989)

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## 5.9 SELF-ASSESSMENT TEST

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1. Examine the government's policy relating to public sector industries in India.
2. What is the official definition of a small-scale industry and village industries? What are the types of government assistance available to them?
3. Under a liberal economic policy the fittest survives. Why? Can there be a safety net to the less competent and the handicapped sectors?
4. In the long-run the "State will wither away" said Karl Marx about Communism. Is it relevant to Capitalism also?

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## **BLOCK - III : ECONOMIC AND INDUSTRIAL POLICIES**

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The regulatory role of Government in relation to business is discussed in this Block. The Government, from time-to-time, is framing and issuing policies, legislations, guidelines, etc., for controlling and regulating the activities of business enterprises. In this context, an attempt has been made in this block to explain the various industrial policies framed by our Government and also the role of Securities and Exchange Board of India in regulating the Indian capital market activities.

This block is consisting of five units. Unit-6 dealt with Economic Policies and Legislation, whereas Unit-7 with the Economic Crisis of 1991. The New Economic Policy has been discussed in Unit-8, while the working of New Industrial Policy is explained in Unit-9. The last unit, i.e., Unit-10 is devoted for discussion on SEBI.

## **UNIT - 6 : ECONOMIC POLICIES AND LEGISLATIONS**

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### **Objectives**

After going through this unit, you should be able to :

- understand the different Industrial Policies beginning from 1948 and the ideologies behind each policy;
- appreciate the direction and pattern of industrial growth during the last 40 years as reflected in these policies;
- examine the rationale behind the changes that are to follow particularly since 1991.

### **Structure**

- 6.1 Introduction
- 6.2 Industrial Policies of 1948 and 1956
- 6.3 Industrial Policies of 1977 and 1980
- 6.4 Industrial Policy Changes in 1990
- 6.5 Economic Policy and Legislation during 1951-91
- 6.6 The Public Sector during 1951-91
- 6.7 Summary
- 6.8 Further Readings
- 6.9 Self-Assessment Test

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### **6.1 INTRODUCTION**

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After the economic goals of a nation are deliberated, and decided by the leaders of political parties in power, policies, programmes, strategies and also the enabling legislations for the attainment of such goals are necessary. In some of the free market economies there are only unwritten goals, policies and very few laws.

The existence of a specific, written down economic policy implies that it is decided by the government and is intended to shape or regulate the market forces in accordance with such a policy. India as a newly independent nation in 1947 resolved to have its own economic policies and subsequently, depending on the political and social forces further changes in these policies were made. In fact this is a continuous and never ending process.

When an economic policy evolves, it includes several aspects - the industrial, agricultural, foreign investment, fiscal - especially taxation measures, market regulation, poverty, etc. However, confining to industry, business and markets it may be said that the Industrial Policies of 1948, 1956, 1977, 1980 and 1991, are the various milestones that have shaped the progress of business and industry and thereby largely the economic development of the country.

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## 6.2 INDUSTRIAL POLICIES OF 1948 AND 1956

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Soon after Independence, the Government spelled out its Industrial Policy in 1948. A quick glance at this policy brings out the following special features: (i) The government proposed to establish a Planning Commission to formulate programmes of development and to secure their execution. (ii) Emphasis would be laid on production of capital equipment, of goods satisfying the basic needs of the people and of export commodities. (iii) Since the mechanism and resources of the government (at that time) could not permit it to enter the industrial field as widely as desirable, the ability to achieve the main objective determined the immediate extent of government responsibility and the limits of private enterprise. However, the Government desired that the state shall play a progressively active role in the development of industries. (iv) On the above consideration, there will be state monopoly of ownership and production in industries like arms and ammunitions, atomic energy, railways and vital defence industries. In coal, iron and steel, aircraft, ship-building, telephones, telegraph and wireless apparatus (excluding radios), mineral oils, etc. the new undertakings will be in the public sector and, if necessary, co-operation from the private sector may be sought. (v) In the remaining industries, private enterprise will be permitted to continue and expand. (vi) Another 13 industries required government regulations. The Resolution also briefly dealt with labour relations, taxation, administrative details, industrial housing, tariff policies, etc. It was proposed to review the policy after 10 years to make further decisions.

The immediate steps taken to implement the policy were; (i) the establishment of Planning Commission; and (ii) the passing of the Industries (Development and Regulation) Act, 1951, which introduced an industrial licensing system in the country.

In addition to the Industrial Policy, later the Economic Objective Resolution was passed by Parliament in December 1954. It declared a socialistic pattern of society as the objective of the country. The Resolution, besides recognizing the necessity of a faster rate growth and an equitable distribution of income, wealth and opportunities, laid stress on the point that "the basic criterion for determining lines of advance must not be private profit, but social gain." Further, the resolution clarified that "major decisions regarding significant socio-economic relationships must be made by agencies informed by social purpose." This part of the resolution has been the basis for the government in taking important socio-economic decisions for more than three decades since then.

The first Five Year Plan (1951-56) also elaborated on this that "The system of private enterprise will have to be very different from the one which now exists . . . Private industry will have to fit into a scheme of national planning equally with other sectors of national economy and will have to be so conducted as to satisfy the public at large, that it meets social needs adequately and avoids misdirection of national resources as well as exploitation or corruption".

The revised Industrial Policy Resolution announced in 1956 reflected the developments during the intervening period and further strengthened the Government's role in the industrial growth.

The Resolution of 1956 listed certain industries in Schedule A of the Resolution and reserved them exclusively for development under Government sector. While many 'basic industries' were listed in Schedule B where also the government wanted to establish new units, entry was, however, open to the private sector with or without government participation. All the remaining industries were to be considered as falling in the third category, the development of which would be ordinarily through private sector though it would be open to the government to enter this area too. The areas demarcated were not rigid and overlapping was to be permitted according to the merits of a case. In order to realize these objectives, the Resolution stated that it was essential to accelerate the rate of economic growth and speed up industrialization and, in particular, to develop heavy industries and machine-making industries to expand the public sector and to build up a large and growing cooperative sector. It was emphasized that the government would facilitate and encourage development of the industries listed in the third category in accordance with the programmes formulated in the successive Five Year Plans. It may be noted here that these demarcations have lost their significance in course of time and Public Enterprises started operating in businesses ranging from aircraft to bread manufacturing.

Apart from the above, the Policy stated that "equally, it is urgent to reduce disparities in income and wealth to prevent monopolies and the concentration of economic power in different fields in the hands of a small number of individuals." The policy recognized the adoption of the socialistic pattern of society as the national objective and stated that it shall be achieved by expanding the public sector and imposing controls over large industrial undertakings in the private sector.

Looking back, some might feel that achievement of economic equality with the developed nations of the world is only a propagandist goal. Instead, the pragmatic goal was growth as far as it leads, to do better than in the past, and to solve as many problems as possible.

**Activity A :**

Why an Industrial Policy is necessary for a country like India?

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**Activity B :**

List out the main features of Industrial Policy Resolution, 1956.

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### 6.3 INDUSTRIAL POLICIES OF 1977 AND 1980

For two decades after the Resolution of 1956, there was continuity in the party in power as well as the Industrial Policy. But in 1977, a different political party, the Janata Party, came to power and a new industrial policy was announced in December 1977.

The main thrust of the industrial policy announced in 1977 was on effective promotion of cottage and small industries widely dispersed in rural areas and small towns.

With a view to justifying the change in ideology, the statement throughout pointed out the failures of the earlier policy and thereby justified the new policy. This policy may be summarised as follows:

**Reservation for small-scale industries :** The policy on the small-scale industries was that whatever could be produced by small and cottage industries must only be so produced. "For this purpose, an exhaustive analysis of industrial products has been made to identify those items which are capable of being established or expanded in the small-scale sector". The list which included about 180 items prior to the announcement of the new policy, expanded to more than 500 with the announcement (and was later raised to 872 from January 1984, when the Congress Party was in power). The list was to be reviewed periodically so that capacity criterion does not lag behind the requirements of the economy. It must also be ensured that production in this sector is economical and of acceptable quality.

**The Tiny Sector :** Special attention will be given to units in the newly identified 'tiny' sector - defined as units whose individual investment in machinery and equipment is up to Rs.1 lakh and which are situated in towns with a population of less than 50,000 (according to the 1971 census figures), and villages. (However, there was no specific reservation policy on this sector).

**Khadi, Handloom and Cottage Industries :** The policy did not go beyond promising increased attention and new plans for the development of Khadi and Handloom cloth and cottage industries under promotional guidance of the Khadi and Village Industries Commission. It says that "the Government is committed to providing maximum financial and market support that is needed for promotion of the Khadi programme."

**Promotional Measures :** An institutional arrangement which was planned to assist the growth of small-scale and the tiny sector was the establishment of District Industries Centres, to be located in district headquarters. These centres are to be developed as separate agencies to deal with all requirements of small and village industries. The services expected to be provided were: "economic investigation of the district's raw material and other resources, supply of machinery and equipment, provision of raw materials, arrangements for credit facilities, an effective set-up for marketing and a cell for quality control, research and extension."

The above four aspects of the industrial policy are more or less interrelated and deal with the small-scale sector.

The Policy stated that the role of large-scale industries will be related to the programme for meeting the basic minimum needs of the population through wider dispersal of small-scale and village industries and strengthening of the agricultural sector. In general, the areas for large scale industry will be: (i) basic industries which are essential for providing infrastructure as well as for development of small and village industries which are essential for providing infrastructure as well as for development of small and village industries, such as steel, non-ferrous metals, cement, oil refineries; (ii) capital goods industries for meeting the machinery requirement of basic industries as well as small-scale industries, which require large scale production, and which are related to agricultural and small-scale industries development such as fertilizers, pesticides, and petrochemicals, etc.; (iii) high technology industries; and (iv) other industries, which are outside the list of reserved items for the small-scale sector, and which are considered essential for the development of the economy such as machine tools, organic and inorganic chemicals.

While a certain measure of growth of existing enterprises is inevitable and also necessary for the continued health of these enterprises, the growth of large industrial houses has been disproportionate to the size of their internally generated resources and has been largely based on borrowed funds from public financial institutions and banks. The policy stated that this process of using the funds of public financial institutions and not seeking other resources must be reversed. Since 1992 the trend seems to be to raise funds more by equity issues to the public.

The Government will regulate the activities of the large industrial houses through its licensing policy to bring them in line with the country's socio-economic goals.

In order to ensure social accountability, the financial institutions whose support is vital for setting up and running of large-scale enterprises will be expected to assume a more active role in overseeing the activities of undertakings financed by them. They, in turn, are to ensure that the management is increasingly professionalized and conforms to national priorities.

**Location of Industries :** The Government recognized the need for balanced regional development. The 1977 policy states specifically that:

The government have decided that no more licences should be issued to new industrial units within certain limits of large metropolitan cities having a population of more than one million and urban areas with a population of more than 5 lakh as per the 1971 census. State governments and financial institutions will be requested to deny support to new industries in these areas such as those which do not require an industrial licence. The Government of India would also consider providing assistance to large existing industries which want to shift from congested metropolitan cities to approved locations in backward areas.

But in less than 30 months the then ruling party disintegrated and the Congress Party came back to power. The Statement of Industrial Policy announced by the new Government in July 1980 is as follows :

The basic objective of the Industrial Policy of 1980 is to attain rapid industrialization and the "revival of the economy which is persistently inhibited by infrastructural gaps and inadequacies in performance".

This basic objective could be achieved by different ways. The major ways by which it was to be achieved are set out as the remaining objectives.

Firstly, the role of the public sector has to be strengthened. It was pointed out that the performance of the public sector had deteriorated sharply with the result that as against a profit of Rs. 3.89 crore it earned in 1976-77, it incurred a net loss of Rs. 32 crore in 1979-80. It has to be identified as the people's sector and not as 'nobody's sector', as it was rendered by the last government.

Secondly, a fairly positive recognition was given to the role of the private sector. The statement admits that the private sector would be allowed to develop "in consonance with the targets and objectives of national plans and policies." The growth of monopolistic tendencies or concentration of economic power, however, will have to be curbed.

Thirdly, the Industrial Policy of 1980 gave a new definition for the tiny sector, by revising their investment limits from Rs. 1 lakh to Rs.2 lakh per unit and for the small-scale unit raising the limit from Rs. 10 lakh to Rs. 20 lakh and for the ancillary unit from Rs. 15 lakh to Rs. 25 lakh. The DIC scheme was reviewed and it was felt that it "has not produced benefits commensurate with the expenditure incurred" and, therefore, new effective alternatives were to be planned.

Fourthly, the problem of development of backward regions was recognized and it was stated that the new policy would aim at economic federalism by setting up nucleus plants in each industrially backward district to generate as many ancillary, small and cottage units as possible.

Fifthly, the Statement recognized the importance of industry in creating a more favourable balance of trade by catering to the ever-increasing foreign markets. The government, therefore, decided to consider favourably requests for setting up 100 per cent export-oriented units, for expansion of existing units exclusively for purposes of export and for allowing higher production for exploiting fully the emerging export opportunities. In a number of cases, the Indian industry has not been able to compete in markets abroad because the scale of output which is related to the level of domestic demand is too small to give them the advantages of modern technology and economies of scale. In cases where a larger production base would increase the competitiveness of Indian industry abroad, the government will consider favourably the induction of advanced technology, and will permit the creation of capacity large enough to make it competitive in world markets, provided substantial exports are likely. The purpose of introducing such a policy would be not only to encourage exports but also to enable the industry to produce better quality products at lower costs which will ultimately benefit the consumer in terms of price and quality.

'Modernization packages' will be evolved to suit the requirements of each industry, and will include all the relevant aspects. It will also be the government's endeavour to ensure that the process of modernization percolates down to small units and the villages. With this end in view, the government will review the present arrangements in terms of special facilities

and incentives such as soft loans, establishment of proper linkages in the field of marketing and strengthening the credit facilities, particularly for the decentralized sector.

The Statement lays down that such industrial processes and technologies as would aim at optimal utilization of energy or the exploration of alternative sources of energy, would be given special assistance, including finance on concessional terms. Similarly, activities which have a direct bearing on and will contribute to improved environment and reduce the detrimental effects on pollution of air and water will also be made eligible for special assistance on appropriate terms.

Sixthly, in the case of existing sick undertakings that show adequate potential for revival, "it will be the policy of the government to encourage their merger with healthy units which are capable of managing the sick undertakings and restoring their viability. The existing guidelines will be reviewed with a view to facilitating greater reliance on voluntary mergers of sick units with healthy units which are capable of implementing a viable revival scheme."

The salient features of this policy may be summarized as (i) rapid industrialization (ii) revitalization of public sector industries (iii) regulation of large and monopoly industrial houses (iv) support to small-scale units (v) encouragement for advancing the technology, research and development (vi) balanced regional development in industrialization (vii) specific efforts in controlling environmental pollution and (viii) selective support for the revival of sick industries.

Since 1990, with a change in the government at the centre, further changes, though not radically different, are to be expected soon. It is a part of the economic administration in India that 'simplifying' and 'streamlining' of administrative procedures are frequently resorted to, which in effect appear like changes in the policy or at least with their implementation. With resource and administrative constraints on the increase, the industrial policy is likely to remain a broad philosophy and its practical significance less distinct in terms of the achievements.

### Activity C

What are the main changes in the Industrial Licensing Policy of 1980?

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## 6.4 INDUSTRIAL POLICY CHANGES IN 1990

The Industrial Policy has changed further with the change in the Government in 1990. The Policy presented to the Parliament on May , 31, 1990, however, has not referred to all aspects that are usually relevant to a comprehensive industrial policy. It has been titled as 'Policy measures for the promotion of small-scale industries and agro-based industries and changes in the procedures for industrial approvals'. With its limited scope, it has dealt with only a few aspects like small-scale industries, agro-based industries, foreign investment, collaboration and imports, location of industrial units, certain exemptions in respect of convertibility clauses inserted by Public Financial Institutions, their loan agreements with the industrial units borrowing from them, and further de-regulation. In all these aspects, one may find a further liberalization of the controls.

Some of the specific measures spelt out in the Policy are as follows:

1. The investment ceiling in plant and machinery for small-scale industries (fixed in 1985) has been raised from Rs. 35 lakh to Rs. 60 lakh and correspondingly, for ancillary units from Rs. 45 lakh to Rs. 75 lakh. In order to enable small-scale industries to play an important role in the total export effort, such of the small-scale units which undertake to export at least 30 per cent of the annual production by the third year will be permitted to step up their investment in plant and machinery to Rs. 75 lakh.
2. Investment ceiling in respect of tiny units has also been increased from Rs. 2 lakh to Rs. 5 lakh. However, with regard to their location, the population limit of 50,000 as per the 1981 census continues to apply.
3. A new scheme of Central Investment Subsidy exclusively for the small-scale sector in rural and backward areas capable of generating a higher level of employment at lower capital cost would be introduced.

With a view to improving the competitiveness of the products manufactured in the small-scale sector, programmes for modernization and upgradation of technology would be implemented. A number of technological centres, tool rooms, process and product development centres, testing centres, etc. will be set up under the umbrella of an apex technology development centre in Small Industries Development Corporation (SIDCO).

To ensure adequate and timely flow of credit for the small-scale industries, a new apex bank known as Small Industries Development Bank of India (SIDBI) has already been established in April 1990. One of the major tasks of SIDBI and other commercial banks/financial institutions would be to channelize need-based, higher flow of credit, both by way of term loans and working capital, to the tiny and rural industries.

In order to widen the entrepreneurial base, the Government would lay particular emphasis on training women and youth under the entrepreneurial development programme. A special cell would be established in SIDCO and state directorates of industries to assist women entrepreneurs.

4. All new units up to an investment of Rs. 25 crore in fixed assets in non-backward areas and Rs. 75 crore in centrally notified backward areas will be exempt from the requirement of obtaining licence/registration.
5. For the import of capital goods, the entrepreneurs would have entitlement to import up to a landed value of 30 per cent of the total value of plant and machinery required for the unit.
6. For imports of raw materials and components, imports will be permissible up to a landed value of 30 per cent of the ex-factory value of annual production. The ex-factory value of production will exclude the excise duty on the item of production. Raw materials and components on OGL will not be included within this 30 per cent limit. For all licensable items of raw materials and components, import licensing procedures will continue to operate.
7. In respect of transfer of technology, if import of technology is considered necessary by the entrepreneur he can conclude an agreement with the collaborator, without obtaining any clearance from the Government provided that royalty payment does not exceed five per cent on domestic sales and eight per cent on exports. If, however, lumpsum payment is involved in the import of technology, the proposal will require Government clearance.

Keeping in view the need to attract effective inflow of technology, foreign investment up to 40 per cent of equity will be allowed on an automatic basis. In such proposals also, the landed value of imported capital goods shall not exceed 30 per cent of value of plant and machinery.

8. The location policy would not be applied to such industries by the Centre except for location in and around metropolitan cities with population above four million. For these cities, location will not be permissible within 20 Km. calculated from the periphery of the metropolitan area except in prior designated industrial areas and non-polluting industries such as electronics, computer software and printing. It will be up to state governments to regulate industrial locations keeping in mind local conditions and requirements and their respective spatial Development Plans, and zoning and town planning laws. Similarly, environmental clearance would have to be obtained from the prescribed authority at the State level.
9. Hundred per cent export-oriented units (EOUs) and units to be set up in Export Processing Zones (EPZs) are delicensed if the investment does not exceed Rs. 75 crore.

Such investments shall be exempt from the convertibility clause applicable to financing by Indian financial institutions.

10. Units set up by MRTP / FERA companies will also be covered by the procedures set out above, but they will continue to need clearances under the provisions and regulations of these two Acts.

## 6.5 ECONOMIC POLICY AND LEGISLATION DURING 1951-91

The Industries (Development and Regulation) Act, 1951, through which the licensing system is operated, in effect empowers the government to licence (or permit) new investment, expansion of licensed units, production of new articles, change of location by the licensed units and also to investigate the affairs of licensed units in certain cases and to take over the management thereof, if conditions so warrant. The objectives behind these powers are, of course, development and regulation of industries. It is in the actual implementation of these objectives, while exercising the powers of the government under the Industries (Development and Regulation) Act that the relevant aspects of the industrial policy are expected to be fulfilled.

### WORKING OF THE LICENSING SYSTEM

Some important features in the working of the licensing system are worth noting. Table-6.1 provides information in this respect.

TABLE 6.1  
PROGRESS OF INDUSTRIAL LICENSES ISSUED

Year	No. of Letters of Intent Issued	No. of Industrial Licenses Issued
1978	440	348
1979	550	365
1980	946	475
1981	916	476
1982	1,043	432
1983	1,005	1,075
1986-87	997	882
1987-88	971 (525)	349 (147)
1988-89	1,215 (610)	332 (149)

- Note :
1. Figures do not include licenses (approvals by FIB) for foreign collaborations, which were, 636 in 1988-89.
  2. Figures for 1987-88 and 1988-89 do not include COB licenses.
  3. Figures in brackets refer to licenses for backward regions.

Source : The Economic Survey 1989-90, for 1987-88 and 1988-89 and RBI Reports on Currency and Finance for earlier years.

The criteria followed in granting a license leave a lot of scope to the discretionary powers of the government. But the damaging element is not only the power involved but the uncertainty about the outcome of a project proposal.

## REGULATION OF MONOPOLIES

One of the objectives of all the industrial policies has been to restrict the growth of monopolies. However there was no separate legislation to this effect for a long time. The Industries (Development and Regulation) Act, 1951 though had this objective, had no specific provision to deal with monopolies as such. As a result, till June 1970, it was only the administrative ad hoc decisions and discretions that had some regulatory effect on monopolies or concentration of ownership. It was on the findings of three official studies followed by the Report of the Monopolies Inquiry Commission that the need for a separate law to tackle the problem of concentration of wealth and monopoly power was felt and the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act) came into force on June 1, 1970.

The preamble of the MRTP Act states that it is an Act to provide that the operation of the economic system does not result in the concentration of economic power to the common detriment, for the control of monopolies, for the prohibition of monopolistic and restrictive trade practices and for matters connected therewith or incidental thereto.

The MRTP Act, broadly speaking, can be divided into two major parts. The first part deals with monopolies vis-a-vis the concentration of economic power, which is relevant here. The second part deals with restrictive trade practices, monopolistic trade practices and unfair trade practices and therefore are not discussed under Industrial Policy. The scheme of the Act as far as the first major part is concerned is that monopolies and industrial units which are construed to have a concentration of economic or monopoly power are to be identified, made to register themselves and their expansion, establishment of new undertakings, diversification, mergers and amalgamations are to be subjected to approval by the government. The directors of such organizations are also brought under some scrutiny with reference to the number of directorships held by them. In exceptional cases, the government may even force an industrial undertaking to divide into a number of undertakings. The criterion to decide in almost all cases involving the approval of the government is public interest and what is prejudicial to public interest is to be disapproved. The Act as one of its unique features, also provides a list of "matters to be considered by the central government before according approval."

## PRIVATE FOREIGN INVESTMENT POLICY

A policy regarding participation of foreign capital was announced in 1949, after the announcement of the first Industrial Policy Resolution. The Industrial Policy Resolution of 1956 has not changed the 1949 policy as far as foreign investments are concerned.

Accordingly, the objective is :

"Utilization of foreign capital in a most advantageous way to the country. The policy recognized the fact that Indian capital needs to be supplemented by foreign capital not only because our national savings will not be enough for the rapid development of the country on the whole as we wish, but also because in many cases scientific, technical and industrial knowledge and capital equipment can be secured along with the foreign capital. This policy also broadly outlined the country's desire to accept foreign capital under the conditions that (i) all undertakings, Indian or foreign, to

conform to the general requirements of the government's industrial policy; and (ii) as a rule, the major interest, ownership and effective control of an undertaking should be in Indian hands. The policy also gave assurances about the repatriation of profits and capital and equitable and fair compensation in the event of nationalization".

All foreign investments and collaborations require the prior approval of the government. The criteria laid down for screening each foreign investment proposal are not uniform. The general policy has been to restrict foreign investment or collaboration to those cases in which technical know-how is not adequately available indigenously or where domestic capital is not forthcoming. The administrative procedures for permitting foreign investment are almost the same as applicable to an industrial license under the Industries Act.

For the purpose of government regulations, certain norms and principles have been evolved with regard to the terms of collaboration agreements. For instance, royalties are generally permitted to a maximum of 5 per cent of the net sales, subject to tax, and in majority foreign capital participation, lower rates are generally prescribed. Similarly, royalty agreements are generally not allowed to run for a period exceeding 10 years and any option for renewal can only be exercised after obtaining a fresh approval from the government. The government favours capitalization of technical collaboration fees in some cases as it helps avoid immediate pressure on the balance of payments.

## **FOREIGN EXCHANGE REGULATION ACT**

As the preamble in the Foreign Exchange Regulation Act, 1973 (FERA), which replaces the earlier Act of 1947, describes it, this Act was passed to consolidate and amend the law regulating dealings affecting foreign exchange with a view to conserving the foreign exchange resources of the country and the proper utilization thereof in the interests of the 'economic development of the country'. The Act broadly deals with :

- assets held in India by non-residents;
- holding of immovable property outside India;
- employment of foreign nationals;
- establishment of place of business in India; and
- acquisition, holding, etc. of immovable property in India by non-residents.

The enactment of this legislation has far-reaching implications for companies that have hitherto been predominantly foreign-owned or controlled as these are now obliged to reduce the non-resident interest in them to forty per cent or lower so as to be out of the restrictions imposed by the Act. Reduction in the overseas interest in the shareholdings of these companies will by itself result in a substantial reduction in the foreign exchange remittances out of India by way of dividends, apart from enabling a new larger participation by Indian nationals in the share capital of such companies.

As has been expressly stated in Section 7 of the Act, any permission or license required under the Act will only be given having regard to all or any of the following factors, namely :

- consideration of the foreign exchange resources of the country;
- all foreign exchange accruing to the country is properly accounted for;
- the foreign exchange resources of the country are utilized as best to subscribe the common good;
- such other relevant factors as the circumstances of the case may require.

## 6.6 THE PUBLIC SECTOR DURING 1951-91

In the changing scenario, the commanding heights of the Indian public sector monoliths are on the verge of collapse. The sector now is being thrown open to face domestic as well as global competition.

The public sector (in 1992-93) comprises 237 operating units, 131 profitable and 58 chronically sick. Due to socio-political reasons, the chronically sick units are kept running. As per the latest available information, the profit making public sector companies together made a profit of Rs. 7,346 crore. The gross margin of the sector is around 11 per cent. The profitability of the sector has not improved over the last 10 years according to the latest Economic Survey. In terms of profits, the top five companies in the public sector are Indian Oil Corporation, NTPC, ONGC, MTNL and Steel Authority of India Ltd. Heavy capital investment in the past combined with massive interest had burdened the gross margins of the sector.

The capacity utilisation of the manufacturing companies numbering 123 in the public sector was around 75 per cent during 1992-93. The sectors like steel, coal, power and petroleum have shown improvement with respect to capacity utilisation over the previous year.

TABLE - 6.2  
PROFILE OF CENTRAL PSE'S

	1981-82	1990-91	1991-92	1992-93
1. Operating Enterprises	188	236	237	237
Profitable Enterprises	104	123	133	131
Loss-making Enterprises	83	111	102	104
(Rs. CRORE)				
2. Capital employed	21935	102083	117983	139933
3. Net Profit	445	2272	2355	3396
(PER CENT)				
4. Ratio of net profit to Capital employed	2.03	2.23	2.00	2.43

Source : E.T. Data Bank '95

## Activity D

Do you think that the present liberalisation policy introduced by our Government is justified? Give reasons.

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## 6.7 SUMMARY

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In a period of about forty-five years since Independence, the Industrial Policy has grown towards making the country a socialistic state and all the supporting measures were also meant to strengthen the same trend. Probably a saturation point was reached and government's role had to be reviewed since the outcomes were not satisfactory. This attempt is felt in the policy of 1991 and almost a total reversal of the first policy may be seen from the next year.

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## 6.8 FURTHER READINGS

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Ruddar Datt., KPM Sundaram, INDIAN ECONOMY, S. Chand & Company Ltd., New Delhi, 1995.

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## 6.9 SELF-ASSESSMENT TEST

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1. Describe the rationale and objectives behind the Industrial Policy of 1956.
2. "The Constitution and the Directive Principles of State Policy remain the same but there is a world of difference in the Government's role when considered in 1956 and 1991". Discuss.
3. Trace the changes in the official definitions of Small Scale Industry and tiny sector.
4. "Government's tightening of its grip over the private sector only lead to the failure of the policy" - Elucidate.

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## **UNIT - 7 : ECONOMIC CRISIS OF 1991**

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### **Objectives**

After studying this unit, you should be able to:

- explain the economic crisis of 1991
- analyse the consequences of import substitution and policy of self-reliance.
- comment on the structural weaknesses of India's external sector
- state the problems faced by the public sector
- discuss the important changes that are introduced in the Industrial Policy, 1990.

### **Structure**

- 7.1 Introduction
- 7.2 Economic Crisis of 1991 - Foreign Trade Situation
- 7.3 Consequences of Import - Substitution and Self-Reliance Policy
- 7.4 Foreign Debt-Debt Servicing Ratio
- 7.5 Exports Vis-a-vis Foreign Debt
- 7.6 Structural Weaknesses of India's External Sector
- 7.7 Public Sector and its Functioning
- 7.8 Rigid Labour Laws
- 7.9 Internal Indebtedness
- 7.10 Policy Changes after 1990-91
- 7.11 Summary
- 7.12 Further Readings
- 7.13 Self-Assessment Test

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## 7.1 INTRODUCTION

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No issue has dominated economic policy-making in the last few years as much as the problems arising from India's Balance of Trade. The situation by the middle of 1991 had become so critical that the country was almost on the brink of default. Foreign exchange reserves of the country were barely adequate to finance two weeks of imports.

In this context, the trend in India's Balance of Trade from the Sixth Five Year Plan onwards, consequences of the import substitution & self-reliance, functioning of the public sector undertakings, the important changes introduced after Industrial Policy, 1991 are mainly discussed in this unit.

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## 7.2 ECONOMIC CRISIS OF 1991 - FOREIGN TRADE SITUATION

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The deficits in balance of payments position started worsening during Sixth and Seventh Plans. During the Seventh Plan the country's foreign exchange reserves were down by about Rs. 4000 crore.

In 1979-80, balance of trade was negative by more than Rs. 3,374 crore and positive net invisibles were around Rs. 3,140 crore. The positive net invisibles were not adequate to offset trade deficit. Hence a deficit of about Rs. 234 crore emerged in the current account. Thus 1979-80 could be identified as the year of the beginning of economic crisis of 1991. The balance of payments problems continued to plague Indian economy during the Sixth Plan. The balance of payment problem that followed the second oil shock of 1979-80 worsened considerably from 1980-81 onwards. The merchandise trade account continued to show a large deficit with net invisible earnings playing a smaller role in financing this deficit. On an average net invisibles neutralised over 60 per cent of trade deficit during the Sixth Plan as a whole. The ratio of net invisible to trade deficit came down from 72 per cent in 1980-81 to 57 per cent in 1984-85.

India had to rely upon borrowings from IMF to meet the huge deficit in the current account of the balance of payment. Under the Extended Fund Facility of IMF, India was authorised to purchase 5 billion SDRS (Rs. 5200 crore) over three years effective from November 9, 1981 to support her external adjustment programme. To improve the capital account of the balance of payments, liberalised facilities for non-resident Indian (NRI) deposits and investments were announced in the Union Budget for 1982-83.

The strain on the balance of payments position had continued and to some extent intensified during the last four years of the Seventh Plan. The following table depicts the balance of payments position during the Seventh Plan.

**TABLE - 7.1**  
**BALANCE OF PAYMENTS DURING SEVENTH PLAN**  
**(CURRENT ACCOUNT)**

Year	Trade Balance	Net Invisibles	Current Account (Net) Rs. Crores
1985-86	- 9586	+ 3630	- 5956
1986-87	- 9354	+ 3523	- 5831
1987-88	- 9296	+ 3004	- 6292
1988-89	- 13555	+ 3145	-10410
1989-90	- 12413	+ 1025	-11388

SOURCE : Economic Survey (1990-91)

The mounting deficits in the foreign trade during 1985-86 to 1989-90 can be explained in terms of spurt in trade deficits on the one hand and relative shrinkage in the net invisibles on the other. The trade deficit - GDP ratio increased from an average 3.4 per cent during the Sixth Plan to 3.7 per cent in the first year of the Seventh Plan i.e. during 1985-86. Trade deficit-GDP ratio declined from an average of 3.4 per cent during the Sixth Plan to 3.2 per cent during the Seventh Plan.

The causes of acceleration in trade deficits can be summed up as under :

- (1) **The Policy of Import Liberalisation** : The process of so called liberalisation of the Import Policy regime was started way back in 1975-76 when the approach of Open General License (OGL) was effectively introduced. It is sometimes argued that import liberalisation has come by way of an imposition of IMF conditionality on India. The Import-Export policy of 1984-85 provided automatic and liberal access to actual users for import of raw materials and components. The scope of imports of capital goods under OGL was enlarged by adding 94 items of industrial machinery to this list. Liberal imports of computer hardware, software etc. were allowed. The Import Export Policy of 1985 placed 201 items of industrial machinery under OGL which led to an increase in the imports. The Import-Export policy of 1988 placed 745 items under OGL. Import liberalisation policy also led to liberalisation of imports of 53 items by 1985 policy and those of 26 items by 1988 policy. The trade policy of 1991, in one sweep, has brought over 1,500 items of capital goods and 2,100 raw materials and components under OGL. The quantum jump in imports has been partly the result of import liberalisation.
- (2) **The Policy of Technological Upgradation** : The Import-Export Policy of 1985 permitted trading houses and export houses to import technical designs, drawings etc. for supporting manufacturers to the extent of Rs. 25 lakh and Rs. 10 lakh respectively against REP additional licenses. The per unit value limit for import of capital equipment has been enhanced from Rs. 5 lakh to Rs. 100 lakh since it has a bearing upon quality and quantity of technical know-how and foreign consultancy under the technical development fund. As a result of this policy of technological upgradation, import bills increased, causing deficit in trade balance.

- (3) **Growth in Bulk Imports** : The share of bulk imports such as POL (Petroleum, Oil and Lubricants), ores and metals, fertilisers, cereals and edible oils in total imports has increased to 48.5% during April-September, 1992 compared to 45% during April-September, 1991.
- (4) **Sluggish Growth in Exports** : The sluggish growth in exports during 1990-91 and 1991-92 has been due to recession in the major industrial economies and a virtual collapse of exports to the erstwhile Soviet Union.
- (5) **Protectionist Trends in International Trade** : The growing trade deficits is the result of sluggish growth in exports. The growth in exports does not show acceleration because of the restrictive trade policies being followed by an increasing number of countries.

### **Causes for Deceleration in Invisible Surpluses**

Invisible surpluses have traditionally financed a large part of trade deficit. However, the trend has been on the decline during 1980-90 on account of a fall in net invisible receipts. The deceleration in net invisible can be attributed to decline in the share of travel receipts in gross invisible receipts, decline in gross private transfer receipts and increase in debt servicing. The significant increase in debt-servicing has put a strain on India's balance of payments. The debt servicing has increased from 8.5% of current account receipts in 1979-80 to 24% in 1991-92.

In the Seventh Plan (1985-86 to 1989-90) the current account deficit is estimated to have averaged at 2.2% of GDP as against 1.3% during the Sixth Plan. The persistent external pressure lowered the foreign exchange resources of the country from Rs. 6816.8 crore in 1984-85 to Rs. 5787.2 crore in 1989-90.

In 1990-91 the current account deficit in the balance of payments was \$ 7727 million which formed 2.5 per cent of GDP. This sizable deficit could be attributed to decline in NRI remittances from the Gulf region, decline in exports to the Gulf region and rise in import bill of oil due to rise in the price of oil in the wake of Gulf war. In 1991-92 the current account deficit was of the order of \$ 3026 million forming 1.0 per cent of GDP. In 1992-93 it increased due to sluggish growth in exports especially to rupee payment areas and revival of imports to more normal levels. The deficit was financed through a combination of traditional financing sources and exceptional financing.

The major problem faced in 1990-91 was how to finance the current account deficit. With the deficit rising, the only way it could be met was by drawing down the reserves. As at the end of December, 1990, the foreign currency assets of the Reserve Bank of India stood at US \$ 1.7 billion. This was despite the drawal of our reserve tranche in IMF of SDR 487 million. The low level of reserves in its turn triggered a number of consequences. India's resource to the commercial borrowing totally dried up as the credit rating agencies downgraded India. Simultaneously, there began an outflow of non-resident Indian deposits. In addition, there were serious difficulties in the rolling over of short term credit which was roughly of the order of US \$5 billion. While current account deficits of the order of \$ 8

billion was easily financed in 1988-89 a deficit of \$ 9.7 billion in 1990-91 became almost impossible to finance. The task before the Government was to explore means to finance the deficit. It was under these circumstances that India approached the IMF for an accommodation.

The year 1991-92 began badly with a further decline of reserves. The tasks before the government were to take steps to bring about a sharp compression of imports on the one hand and on the other, to find sources of exceptional financing to meet the current account deficit. A tight monetary policy was put in place. Severe import compression measures which were adopted earlier continued to operate. For raising the needed reserves to meet the current account deficit, unorthodox steps were taken, including the pledge of gold. In the meantime a stand-by arrangement with IMF was negotiated. Steps were also taken to obtain fast disbursing assistance from the World Bank, Asian Development Bank and some bilateral donors. Adjustments in the exchange rate, along with structural reforms in trade, industrial and foreign investment policies were simultaneously initiated.

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### 7.3 CONSEQUENCES OF IMPORT-SUBSTITUTION AND SELF-RELIANCE POLICY

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Prior to June 1991, most items of raw materials, intermediates, components and capital goods were importable only against a license, and imports were typically subject to a very high level of tariffs. The highly restrictive trade regime had become counter-productive. It provided unduly high protection for industry in which high cost domestic production was too easily tolerated, in the name of import substitution and self-reliance. The result was a high cost structure which made it impossible to compete in export market unless supported by large subsidies of one kind or another.

Not only were exports made non-competitive, but the system also encouraged domestic entrepreneurs to look inward in planning investments. Capacities were set up essentially to meet domestic requirements with the expectation that imports would automatically be shut out once the indigenous capacity was available, despite high costs. Inevitably Indian industry, especially the large corporate houses, did little to develop an export strategy or to actively explore niche markets in the world. It was necessary to change the system drastically, if the bias against exports and other type of foreign exchange earnings was to be reduced.

#### Activity A

Examine and comment on the main trends in India's Foreign Exchange reserves' position.

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## Activity B

What is 'Import - Substitution'?

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### 7.4 FOREIGN DEBT - DEBT SERVICING RATIO

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Indian economy during 1950-51 to 1984-85 utilised foreign aid to the tune of Rs. 31,437 crore. Of this, 78.5% were loans, and grants formed only 21.5%. During Sixth Plan the share of grants in the total external assistance declined to 16%. During Seventh Plan utilisation of external assistance was of the order of Rs. 22699.8 crore. During the period, the grants component of external assistance was around 11.5%. During 1985-86 to 1988-89, Rs. 14,851 crore worth external assistance had been utilised to finance the deficit in balance of payments. In 1991-92 total aid utilised was of the order of Rs. 11,615 crore. The share of grants in aid utilisation was just 7.9%.

The problem of debt servicing is the most serious of all problems associated with external assistance. The term "debt servicing" refers to amortisation of loans and interest payments. The amount of total debt servicing has risen from Rs. 2,523 crore in 1984-85 to Rs. 15,928 crore in 1991-92. During 1989-90 around 56% of external assistance was used towards the servicing of past debt. Around 25% of the export earnings are drained out in the form of debt servicing charges.

Foreign aid is always with strings. The advanced donor countries stipulate certain implicit or explicit conditions with the aid. The shrinking grants components in aid reduces the efficiency of aid.

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### 7.4 EXPORTS VIS-A-VIS FOREIGN DEBT

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From the point of view of development, export trade plays the dynamic role of converting a part of the domestic resources into the more productive forms of capital, machinery and equipment. This conversion is direct and immediate where the import bills are paid from current export earnings, and indirect where the imports are first financed by foreign loans which are subsequently repaid from export earnings.

When imports are financed by exports, the domestic buyer has the freedom to buy from the market of his choice and at the best of competitive price whereas when imports are financed by foreign aid, the source of supply is restricted to the market of the lender and prices are more often likely to be marked up by the sellers in the lending country as they know that the buyer has hardly any choice in the source of supply.

However, in spite of the best efforts, it may not be possible for a country in the early stages of development to finance the needed imports entirely by exports. The developing country therefore has to seek foreign loans or foreign participation in investment activity. Loans carry interest and the principal has to be repaid, while foreign participation in domestic economic activity in which remittances of profits and eventual repatriation of capital. All this means foreign exchange, which can only be acquired through increase in exports.

## 7.6 STRUCTURAL WEAKNESSES OF INDIA'S EXTERNAL SECTOR

The following structural weaknesses of India's external sector are responsible for sluggish growth in her exports :

- (i) India's exports do not pick up in periods of boom conditions in the world economy to the same extent as the exports of many other competitors. On the other hand, India is quick to pick up sluggishness in exports in response to sluggishness in world trade much more quickly than other exporters. It is evident from the fact that India's exports in dollar terms decelerated during 1990-91, 1991-92 and 1992-93 when the developed economies were under the grip of recession.
- (ii) India's exports register a growth largely due to growth of market rather than by the extent of market penetration. The extent of market penetration depends upon the extent of competitiveness of exports.

The competitiveness of India's exports has not increased due to low productivity and consequently high costs. The uncompetitiveness of Indian products could be attributed to the growth of domestic industries under the umbrella of protection. However since July 1991, reforms under the new Economic Policy have been effected to impart inherent competitive strength to the industrial sector to expose it to the international competition. But to be competitive, the technological base of Indian economy has to be strengthened. Another important weakness of the external sector is the lack of export culture. In fact high type of export culture embraces within its purview production of exportable goods of high quality, with proper packaging, delivery schedules and after sales service etc. India suffers a good deal in regard to her export image due to lack of export culture. The export culture can be built up by an integrated approach to export promotion. An integrated approach envisages competitive price, right quality, proper packaging, compliance with delivery schedule and other terms and conditions of export order.

Another weakness of India's external sector is the tendency for exporting what we produce rather than producing especially for export. In fact exports require totally different type of products from the products produced for the domestic market. Since domestic market is not quality conscious and the international market requires superior quality and technologically latest vintage products, it requires substantial product differentiation to promote export. The tariff and trade policies created business to the import of goods from developing countries which lead to our consumers being satisfied with whatever quality was made available to them and thus since the manufacturers could push through the product despite their poor quality there was no compulsion on the part of Indian manufacturers to improve upon their product quality.

## 7.7 PUBLIC SECTOR AND ITS FUNCTIONING

The number of central public enterprises has risen from 163 in 1980-81 to 236 in 1989-90, capital employed from Rs. 18,207 crore to Rs. 19,787 crore and turnover from Rs. 28,635 crore to Rs. 1,18,355 crore. They made a gross profit before interest and tax of Rs. 11,355 crore in 1989-90 and they generated internal resources (gross) amounting to Rs. 11,372 crore as compared to Rs. 1,225 crore in 1980-81.

It may be added that a major portion of the public sector industrial investment is in the infrastructural industries and has supported and formed the basis of the country's industrial progress since the beginning of planning.

As can be seen from above the growth of the public sector is indeed impressive. But the success is quantitative and not qualitative. Out of the 237 operating public enterprises, 102 enterprises incurred a total net loss of Rs. 3,674 crore in 1991-92. It is estimated that there are 50 chronically sick public sector units. The accumulated losses of those units stood at Rs. 6,367 crore at the end of March, 1990.

Some of the important reasons responsible for the poor performance of the public enterprises are lack of emphasis on profitability, unsatisfactory location, under-utilisation of installed capacity, lack of technical feasibility, delay in project commissioning, lack of professionalisation of management, defective staffing, recruitment and promotion policy, lack of rational pricing policy, inefficient materials management, political interference, etc.

The profitability criterion was not given a proper place. Some of the persons who formulated the policy of these undertakings as well as those who were entrusted with setting them up and with turning them played down the idea of profits and unduly emphasised the welfare aspect. It is only recently that the profit aspect of state enterprises has been insisted upon.

Another unsatisfactory feature of public undertakings is their uneconomic location. There is a clamour for locating these undertakings in certain regions on the part of the ruling party bosses, influential persons and public leaders. The Economic Survey 1992-93 reveals that the poor performance of Nagaland Paper Project has been due to its inappropriate location.

Low utilisation of capacity has been a very important reason for the low profitability. Enormous installed capacities have been created with the help of foreign credits and know-how on easy terms, but of which fuller use has not been made. The phenomenon of under-utilisation has arisen out of overestimating demand, administrative deficiencies, lack of proper working techniques, labour troubles, failure to install balancing equipment or making technical improvement essential for fuller utilisation of capacity.

**Lack of Feasibility Study :** The committee on public undertakings in its thirteenth report points out how faulty has been the planning and how poor was the quality of studies carried out in connection with some important projects. It is pointed out that tenders were invited without any project report in the case of Bombay Fertiliser Project, Hindustan Pesticides and Indian Telephone Industries.

It is inconceivable that a business project involving huge amounts should be launched without essential preliminary. Delay in project commissioning was generally a rule rather an exception. It unnecessarily raised the cost of construction and deprived people of the fruits of the project much longer than was necessary.

Lack of professional management, defective staffing, recruitment and promotion policy have also contributed to the inefficiency of public sector. Lack of performance accountability has added to the problems. Political interference and lack of autonomy have significantly eroded the desire of public sector to be vibrant.

Large volumes (approximately Rs. 1,01,800 crore as at the end of 1990-91) of public resources are invested in the public sector and measures to increase the efficiency of the public sector must have high priority in any reform effort. A few public sector units are doing well but there is little doubt that the sector as a whole has not generated adequate surpluses for reinvestment and too many enterprises are chronic loss makers, putting a heavy burden on the budget. These problems are common to most countries going through structural adjustment and all are taking corrective measures. Many countries have responded with aggressive privatisation programmes involving transfer of management to the private sector. Explicit privatisation of this sort is not being contemplated in India.

If many public sector undertakings have been surviving year after year despite making losses it is because they are being subsidised by public exchequer. The budgetary support for loss making public sector is being phased out progressively. During the sixth plan this support added upto 58.4% of the central public enterprises plan outlays, with the balance financed from internal resources (36.7%) and budgetary resources (4.9%). During the Seventh Plan, central budgetary support declined to 40% and the affected public enterprises had to bend for themselves. There has been a further decline in budgetary support with the figures budgeted for 1992-93 being just 18.6%.

The PSUs have also been told that in future they will have to generate resources to finance future investment primarily through internal surpluses or by accessing the capital market, again putting a premium on efficiency and financial liability.

#### **Activity C**

List out five public enterprises which are producing goods and another five enterprises producing services.

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## Activity D

Refer the latest Survey of Public Enterprises and prepare a list of top five profit - making and top five loss - making units.

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## 7.8 RIGID LABOUR LAWS

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Because of the regulated and rigid labour laws the Indian labour has not enjoyed an environment which promotes initiative, enterprise and the freedom to contribute strongly to the development process of the industry and to their own self development process. We need to ensure work ethic, work culture and sense of self-fulfillment. Labour laws should result in strong employee involvement. Laws are built in the absence of trust between the management and labour and consequently leading to low productivity. Rigid labour laws have not created a free and fair environment for policy making and decision making and has resulted in misuse and abuse by one side or the other. Labour laws should lead to harmonious industrial relations between the management and employees.

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## 7.9 INTERNAL INDEBTEDNESS

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Public debt can be classified as internal debt and external debt. The internal debt comprises loans raised from private individuals as well as from financial and other institutions in the country. The external debt consists of loans obtained either from international financial agencies or from foreign governments.

Public debt comprises (i) permanent debt i.e., loans raised in the markets in India as well as long term securities issued to the Reserve Bank of India in conversion of ad hoc treasury bills; (ii) floating debt i.e., largely treasury bills and (iii) external debts. All those items of public debt are marketable.

Besides marketable public debt, there are other non-marketable obligations of the Government of India. These include small savings, State Provident Fund, PL-480 deposits, income-tax, annuity deposits, Public Provident Fund etc., and balances in the various reserve funds and deposit accounts such as depreciation and other reserve funds of departmental undertakings like Railways, Post and Telegraphs, deposits of local funds, civil deposits, etc. These are other liabilities of the Government of India.

**TABLE - 7.2**  
**PUBLIC DEBT OF INDIA - 1950-51 TO 1991-92 (SUMMARY)**  
(Rs. Crores)

	1950-51	1960-61	1981-82	1982-83	1991-92
Internal Debt	2022 (98.5)	3978 (84)	35726 (74)	46936 (77.4)	170104 (82.7)
External Debt	32 (1.5)	761 (16)	12358 (26)	13685 (22.6)	35501 (17.3)
Total Public Debt	2,054	4,739	48,084	60,621	2,05,605

The percentage shares of two broad components are indicated in brackets below their respective figures.

The market loans and treasury bills have been the two pillars on which the edifice of Indian Internal debt has rested.

The outstanding debt liabilities of state Governments stood at Rs. 69,587 crores at the end of March 1988. A major part of the State debt liabilities (Rs. 28,088 crore or 71.5% at the end of March 1988) is accounted for by loans and advances from the Central Government for plan and non-plan purposes.

Total interest payment on internal debt increased from Rs. 40 crore in 1950-51 to Rs. 32,500 crore in 1992-93. The growth in interest payment reflects the growing internal debt which itself reflects the large fiscal deficits.

Currently India is devoting about 14% of its national income for debt servicing.

India's position as a debtor to foreign countries is not at all flattering.

Because a substantial portion of the debt has been for unproductive purposes, these loans mean a burden on the community. It leads to inflationary pressures.

### **7.10 POLICY CHANGES AFTER 1990-91**

The industrial policy of 1991 abolished industrial licensing for all projects except for a few industries related to security and strategic concerns, hazardous chemicals and environmental factors. This policy abolished all existing registration schemes such as Delicensed registration, Exempted industrial registration and DGTD registration. All substantial expansion of units would be exempted from licensing. This policy also

envisaged automatic clearance for the imports of capital goods, pi  
exchange requirements for such imports could be ensured through foreign

This industrial policy permitted direct foreign investment upto 51%  
industries. These included 34 broad areas. The Government of India on  
further liberalised its policy in regard to foreign investment. According  
Indians (NRIs) and Overseas Corporate Bodies (OCBs) were permitted to  
per cent foreign equity in high priority industries including hotels, t  
industries, shipping and hospitals. Besides, NRIs and OCB's were allowed  
100% foreign equity in industries under Schedule-III (items reserved for small scale  
industry), provided the export obligation criterion prescribed for the industry would be  
satisfied. The notification of October 28, 1991 also stated that the existing scheme of 100  
per cent NRI investment in 100 per cent export oriented units and also the scheme for the  
revival of sick units by NRIs would continue.

The Trade Policy of 1991 freed import-export trade from the shackles of administrative  
controls and licenses, linking all non-bulk and non-capital goods imports to exports through  
a market mechanism of freely tradable Exim scripts (Replenishment licenses). The Exim  
scripts would also be traded on Stock Exchanges. In the supplementary trade policy  
announced on August 13, 1991, six import items were decanalised and put under OGL.  
While 14 other imports were decanalised and allowed to be imported through Exim scripts.

A major liberalisation of export control and procedures was effected on September 4, 1991  
when exports of 63 items, mostly chemicals and metal products, were decanalised.  
Similarly 17 items were shifted from the existing list of items banned or restricted for  
export to the OGL category.

The process of liberalisation culminated in a move towards privatisation of public  
enterprises. The Government decided to offer 20 per cent of its shareholding in public  
sector units to mutual funds, financial institutions and the general public.

The liberalisation process moved forward in the course of the year 1992. The Liberalised  
Exchange Rate Exchange Management System (LEREMS) was introduced on March 3,  
1992 to replace Exim scripts. Under LEREMS, 60 per cent of export earnings and inward  
remittances were allowed to be converted into rupee at the market determined exchange  
rate and the balance 40 per cent at the RBI determined exchange rate. Thus LEREMS  
introduced the dual exchange rate system. This system reduced the difference between the  
free market rate and hawala rates of exchange to around 8 per cent.

The trade policy of 1992 substantially liberalised the trade regime. The import of capital  
goods, raw materials, intermediate goods and components were virtually freed from import  
licensing. The Union Budget for 1992-93, brought down the maximum import duties to 110  
per cent to make Indian goods competitive in the World market.

The Foreign Investment Policy in 1992 became more liberal effective from May 14, 1992.  
Foreign companies have been allowed to use their brand name or trade marks on goods sold  
in the domestic market. Effective from September, 15, 1992 foreign investors have been  
allowed repatriation of their capital to be valued at market rates on stock exchanges rather

determined by RBI. In September 1992, the Government of India opened the capital market to foreign institutional investors (FIIs), such as mutual funds, pension funds, investment trusts and asset management companies. All these concessions will help to globalise Indian economy.

The capital market reforms in 1992 were designed to make financial system of the country work with least possible restrictions. The Capital Issues (Control) Act, 1947 was repealed in May 1992. The companies were made free to approach the capital market without prior permission from the Government subject to getting offer documents cleared by Securities and Exchange Board of India (SEBI), control over price and premium fixation has also been removed and most issuing companies are free to fix the price of their securities for public as well as rights issue.

In pursuance of the recommendations of the Narasimham Committee, the RBI has framed new guidelines to govern entry of new private sector banks to make banking sector more competitive. Banks have been given freedom to rationalise their existing branch network.

The liberalisation process in 1992 was accompanied by certain strategic reforms in the public sector. The sick public sector units are to be referred to the Board for Industrial and Financing Reconstruction (BIFR) for rationalisation as is the case with the sick private sector units. Partial disinvestment of equity has been made in selected public enterprises to mobilise non-inflationary resources and to introduce greater accountability through private sector participation.

In 1993, the Indian economy was further liberalised to expose it to domestic and foreign competition. The Foreign Exchange Regulation Act (FERA) 1973 was liberalised through an ordinance on January 9, 1993. As a result of this, companies with more than 40 per cent of foreign equity are now to be treated on par with fully Indian owned companies. The FERA companies have been exempted from restrictions on the establishment of branches and acquisition of any company in India in business other than agriculture and plantations. Indian companies and Indian nationals are now allowed to start joint ventures abroad. All these liberal measures would help to globalise Indian economy.

In 1993 Budget of the Government of India the LERMS, that is, partial convertibility of rupee was replaced by the unified Exchange Rate System, that is full convertibility of rupee. Effective from March 2, 1993 the export earnings and inward remittances will be converted into rupee at market - determined exchange rates. Also all foreign payment on current account shall be at the market determined exchange rate. The new exchange rate system will also help to globalise the Indian economy.

The 1993-94 Union Budget has scaled down the maximum import duties on a number of commodities to transform high cost Indian economy to a competitive economy both domestically and internationally.

## Activity E

What are the main changes introduced by the Foreign Investment Policy, 1992.

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### 7.11 SUMMARY

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For a developing country like India, foreign exchange is one of the very important resources. But the country's balance of trade position started worsening during Sixth Plan and intensified to some extent during the last four years of the Seventh Plan. Liberalisation of imports, technological upgradation, growth in bulk imports, sluggish growth in exports are some of the important reasons for increase in trade deficits. Failure of the Indian products to meet the international quality standards is also one more reason for decrease in surplus.

Even though the Indian public sector is very big, most of the public sector units are not being run efficiently. Lack of emphasis on profitability, lack of professional management, defective staff recruitment and promotion policy, political interference are some of the most important reasons for the poor performance of public enterprises. The process of liberalisation, introduced with the Industrial Policy of 1991, culminated in a move towards privatization of public enterprises, in addition to the introduction of certain strategic reforms for improving the functioning of public enterprises.

### 7.12 FURTHER READINGS

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Ahmed Jaleel, 1983, Foreign Trade and Balance of Payments in India's Economic Problems, (ed) J.S. Uppal, Tata Mc Graw Hill Publishing Company Limited, New Delhi.

Government of India - Planning Commission : Seventh Five Year Plan 1985-90, Vol.I.

Reserve Bank of India : Report on Currency and Finance (Latest)

Economic Survey.

Annual Survey of Industries.

Annual Report on Public Sector Undertakings  
(Public Enterprise Survey).

### 7.13 SELF-ASSESSMENT TEST

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Treat each one of the objectives given as a separate question and try to answer it briefly.

## UNIT - 8 : NEW ECONOMIC POLICY

### Objectives

After studying this unit, you should be able to :

- understand the components of Economic Policy
- find out the need for New Economic Policy (NEP)
- explain the conditions prevailing in Indian economy before the announcement of NEP
- classify the main areas of NEP
- assess the impact of NEP objectively

### Structure

- 8.1 Introduction
- 8.2 Components of Economic Policy
- 8.3 Need for New Economic Policy
- 8.4 New Economic Policy, 1991
- 8.5 New Economic Policy - Main Reforms
- 8.6 New Economic Policy - An Assessment
- 8.7 Summary
- 8.8 Annex I & II
- 8.9 Further Readings
- 8.10 Self - Assessment Test

### 8.1 INTRODUCTION

The basic problem of an economic society is harnessing the scarce resources available in such a way as to satisfy as many wants as possible. The economic problem is essentially that of the optimal allocation of resources. It basically relates to the necessity of choosing what, how, and for whom to produce, and how to achieve economic growth and maximise welfare. Hence, the main problem faced by an economic society is to chart a course of action to utilise the limited means in a manner previously decided upon. This charting leads to different types of mechanism to solve the economic problem, depending upon the social and political structure of a society.

## 8.2 COMPONENTS OF ECONOMIC POLICY

The Economic Policy of any country covers the following important areas :

- i) Economic system
- ii) Economic planning, policy statements and programmes
- iii) Economic controls, regulation and legislation
- iv) Role of public and private sectors
- v) Foreign collaboration, investment and trade
- vi) Role of small scale sector
- vii) Trade Policy, Monetary Policy and Fiscal Policy
- viii) Policy on Labour
- ix) Policy on Agriculture

### i) Economic System

An economic system of a country refers to the form of economic organisation constituted by the mode and method of production, kinds of economic entities and institutions, the objectives and functions of the economy directed towards satisfying people's wants. According to Prof. Halm "In all economic systems the basic problem is the allocation of scarce means among the competing ends for the achievement of maximum results". The fundamental problem for an economy is to provide answers to the following three fundamental questions.

- a. **What to produce?** : What type of goods should be produced from the given limited resources and in what quantities?
- b. **How to Produce?** : How these derived goods shall be produced i.e., who shall produce them, what shall be produced and what methods shall be adopted?
- c. **For Whom to Produce?** : For whom and how these goods shall be distributed?

The above questions would be decided with reference to the nature of economy as to whether it is a capitalist economy, or a socialist economy or a mixed economy. Each type of economic system would fix certain goals with reference to the given economic structure and the nature and working of particular factors obtaining in that economic system.

An economic system is supposed to exist primarily to create such conditions as to make it easy for human beings to satisfy their wants. However, the exact manner in which the problems like allocation of resources among various alternative uses, fixation of prices, and direction and determination of input and output will be tackled, would depend upon the particular type of economic system which is adopted by a particular country.

### ii) Economic Planning, Policy Statements and Programmes

Economic growth fostered under planning must be perceptible because very slow and imperceptible changes cannot catch the imagination of the people. What an unplanned society achieves over a long period, a planned society should be able to achieve in a short

period. This fact alone can establish the faith of the community in planning as a lever of social and economic change.

Planned economic development by its very nature implied government regulation of the market mechanism and control over free private enterprise. The successive Five Year Plans in India are formulated in accordance with the Policy Resolutions taken and statements made from time to time. The instruments of policy consisted of both direct and indirect measures to influence and regulate economic activities in particular sectors or sub-sectors.

Policies governing the regulation of trade and industry in different respects were laid down in Industrial Policy Resolutions Statements, monetary, fiscal policies and export-import policies. Changes in the economic environment required changes to be made in these policies from time to time. New laws were required to be enacted and amendments made in the existing laws so as to enable the Government to introduce new measures or to set up appropriate regulatory agencies. Issue of administrative orders along with rules and regulations also provided the basis for different measures of control.

The Directive Principles of State Policy laid down in the Constitution also had a significant bearing on the government regulatory policies. The Directive Principles of our Constitution laid down : "The State shall, in particular, direct its policy towards securing - (a) that citizens, men and women equally, have the right to an adequate means of livelihood; (b) that the ownership and control of the resources of the community are so distributed as best to subserve the common good; (c) that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment".

Industrial Policy as an important document portrays wide canvas and sets tone for implementing promotional and regulatory roles of the government. This policy spells out the government policy towards the establishment, growth and management of the industry. The policy also indicates the respective areas of the public, private, joint and co-operative sectors as also of the large, medium and small scale sectors. It also spells out the government's policy towards foreign collaboration and investment and legislation.

### **iii) Economic Control and Regulation**

The government regulation of business refers to all measures and instrumentalities which are aimed at defining and laying down the limits of private enterprise and private efforts. For example, in our country the government control and regulation over business has assumed the following forms :

1. Economic planning to regulate investment activity by the private enterprise.
2. Industrial policy to determine priorities of different segments of the economy.
3. Regulation of investment, location, size etc., of business undertakings through licensing under Industries (Development and Regulation) Act, 1951.
4. Regulation of costs and prices of industrial produce through tariff policy.
5. Regulation of monopolistic and restrictive trade practices through MRTP Act, 1969.

6. Regulation of management in corporate sector through the provisions of the Companies Act, 1956.
7. Regulation of working and living conditions of workers, industrial relations, etc. through labour legislations like Factories Act, 1948, Industrial Disputes Act, 1947, etc.
8. Regulation of specific business activities like speculation in shares and commodities, capital issues, imports and exports, foreign exchange, etc., through legislations like Securities (Contracts) Act, 1956, FERA, 1973, SEBI Act, 1992.

#### **iv) Role of Public and Private Sectors**

Another important component of economic policy is the specification of the role assigned to public and private sectors in the economic sphere. The economic policy spells out the policy of the government on the following :

- a. To what extent should the public sector pursue the socially determined goals?
- b. To what extent should the State guide the private sector to follow the socially determined goals?
- c. To what extent should the State check the distortions in investment decisions arising out of private sector interests going against the public sector?

Although the public sector in mixed economy was conceived of as a major partner in the process of development, the private sector was to be permitted to exist and supplement the efforts of the public sector within the overall framework laid down for the economy.

#### **v) Foreign Collaboration and Investment**

Foreign capital and collaboration are vital for the acceleration of growth mechanism and in fact international capital movements are beneficial to both developed and developing economies. The economic policy of the government should specify various issues relating to external sector. These issues include : balance of payments, foreign investment, foreign collaboration, foreign exchange reserves, external debt, imports and exports and direction of trade.

#### **vi) Role of Small Scale Sector**

"Small is beautiful", argues E.F. Schumacher. The need for national policy for the development of small scale industries arises because they provide immediate large-scale employment, offer a method of ensuring a more equitable distribution of the national income and facilitate an effective mobilisation of resources of capital and skill which might otherwise remain unutilised.

#### **vii) Trade, Fiscal and Monetary Policies**

The economic environment in which a business enterprise operate, is significantly influenced by the trade, fiscal and monetary policies of the Government.

Government uses the Trade Policy as part of its general economic policy to develop the country and to diversify the economy. It also takes the form of organising international trade and bilateral and multi-lateral trade agreements. The policy also takes into account the form of export promotion through import liberalisation. The trade policy of a country has tremendous impact on the economic development and sometimes it may even lead the country into debt trap (Examples : Brazil, Mexico etc.).

Monetary Policy refers to the use of instruments within the control of the Central Bank to influence the level of aggregate demand for goods and services or to influence the trends in certain sectors of the economy. The primary objective of the monetary policy is to maintain domestic price stability and exchange rate stability. It may have other objectives like promotion of social justice, expansion of growth, etc.

The Fiscal Policy of the Government is concerned with raising revenue through taxation and other means and deciding on the level and pattern of expenditure. It will have repercussions on the whole economy, affecting the prime level, the levels of industrial activity, employment, financial resources and purchasing power of the people. A close co-ordination of trade, monetary and fiscal policies is necessary for smooth operations of the economy, more particularly the business sector.

#### **viii) Labour Policy**

The existence of good human relations, organised labour movement, collective bargaining, fair dealing by management with the workers, joint consultation at all levels, etc., are necessary for the establishment and maintenance of harmonious industrial relations. The labour policy of the government has to facilitate the pursuance of the directive principles embodied in the Constitution.

However, the success of labour policy depends upon the national wage policy. A national wage policy is in effect, an essay in balancing sectional interests and in reconciling them with national interests to the greatest extent possible. A wage policy aims at imposing a discipline on all wage payments in the economy so that excessive, inadequate, or inappropriate wage payments may not come in the way of the fulfillment of the objectives, economic and social, which the country has set for itself in pursuit of steady national development.

#### **ix) Agriculture Policy**

Agriculture forms the backbone of the Indian economy. Even today agriculture is the source of livelihood for around 70 per cent of the population in the country and this sector accounts for about 30 per cent Gross Domestic Product (GDP). No strategy of economic reform and regeneration in India can succeed without sustained and broad-based agricultural development.

## Activity A

The Indian economy is moving from mixed economy to market economy. Do you agree on the need for this shift? If so, state the reasons.

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### 8.3 NEED FOR NEW ECONOMIC POLICY

The development strategy which has been adopted after Independence by the government continued without much of a change upto the beginning of the eighties. Later there arose the need for reviewing and revamping it in the light of the political, economic and social changes throughout the world after 1985.

The winds of change around that time are sweeping across the globe which has been undergoing a political turmoil accompanied inevitably by economic turbulence. The direction of this change has been towards liberalisation, because experience suggests that the institutional context within which policies are implemented is as important to their success or failure as the policies themselves. A quick review of the economic systems in East Asian countries (Ex. China, Indonesia, Korea, Thailand, Malaysia) would suggest that in most of them, in the initial stages, the Government intervened systematically, in one form or the other and through regulatory channels to foster development. Their spectacular success should be attributed, at least in part, to such policy interventions.

Our country also followed an interventionist policy which, unfortunately, degenerated into a rigid regulatory and control syndrome. While the East Asian economies changed their policies in line with the changed circumstances, our successive governments insisted on a strict adherence to old policies even after they became irrelevant and counter productive. In many areas, the economy became a victim of the dogmas of the past, committing the country to a set of policies which only introduced increasing rigidities in the system. Their cumulative result was a strain on the economy which produced the present situation. Some of the assumptions that were made by the framers of the economic planning in our country were no longer valid.

In the middle of 1991 India was in a situation of unprecedented economic crises and socio-political instability. The economy was in such a bad condition that the country was facing difficulties in meeting its international commitments, the access to external commercial credit markets was denied, international credit rating had been downgraded and the international financial agencies were expressed doubts on India's ability to manage its economy properly. On internal front serious inflation (17 per cent per annum), short supply of essential commodities and break down of fiscal discipline were being experienced. Foreign currency reserves fell to around \$ 1 billion, just sufficient to meet the requirements of the country for a few days.

## Activity B

i. What do you know of the New Economic Policy, 1991?

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ii. Have you or any of persons known to you ever faced any difficulty in getting your/his work attended to by any Government Department? Explain.

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## 8.5 NEW ECONOMIC POLICY, 1991

The Government headed by Mr. P.V. Narasimha Rao announced a new economic policy on 24th July 1991, which seeks to drastically alter the economic scenario in our country. The basic reason behind the reforms is to accelerate the pace of development and to make the Indian economy competitive internationally. There is an expectation that, in due course, these measures would place the country amongst high performing economies, which started off at a much lower level of economic development in the recent past, but which subsequently achieved economic miracles. The major reforms among these related to : industrial policy and industrial licensing, devaluation and partial convertibility of the rupee, trade policy, reduction of fiscal deficit, measures to reduce inflationary pressures, simplification of bureaucratic controls and procedures, liberalisation of foreign investment norms, relaxation of controls on import of foreign technology, changes in FERA and MRTP Act. These were accompanied by abolition of the controlling offices like the Controller of Capital Issues and Chief Controller of Imports and Exports, arming SEBI with substantial powers, and public sector disinvestment, etc.

### Objectives

According to the memorandum submitted by Mr. Manmohan Singh, the Finance Minister, "the new economic policy's thrust will be to increase the efficiency and international competitiveness of industrial production, to utilize foreign investment and technology to a much greater degree than in the past, to improve the performance and rationalise the scope of the public sector, and to reform and modernise the financial sector so that it can more efficiently serve the needs of the economy". The objectives of the NEP can be briefly stated as follows:

1. Deregulation of Indian economic system;
2. Increasing the competitiveness of Indian industries;
3. Privatisation of public sector undertakings;
4. Development of indigenous technology; and
5. Linking the Indian economy to the global market so as to acquire the ability to pay for imports, and to make us less dependent on aid.

## 8.6 NEW ECONOMIC POLICY - MAIN REFORMS

The Government announced in 1991 a series of initiatives in respect of policies relating to the following areas :

1. Industrial Policy Reforms
2. Public Sector Reforms
3. Financial Sector Reforms
4. Fiscal Policy Reforms
5. Social Policy Reforms
6. Trade Policy Reforms
7. Foreign Investment Policy Reforms
8. Legislative Reforms
9. Small Sector Reforms

Along with other economic reforms, the policy package covered the following reforms :

- A. Industrial Licensing
- B. Foreign Investment
- C. Foreign Technology Agreements
- D. Public Sector Policy
- E. MRTP Act

### 1. Industrial Policy, 1991

The Industrial Policy Resolution 1956 and industrial policy statements of late years were amended on the following lines.

a. **De-reservation of Industries** : The Government reserved 17 industries exclusively for public sector through the Industrial Policy Resolution, 1956 and the same remained without any change even in the subsequent industrial policy statements. The present policy brought down the reserved list to 6 (see Annex I). Among the industries dereserved are core industries like iron and steel, electricity, air transport, ship building, heavy machinery, telecommunication cables and instruments. Industries which continue to be reserved for the public sector are only in areas where security and strategic concerns predominate.

### b. Removal of Licensing :

1. The industrial policy abolished licensing for all industries except for 15 specified industries which will continue to be subject to compulsory licensing for reasons related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons and items of elitist consumption (see Annex-II).
2. In locations other than cities of more than 1 million populations, there will be no requirement of obtaining industrial approvals from the Central Government except for industries subject to compulsory licensing. In respect of cities with population greater than 1 million, industries other than those of a non-polluting nature such as electronics, computer software and printing will locate outside 25 kms of the periphery, except in prior designated industrial areas.

3. Existing units will be provided a new broad banding facility to enable them to produce any article without additional investment.
4. The exemption from licensing will apply to all substantial expansions of existing units.
5. The mandatory convertibility clause will no longer be applicable for term loans from the financial institutions for new projects.

The exemption from licensing and deletion of mandatory clause of financial institutions are expected to be particularly helpful to many dynamic small and medium entrepreneurs who have been unnecessarily hampered by the licensing system. The economy would benefit by becoming more competitive, more efficient and more modern.

## 2. Public Sector

In the framework of the New Economic Policy, Public Sector industry has been given an important role as an autonomous, competitive and efficient sector, to provide essential infrastructure goods and services, development of natural resources and areas of strategic concern. A positive and productive future awaits public sector industry. To reach that goal, considerable restructuring is involved. The Eighth Plan recognised this and proposes a major public sector reform initiative. The initiative will consist of the following integrated strategies :

- a. Restructuring involving modernisation, rationalisation of capacity, product-mix changes, selective exit and privatisation is needed on a massive scale, make public enterprise viable, efficient and competitive.
- b. Autonomy and performance accountability of public enterprises are critical to make them a dynamic force. The system of Memorandum of Understanding (MOU) between administrative ministries and public enterprises which has been launched in the Seventh Plan has these objectives in its design. However, its effectiveness needs to be improved.
- c. Changes in management practices at specific enterprise level to promote efficiency, dynamic leadership, resourcefulness and innovation are needed.
- d. State level public enterprises have serious problems. Governmental interference, lack of professionalism and ad hoc investment and employment decisions have resulted in chronic sickness of many of them. A major effort is called for, in collaboration with the State Governments, to promote reforms in them.
- e. In the changing economic environment, technology will be a major tool to improve competitiveness and efficiency of public enterprises. Their capability in the sphere of development and use of technology effectively or to integrate technology in their corporate strategies (expansion, diversification, marketing etc.) is weak now. The new reform initiative needs to address this through building up of active linkage among R & D laboratories, educational institutions and public enterprises. This is vital in the emerging inter-dependent and globalising economic environment.

- f. The organisation of Government (Ministries and Agencies) for public sector has historically grown in a certain pattern. Presently many regulations (price, distribution, investment and import controls) are being dismantled. This liberalisation not only calls for re-structuring of enterprises but also of the Government in the governance of industrial growth and management of interface with the enterprises.

As a follow-up of this policy, several measures have been taken through the NEP for reforming the public sector :

- (i) **Making Public Sector Units Efficient and Competitive** : The number of industries reserved for the public sector has been reduced from 17 to 6. Even in these areas, private sector participation will be allowed selectively. Joint ventures with foreign companies have now become possible. Thus the thrust of the policy is to make the public sector efficient and competitive.
- (ii) **Review of Portfolio of Public Sector Investment** : Portfolio of public sector investments will be reviewed with a view to focusing the public sector on strategic, high-tech and essential infrastructure. Despite certain reservations in favour of public sector, there would be no bar for these exclusive areas to be opened to private sector on a selective basis. Similarly, the public sector will also be allowed entry in areas not reserved for it.
- (iii) **Rehabilitation Scheme for Sick Public Enterprises** : Public enterprises which are chronically sick will be referred to the Board for Industrial and Financial Reconstruction (BIFR) or other high level institutions for the formulation of revival/rehabilitation schemes. A social security mechanism will be created for protecting the interests of workers likely to be affected by such rehabilitation.
- (iv) **Disinvestment of Shares** : To raise resources and encourage wider public participation, a part of the government's share holding in the public sector would be offered to financial institutions, mutual funds, general public and workers.
- (v) **Professionalisation of Management** : Boards of public sector companies would be made more professional and given greater powers.
- (vi) **Performance Improvement** : For the purpose of performance improvement, managements would be granted greater autonomy. There will be a greater thrust on performance improvement of public enterprises through the Memorandum of Understanding (MOU) system. Under this system, the management will be granted greater autonomy and held accountable for results. The MOU signed between Government and the public enterprises would be placed in Parliament with a view to holding a fuller discussion on performance.

### 3. Financial Sector

The Government of India set-up a High Level Committee with Mr. M. Narasimham, former Governor of Reserve Bank of India, as Chairman to examine all aspects relating to the structure, organisation, functions and procedures of the financial sector. The Committee submitted its report in November, 1991. On the basis of the recommendations of this

Committee the Government brought the reforms in the financial sector in the following areas:

**i. Reforms relating to Commercial Banks.**

- a. Statutory Liquidity Ratio (SLR)
- b. Cash Reserve Ratio (CRR)
- c. Interest Rate Structure
- d. Structural Organisation of Banks.
- e. Setting-up of Asset Reconstruction Fund.

**ii. Reforms relating to Development of Financial Institutions (DFIs).**

**iii. Reforms of Money and Capital Markets in India.**

The reforms relating to financial sector are discussed elaborately in Block-IV, Unit-12.

#### **4. Reforms relating to Fiscal Policy**

The reforms in this area are aimed at moving towards a simple system of taxation with moderate rates, few exemptions and a wide tax base. The following are the steps taken for bringing reforms in this area.

- a. The Central Government through the Budgets sought to restore fiscal balance by bringing the deficit down to 6% of Gross Domestic Product (GDP).
- b. In regard to both excise and customs, there has been a drastic cut in the number of end use notifications, which will greatly reduce the possibility of disputes and the scope for discretion. Besides, the number of rate categories was sharply reduced, the peak rates were brought down and a significant switch over was effected from specific to advalorem duties to strengthen built-in revenue elasticity. The system of credit for taxes paid on inputs, called MODVAT, was extended to cover petroleum and capital goods. These changes in commodity taxation have brought MODVAT closer to a VAT type system, and will facilitate the eventual introduction of a full-fledged Value Added Tax. A modest beginning was also made in extending indirect taxation to services such as telephones, non-life insurance and stock brokers.

- c. In the area of direct taxes, many reforms were brought in the area of personal income tax, non-resident investments and corporate tax.

Thus a number of measures have been taken mainly based on the recommendations of Tax Reforms Committee headed by Raja J.Chellaiah to simplify the tax structure and widen the tax base.

#### **5. Social Policies**

The Government through its economic policy tried to bring changes even in social sector. In this direction the government has provided for higher outlays on elementary education, rural drinking water supply, assistance to small and marginal farmers, programmes for women and children, programmes for the welfare of the society, as well as increased

spending on infrastructure and employment creation projects in the rural areas. The other measures taken by the Government in this area include the following :

- a. **National Renewal Fund** : The Government with the help of the World Bank created a National Renewal Fund (NRF) to set up schemes for compensation, retraining and redeployment of workers affected by the restructuring. The fund will provide safety net for the structural adjustment being undertaken in the country. The Fund is being financed by proceeds of sale of public sector equity and contribution from multilateral and bilateral donors.

The main objectives of NRF are : (i) to provide assistance to cover costs of retraining and redeployment of employees resulting from modernisation, technology upgradation and industrial restructuring; (ii) to provide funds for compensation of employees effected by restructuring or closure of industries, both in the public and private sectors; and (iii) to provide funds for employment generation schemes to build a safety net for workers. The NRF has three components, viz., National Renewal Grant Fund, Employment Generation Fund and Insurance Fund for Workers.

- b. The Public Distribution System has been strengthened and expanded in 1,700 specially identified backward blocks.
- c. Expenditure on the social sectors, including rural development, health and education which had to be restrained in the first year of the reform because of the severity of the fiscal crisis, has been substantially stepped up in the Budgets for 1993-94 and later, reflecting the improvement in the fiscal situation.

## 6. Trade Policy and Reforms

The Government brought more reforms in this area than in any other area. The government announced a new trade policy widening the replenishment license system into a broad based system of incentive licenses (Exim scrips) given to exporters, then moving to a dual exchange rate (i.e. partial convertibility of rupee) with elimination of most licensing controls except on consumer goods, and finally moving to the present unified exchange rate. The reforms in this area include :

- a. Import control through licensing has been virtually abolished. Except for consumer goods which remain restricted, almost all items of capital goods, raw materials, intermediates etc., can be freely imported subject only to payment of customs duties.
- b. Import duties have been reduced in stages with the maximum duty lowered to 150 per cent in July 1991, 110 per cent in February 1992 and 50 per cent in April 1995. Duties on capital goods have been reduced to levels ranging between 25 per cent and 35 per cent for many categories, and even lower for export schemes and certain project imports, though certain types of machinery attract higher duty rates.
- c. Liberalisation of imports of gold and silver has considerably reduced the incentive for smuggling.

- d. The exchange rate of the rupee is today determined by demand and supply conditions in the foreign exchange markets.

## 7. Foreign Investment and Collaboration

The government announce a new policy designed to attract investment in larger volumes by simplifying the rules and procedures and making the terms offered to foreign investors more in line with current practices all over the world. These measures include the following.

- a. **Foreign Investment** : To attract foreign investment in high priority industries, requiring large investments and advanced technology, direct foreign investments upto 51 per cent foreign equity shall be given approval. The industries eligible for such foreign investment are those included in Annexure to the Industries (Development & Regulation) Act, 1951.
- b. **Foreign Technology Agreements** : With a view to injecting the desired level of technological dynamism in Indian industry, automatic permission will be given for foreign technology agreements in high priority industries included in Annexure II upto a lump-sum payment of Re. 1 crore, 5 per cent royalty for domestic sales and 8 per cent for exports subject to a total of 8 per cent sales over ten year period from the date of agreement or seven years from commencement of production. Similar facilities would be provided to other industries as well if such agreements do not require the expenditure of foreign exchange. All other proposals will need specific approval under the general procedures in force. No permission will be necessary for hiring of foreign technicians, foreign testing of indigenously developed technologies.

In respect of industries other than those in Annexure III, automatic permission will be given subject to the same guidelines as above if no free foreign exchange is required for any payments.

- c. **Foreign Investment Promotion Board** : The Government constituted Foreign Investment Promotion Board (FIPB) as a single window organisation to clear all proposals relating to foreign investment expeditiously.
- d. The Government of India has joined as a member of the Multilateral Investment Guarantee Agency (MIGA) alongwith many other developing countries in promoting foreign investment.

## 8. Legislative Reforms

In order to bring changes announced in the new economic policy, the Government amended the following important economic legislations.

1. **MRTP Act, 1969** : To give effect to the industrial policy of the Government, major amendments were made to the MRTP Act in 1991. Through these amendments the government removed threshold limits of assets in respect of MRTP companies and dominant undertakings. More emphasis will be laid on controlling and regulating monopolistic, restrictive and unfair trade practices rather than making it necessary for the monopoly houses to obtain prior approval of Central Government for expansion,

establishment of new undertaking, merger, amalgamation and appointment of certain directors.

Simultaneously, the newly empowered MRTP Commission will be authorised to initiate investigations suo moto or on complaints received from individual consumers or classes of consumers in regard to monopolistic, restrictive and unfair trade practices.

2. **FERA, 1973** : The recent changes in economic policy of the Government, especially the liberalisation of the industrial sector and moves to open the economy through changes in trade policy and encouragement of foreign investment made it necessary to modify several provisions of the Foreign Exchange Regulation Act (FERA). Various facilities were extended to foreign/FERA companies on the appointment of technical and management advisors, opening of branches, acquisition of immovable property, borrowing of money or acceptance of deposits, etc. Facilities were also extended to non-resident Indians, Indian companies and residents for the opening of foreign currency accounts in India following the introduction of partial convertibility on current account since 1st March, 1992. Notifications were also issued exempting non-resident Indians returning to the country from making declarations on their arrival in India regarding their assets abroad and from the requirement of prior approval for the acquisition of immovable property in India.
3. **Sick Industrial Companies Act, 1985** : The Act has been amended to bring public sector undertakings within the jurisdiction of the Board for Industrial & Financial Reconstruction (BFIR), which will now have to decide whether these units can be effectively restricted or whether they should be closed down.
4. **Securities and Exchange Board of India Act, 1992** : The Securities and Exchange Board of India (SEBI), which was set up in 1988, as a non-statutory body was given statutory powers under this Act.
5. **Capital Issues (Control) Act, 1947** : The Capital Issues (Control) Act, 1947 was repealed and the office of the Controller of Capital Issues (CCI) was abolished in May, 1992. The control over price and premium on shares is removed and the companies are now free to approach capital market after clearance by SEBI.

## 9. Small Sector Reforms

The small scale industries occupy an important place in the Indian economy. This sector has emerged as a dynamic and vibrant sector of the economy during the eighties. Giving due importance to this sector, the Central Government issued a separate policy statement for small and decentralised sectors on August 6, 1991. It has made growth and competition as the central keystones of the new policy frame which is in tune with the liberalisation shown in the Industrial Policy of 1991. The salient features of this policy are as under :

1. Several problems of small industries are associated with lack of financing. The emphasis would be to ensure adequate flow of credit for viable operation of this sector. The large industrial undertakings would be allowed equity participation in small industries upto a limit of 24% of equity share holding. The scope of National Equity Fund Scheme has been widened to cover profits upto Rs.10 lakh or 15% of the total equity shareholders.

Single Window Loan Scheme will cover projects upto Rs.20 lakh with working capital margin upto Rs.10 lakh.

2. Tiny and service industries have been recognised as specific sub-sectors. The investment limits in these sub-sectors would be Rs.5 lakh and there will be no restriction on their location. Such units will be given special benefits.
3. Bureaucratic delay in granting the loans would be cut drastically and loaning procedure would be made simple.
4. Small business houses will be given opportunity for improvement of technology. The equity participation by large sector will stimulate technology flow to small units. Technological Development Cell in the Small Industries Development Organisation (SIDO) will be set up.
5. Export Development Centre in the SIDO will be set up to promote exports of small scale sector products.
6. Marketing of the products will be undertaken by cooperatives, government organisations and other professional agencies by adopting a consortium approach.

#### Activity C

1. Take one area of NEP and state whether reforms announced in that area are sufficient or not. What other measures do you feel are necessary?

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### **8.7 NEW ECONOMIC POLICY - AN ASSESSMENT**

The new economic policy (1991) of the Government of India is mainly aimed at bringing about an environment which enables multifarious business activities accomplish desired utilisation of available material and human resources and ensures that the resources are used in the most productive manner. An objective analysis of the impact of the reforms is necessary though four-year period is not long enough.

The Government initiated the reforms at a time when the country was in the midst of unprecedented economic crisis and socio-political turmoil. For the first time in its history, India was faced with the prospect of defaulting on its international credit payment obligation resulting in down-grading of international credit rating. The international financial community's confidence in India's ability to manage its economy had been severely eroded. The crisis reached to such an extent where-by we could only borrow against the security of our gold reserves by physically transporting the gold abroad. The economy suffered from serious inflationary pressures, emerging scarcities of essential commodities and break-down of fiscal discipline. We were on the very verge of a calamitous economic precipice.

In 1995, four years down the road, this looks no more than a bad dream. Today, the economy is strong in many respects and is poised for accelerated growth in the years to come. The achievements of these four years are remarkable. According to the Economic Survey, 1994-95 "compared to overall economic growth of 0.9 per cent in 1991-92, the rate in 1994-95 is expected to be 5.3 per cent. Industrial production, which virtually stagnated in 1991-92, is expected to grow by 8 per cent in 1994-95. Food-grain production had declined to 168 million tonnes in 1991-92; it is expected to attain a record high of 185 million tonnes in 1994-95. Compared to an actual decline in 1991-92, the dollar value of exports has increased by more than 17 per cent in the first ten months of 1994-95, on top of a 20 per cent increase in 1993-94. In the year ended 31st March, 1991 India had added \$8 billion to her stock of external debt; in the first half of 1994-95 the level of external debt actually declined by almost \$300 million. From a level of hardly one billion dollars in June 1991, foreign currency reserves had climbed to over \$19.5 billion by mid-February 1995. Whereas the increase in employment is estimated to have been only about 3 million in 1991-92, an expansion of about 6 million is estimated for each of the years 1992-93 and 1993-94, with prospects for a larger rise in the present year".

Today, we reached such a situation where no political party, irrespective of their ideology, could reverse the reforms. In fact a broad political consensus has emerged on the economic reform which guarantees its irreversibility. Most State Chief Ministers with diverse ideological background have pledged their support to the pursuit of economic reform, albeit with marginal difference. The Director General, NCAER in his article, "The Economy-challenges after Good Start" in the Hindu Economic Survey of Indian Industry, 1995 stated "there appears to be a solid consensus among all Indian political parties across the spectrum on economic reforms and the liberalisation process. This consensus appears to agree that liberalisation and debureaucratisation are necessary; that private and foreign investments in India should be encouraged; that the Indian economy should be encouraged; that the Indian economy should become competitive domestically and in the world and that the policies of opening up of the economy and freeing it from controls will improve its competitiveness, and should apply to all sectors of the economy, not merely to industry and trade".

### **Fears over Reforms**

The new economic reforms brought drastic changes in certain fields and created certain confusion and misunderstanding among individuals. Some people in the country are finding it difficult to digest the impact of change. More particularly the Indian Bureaucracy tuned to regulation and controls will not easily accept a regime of deregulation. The critics of NEP express their fears over the economic reforms on the following grounds :

1. **Increase in Inflation** : The most serious criticism of the New Economic Reforms is that the reforms resulted in increase in inflation and the Government failed to control it. It is true that the rate of inflation was high and the price increase was almost continuous from 1991-92 to 1994-95. But there is substantial fall in the rate of inflation in the recent past compared to 17 per cent prevailing before undertaking these reforms. It is around 8 per cent since June 1995.
2. **Increase in Unemployment** : The critics argue that reforms are leading to large scale retrenchment of workers. They say that the NEP is silent about tackling the growing

industrial sickness. But the Government with foresight created a National Renewal Fund and it is expected to provide compensation, retraining and redeployment.

3. **Absence of Human Face** : Critics argue that the benefits of economic reforms have not trickled down to the poor and the imbalance between the haves and havenots has widened with deleterious consequences to the future stability of the society. The Government, of late, realised the fact and the Prime Minister in his speech on 15th August 1995, stated that the government will be spending Rs.5,000 crore on social sector during 1995-96.

There are some genuine serious concerns regarding the economy during the last four year period. These include :

- a. Increase in gross fiscal and revenue deficits.
- b. Mounting debt of the Government leading to increase in debt service obligation.
- c. Failure of disinvestment programmes of public enterprises.
- d. Substantial losses of State Electricity Boards due to excessive subsidy to agricultural sector.
- e. Increase in Government expenditure due to increase in establishment expenditure, subsidies, defence expenditure and implementation of populist measures.
- f. Fall in the foreign exchange reserves.
- g. Fall in the value of rupee against dollar.

#### Activity D

(i) The critics of NEP are stating that the living conditions of poor are becoming miserable after introduction of reforms. Do you agree?

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(ii) The economic reforms in India are not complete and there is still some unfinished agenda. State the areas where reforms are necessary.

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### 8.8 SUMMARY

The global changes and the crisis in the economy made the then newly elected Central Government to undertake reforms in July 1991. The areas of reforms include : reforms in Industrial Policy, Public Sector, Financial Sector, Social Sector, Trade Policy, Foreign Investment, Small Scale Sector etc. On the whole, the new economic policy created a new environment in the Indian economy. The reforms carried out in the past four years have had an invigorating effect on various sectors of the economy which is now poised for

accelerated growth in the years to come. If India is to enter the 21st Century with confidence and be respected in the comity of nations, then Indian economy has to be strong and vibrant and the fruits of development equitably shared.

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## 8.9 ANNEX - I & II

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### Annex. 1 :

Proposed list of Industries to be Reserved for the Public Sector.

1. Arms and ammunition and allied items of defence equipments, Defence aircraft and warships. 2. Atomic Energy. 3. Coal and lignite. 4. Mineral oils. 5. Minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953. 6. Railway transport.

### Annex. 2 :

List of Industries in respect of which Industrial Licensing will be Compulsory.

1. Coal and Lignite. 2. Petroleum (other than crude) and its distillation products. 3. Distillation and brewing of alcoholic drinks. 4. Sugar. 5. Animal fats and oils. 6. Cigars and cigarettes of tobacco and manufactured tobacco substitutes. 7. Asbestos and asbestos-based products. 8. Plywood, decorative veneers, and other wood-based products such as particle board, medium density fibre board, block board. 9. Tanned or dressed furskins. 10. Paper and Newsprint except bagasse based units. 11. Electronic aerospace and defence equipment; all types. 12. Industrial explosives, including detonating fuse, safety fuse, gun powder, nitrocellulose and matches. 13. Hazardous chemicals. 14. Drugs and Pharmaceuticals (according to Drug Policy). 15. Entertainment Electronics (VCRs. Colour TVs, C.D.Players, Tape Recorders).

Note : The compulsory licensing provisions would not apply in respect of the small-scale units taking up the manufacture of any of the above items reserved for exclusive manufacture in small scale sector.

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## 8.11 FURTHER READINGS

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1. Indian Institute of Foreign Trade, Training Programme on Restructuring of Indian Economy for officers of Indian Administrative Service. Back-ground Papers 1994.
2. Aswathappa, K. 1994, Essentials of Business Environment, Bombay, Himalaya Publishing House.
3. Jagdish Prakash, 1994, Current Business Scenario in India, Allahabad, Prayag Pustak Bhavan.
4. The Hindu, Survey of Indian Industry, 1995.
5. The Economic Survey 1994-95.
6. Ruddar Dutt and Sundaram, 1993. Indian Economy, New Delhi, S. Chand & Sons.

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## 8.12 SELF - ASSESSMENT

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Take each one of the above objectives as a separate question and try to answer it briefly.

BRAOU

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## **UNIT 9 - THE WORKING OF THE NEW INDUSTRIAL POLICY**

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### **Objectives**

After studying this unit, you should be able to :

- appreciate the new developments that have taken place in the public sector, private sector industries and the foreign direct investment in India
- examine the significant changes in the infrastructure sector as well as the capital market and the transformation that is taking place in the small scale industrial sector
- understand the broad implications of the working of the new industrial policy and possibly foresee the course of events that may follow in the text few years.

### **Structure**

- 9.1 Introduction
- 9.2 Industrial Growth
- 9.3 Public Sector
- 9.4 Investment in the Private Sector
- 9.5 Foreign Direct Investment
- 9.6 Infrastructure and other industries
- 9.7 Take-over and Mergers
- 9.8 Capital Market : Trends in Capital Issues
- 9.9 The Small-Scale Sector
- 9.10 Summary
- 9.11 Further Readings
- 9.12 Self-Assessment Test

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### **9.1 INTRODUCTION**

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The genesis of the new economic policy and the broad outlines of new Industrial Policy of 1991 have already been examined. The new policy has to be implemented with care, preparing the economy gradually to turn towards the new directions and making it to accept the new norms and structural changes. In every society people resist change, at least to begin with. This resistance has to be overcome. In this process, there have been fairly good results during the last ten years and more particularly during 1992-95. A mid-course appraisal is attempted in this unit.

Liberalization, privatization and globalisation policies were introduced by the then Prime Minister in 1985, and these policies were accelerated later in 1991-92. Three years (from 1991-92) period is not a sufficiently long period to assess the impact of these policies, but it would be appropriate to understand how the policies have accelerated the growth and in what directions they are taking the economy.

There is not much disagreement about the theoretical models of economic reforms, their rationale, their objectives and their designs: All the debate, disagreements and controversies about reforms centre around issues of sequencing and pacing of the measures, their applicability in the particular circumstances and the packaging of the different measures considering their complementarities and mutual trade-offs.

### **Basic Principles of Economic Reforms**

Let us consider the essential basis of economic reforms, especially of the type that has been introduced in India in the last few years. There are three components of these reforms : deregulation, competition and strong budget constraints. Deregulation allows the market forces to have a free play. But allowing freedom of market forces does not necessarily result in a competitive market economy. As efficient allocation of resources is associated with competition, it has to be nurtured and promoted as a policy decision. The budget constraints refer to limiting expenditure to income, where income consists of both current income and sustainable borrowing against future income. Such a budget constraint is a necessary condition for macro-economic stability. Finally, to bring the argument where it started, macro-economic stability is a necessary condition for market prices playing their role in the efficient allocation of resources.

### **Programme of Economic Reforms**

A programme of economic reforms supported by the IMF and the World Bank was adopted in 1991 and is of a kind that many countries had adopted with the Fund-assistance of upper-credit-tranche facilities, with their conditionalities. The programmes were designed in such a manner that they could be tailored depending on the varying initial conditions and the specific causes of the problems of the individual countries. However, the actual policy measures were quite uniform in practically all of them.

Because of the differences in the conditions of the different countries where the model has been applied, the specific outcomes have also been quite different, making it very difficult to judge if the programmes have been on the average, successful or not. What is important, however, is to appreciate that the outcomes have been different and that there is no automatic assurance that a country would be necessarily successful if it adopted this programme. But one thing is abundantly clear. Fund type programmes over a relatively long period have a greater chance of success than otherwise. However, it is agreed that the success of the reform should be assessed in terms of the number of objectives successfully achieved.

There were three main points of the Indian reform programme as introduced in 1991. First, fiscal deficits were to be reduced drastically. Second, exchange rates were to be depreciated and third, a number of structural reform policies were to be introduced, including tax reform, deregulation of prices, delicensing of investment, liberalization of foreign trade and foreign investment regime, as well as certain measures reforming the financial sector. The

public enterprises had to justify their continuation by greater efficiency and lesser dependence on the government's finance and subsidy. The infrastructure like the power, communication and transport are to be developed faster so that the industrial growth process is fully complemented.

### Activity A

Describe the basic methodology in the implementation of the economic reforms.

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## 9.2 INDUSTRIAL GROWTH

Let us consider the trend of economic indicators during the last three years. The Gross Domestic Product (GDP) indicated a growth rate of barely 0.9% during 1991-92 which increased to 4.3% during 1992-93 and remained at the same level in 1993-94. There is evidence of gradual recovery.

Since the beginning of 1993, private capital flow has surged and, combined with the demand stimulus in 1993-94, buoyant export growth and a growing investment response to the liberalisation, it has helped to generate a broad-based economic recovery. Economic growth rebounded to 5.3 per cent in 1994-95 (See Table-9.1) and as per the latest data it recorded 6.2 per cent growth rate in 1994-95.

**TABLE-9.1**  
**KEY ECONOMIC INDICATORS**

	1990-91	1991-92	1992-93	1993-94	1994-95
	Percent change				
Real GDP growth	5.4	0.9	4.3	4.3	5.3
Wholesale price (end of the period)	12.1	13.6	7.0	10.8	10.4
Export volume	3.7	- 2.0	3.8	23.4	14.2
Import volume	6.5	- 20.2	8.8	8.7	21.4
	Percent of GDP				
Central Govt. deficit	8.6	6.3	5.7	7.7	6.7
Consolidated pub. deficit	10.5	9.0	8.4	11.0	10.5
External current account deficit	3.4	0.7	1.6	0.3	0.5
	Billion dollars				
Gross official reserves :	12.1	13.6	7.0	10.8	10.4
End of the period	2.2	5.6	6.4	15.1	20.8

(IMF Survey, July 31, 1995)

In qualitative terms, the Business World (6-19 September, 1995) based on a sample study of 200 companies, has observed the following trends in the private corporate sector:

1. Amidst the great corporate churning, sales have roared back, after stalling in the first two reform years.
2. Profit margins have been squeezed, suggesting that firms now face heightened competition in the market. But operating profits have shot up, because sales have climbed.
3. The cost of marketing products has skyrocketed, once again implying that the marketplace is fiercely competitive today.
4. Employee productivity is up, as measured by the value addition per employee.
5. Companies have turned the spotlight on quality. Over the four-year period, the number of corporations that qualified for the ISO 9000 benchmark has shot up from under five to more than 800.
6. Indian companies are more competitive globally, reflected in a sharp surge in exports.
7. Major financial restructuring is under way. Companies now exhibit a greater reliance on equity and less on raising debt to fund their expansion plans. This is both good and bad news; the interest bill has slumped, but the return on shareholders' funds (equity plus free reserves) has dipped.
8. The corporate world is cash-rich. So income from interest earned is up. The outcome has been a surge in "other income".
9. The rate of increase of gross block (total assets) of companies was high in the first two reform years, but fell in 1993-94. That may be because firms put their cash in the stock markets, instead of in assets.
10. The effective corporate tax rate has dipped, a point senior finance ministry officials have been underlining, for some time.

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### **9.3 PUBLIC SECTOR**

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Memorandum of Understanding has been signed with 98 public sector units during 1992-93 and 104 PSUs were listed for 1993-94 for the purpose. The basic purpose of the MOUs is to reduce the 'Quality of Control' and to increase the 'Quality of Accountability'. A review of the MOUs undertaken for 97 PSUs during 1992-93 reveals that 37 were rated as 'excellent' and 35 as 'very good'. This indicates a significant improvement in the performance levels of 75% of the PSUs. Many of the PSUs do not have chief executives for quite a long time, and have become the victims of indecision and inefficiency. Also in the theory of privatization, it is generally argued that the loss-making units should be privatized. But the Government seems to be going in for a kind of deficit-privatization to reduce the budgetary deficits.

Moreover, it is the healthy and high profit PSUs whose shares are being offered for disinvestment. (Perhaps because shares of loss-making units may not sell in the market!)

Another area which needed remedial action was that the PSUs were overstaffed. The National Renewal Fund (NRF) was created to provide workers an opportunity to seek voluntary retirement. Secondly, training and retraining of workers in the emerging areas of hi-tech were to be undertaken so that the workers could be absorbed more productively elsewhere. But a review of this scheme reveals that it has been limited to a Voluntary Retirement Scheme (VRS) only. Consequently, instead of getting rid of the deadwood in these sectors, talented and qualified workers and officers made use of this scheme. For instance, of the 1,000 who left IDPL, most belonged to the management cadre. In ITDC, almost all qualified cooks and managers left using the VRS in a short span of three months. Same was the story at STC. It cost BHEL Rs. 10 crore to compensate its qualified 1,000 managers. But strangely, the scheme has been reintroduced.

The proponents of the structural adjustments programme have been arguing that as a result of liberalization, there would be an increase in unemployment in the short period, but as the economy picks up as a consequence of the higher doses of foreign direct investment and domestic investment, employment elasticity will improve.

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## 9.4 INVESTMENT IN THE PRIVATE SECTOR

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Structural reforms have focused on liberalising product markets. The liberalisation of factor markets has so far centred on financial markets. The private sector response to these reforms has been impressive. The turn-over and profits of most of the companies have gone up in 1994-95. But it is not wholly because of increase in productivity or efficiency, but also because of price hike.

There are now private airlines, postal (courier) services, telecommunication, railway transport, television channels etc., which have offered a vast and dynamic opportunities for private investment. If public issues worth Rs. 25,000 crore have been subscribed in a year where the earlier average was Rs. 10,000 it only means that there are invisible savings available and the investment opportunity was under control. The "liberalisation" process has opened up the economy to new opportunities. Corporate sector has now entered agriculture. Expansions and mergers are no more restrained by law and therefore have become only business propositions.

### Activity B

What is disinvestment in the context of public sector industries?

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## FOREIGN DIRECT INVESTMENT

The Industrial policy statement of 1991 clearly stated: "in order to invite foreign investment in 'high priority industries requiring large investment and advanced technology, it has been decided to provide approval for foreign direct investment upto 51% (foreign) equity in such industries". Industry-wise breakup of foreign collaborations approved during 1991-92 to December 1993 reveals that priority sectors like metallurgy, power, oil refinery, electrical equipment, transportation and chemicals account for about 61% of total foreign investment approved and non-priority sectors like food processing, hotels and tourism etc. account for about 39% of total investment. India, after becoming a member of the World Trade Organisation (WTO) by having signed the GATT earlier, is now committed to take up more reforms.

The Government of India continues to invite foreign investment in setting up power plants on 100% equity basis and at a guaranteed return to be remitted in foreign exchange. It is feared that such a policy may soon result in the closure of BHEL due to lack of orders but BHEL must learn to face the competition. During 1980-81 to 1992-93, the output of consumer durables increased at an average annual rate of 10% and that of the wage goods was as low as 4.5%. Also 43% of these investments are in the nature of portfolio investment (financial investment) which only strengthens speculative trading in shares. This led to an artificial boom in the share market and the BSE index touched a high of 4202 on 18th June, 1994. The RBI's money management may be rendered ineffective with the growth of non-banking sector and mutual fund companies.

**TABLE-9.2**  
**INDIA'S FOREIGN TRADE DURING THE POST-LIBERALISATION PERIOD**  
**(1991-92 TO 1994-95)**

	in US \$ million		
	Exports	Imports	Trade Balance
1990-91	18,145	24,073	- 5,928
1991-92	17,866 (- 1.5)	19,411 (- 19.4)	- 1,545
1992-93	18,537 (3.7)	21,882 (12.7)	- 3,345
1993-94	22,173 (19.6)	23,212 (6.1)	- 1,039
1993-94 (April-Sept)	10,351	10,791	- 440
1994-95 (April-Sept)	11,621 (12.3)	12,851 (19.1)	- 1,230

Note : Figures in brackets represent percentage increase or decrease over the corresponding period in the previous year.

Source : RBI Bulletin, June 1995 and Press release of the Ministry of Commerce dated November 4, 1994.

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## 9.6 INFRASTRUCTURE AND OTHER INDUSTRIES

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Literacy is less than 50 per cent in some of the States. Government's expenditure on primary and secondary education has remained static, but in the case of higher education, it has actually decreased. Self-financing/privatization of higher education has been introduced, at least in some institutions. Motor traffic has increased several fold during the past decade, but expansion and maintenance of roads lags far behind resulting in congestion and accidents. Rampant corruption takes away a part of the estimated expenditure on public works. Road building (of international standards) and maintenance have now been opened to foreign investors according to which they will construct the road at their own cost, maintain it for certain years and collect a toll fee to recover their investment and leave it to the country.

### Activity C

What infrastructures have been improved in the process of implementation of the new Industrial Policy?

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## 9.7 TAKE OVER AND MERGERS

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A study (IIM-C) reveals that just six years ago, there were only 15 takeovers in the country. In 1993, that number shot up to 52, and in the first 10 weeks of 1994, there have already been 29 take-overs or bids. It is said that "take-overs will peak by the end of the year, with even hostile ones becoming common".

Now that the industrial/business firms are liberated from the stringent Foreign Exchange Regulations Act (FERA), the Monopolies and Restrictive Trade Practices (MRTP) Act, and the Industries (Development and Regulation) Act. They are entering greenfield (agriculture) and are planning fast growth take-over strategies.

That is because the benefits of taking over a company - readymade manufacturing facilities, well-entrenched brands, captive market shares, no entry delays, and an established distribution network - are lucrative enough to make this strategy preferable to organic growth. And this business strategy works equally well if companies are trying to enter either new business areas or only consolidating in existing ones.

A new dimension to the Merger and Acquisition (M & A) game has been added by the government which, after decades of zealously guarding the enterprises it floated, is about to sell parts of those very enterprises. ABB and Siemens have put in bids for Bharat Heavy Electricals Ltd., and HMT is now being eyed by a host of raiders.

Likewise, the Board for Industrial and Financial Reconstruction (BIFR) too has become a facilitator of M & A deals. In its redefinition, sick firms, which have eroded their net worth, no longer have to post net losses for two successive years before they can be declared sick. Thus instead of hampering take-overs, the BIFR is keen that sick companies be acquired quickly.

Some recent examples :

- \* The B.D. Bangur Group of Calcutta has taken up a 46.8 per cent stake in Guest Keen Williams. The deal, effected through Bearbull of Germany, involves the buy-out of the London-based Guest Keen Nettlefold's holdings in the Indian company.
- \* Pepsi Foods is all set to take over the Bombay-based Duke & Sons. Starting off as a strategic alliance between the two companies, the deal is likely to culminate in a takeover.
- \* G.P. Goenka's Duncan Agro has outbid the Madras-based entrepreneur M.P. Jain to acquire the ailing Andhra Cements, whose accumulated losses exceed Rs. 250 crore. While Jain wanted a loan waiver worth Rs. 102.8 crore, Goenka won with a loan waiver demand of Rs. 91.9 crore.
- \* Indian Aluminum Company Ltd. (INDAL) is targeting the Hyderabad-based Annapurna Foils, a BIFR case, for a management takeover. Starting with 25 per cent stake, INDAL eventually plans to buy the unit.
- \* Ceat Tyres and Apollo Tyres are bidding for Premier Tyres, a BIFR case. According to the financial institutions - which hold 60 per cent equity stake in Premier Tyres - Ceat Tyres is the front-runner in this race.
- \* Alcatel South Asia Pacific, which is part of the French telecommunications transnational Alcatel, is bidding for Priyaraj Electronics, a Bangalore-based company manufacturing rural automatic exchanges, push-button telephones, and printed circuit boards.
- \* Telecommunications titan Siemens is trying to take over transmission equipment manufacturer Punjab Communications, a wholly-owned subsidiary of the Punjab State Electronics Development Corporation.

#### Activity D

Why do multi-nationals prefer a take-over? List out the reasons.

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## 9.8 CAPITAL MARKET : TRENDS IN CAPITAL ISSUES

The SEBI Act of 1992 and the Securities (Contract and Regulation) Act of 1956 were amended in January 1995 for vesting SEBI with regulatory powers over corporates in the issuance of capital, transfer of securities and other related matters. So far, the government's regulatory body did not have these powers thereby impeding its ability to protect the interests of the investors. In addition, SEBI has also been empowered to impose monetary penalties on capital market intermediaries and other participants for a range of listed violations. The SEBI Act had earlier allowed SEBI only to suspend and cancel the registration as well as prosecute intermediaries.

An over regulated market, like the one prevailing in the pre-1992 period, is surely a disincentive for investment. On the other hand, an under-regulated market has a potential hidden risks for the average investor. The regulator's job is to draw a fine line between the two.

It may be pointed out that when the offices of the Controller of Capital Issues were done away with in 1992, the idea was not to replace one with another in the capital market but to simplify procedures. SEBI started vetting an ever increasing number of public issues applications, which touched 1,650 in 1994-95. Its disclosure norms were ponderous rather than rigorous. And the case-by-case clearance raised more questions than confidence.

SEBI would now like to stop vetting prospectus and would tighten the guidelines instead, with severe penalty for violators.

One serious drawback in the present system is the practice of estimating the future projections of the company in the prospectus. Nowhere in the world is this done. As for the secondary market, the lack of liquidity and a certain measure of speculation have become big problems. Though there are 9,000 scrips listed in the Bombay Stock Exchange (BSE), only 800 are being actively traded.

The M.J. Pherwani Committee (1991) which recommended the setting up of NSE had observed that the debt market, especially for long-dated fixed income securities, accounts for a major portion of the volume of trading in developed countries. It was the availability of debt market that provided the impetus to capital formation in the U.S.

The high cost of debt services coupled with shortage of equity papers affecting the stability and sustained growth of Indian capital market is yet another grey area to be taken care of. More than anything else, for healthy growth of the market, there is need to regulate the activities of the stock exchanges as well. Usually, the big market players seem to be quite influential in determining which way the market should go so much so that the mutual funds have also been influenced (the path chartered out for them) by the speculators.

A number of reforms did take place in the mechanics and modalities of domestic investment. Setting up of the NSE at Bombay, an Over-The-Counter Exchange of India at some places, regulations for brokers, listing of shares, mutual funds functioning, new financial instruments, introduction of proportionate allotment system, curbing of insider trading (though not easy implementation), and so on, have been quite encouraging for the rejuvenation of the capital market. However, complete check over manipulations in bought-

out deals and underwriting, setting up a Depository System and such other reforms are also urgently needed. Now the Government is intending to introduce Non-Voting shares which will herald a new era in portfolio investment. It is hoped that with banking reforms and streamlining of capital market activities, India's financial sector will come of age and contribute significantly to the country's economic development, sooner than later.

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## 9.9 THE SMALL-SCALE SECTOR

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The small-scale industrial sector of the country forms the back-bone of the Indian economy. It contributes to around 40 per cent of the production and more than 50 per cent of India's export earnings. The intrinsic advantages of small-scale industries viz., low capital, lower overheads, high employment-to-capital-employed ratio make this sector quite competitive in the present day environment of liberalisation. As such, these industries have been the most appropriate to take on the full benefits of India's economic reforms.

Presently, more than three million small industrial units are functioning in the country producing around 40 per cent of the total industrial output and giving employment to more than three crore. This is much more than what the organised sector has been doing. The policy of reservation of items to be manufactured in the small sector has been diluted and even big units have entered into their area, thus creating problems for small entrepreneurs. Policy changes have enabled the large-scale sector to sponsor small-scale units. The SSIs which were thriving due to import restrictions, reservation, and subsidies and incentives have now found that all these have almost disappeared. The time has come when SSIs have to meet the exacting demands of an open economy in every respect. Only the export-oriented, and the service-sector-oriented have been able to strengthen themselves. In the consumer goods sectors wherever there is competition from imports, there has been extensive damage and loss.

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## 9.10 SUMMARY

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In conclusion, it may be said that the new economic reforms have been successful so far in achieving the objectives laid down in the 1991 Industrial Policy Statement. They may have opened the international window too wide and permitted multinationals in all areas, irrespective of the prioritization of hi-tech areas. Secondly, multinationals have started coming but there is a fear that they will subvert Indian capital and establish their supremacy in the corporate sector.

The reforms have bypassed agriculture. In the manufacturing sector the growth rates have been very good and in the services sector still better. The consumer goods sector has prospered but the capital goods sector has not done well.

The process of reforms has failed to reduce the fiscal deficit as a percentage of GDP, which after declining to 5.7 % in 1992-93, has again shot up to 7.6% in 1993-94. India had the unique opportunity of six continuous good monsoon years and the inflation rate and wholesale price index have been going around 10.0% during 1993-94.

There is a rise in the foreign reserves to 18 billion and the balance of the trade gap has been reduced to \$ 1,000 million during 1993-94 as against \$ 3,500 million during 1992-93 and the exchange rate of the rupee has become stable. These are good achievements.

The World Bank has emphasised the need for market-friendly government interventions. But free markets are neutral institutions, whose market could be good or bad. Certain conditions have to be met to make markets work efficiently and make them work for the benefit of the people.

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## 9.11 FURTHER READINGS

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Jacobson Staffen and Ghayar Alam, 1994, *Liberalisation and Industrial Development in the Third World*, Sage Publications : New Delhi.

Sengupta, Arjun, 1995, 'Sustainable Economic Reforms', *Indian Economic Journal*, Vol.42, 3.

Streeten, Paul, 1994, 'Markets and States: Against Minimalism and Dichotomy', *Political Economy Journal of India*, Vol.3, Issues 1 & 2, January-June.

Dutt, Ruddar, 1995, 'New Economic Reforms - Need for Some Rethinking', *Indian Economic Journal*, Vol. 42, 3.

Jalan, Bimal, 1991, *India's Economic Crisis - The Way Ahead*, Oxford University Press, Delhi.

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## 9.12 SELF-ASSESSMENT TEST

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1. Explain the major changes that are taking place in the private corporate sector since 1992.
2. "The economy is opening up. There will be challenges and opportunities, many will be pushed down and many will grate the opportunities" Describe.
3. Describe the merger and take over trends in recent times. Use real - life examples.
4. Explain the working of the new industrial policy as far as (a) Privatization and (b) foreign direct investment are concerned.
5. Explain the significant developments in the consumer goods market in India.
6. (a) "Godrej has stopped manufacturing (computer) printers and has started marketing Japanese made printers". What does it imply?  
  
(b) "The Madras High Court has accepted the claim of Maruti Udyog Ltd., that Hindustan Photo Films has to pay about Rs. 5 Crore (part of an inter-corporate loan) to MUL and if it fails to pay, winding up proceedings can be commenced in January 1996 (The Hindu, dated 13th Nov. 95)", comment.  
  
(c) Evaluate the response of the public sector services in post offices and banks in spite of the fact that fairly large number of private sector competitors have started operating now. Has private competition made any change?

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# UNIT-10 : SECURITIES AND EXCHANGE BOARD OF INDIA

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## Objectives

After studying this unit, you should be able to :

- define the concept of capital market
- explain the growth of capital market in India
- analyse the necessity for the existence of SEBI for proper functioning of capital market.

## Structure

- 10.1 Introduction
- 10.2 Concept of Capital Market
- 10.3 Control of Capital Issues
- 10.4 Growth of Capital Market in India
- 10.5 Securities and Exchange Board of India
- 10.6 Role of SEBI
- 10.7 Critical Appraisal of Role of SEBI
- 10.8 Summary
- 10.9 Further Readings
- 10.10 Self-Assessment Test

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## 10.1 INTRODUCTION

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The repeal of Capital Issues (Control) Act 1947 and the establishment of Securities and Exchange Board of India (SEBI) has been a milestone in the history of capital market in India. There has been a complete metamorphosis of market system, policies and regulations with the birth of SEBI. The Board has introduced a set of comprehensive guidelines for various issues concerning primary and secondary market and made rules and regulations for various market intermediaries.

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## 10.2 CONCEPT OF CAPITAL MARKET

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A capital market deals with financial assets, excluding coins and currency. The financial assets comprise banking accounts, pension funds, provident fund, mutual fund, insurance policies, debentures and other securities.

Stock market and money market are two basic components of capital market. Capital market may be defined as a financial market which provides and facilitates an orderly exchange of long term financial claims.

Capital market is a medium for mobilising finance out of the savings of the community and making it available to the users i.e. industry, trade and commerce for meeting their fund requirements.

Indian capital market has made spectacular growth in the last decade, in terms of the capital listed, market capitalisation, turnover, number of deals per day, number of stock exchanges and the number of investors. The recent economic liberalisation and concession programmes have given further impetus to this growth and it is expected that the decade of nineties will see a much faster growth of Indian capital market. Our markets are now venturing to open avenues for rural investors and also for international investors.

The capital market consists of a primary market where securities are issued and a secondary market where scrips are traded. Secondary market is a market place which provides liquidity to scrips issued in the primary market. Growth of secondary market is dependent upon primary market. Trading activities in the secondary market are done through the Stock Exchanges [23 including Over The Counter Exchange of India (OTCEI) and National Stock Exchange of India (NSE)].

Secondary market operations involve buying and selling of securities on the stock exchange through its members. The companies hitting the primary market are mandatorily required to list their stocks on one or more stock exchanges including a regional stock exchange. Listing of securities provides liquidity and offers an opportunity to the investors to buy or sell the scrips. The following intermediaries are involved in the stock market.

1. Broker/member of stock exchange - buyer's broker and seller's broker.
2. Portfolio manager
3. Investment adviser
4. Transfer agent

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## 10.3 CONTROL OF CAPITAL ISSUES

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On May 17, 1943 the Government of India under Defence of India Rule 94-A introduced control over capital issues to canalise the scarce resources of the capital market in Government loans. The purpose of this control was to bring about "a judicious" balance between Government borrowing and industrial investment". It was to prevent utilization of investible funds, scarce materials and services for purposes which made little or no positive

contribution to the prosecution of the war. It lapsed at the end of September, 1946 but the control was continued under a special ordinance No. XX of 1946.

In April 1947, Capital Issue (Continuance of Control) Act was passed with a view to preventing mushroom growth of companies, especially in an atmosphere of undue optimism and prevailing boom. It intended to give a measure of protection to the unwary investor against the onslaught of unscrupulous company promoters. It was designed "to secure a balanced investment of the country's resources in industry, agriculture and the social services to ensure that the available capital are utilised on a balance plan of agriculture, industrial and other developments and to keep a balance between the manufacture of capital and consumer goods". The control had for its objective the fostering of a rational and "healthy growth of corporate sector by ensuring, inter alia, that investment does not go into channels which are wasteful and not in accordance with the objectives of the plan; that companies have capital structure which is sound and conducive to the public interest; and that there is no undue congestion of offers for public subscription during any part of the year.

The control was administered by Ministry of Finance (Department of Economic Affairs) through the Controller of Capital Issues, who was specifically appointed for the purpose. The term "issues of capital" was defined in the Act as the issue of any securities whether for cash or otherwise and also covered capitalisation of profits or reserves for the purpose of converting partly paid shares into fully paid shares or increasing the par values of shares already issued.

Apart from the main objective, capital issues control was also utilised for several other purposes like the regulation of (a) bonus issues, (b) terms and conditions of foreign capital participation in Indian companies, (c) terms and conditions of dilution or repatriation of companies under FERA, (d) capital reorganistical plans of companies including mergers and amalgamations, (e) capital structure of companies as well as terms and conditions of additional issues, and (f) volume and timing of private issue of capital.

The working of the capital issues control has been subjected to criticism in official as well as non-official quarters. The criticism may be summarised as follows : (i) Control has got a negative approach; (ii) Control entails an overlapping of work with licensing committee formed under the Industries (Development and Regulation) Act; (iii) Control obstructs the formation of new companies; (iv) Control does not provide for a machinery for follow up after the sanction; (v) its main purpose was to refuse consent where the investment was clearly undesirable and was not to positively direct investment in the desired channels.

### **Control of Capital Issues - Abolition**

Till 1992, Capital issues were governed by Capital Issue (Control) Act 1947, administered by Controller of Capital Issues. The Act was abolished in the light of pronouncement of the Finance Minister in his budget speech for 1992-93 and recommendations of the Narasimham Committee and Estimates Committee of the Parliament. The promulgation of Ordinance No.9 of 1992 dated 29th May 1992 announced the abolition of Controller of Capital Issues (CCI) and repeal of Capital Issues (Control) Act 1947. The office of the Controller of Capital Issues (CCI) has since been abolished.

## 10.4 GROWTH OF CAPITAL MARKET IN INDIA

The capital market in India has witnessed spectacular growth during the last decade. The trend is overwhelmingly euphoric consequent to the process of liberalisation and the gradual shift towards free market forces.

The Securities and Exchange Board of India (SEBI), set up as an administrative body in 1988, was given statutory status on Jan. 30, 1992 by the promulgation of SEBI ordinance which has since become an Act of Parliament.

Key statistics related to capital market in India is given in Table 10.1 below :

**TABLE 10.1**  
**KEY STATISTICS RELATED TO CAPITAL MARKETS**

	1991-92	1992-93	1993-94	1994-95 (As at the end of Feb. '95)
1. List of companies (Number)				
- All Stock Exchanges	6480	6925		
BSE		2903	3885	4785
2. Market Capitalisation				
- BSE (Rs. Crores) (as on 31 March)	354106	177066	398349	433383
3. Total Capital Issues				
- Number	572	1038	1126	1501
- Amount (Rs. Crores)	13450	28195	32323	37125
4. Total number of capital market intermediaries registered with SEBI as on March 10, 1995 stands at :				
<b>Intermediary</b>			<b>Number</b>	
A. Merchant Banks			750	
- Category I			326	
- Category II			36	
- Category III			117	
- Category IV			271	
B. Registrars and Share Transfer Agents			252	
- Category I			169	
- Category II			83	
C. Mutual funds			22	
D. FIIS			306	

## History of development in the capital market since 1991

A summary of the developments in capital market since 1991 (year-wise) is given below :

### Year 1991

- In order to create an additional short-term avenue to invest and bring money market instruments within the reach of individuals and small bodies, Reserve Bank of India (RBI) announced the decision to set up Money Market Mutual Funds (MMMFs) by banks and financial institutions.
- Freeing of interest rates on debentures and the mandatory requirement of rating of certain categories of debentures.
- Permission was given for setting up of mutual funds in private and joint sector.
- The ceiling on the acquisition of share/debenture of Indian companies by Non-Resident Institutions (NRIs) and Overseas Corporate Bodies (OCBs) under the portfolio investment scheme was raised from 5% to 24%.
- In August 1991, Government issued a directive to stock exchanges to ensure greater transparency in stock exchange transactions.
- A scheme of registration of sub-brokers for investor protection was introduced.
- To improve the liquidity of major stock exchanges, the stock exchanges were asked to work out a scheme of 'Market Makers'.
- Direct foreign investments upto 51 per cent was allowed in select industries.
- Ceiling on interest rates by term lending institutions was removed and floor on interest rates was introduced resulting in increase in the interest rates on term loans. This resulted in increase in public issues for mobilising more funds.

### Year 1992

The Capital Issues (Control) Act was repealed in May 1992 and the office of the Controller of Capital Issues (CCI) was subsequently abolished. The pricing of capital issues was freed. The Securities and Exchange Board of India (SEBI) was reconstituted as a Board with statutory powers in Feb. 1992. The main objects of SEBI were capital market regulation for investor protection and fair trading practices.

For greater transparency in stock markets the following steps were taken by SEBI and other Government agencies :

- SEBI was authorised to conduct inspections of various mutual funds.
- SEBI introduced the process of registration of intermediaries such as stock brokers and sub-brokers etc.

- Companies were required to disclose risk factors relating to the project in public issue terms and prospectus.
- Merchant banking was statutorily brought under the regulatory framework of SEBI. The Merchant Bankers were to be authorised by SEBI.
- Regulations on insider trading under the provisions of SEBI Act were notified.
- The broad basing of the governing bodies of stock exchanges was initiated.
- Trading hours in stock exchange were increased to 3 hours from 2 1/2 hours.
- The public issue application form was revised to contain a memorandum of salient features of the prospectus.
- RBI permitted companies to accept capital contributions and issue shares or debentures to NRIs or OCBs without prior permission from RBI.
- The Government allowed FIIS to invest in pension funds, mutual funds, investment trusts, assets or portfolio management companies etc. to invest in the Indian Capital Market provided they were registered with SEBI.
- The Government gave formal approval for setting up of the National Stock Exchange of India (NSE) by financial institutions and banks with IDBI as the nodal agency.
- Indian companies were permitted to access international capital market through Euro-Equity issues aimed at mobilising capital for modernisation and import requirements.
- A new financial instrument 'Stock Invest' was introduced to be used by the investors for payment of application money for new capital issues.
- A new Over The Counter Exchange under the name Over The Counter Exchange of India (OTCEI) was set up with a view to facilitating small companies to approach public.
- In April 1992 the irregularities and fraudulent manipulations in securities (Securities Scam) trading of certain banks and financial institutions surfaced.
- The BSE sensex reached its all time high of 4547 in April 1992 and closed at around 2600 at the year end.

#### **Year 1993**

- Trading in debt instruments began on the OTCEI. The debt instruments traded were non-convertible debentures of various companies.
- The Government accorded recognition to the National Stock Exchange of India Ltd. (NSE) Bombay, a step that was expected to introduce modern trading systems in securities in the country.

- The Bombay Stock Exchange introduced circuit-break system to regulate speculation in the trading of shares.
- The Bombay Stock Exchange authorities decided to conduct weekly settlement in respect of non-specified securities from Feb. 1993.
- The OTCEI proposed to introduce a stock-lending scheme by which players in the market can borrow funds.
- The Government finalised the bill to enable nationalised banks to access the capital market.
- The government permitted PSUs to allot bonds under public issues to NRIs and OCBs like FIIS, under the new guidelines for public sector bonds for 1993-94.
- The Ministry of Finance issued guidelines and procedures for issue of foreign currency convertible bonds and ordinary shares through global depository receipt mechanism. It prescribed the limit indicating that an aggregate foreign investment made either directly or indirectly through global depository receipt mechanism shall not exceed 51% of the issues and subscribed capital of the issuing company.
- RBI announced the setting up of Securities Trading Corporation of India to develop a secondary market in Government securities and public sector bonds.
- The Standing Committee reviewing the stock invest schemes allowed banks to refuse to act on a stop notice from the purchase of stock invest. Besides blank purchases of stock invest's for onward sale to financial intermediaries was also prohibited by the Committee.
- The following steps were taken for removing deficiencies in the stock market :
  - a) Procedures for share allocation (proportionate allotment) in over-subscribed issues made more transparent.
  - b) A system of appointing SEBI representatives to supervise the allotment process was introduced to minimise malpractices in allotment of oversubscribed public issue.
  - c) An advertisement code was laid down for fair advertisements.
  - d) Prudential norms were introduced for rights issues.
  - e) Public sector bonds were brought under the regulatory authority of SEBI.
- Capital adequacy norms were prescribed for financial intermediaries such as merchant bankers and stock brokers.

SEBI notified the regulations for mutual funds. The mutual funds were required to be formed as Trusts and managed by a separate Asset Management Company (AMC) and supervised by a board of trustees or trustee company.

- SEBI proposes to make it mandatory for brokers to maintain separate accounts for their clients and for themselves.
- In order to check speculative pressures arising from this mechanism, SEBI issued a directive to stock exchanges in December, 1993 that henceforth all transactions in securities shall be settled at the end of each settlement by delivery and payment and the existing carry-over positions shall be liquidated in a time bound manner.
- Joint Parliamentary Committee (JPC) submitted its report of inquiries into the securities scam to the Parliament in December 1993.
- The BSE sensx reached a low of 2020 in August 1993 against its peak of 4547 in April 1992. The sensx rose to the level of 3350 at the end of the year.

#### **Years 1994 & 1995 (up to 31st March 1995)**

- National Stock Exchange commenced debt market operations in June 1994 and trading in equities in Nov. 1994.
- SEBI asked companies to disclose the promises and performances in respect of earlier issues in the offer document of fresh issues.
- Measures were initiated by the Government and SEBI for the setting up of Depositories for solving the problems of present settlement system.
- Due to increase in interest rates in U.S. and fall of Peso in Mexico, many of the FIIS have started selling their investments in developing countries including India. This affected the share market adversely.
- OTCEI also started trading in equities of selected companies listed on approved stock exchanges.
- Mutual Funds have been requested to adhere to a code of advertisements and a procedure for calculating and declaring Net Asset Value of mutual funds had been specified.
- In Oct. 1994, the Euro proceeds were required to be mandatorily retained abroad and to be repatriated as and when expenditure for the approved end uses were incurred.
- For controlling the takeover in public interest, SEBI came out with new regulations under the name 'Substantial Acquisitions of Shares and Take-overs' in Nov. 1994.
- In January 1995, the Government promulgated an ordinance to amend the SEBI Act giving it more powers for ensuring the orderly development of the capital market and enhance its ability to protect the interest of investors.

- In January 1995, an ordinance was promulgated for amending the securities contract (Regulations) Act 1956, for deleting Section 20 of the Act relating to "Prohibition of Options Futures" paving the way for trading in options.
- The Bombay Stock Exchange started Bombay Stock Exchange On Line Trading (BOLT), an automatic trading system on a few of the listed companies.  
  
The number of companies in BOLT will be increased in future.
- The Committee set up under the Chairmanship of Shri G.S.Patel under the instructions of SEBI to review the revival of Badla System has submitted its report.
- The sensex rallied in June 1994 to reach all time high of 4618 in Sept. 1994 and then came down to a level of 3925 at the end of 1994. In 1995 the sensex has gone down further.

### Activity A

Review your understanding of the following phrases :

1. Capital Market :

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2. Primary Market :

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3. Secondary Market :

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4. Control of Capital Issues :

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5. Intermediaries in Secondary Market :

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### Activity B :

Go to any nearby library and review the developments in Capital Market since April 1995.

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## **10.5 SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)**

The need for a separate board for proper functioning of capital markets was first declared by the late Shri Rajiv Gandhi in his budget speech for the year 1987-88 when he said " . . . for a healthy growth of capital markets investors rights must be fully protected and trading malpractices must be prevented. Government has decided to set up a separate board for the regulation and orderly functioning of stock exchanges and securities industry".

In April 1988, the Government of India, by passing a resolution, constituted Securities and Exchange Board of India (SEBI). It operated on the basis of this resolution till Feb. 1992 when it was granted statutory status. The SEBI Act of 1992 was made effective from 30th Jan. 1992. SEBI was established on a statutory basis with effect from 21 Feb. 1992.

### **SEBI's Constitution**

The SEBI Act 1992 provides for establishment of a statutory board with branches. The Board shall consist of the following members, namely

- (a) A chairman
- (b) Two members from amongst the officials of the Ministries of the Central Government dealing with Finance and Law
- (c) Two other members having experience of securities market
- (d) One member from amongst the officials of the Reserve Bank of India

SEBI has been given autonomous status as a body corporate with perpetual succession and common seal. According to the preamble of the Act, the objectives of setting up SEBI are to protect the interest of investors in securities, to promote the development and to regulate the security market.

### **SEBI's Organisation**

SEBI's activities have been divided into five operational departments each headed by an Executive Director, a legal department and an investigation department also headed by officials of the rank of Executive Directors. Besides the above departments, SEBI has opened regional offices at New Delhi, Calcutta and Madras. The headquarters of SEBI is located at Bombay.

The powers of SEBI can be exercised by way of regulation. SEBI cannot act independently. It is bound by directions of policy given by Central Government from time to time in writing. SEBI has to submit an annual report to the Government each year giving therein a true and full account of its activities, policies and programmes. A copy of the report and also that of the rules and regulations made by SEBI are to be laid before the Parliament.

## **Powers of SEBI**

SEBI as a regulatory and development board has wide and varied powers. It has power to :

1. call for periodical returns from recognised stock exchanges
2. call for any information or explanation from recognised stock exchanges or its members
3. direct inquiries to be made in relation to affairs of stock exchanges or its members
4. grant approval of bye-laws of recognised exchanges
5. make or amend bye-laws of recognised exchanges
6. declare applicability of section 17 of Securities Contracts (Regulation) Act in any state or area and to grant licenses to dealers in securities
7. compel listing of securities by public companies
8. control and regulate stock exchanges
9. grant registration to market intermediaries
10. register and regulate working of collective investment schemes including mutual funds
11. promote self-regulatory bodies
12. prohibit fraudulent and unfair trade practices relating to securities
13. prohibit insider trading
14. promote investor's education and trading of intermediaries in capital market
15. regulate substantial acquisition of shares and take over of companies
16. levy fees
17. conduct research and other functions.

These above said powers and functions are not exhaustive. SEBI's efforts so far include measures for efficiency, reforms and transparency in primary and secondary market, regulation of mutual funds and market intermediaries and introduction of Form 2A (abridged prospectus) and stock invest. A lot of investor protection guidelines have also been framed and implemented.

## **10.6 ROLE OF SEBI**

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Let us now discuss various measures taken by SEBI in regulating the functioning of capital market in India.

### **Market Regulations**

Rules/regulations have been notified by SEBI under SEBI Act for regulating intermediaries in the securities market, namely merchant bankers, brokers and sub-brokers, portfolio managers, underwriters, bankers to an issue, registrars and share transfer agents. These intermediaries have been brought into the regulatory purview for the first time and would now have to adhere to specific capital adequacy norms, meet certain eligibility criteria and abide by a code of conduct which specifies a high degree of responsibility towards investors. The regulations also lay down the responsibilities and obligations of these intermediaries and provide for action by SEBI in case of default.

### **Primary Market Reforms**

SEBI has initiated reforms in the primary market. The objective is to strengthen the standards of disclosure, introduce certain prudential norms for the issues and intermediaries and remove the inadequacies and systematic deficiencies in the issue procedures. The following important steps are taken by SEBI in this regard : (a) The minimum percentage of securities to be issued to the public for the purpose of listing of securities was reduced from 60 per cent to 25 per cent through an amendment of Securities Contracts (Regulations) Rules, 1957; (b) An advertisement code was laid to ensure that advertisements were fair and did not contain statements to mislead the investors; (c) Allotment procedures were revised to introduce the requirement that shares be allotted on pro-rata basis, raise the minimum amount of application money for public and rights issue to Rs. 5000 and for on par issues from 100 to 500 shares, allow mutual funds and Foreign Institutional Investors (FIIs) to apply for firm allotment in public issues and reduce the number of collection centres to a minimum of 30; (d) A system of appointing SEBI representatives to supervise the allotment process was introduced to minimise malpractices in allotment of oversubscribed public issues; (e) prudential norms were introduced for rights issues; and (f) public sector bonds were brought under the regulatory authority of SEBI.

### **Mutual Funds**

SEBI has notified the regulations for Mutual Funds. These regulations require them to be formed as trusts and managed by a separate Asset Managed Company (AMC) and supervised by a board of trustees or trustee company. The regulations lay down certain eligibility criteria for the sponsors of mutual funds and require that AMC's have a minimum net worth of Rs.5 crore of which the sponsors must contribute atleast 40 per cent. The SEBI (Mutual Fund) Regulations also provide for an approval of the offer documents of schemes by SEBI. The Regulations prescribe minimum amount to be raised by each scheme. A close-ended scheme with a fixed size of mutual fund must raise a minimum of Rs.20 crore and open-ended schemes of Rs.50 crore. The entire subscription amount must be refunded within six weeks of the closure of the scheme in case the amount collected by the scheme

falls short of the prescribed amount. There will also be certain investment restrictions for AMCs. The advertisement code prescribes norms for fair and truthful disclosures by the mutual funds in advertisement and publicity materials.

### **Secondary Markets and Intermediaries**

SEBI has made it mandatory for brokers to maintain separate accounts for their clients and for themselves. They must disclose the transaction price and brokerage separately in the contract notes issued to their clients. They must also have their books audited and file the same with SEBI.

SEBI has issued directives to the stock exchanges to ensure that contract notes are issued by brokers to clients within 24 hours of the execution of the contract. Exchanges are to see that time limits for payment of sale proceeds and deliveries by brokers and payment of margins by clients to brokers are complied with. For ensuring the fulfilment of deals (safety of the trades) in the market and for protecting investors, SEBI has introduced capital adequacy norms for brokers. This will ensure that member firms are adequately capitalised in relation to their outstanding position. The norms prescribe a base minimum capital plus additional capital related to volume of business. The exchanges are amending their bye-laws to incorporate the capital adequacy norms.

Through an order under the Securities Contracts (Regulations) Act of 1956, SEBI has directed the stock exchanges to broad-base their Governing Boards and change the composition of their arbitration, default and disciplinary committees.

SEBI is also contemplating other aspects for market development which include reducing the settlement cycles, encouraging the setting up of depository institutions and developing the market infrastructure.

### **Market and Institutional Development**

RBI has issued guidelines to banks for providing financial support to market makers (who make a commitment to quote buying and selling prices and to purchase and sell at these prices) for scrips in various stock exchanges. Market makers are approved by SEBI, based on the recommendations of the stock exchange. The introduction of market makers will improve liquidity of scrips and benefit investors.

Recognition has been accorded by Government to the National Stock Exchange of India Ltd. (NSE). As a model exchange it is expected to move rapidly towards a nation-wide electronic screen based "scripless and floorless" trading system in securities which will be both efficient and transparent and offers equal and nation-wide access to investors.

The Over The Counter Exchange of India (OTCEI), Bombay started its operations in Sept. 1992 and various companies have already been listed with it. Regional windows have been opened at Delhi and Madras, besides representative offices in 18 major cities throughout the country.

## **Foreign Institutional Investors (FIIs)**

With a view to facilitating the entry of FIIs into the country SEBI has simplified the common application form. The entry of FIIs is also to be facilitated by increasing the role of foreign brokers in the transactions of FIIs. Foreign brokers will be allowed to assist FIIs and operate on their behalf by transmitting orders to buy or sell securities to members of the Indian Stock exchanges. These foreign brokers have been permitted to open bank and custodial accounts for this purpose. Government has also allowed some foreign firms to set up joint ventures in the financial sector.

## **Globalising Indian Equity**

Euro-equity issue is made by an instrument termed "Global Depository Receipts" (GDRs). A GDR is a dollar denominated instrument tradable on a stock exchange in Europe or USA.

A GDR represents a certain number of equity shares. Though GDR is denominated in dollar terms, the equity shares comprised in each GDR are denominated in rupees. For example a GDR of \$ 30 may comprise two equity shares of \$ 15 per share equivalent to Rs.450 per share, at the rate of exchange prevailing at the time of issue.

The securities are issued by the issuing company to an intermediary called "depository". The equity shares are registered in the name of the depository who subsequently issues the GDR to the investors. The issuers and the depository enter into "depository agreement" detailing the terms and conditions of the agreement between them.

## **Capital Issues**

SEBI had issued comprehensive guidelines on 11th June 1992 for investors' protection and disclosure. There have been subsequently nine clarifications on these guidelines. These guidelines apply to all issues of capital made after 11th June 1992.

The Department of Company Affairs by a notification dated. 3.10.1991 had laid down the furnishing of managements perceptions of the risk factors. This came into effect from Nov. 1991. After the constitution of SEBI, investors are provided with a detailed account of risk factors in the offer documents, both in the case of initial issues through prospectus as well as the rights issue of an existing company. Vetting of prospectus and letter of offer by SEBI has been made compulsory.

The salient features of the stock invest scheme such as details of the issues, project, promoters and risk factors are to be supplied along with the application in non-detachable form (Form 2A Memorandum). By this, investors are given first hand information about the issue so as to enable them to take a fair, well informed investment decision.

Stock invest scheme which has been introduced in March, 1992, at the instance of SEBI provides for use of 'Stock invest' which is a legal non-negotiable instrument like cheque and is to be used to subscribe to capital issues. The novel idea being that the money which is used to subscribe to an issue will continue to earn interest even after the share application is made by the investor. Investor will not lose any interest on the money invested in the capital issue. The validity period has been reduced from 6 months to 4 months.

As part of its role towards investor protection, SEBI has evolved a system of redressal of investor grievances and is consistently taking up investors complaints against companies, brokers and other intermediaries. SEBI issues from time to time "Investors Guidance Series" to clarify, guide and educate the investor community on matters such as mutual funds, grievances and remedies available to investors holding debentures, the stock invest scheme, investment considerations in the primary market and caution against illegal transactions.

SEBI has also taken direct steps by way of investor education. It has issued a few investor guidance advertisements and published a book regarding "Investor Guidance - Rights and Remedies". Besides increasing investor awareness and to making them come up as a strong community, SEBI has also registered certain active investors and associations.

SEBI has taken various measures to protect investors such as - announcing guidelines on disclosure and investor protection, registration and regulation of market intermediaries, appointment of SEBI's representative to oversee allotment where issues are oversubscribed and setting up an investor grievances cell to handle investor complaints.

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## **10.7 CRITICAL APPRAISAL OF ROLE OF SEBI**

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It is clear from the above discussion that SEBI was set up to monitor the capital market, especially to safeguard the interest of investing public. But it is increasingly seeming to slacken on the primary market front. SEBI has the credit of introducing the proposals like proportional allotment in oversubscribed issues, appointment of SEBI's representative during allotment in oversubscribed issues, an issue-advertising code and penalty point system for delinquent lead managers. But it has not been very successful in maintaining order in the primary market.

The vetting of draft proposals is one area where SEBI is seen faltering increasingly. There are many companies which approach the market to make a quick buck, exploiting the boom in the investment climate. Promoters known for implementing projects with massive delays and cost over runs and those with pending criminal cases and huge outstanding debts constantly enter the market. According to SEBI officials it has no right to prevent anyone from raising funds as long as adequate disclosures are made.

Promoters to whom banks refuse to extend credit facilities due to massive outstandings generally approach the market to mobilise funds. There are several cases where prospectus does not disclose litigations arising out of guarantee as well as pending litigation against individual promoters though it is a market practice for directors of a company to stand as surities while taking loans from banks.

Companies can go ahead with public or rights issues only when SEBI issues an acknowledgment card based on the "due diligence" certificate filed by the lead manager. When lack of diligence in maintaining disclosure standards is detected or if the lead manager dissociates himself stating that the promoter hid material information from him, SEBI can withdraw this card and prevent the company from making the issue.

In some cases acknowledgment cards were withdrawn following their lead managers' dissociation from the issues.

SEBI has also taken stringent measures in some cases and directed promoters to send letters to the share allottees making the disclosures in detail with an offer to buy back the shares if the allottees did not wish to take the shares in the light of disclosures.

However, in later cases, companies have successfully approached the courts to stay the withdrawal of the acknowledgement cards to go ahead with the issue. Merchant Banking circles feel that SEBI's inaction in such cases was unwarranted especially when it was convinced that the disclosure standards were not met with. The need to legislate exhaustively is increasingly felt.

As of now SEBI does not adequately monitor the issue after it has opened. The directors of Asia Fertilisers closed their issue well before it was fully subscribed. There is no legislation to tackle such a case.

### **Penalty Points**

SEBI attaches penalty points to delinquent lead managers as a monitoring mechanism. Their defaults are classified into general, minor, major and serious cases with the serious defaults attracting a penalty of four points. A cumulative score of eighty penalty points gives SEBI the right to deregister the merchant banker.

However, the maximum points that can be given in a single issue is four, which means a lead manager committing a series of blunders in a single issue would get away with only four penalty points. According to market reports only five merchant bankers have penalty points to their names and no merchant banker has been deregistered to date. Though SEBI comes out with a list of companies against whom investor complaints have been received, lists of top defaulting merchant bankers are never publicised.

Grey market operations too have not been contained by SEBI successfully. In one specific case a company has reportedly issued letters to some non-resident Indians agreeing to buy back the shares at a premium but the promoters contend the offering to buy back shares "is only an assurance to give confidence to the prospective investors". Though grey market may not be under SEBI's purview it is important to prevent its operations.

The advertising code developed by SEBI prevents celebrities from endorsing new issues. However, this too is circumvented by promoters by placing retired Government officials, cricketers, film stars and the like on their boards. This form of celebrity endorsement through the back door easily hoodwinks the investors.

SEBI has permitted free pricing of new issues and met the long standing demand of merchant bankers and issuers. SEBI feels that market forces should decide the fate of issues and that it should not interfere with free and fair play of market in fixing the prices.

SEBI has issued a series of guidelines, clarifications, rules and regulations to develop, stabilise, consolidate and strengthen the Indian Capital market. However, the guidelines, clarifications etc. issued, appear to be too many in number and quite confusing and cumbersome. It may be worthwhile for SEBI to consolidate all the guidelines together with suitable clarifications and issue a fresh consolidated set of guidelines.

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## 10.8 SUMMARY

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Capital market is a medium for mobilising the finance out of the savings of the community and making it available to the users, i.e., to the industry, trade and commerce for meeting their fund requirements. It deals in financial assets comprising banking accounts, pension funds, provident fund etc. Stock market and money market are two basic components of capital market.

The Indian capital market has made spectacular growth in the last decade. The recent economic liberalisation programme has given a further impetus to this growth. The Securities and Exchange Board of India was set up to regulate and monitor the capital market, especially to safeguard the interests of the investing public.

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## 10.9 FURTHER READINGS

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Sekhar, K., 1993. Guide to SEBI, Capital Issues, Debentures and Listing. Agra : Wadhwa & Co.

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## 10.10 SELF-ASSESSMENT TEST

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1. Define the concept 'Capital Market'. State the important events in the development of capital market in India.
2. Critically appraise the role of SEBI in regulating the functioning of capital markets.

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## **BLOCK-IV : MONETARY AND FISCAL SYSTEM**

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The Government, through its fiscal-cum-budgetary policies, is affecting the business organisations directly as well as indirectly. Starting from 1991-92, our Government is initiating a number of changes to make our system more effective.

Despite the overall progress made by the Indian Financial System, its operational system has been unsatisfactory upto 1991. The Government of India, through New Economic Policy of 1991, is bringing reforms in our financial system on war-footing.

The block is devoted completely for discussion on the above mentioned two aspects in two units. Unit-11 discussed the Fiscal Policy of our Government, whereas Unit-12 mainly concentrates on the reforms introduced in the financial sector.

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## **UNIT - 11 : FISCAL POLICY**

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### **Objectives**

After studying this unit, you should be able to :

- list out the main recommendations of Raja Chellaiah Committee relating to corporate tax, income tax & indirect taxes
- explain the concept of Value Added Tax (VAT)
- state the main deficiencies of banking sector and also the investment policies of banks
- analyse the Indian Fiscal Policy.

### **Structure :**

- 11.1 Introduction
- 11.2 Corporate Tax
- 11.3 Income Tax
- 11.4 Indirect Taxes
- 11.5 Value Added Tax
- 11.6 Banking Sector - The Main Deficiencies
- 11.7 Investment Policies of Banks - An Appraisal Until 1991
- 11.8 Fiscal Policy - Changing Scenario
- 11.9 Summary
- 11.10 Key Words
- 11.11 Further Readings
- 11.12 Self-Assessment Test

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### **11.1 INTRODUCTION**

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The reforms in Indian tax system became imperative in the wake of structural adjustments and swift economic liberalisation measures initiated in the Union Budget for 1991-92. Accordingly in August, 1991, the Government of India constituted a Tax Reforms Committee headed by Raja Chellaiah with the following terms of reference :

- (i) To examine the structure of direct and indirect taxes;
- (ii) To make recommendations inter alia for making the tax system more elastic and broad based, and
- (iii) To suggest measures required for simplifying the existing laws and regulations to facilitate better enforcement and compliance.

The Chellaiah Committee submitted its interim report in February 1992 to the Government of India to enable the Finance Minister to draw heavily upon it in framing the proposals for 1992-93 budget. Accordingly, some of the suggestions of this Committee were implemented in 1992-93 Budget. The Committee submitted its final report in two parts, Part-I in August 1992 and Part-II in January, 1993. The Finance Minister incorporated some of the recommendations in 1993-94 budget.

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## 11.2 CORPORATE TAX

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The main recommendations of Raja Chellaiah Committee with regard to corporate tax are as follows :

1. The Chellaiah Committee has recommended that the corporate tax for domestic companies should be lowered to 45 per cent in 1993-94 from 51.75 per cent, by abolishing surcharge. It should be lowered further to 40 per cent in 1994-95. Corporate tax reforms were considered in the 1994-95 budget. Corporate tax on domestic companies has been reduced to a uniform rate of 40%. Surcharge on Corporate Tax would continue at the rate of 15 per cent of income over Rs.75,000/- in the case of domestic companies. No changes were incorporated in 1995-96 budget.
2. The Committee has suggested that the tax rates for foreign companies should be lowered. It has recommended that the difference between the rates on domestic and foreign companies should be around 7.5 percentage points. In no case the difference should exceed 10 percentage points.

Tax on companies incorporated abroad but earning income in India (i.e., foreign companies) is levied at 55%.

3. The Committee has also suggested that the double taxation of foreign companies in respect of fees for technical services be avoided.
4. The Committee has favoured the retention of the general rate of depreciation on plant and machinery at 25%.
5. The Committee has recommended the abolition of tax on interest.

Lowering of corporate tax should enable industry to retain a greater part of its earnings and use it for future growth and expansion. Incidence of tax evasion is expected to come down.

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## 11.3 INCOME TAX

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As far as Income Tax is concerned, the main recommendations of Chellaiah Committee are as follows :

1. The Chellaiah Committee has recommended the policy of moderating tax rates and widening the tax base combined with fewer deductions and exemptions and effective enforcement to encourage voluntary tax compliance thereby reducing tax evasion.

2. The Committee has recommended an income-tax regime with a narrower spread between entry rate of income tax and maximum marginal rate along with lower rates of taxation. It has therefore, recommended that incomes falling in the slab Rs.50,000 to Rs.2,00,000 should be taxed at 27.5% and the maximum marginal rate of income tax of 40% inclusive of surcharge. Surcharge should be applicable to incomes above Rs.2,00,000.

The 1995-96 budget has proposed to enhance the exemption limit of income tax in the case of individuals and association of families from Rs.35,000 to Rs.40,000. Additional exemption under 80L of IT Act had been increased from Rs.10,000 to Rs.13,000.

<b>Income Slab</b>	<b>Proposed Rates</b>
Up to Rs.40,000	Nil
Rs.40,000 - 60,000	20%
Rs.60,000 - 1,20,000	30%
Above Rs.1,20,000	40%
Standard deduction	Rs.15,000

3. The Committee has recommended the withdrawal of exemptions in respect of various savings linked tax exemption schemes such as Equity-Linked Savings Scheme and National Savings Scheme (NSS) admissible for deductions under section 80 CCA and 80 CCB of IT Act because these conferred larger tax benefits on higher income groups.
4. The Committee has recommended that the income of a minor child from gifted assets be clubbed with that of the parent to plug the loophole of cross gifting used to evade the clubbing under the existing tax law.
5. The Committee has recommended that double taxation in the sense of taxing the income of a partnership firm and also taxing the partners on their share in the income of the firm be avoided.
6. The Committee has suggested a Presumptive Tax Scheme in respect of small shop owners and traders. This scheme should be introduced on an optional basis stipulating that the shop keepers may pay tax in lumpsum in case their turnover falls between Rs.3 lakh and Rs.5 lakh. This suggestion aims at attracting new tax payers.
7. The Committee has suggested the taxing of leave travel allowance and receipts on retirement.
8. The Committee has recommended that the agricultural income in excess of Rs.25,000 accruing to the non-agriculturists be taxed by aggregating it with non-agricultural income.

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## **11.4 INDIRECT TAXES**

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Raja Chellaiáh Committee made the following recommendations in relation to indirect taxes :

## **Customs Duties**

1. The Committee has recommended reduction in the general level of tariffs. It has recommended a drastic reduction in customs tariff rates to 15-20 per cent by 1997-98.
2. The Committee has favoured a stable import duty rate to avoid pressures for exemptions and concessions which ultimately prove counter-productive.
3. The Committee has also made recommendations for a speedy system to determine anti dumping duties which will acquire greater importance with the reduction in Customs Duty rates.
4. The Committee has ruled out a single import duty regime and favoured a very limited number of rates.
5. The Committee has favoured all goods being subjected at least to a minimum tariff. It has therefore recommended a minimum 5 per cent customs on all goods which now enjoy total exemption.
6. The Committee has recommended that customs tariff on finished goods should be higher than that on basic raw materials and those on components and machinery should be in between.

## **Excise Duties**

1. The Chellaiah Committee has suggested that the present excise tax system be gradually transformed into a genuine VAT (Value Added Tax).
2. The Committee has recommended the extension of MODVAT (Modified Value Added Tax) to textiles and petroleum products.
3. The Committee has recommended three rate MODVAT regime at the manufacturing level with excise duty rates of 10%, 15% and 20% and selective excise duties on non-essential commodities at 30%, 40% and 50%.
4. The Committee has suggested the extension of MODVAT to wholesalers. It would strengthen the revenues of State Governments.

In the 1992-93 Budget the maximum import duty was reduced from 150 per cent to 110 per cent. In 1993-94 it was further reduced to 85%.

## **Activity A**

Review your understanding of the following phrases.

1. Corporate Tax
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## 2. Income Tax

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## 3. Customs Duty

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## 4. Excise Duty

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### 11.5 VALUE ADDED TAX (VAT)

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France was the first country to introduce VAT in 1954 followed by UK in 1972 and USA in 1973. Let us understand what VAT is, examine its pros and cons and also the possibilities of its replacing the excise duties, general sales tax or corporate profit tax in India.

VAT is levied on the basis of the value added to the value of a product at every stage of its sale in the process of production and distribution. In other words, it is assessed at each stage only on the increase in the value of a commodity since the last taxable transaction. Take an example. Suppose a person buys cotton worth one lakh rupees. After ginning it in his factory he sells it to a spinner for Rs.3,00,000. He has added Rs.2 lakh to the value of cotton he has purchased. If the rate of VAT is 10%, he will be assessed at Rs.20,000. Now suppose the spinner turns the ginned cotton in his factory into yarn for Rs.4 lakh (which he had purchased for Rs.3 lakh). He has added to its value another Rs.1 lakh and at 10% VAT rate, he will be charged Rs.10,000 tax. The textile manufacturer uses the yarn to make cloth which he sells for Rs.6 lakh (having purchased for Rs.4 lakh himself). He has added value to the commodity in the process of production of Rs.2 lakh and he will be called upon to pay Rs.20,000 as a tax, assuming again 10% VAT rate.

Thus, under this system of taxation "the sum of the value added at each successive stage is equal to final price of products and the sum of the tax paid at each successive stage will be same as the tax which would be payable if it were charged on the full value of the final product. It is clear that under this system, it is compulsory for a manufacturer to preserve all the relevant documents, vouchers, etc., to be able to claim a rebate from taxes paid by him earlier on his inputs. The business firm has to pay VAT at the relevant rate applied to total sales during a given period, deducting the amount paid by the firm in buying intermediate products, or inputs capital equipments etc.

On the whole, there seems to be a strong case for the introduction of VAT. Transitional problems can be solved and initial difficulties overcome. Long term fiscal policy introduced VAT in its modified form. That is why it has been dubbed as Modified Value Added Tax (MODVAT). MODVAT was introduced in 1985-86 in selected industries. It has now been extended to cover all the categories of excise duty, except those relating to

textiles and tobacco. The Chellaiah Committee has suggested that the present excise tax system be gradually transformed into genuine VAT.

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## **11.6 BANKING SECTOR - THE MAIN DEFICIENCIES**

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### **Governmental**

The main deficiencies experienced by the banks from the side of Government are as follows :

1. Apathy of Government towards strengthening banks' management towards dynamism and efficiency
2. Appointments not being based on performance
3. Lack of independent and professional persons
4. Uncertain tenure of chief executive officers
5. Lack of autonomy
6. Excessive control by Government
7. Flow of credit to some productive sectors has been restricted due to excessive priority sector lending
8. Loans at subsidised rates and unacceptable levels of cross subsidisation
9. Complex legal frame work for effecting recoveries.

The senior officials of the Department of Banking of the Government of India interfere in the management of banks. It leads to decision making on the basis of political expediency rather than by following strict banking norms.

The increasing advances to unemployed for self-employment and loans to weaker sections have led to the problem of bad debts, doubtful debts and overdues. Loans of the order of several crores of rupees are overdue as these have not been recovered by banks as per stipulated schedules. Non-recovery as a percentage of demand is very high. This threatens the very viability of the banks.

### **Reserve Bank**

The main problems of banks from the side of RBI are :

1. Excessive control by the Reserve Bank of India
2. Plethora of regulations - RBI Act, Banking Regulations Act, Negotiable Instruments Act, etc.

3. Increasing SLR/CRR consuming bulk of bank finance
4. Banking secrecy has prevented public knowledge of quantum of losses involved.

### **Internal**

The main problems faced by the banks internally are :

1. Multiple and unfocused objectives
2. Inadequate management practices
3. No accountability for results
4. Management appointments not being based on performance
5. Inadequate mechanisation, low technology levels
6. Inadequate internal control
7. Overmanning
8. Labour problems resulting in low productivity
9. Irregularities in preparation of internal reconciliation
10. Reduced efficiency due to bureaucratic hurdles and delays - customer service has suffered
11. Lack of customer orientation which results in poor standard of service to the clientele
12. Inadequate Human Resources Management practices.

The quality of service rendered by the banks has deteriorated. It has been caused by staff indiscipline and absence of the system of accountability. The banks have made inroads into certain areas without adequate professionally trained staff.

Low level of profitability ratio is due to relatively lower interest rates on priority sector advances and such other advances to weaker sections. The average yield on such advances was much lower compared to conventional advances. The ever increasing ratio of priority credit to total credit was depressing the interest yield on advances year after year. The rising establishment expenses also contributed to the decline of profitability ratio.

Reasons for low level of profitability are continuous increase in SLR/CRR, persistent increase in emphasis on social goals, rising incidence of industrial sickness, rapid branch expansion, unfavourable deposit mix of banks and growing incidence of finance disintermediation.

The Narsimham Committee on Financial Reforms has pointed out that the progressively increasing SLR/CRR have been preempting a large part of bank resources into low income earning assets, thus reducing bank profitability.

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## **11.7 INVESTMENT POLICIES OF BANKS UNTIL 1991**

### **- AN APPRAISAL**

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In response to the rapidly increasing credit needs of agriculture and industry arising out of economic development programmes, the bank advances have registered tremendous increase from Rs.4,684 crore as at the end of March 1971 to Rs.25,371 crore at the end of March 1981. The upward trend has continued till the end of March 1992 at which the total bank credit stood at Rs.1,25,592 crore. However, it is important to note that the expansion of Rs.9,291 crore (7.9%) in bank credit during 1991-92 was substantially lower in percentage terms as compared to that of Rs.14,848 crore (14.6%) in 1990-91. It was due to RBI's credit policy which stipulated that each bank was to ensure that its incremental non-food credit deposit ratio would not exceed 60%.

The total bank credit as a percentage of total deposits (credit-deposit-ratio) has however revealed downward trend. The credit-deposit-ratio has declined from 79.3% in 1971 to 66.8% in 1981 and registered a further decline to 59.8% in 1988. In 1991-92 credit-deposit-ratio declined to around 54 per cent. The downward trend in credit-deposit-ratio could be attributed to rising CRR and SLR during 1971-91 under credit squeeze policy of RBI. Increase in CRR and SLR have been responsible for large diversion of bank deposits to cash reserves and investment in Government securities leaving lesser portion of deposits for loans and advances (bank credit).

There was considerable shift in allocation of bank credit pattern also. During the last two decades, the share of agriculture in total bank credit has increased from 2.2% to 14.4% whereas the share of industry has declined from 67.5% to 48.7%. The share of food procurement credit has gone up from 3.5% to 12% over the same period.

The share of priority sector advances in total bank credit has increased from 14.6% at the end of June 1969 to 39.3% at the end of March, 1991.

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## **11.8 FISCAL POLICY - CHANGING SCENARIO**

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Economic restructuring has to be supported by the financial sector which is capable of mobilising resources in adequate quantities at reasonable rates of interest and allocating them efficiently. This calls for an efficient and modern banking system. A comprehensive reforms programme has been initiated following the recommendations of the Narasimham Committee. The important recommendations of the Narasimham Committee are :

(1) Directed Investments; (2) Directed Credit; (3) Deregulation of Interest Rates; (4) Structure of the Banking System; (5) Prudential Norms and Regulations; (6) Recovery of Loans; (7) Computerisation of Banks; (8) Removal of Duality of Control; and (9) Free and Autonomous Banks.

These recommendations are discussed in detail in "Unit-12 : Financial Sector Reforms".

## Activity B

Go to your nearest library and collect details regarding progress in implementing suggestions of Chellaiah Committee on tax reforms.

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## 11.9 SUMMARY

Number of changes are taking place in the Indian Economy from 1991 and the Indian Tax System is not an exception. Raja Chellaiah Committee, appointed by the Government of India in 1991, studied both the direct and indirect tax structure existing in India. The Committee offered a number of recommendations not only for simplifying the existing laws but also for making the tax system more elastic. These recommendations are mainly related to the areas like corporate tax, income tax, indirect taxes, introduction of Value Added Tax, etc., and some of them are already implemented.

Even though there is tremendous increase in the financial assistance sanctioned by banks to various sectors, our banking sector is facing number of problems from Government and Reserve Bank of India. This is in addition to the internal problems faced by the banks. Basing on the recommendations of the Narasimham Committee, the Government of India is taking various measures for making the banking system more efficient.

## 11.10 KEY WORDS

**Corporate Tax** : The income tax on the net profits of joint-stock companies is called Corporate Tax.

**Income Tax** : Income tax is levied on the income of individuals, hindu undivided families and unregistered firms.

**Customs Duty** : Customs duties include both import and export duties. The import duties contribute nearly 90 percent of our total customs revenue.

**Excise Duties** : These are levied on commodities produced within the country.

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## **11.11 FURTHER READINGS**

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Chellaiah, Raja, J. Fiscal Policy in a Developing Economy.

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## **11.12 SELF-ASSESSMENT TEST**

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1. List out and analyse the recommendations of Raja Chellaiah Committee relating to direct taxes.
2. Explain concept of Value Added Tax in detail.
3. Go through the Annual Budget of the Government of India for the current year and make a summary of changes in tax structure from 1991 to till date.
4. What are the main deficiencies from which our banking sector is suffering. Analyse the recommendations offered by Narasimham Committee to strengthen the banking system.

BRAOU

# UNIT-12 : FINANCIAL SECTOR REFORMS

## Objectives

After studying this unit, you should be able to :

- understand the need for reforms in financial sector in India
- explain the main recommendations of the Narasimham Committee
- specify the action taken by the Government and the RBI for reforming the financial sector in India
- assess the impact of reforms on Indian Economy.

## Structure

- 12.1 Introduction
- 12.2 Need for Reforms in Financial Sector
- 12.3 Narasimham Committee on Financial Reforms
- 12.4 Major Recommendations of Narasimham Committee
- 12.5 Financial Sector Reforms - Government Action
- 12.6 Summary
- 12.7 Further Readings
- 12.8 Self - Assessment Test

## 12.1 INTRODUCTION

The financial sector - economic growth relationship had not received adequate attention of classical and neo-classical economists. It was John Manard Keynes who accorded a specific place for money in macro-economic analysis. There has been a phenomenal increase in financial assets in the last five decades and the ratio of financial assets to GNP has risen substantially in both the developed and developing countries compelling economists and other analysts to focus more on the impact of financial system on the functioning of the economy and in influencing real economic activity.

According to Prof. C. Rangarajan, Governor of the Reserve Bank of India, the central economic function of the financial sector is financial intermediation, that is mobilisation of financial resources and the allocation of these financial resources. Further, efficient financial intermediation also involves minimising the transaction cost of transferring funds from original savers to final investors.

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## **12.2 NEED FOR REFORMS IN FINANCIAL SECTOR**

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The Indian Financial Sector today comprises an impressive network of Banks, Development Financial Institutions (DFIs), Insurance, Finance, Leasing, Venture Capital and Mutual Fund Companies, and a wide range of financial instruments. There has been a considerable widening and deepening of the Indian Financial System, particularly in the last two decades. Despite the overall progress made by the financial system in India, its operational system has been unsatisfactory up to 1991. In July, 1991 the Central Government announced its New Economic Policy (NEP). Liberalisation, deregulation, delicensing, reforming and restructuring of the economy through NEP made the Government to bring reforms in financial sector immediately. Let us now discuss the need for undertaking reforms in financial sector with particular reference to banks and developmental financial institutions.

**Commercial Banking in India**

manning especially in the urban and metropolitan centres and inadequate progress in updating work technology. Both management weaknesses and trade union pressures have contributed to this. There have also been weaknesses in the internal organisational structure of the banks, such as lack of sufficient delegation of authority, inadequate internal controls and deterioration in what is termed 'housekeeping' such as balancing of books and reconciliation of inter-branch and inter-bank entries.

The most serious damage to the banking system and the one which contributed most to the decline of portfolio quality has been political and administrative interference in credit decision-making. Populism and political and administrative influence bordering on interference should have no place in the lexicon of banking and finance, but unfortunately, over the years, competitive populism has affected banking and credit operations. As a result of the political and administrative interferences, the public sector banks in India have suffered badly : lower income, inadequate provisioning for bad debt, locking of credit from more productive uses and erosion of profitability. The deterioration in the financial health of the system has reached a point where

## 2. Directed Credit

As regards directed lending, at present there is a direction to the banks by RBI that 40 per cent of net bank credit should go to priority sector which include agriculture, small scale industry, small business and programmes for poverty alleviation. The Committee recommended that the directed credit programmes be phased out. The Committee proposed the re-definition of the priority sector to include only the small and marginal farmers, the tiny sector of the industry, small business and transport operators, village and cottage industries, rural artisan and other weaker sections. The Committee recommended that the aggregate credit to the redefined priority sector be fixed at 10 per cent.

## 3. Deregulation of Interest Rates

The Narasimham Committee felt that the present structure of administered interest rates are highly complex and rigid and hence proposed deregulation of interest rates so as to reflect emerging market conditions.

Nationalisation of 14 commercial banks on 19 July, 1969 was a radical measure in the history of Indian banking. Several changes took place in the sphere of banking sector after nationalisation. These changes are quite apparent in branch expansion, deposit mobilisation, credit deployment etc.

Despite the overall progress made by the banking system in India, its operational inefficiency has been characterised by low profitability, high and growing non-performing assets and relatively low capital base. On the eve of the reforms, the net profits of public sector banks (excluding RRBs) after provisions and contingencies were no more than 0.18 per cent of working funds in 1990-91. The spread between interest earned and paid as a proportion of working funds was 2.95 per cent. The proportion of non-interest expenditure to working funds in the same year was 2.65 per cent. With the decline in the quality of loan assets, the need for provisioning had become more urgent. Several banks were in fact not in a position to make adequate provisions for doubtful debts. The capital base i.e., the ratio of paid-up capital and reserves to deposits of public sector banks at slightly over 2.85 per cent in 1990-91 was much lower by international standards and in fact, has gone down over time. The approach that with government ownership there was little to worry about the ratio had resulted in a situation where the capital-deposit ratio had begun to fall. Lack of proper disclosure norms led many banks to keep the problems under cover. The financial position of the Regional Rural Banks was far worse. The balance sheet of the performance of the banking sector was thus, mixed - strong in widening the credit coverage but weak as far as viability and sustainability was concerned.

The major factors responsible for these are : (a) directed investment and (b) directed credit programmes. In both these cases, rates of interest that were available to banks were less than the market related rates or what they could have secured from alternate deployment of funds. There has been a deterioration in the quality of the loan portfolio which in turn has come in the way of banks' income generation and enhancement of their capital funds. Inadequacy of capital has been accompanied by inadequacy of loan loss provisions. The accounting and disclosure practices also do not always reflect the true state of affairs of banks and financial institutions. The erosion of profitability of banks has also emanated from the side of expenditure as a result of fast and massive expansion of branches, many of which are unremunerative particularly in the rural areas, a considerable degree of over-

should be permitted to set up joint ventures in regard to merchant and investment banking, leasing and other newer forms of financial services.

## 5. Prudential Norms and Regulations

Prudential norms and regulations mean the norms and regulations relating to income recognition, provisioning for bad and doubtful debts and capital adequacy.

In regard to income recognition the Committee recommended that in respect of banks and financial institutions which follow the accrual system of accounting, no income should be recognised in the accounts in respect of non-performing assets. An asset would be considered non-performing if interest on such asset remains past due for a period exceeding 180 days at the balance sheet date. The Committee further recommended that banks and financial institutions be given a period of three years to move towards the above norms in a phased manner beginning with the current year.

For the purpose of provisioning, the Committee recommended that using the health code classification which is already in vogue in banks and financial institutions, the assets should be classified into four categories namely, Standard, Sub-standard, Doubtful and Loss Assets. In regard to Sub-Standard Assets, a general provision should be created equal to 10 per cent of the total outstandings under this category. In respect of doubtful debts, provision should be created to the extent of 100 per cent of the security shortfall. In respect of the secured portion of some doubtful debts, further provision should be created, ranging from 20 per cent to 50 per cent, depending on the period for which such assets remain in the doubtful category. Loss Assets should either be fully written off or provision be created to the extent of 100 per cent. The Committee was of the view that a period of four years should be given to the banks and financial institutions to conform to these provisioning requirements. However, it is necessary for banks and financial institutions to ensure that in respect of doubtful debts 100 per cent of the security shortfall is fully provided for in the shortest possible time.

The Committee stated that the balance sheets of banks and financial institutions should be made transparent and full disclosures made in the balance sheets as recommended by the International Accounting Standards Committee. This should be done in a phased manner commencing with the current year. The Committee suggested that the criteria recommended for non-performing assets and provisioning requirements be given due recognition by the tax authorities.

While coming to the capital adequacy of the banking system the Committee suggested that the banks and financial institutions should achieve a minimum 4 per cent capital adequacy ratio in relation to risk weighted assets by March 1993, of which Tier 1 capital should not be less than 2 per cent. According to the Bank of International Settlements (BIS), standards of 8 per cent should be achieved over a period of 3 years, that is, by March 1996. For those banks with an international presence it would be necessary to reach these figures even earlier.

The Committee opined that in respect of those banks whose operations have been profitable and which enjoy a good reputation in the markets, they could straight-away approach the capital market for enhancement of their capital. The Committee, therefore recommended that in respect of such banks, issue of fresh capital to the public through the capital market

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## 12.3 NARASIMHAM COMMITTEE ON FINANCIAL REFORMS

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The Government of India had set up a High Level Committee in August, 1991 with Mr. M. Narasimham, former Governor of the Reserve Bank of India as its Chairman to examine all aspects relating to the structure, organisation, functions and procedures of the financial system in India.

### Terms of Reference

The terms of reference of the Committee are :

1. To examine the existing structure of the financial system and its various components and to make recommendations for improving the efficiency and effectiveness of the system with particular reference to the economy of operations, accountability and profitability of the commercial banks and financial institutions;
2. To make recommendations for improving and modernising the organisational systems and procedures as well as managerial policies;
3. To make recommendations for infusing greater competitive vitality into the system so as to enable the banks and financial institutions to respond more effectively to the emerging credit needs of the economy;
4. To examine the cost, composition and adequacy of capital of the various financial institutions and to make suitable recommendations in this regard;
5. To review the relative roles of different types of financial institutions in the financial system and to make recommendations for their balanced growth;
6. To review the existing supervisory arrangements relating to the various entities in the financial sector, in particular the commercial banks and the term lending institutions and to make recommendations for ensuring appropriate and effective supervision;
7. To review the existing legislative framework and to suggest necessary amendments for implementing the recommendations that may require legislative changes;
8. To make recommendations on any other subject matter as the Committee may consider germane to the subject of inquiry or any related matter which may be specifically referred to the Committee by the Government of India.

The Committee submitted its report in November, 1991.

## 12.4 MAJOR RECOMMENDATIONS OF NARASIMHAM COMMITTEE

The Narasimham Committee was primarily interested in improving the financial health of public sector banks and development financial institutions, so as to make them viable and efficient and meet fully the emerging needs of the economy. The basic assumption and approach of the Committee is that greater market orientation would strengthen the financial system and thus improve its efficiency. In this connection the Committee stated "The solvency, health and efficiency of the institutions should be central to effective financial reform". The major recommendations of the Narsimham Committee centred round the banking system, the development financial institutions, the money and capital market.

### Recommendations Relating to Banking System

The Narasimham Committee's recommendations are based on the fundamental assumption that the resources of the banks come from the general public and held by the banks in trust and that they have to be deployed for maximum benefit of their owners, viz., the depositors. The assumption automatically implies that even the Government has no business to endanger the solvency, health and efficiency of the nationalised banks under the pretext of resources for economic planning, social banking, poverty eradication, etc. At the same time, the Government has no right to get hold the funds of the banks at low rates of interest and use them for financing its consumption expenditures - paying the salary of the employees, for example - and thus defraud the depositors. The Narsimham Committee recommendations aim at :

- (i) ensuring a degree of operational flexibility :
- (ii) internal autonomy for the public sector banks in their decision making process; and
- (iii) greater degree of professionalism in banking operations.

The specific recommendations relating to the banking system are as follows :

#### 1. Directed Investments

In this area the Committee made two recommendations aimed at enhancing the competitive vitality of the banking industry :

- a) **Statutory Liquidity Ratio (SLR)** : According to the Committee the Statutory Liquidity Ratio should be brought down in a phased manner from the 38.5 per cent existing in 1991 to 25 per cent over a period of 5 years.
- b) **Cash Reserve Ratio (CRR)** : Every commercial bank in India has to keep with the RBI 15 per cent as minimum cash reserves against demand and time deposits. The Committee proposed to the RBI to consider progressively reducing the Cash Reserve Ratio from its present high level. The Committee also opined that the interest rate paid to the bank on this SLR investment and on Cash Reserve Ratio (CRR) in respect of the impounded deposits on the basic minimum should be increased.

### **3. Prudential Norms**

Prudential norms have been laid down by RBI as part of the reformatory process. The purpose of prudential system of recognition of income, classification of assets and provisioning of bad debts is to ensure that the books of the commercial banks reflect their financial position more accurately and in accordance with internationally accepted accounting practices. These will help in more effective supervision of banks.

Now, prudential norms require banks to make 100 per cent provision for all loss assets on non-performing assets (NPAs). As funding required for provisioning was placed at Rs.14,000 crore, it was phased over two years. Banks had to make at least 30 per cent provision against doubtful and bad during 1992-93 and the balance 70 per cent in 1993-94.

### **4. Capital Adequacy Norms**

The RBI in April, 1992 fixed capital adequacy norms for banks. The banks have to comply with the norms over a three year period. Banks were expected to reach 4 per cent of capital to risk assets ratio (CRAR) by March, 1993. This should be raised to 8 per cent by March 1996 by all scheduled commercial banks. Foreign banks operating in India and Indian banks with international presence were, however, required to attain 8 per cent by March, 1993 and 1994 respectively.

The prudential guidelines and the new capital adequacy norms expect scheduled commercial banks to make large provisions amounting to over Rs.14,000 crore for bad and doubtful advances in their portfolio. The viability and the financial health of the banking system was sought to be protected by a capital contribution of Rs.5,700 crore by the Central Government in the budget for 1994-95.

A new capital framework has been introduced for Indian scheduled commercial banks based on the Basu Committee recommendations presenting two tiers of capital for the banks.

The Government of India has amended the Banking Companies Act to enable the nationalised banks to access the market for capital funds through public issues, subject to the provision that the holding of the Central Government will not fall below 51 per cent of the paid-up capital.

### **5. Freedom of Operation**

Scheduled commercial banks have now been given freedom to open new branches and upgrade extension counters, after fulfilling capital adequacy norms and prudential accounting standards. They are also permitted to close non-viable branches other than in rural areas. Bank lending norms have been liberalised and banks have been given freedom to decide levels of holding of individual items of inventories and receivables.

### **6. Permission for New Banks**

Government of India and RBI have accepted 12 proposals to set up new private sector banks and six banks have already started functioning. These banks have been allowed to

raise capital contribution from foreign institutional investors upto 20 per cent and Non-Resident Indians up to 40 per cent.

## **7. Supervision over Commercial Banks**

A Board of Financial Supervision has been set up with an Advisory Council to strengthen the supervisory system of banks and financial Institutions. A separate Department of Supervision was also established in RBI in December 1993 for assisting the Board.

## **8. Recovery of Debts**

"Recovery of Debts due to Banks and Financial Institutions Act, 1993" was passed to set up Special Recovery Tribunals to facilitate quicker recoveries of loan arrears. Five tribunals started functioning at Calcutta, Delhi, Jaipur, Ahmedabad and Bangalore and an Appellate Tribunal has been set up at Bombay.

## **9. Other Measures**

The Government of India took the following other measures also to reform and strengthen the financial sector in India :

- a) Banking Regulation Act, 1949 was amended to enable a banking company to have a non-executive Chairman and upto three Directors from among the Directors of promoting institutions, and to raise the ceiling for the exercise of voting rights for a shareholder upto 10 per cent, and to raise the penalties for contravention of the Act.
- b) Agreement was reached with employees /Trade Unions in October 1993 and it paved way for faster computerisation in banks.
- c) Bank lending norms have been liberalised and banks were given freedom to decide levels of holding of individual items of inventories and receivables.
- d) Scope of mandatory consortium arrangement was narrowed to 76 large borrowal accounts in place of 934 accounts.
- e) Guidelines were issued to banks to ensure qualitative improvement in banks' customer service as a follow-up on the recommendations of the committee on customer service in banks.

## **10. Reforms Relating to DFIs**

The DFIs have taken steps to widen their resources base and mobilise funds in domestic as well as international markets.

### **Prudential Norms**

The DFIs have recognised the importance of prudential norms as a means to maintain financial health and have also been following norms for credit concentration, asset classification, income recognition and provision for bad debts. In March, 1994, RBI issued

guidelines on prudential norms to be followed by DFIs in India. These norms are similar to the norms issued to the commercial banks.

### **Diversification of Operations**

In tune with the changing environment, the DFIs have been diversifying their operations and reorienting their business strategies.

### **Rationalisation of Interest Rates**

Interest regime has become more liberalised. DFIs have also amended the norms regarding promoter's contribution and debt-equity ratio to increase promoter's stake in projects. Convertibility clause is no longer obligatory for assistance sanctioned by term lending institutions.

### **Other Measures**

The other measures include :

- a) Industrial Finance Corporation of India (IFCI) converted into a company and through its maiden public issue raised over Rs.600 crore as equity (including premium).
- b) Floating interest rate on financial assistance (linked to interest rate on 364 day treasury bills) introduced by some all India development banks.
- c) Financial institutions' access to SLR funds reduced and they are encouraged to approach capital market for funds.

### **Activity D**

Assuming that you are a Manager of a Bank, state whether the measures taken by the Government and RBI for reforming the financial sector are appropriate. What suggestions would you like to give for further reforming the financial sector in India?

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## **12.6 SUMMARY**

The financial sector reforms in India are an integral part of the overall programme of economic reforms aimed at improving productivity and efficiency of financial institutions. In fact, the efficiency of the reforms in the economy would have got blunted without corresponding reforms in the financial system and hence Government was required to take them simultaneously. The Government of India and the RBI already started reforming the

banking sector, DFIs, money and capital markets even though the Government is finding it difficult to enforce changes. For reforms to be effective, honest and sincere efforts are necessary, not just a facade of doing so. Reforms cannot be half-hearted nor piecemeal, and having accepted change, the Government and the institutions have to work with conviction and commitment.

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## **12.7 FURTHER READINGS**

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1. Economic Survey, 1994-95, Government of India Publication.
2. Report of the Narasimham Committee, Nabhi Publication, New Delhi, 1993.
3. C.Rangarajan, The Reform of the Financial Sector : Choices and Lessons, RBI Monthly Bulletin, December, 1994.

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## **12.8 SELF-ASSESSMENT TEST**

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Critically evaluate the reforms undertaken in India for reforming the financial sector.

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## **BLOCK - V : PLANNING POLICIES AND PROGRAMMES**

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The Government of India is encouraging the process of industrial development and economic growth by fixing targets in the form of Five Year Plans. In order to stimulate it further, as it is known, the Government is following liberalisation policy due to which the whole gamut of planning underwent pronounced transformation in the last four years.

In this context, this block mainly provides you information on planning policies and programmes implemented by our Government. This block is divided in two units, unit-13 discussed fully about various Five Year Plans and unit-14 about the effect of liberalisation on our planning.

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## **UNIT-13 : PLANNING IN INDIA**

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### **Objectives**

After reading this unit, you will be able to :

- explain the meaning of and the need for planning both at micro as well as macro (business unit and national) levels
- trace the origin and evolution of national planning in India
- describe the socio-economic objectives of Indian 5-Year Plans
- analyse resource mobilisation and allocation pattern of plan outlays of public sector; and
- comment on the relative success record of the planned development and the reasons thereof.

### **Structure**

- 13.1 Introduction
- 13.2 Factors Contributing to Adoption of Planned Development
- 13.3 Meaning and Need for Plan : Planning and Evolution of Planning in India
- 13.4 Socio-Economic Objectives of Indian Five-Year Plans
- 13.5 Priorities of Various Five Year Plans
- 13.6 Total Outlay - Private and Public Sectors
- 13.7 Mobilisation of Resources of Financing the Five-Year Plans
- 13.8 Allocation of Resources or Pattern of Investment
- 13.9 Planning in India - A Critique
- 13.10 Summary
- 13.11 Further Readings
- 13.12 Self - Assessment Test

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## 13.1 INTRODUCTION

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From the preceding 12 units, you should have understood various facets of environment under which business units function. The socio-politico-economic and legal environment including international milieu impose constraints on the one hand and provide facilities for growth and diversification as well as new investment avenues on the other. You were also explained various policies such as industrial, Exim (Export-import), banking and monetary policies and their implications and impact on private business. In fact, all these policies and institutional set up, created and strengthened over time, in a way constitute part of macro-economic planning. Then what is Planning? In what follows, this is explained to you. However, first you have to know the factors contributing to planned development. Note that Units 13 & 14 are to be read together. For better understanding and comparison, certain aspects of Unit-13 are covered in Unit-14.

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## 13.2 FACTORS CONTRIBUTING TO THE ADOPTION OF PLANNED DEVELOPMENT

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You are aware that humans are the highest order of creatures on earth. As human beings have powerful and sharper brains, almost all their thinking, actions/efforts and in a way behaviours are all pre-planned or based on systematic/scientific principles. Thus, planning is not a novelty and it is as old as human beings themselves. What is novel is its application to national/global or macro levels. In this sense, planning is an innovation of the 20th century. How did the present century contribute to the popularity of planning?

Six important historical events ushered in planned development. They are : the two World Wars (1914-18, 1939-45), Bolshevik (Communist) Revolution of 1917, followed by the unprecedented success record of planning in the former USSR in a relatively short period of about three decades; the bitter lesson of market failure evidenced by the Great Depression of the 1930s (1929-33) which intervened the two Wars, the Keynesian Revolution of the 1940s which convincingly supported the state intervention for economic development and the birth of about 100 third world - countries as a political fallout of the two Wars. By the early 1950s, the war-torn industrial economies were in need of reconstruction and the newly liberated poor third world economies (LDCs) were eager to improve their standards and catch up with the west. All these factors necessitated the adoption of planning as a means to achieve rapid growth with social justice. India too followed the same path after becoming a sovereign democratic nation.

### Activity A

1. Review your understanding of the reasons for popularity of planning in the first half of the 20th century.

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2. Comment on the statement that Planning is as old as human beings themselves.

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### **13.3 MEANING AND NEED FOR PLAN : PLANNING AND EVOLUTION OF PLANNING IN INDIA**

#### **Meaning and Importance**

Although in common parlance, the terms "Plan" and "Planning" are used synonymously, they are not the same. A plan is simply a sketch, blueprint, model or a document. Planning is a broader term and is defined variously. Here it is enough to note the widely shared meaning or definition. It may be defined as a deliberate and systematic thinking and effort in estimating, pooling and allocating available and potential resources with a view to achieving pre-determined objectives. It thus implies :

- a) Deliberate, rational and scientific thinking and effort in estimating present and potential resources (human and non-human)
- b) Pooling or mobilising the resources
- c) Allocating the mobilised resources for realising the pre-determined objectives.

Today the old issue of plan or no plan is no more debated. What is debated is in which areas and to what extent and through which means planning is to be adopted. World over, planning has become a routine affair not only at national level but at the micro unit level of firms, especially in large corporations. Analogous to an economy, every company or any business unit desires survival, expansion and maximum profits. All these need systematic and well conceived efforts and strategies.

As noted earlier, planning is warranted both for reconstruction of already developed but war-torn economies and for the development of poor countries to achieve full employment and eradicate poverty by breaking vicious circles. It has a role in free market capitalist economies, regulated socialist economies and partially controlled mixed economies like India. The rationale for planning stems from market failures, imperfect markets, poorly developed institutions, and initial skewed distribution of resources. Historically, it was observed that uncontrolled market economies were often subjected to economic stagnation, periodical decline in economic activity, severe price fluctuations, unstable employment, investment, etc. These problems are more severe with regard to the less developed countries (LDCs) where market forces of demand and supply in factor, goods and money markets are not tuned to provide useful signals. They suffer from supply rigidities and insensitivity in demand. Structurally, they are backward and unorganised. All these factors necessitate planning to set right things and provide congenial environment for accelerating the growth process and proper distribution of the produced output. In brief, following the Great Depression of the 1930s (which was characterised by throwing out of employment

millions of employed people and very low level of output), planning has become almost a crazy universal affair for achieving rapid growth with justice and stability.

### **Evolution of Planning in India**

After adopting the first Industrial Policy Resolution in 1948, ushering in mixed economy set up and implementing Constitution of India from 1950, planned development commenced. Although formally planned development began in 1951 with the launching of the First Five Year Plan, it in no way means that Indians were ignorant about planning or they did not attempt it earlier. In fact, in the pre-Independence period half a dozen efforts were made to emphasize the need for planning and preparing plans. Some of them are : 1) Sir M. Vishveshwaraiah's book "Planned Economy for India" in 1934, 2) Setting up of "National Planning Committee" under the chairmanship of Jawaharlal Nehru by the All India Congress Committee in 1938, 3) Bombay Plan of 1944 prepared by eight industrialists, 4) A 10-Year Plan of M.N. Roy produced under Hind Mazdoor Sabha and 5) Gandhian Plan of S.N. Agarwal prepared under the aegis of Sarvodaya organisation. Admittedly, these efforts were only conceptual frameworks waiting for implementation. All the same, they had the salutary effect of preparing a background and paving the way for planned development after political independence.

The Planning Commission of India was established in 1950 and the National Development Council (the apex body of planning in India) in 1952 through executive orders. Both are non-statutory bodies and hence their allocations and recommendations are non-mandatory. This is why the plans prepared by the Planning Commission and approved by the National Development Council must be presented to the Parliament, and after its acceptance the plans are executed. The Chairman of both the Planning Commission and National Development Council is the Prime Minister of India. Apart from the Chairman, the Planning Commission consists of a Deputy Chairman and a few members (at present 8) - both official and non-official. As to the National Development Council, it comprises all the members of the members of the Planning Commission and all the Chief Ministers.

The Calendar of Five-Year Plans in India is that of fiscal calendar beginning from 1st April and ending on 31st March. Commencing from the First Five-Year Plan that began from April 1, 1951, so far India completed seven Five-Year Plans, 3+1+2 Annual Plans and the first 3 years of the on-going Eighth Five-Year Plan. We are now (1995-96) in the 4th year of the 8th Plan. It is useful to note the periods of each plan implemented so far.

1st 5-Yr Plan : 1951-52 to 1955-56 or in brief 1951-56.

2nd 5-Yr Plan : 1956-57 to 1960-61 or 1956-61

3rd 5-Yr Plan : 1961-62 to 1965-66 or 1961-66

3 Annual Plans : 1966-69 (1966-67, 1967-68, 1968-69)

4th 5-Yr Plan : 1969-70 to 1973-74 or 1969-74

5th 5-Yr Plan : 1974-75 to 1978-79 or 1974-79

(The original 5th Plan could not run its full course due to the replacement of Congress Government at the centre by the Janata Government in 1977. The Janata Government, after scrapping the on-going 5th Plan of the Congress Government, introduced its own plan called Rolling Plan. Officially it was called "Draft Five Year Plan 1978-83).

Annual Plan 1979-80

6th 5-Yr Plan 1980-81 to 1984-85 or 1980-85

7th 5-Yr Plan 1985-86 to 1989-90 or 1985-90

2 Annual Plans 1990-92 (1990-91, 1991-92)

8th 5-Yr Plan 1992-93 to 1996-97 or 1992-97

In the succeeding Unit-14, Perspective Plan, Annual Plans, Rolling Plan of the Janata Government and Indicative Planning, introduced in the 8th Plan, as well as planning under liberalisation policies will be explained. Deferring them, you are now explained the objectives of Indian Plans.

### Activity B

1. Understand the terms  
Plan

Planning

2. Explain the need for Planning under different economic situations such as free enterprise market-based economies, Industrially Advanced Countries (IACs) and Mixed economies.

3. Was there any effort and thinking about planning in India before Independence?

4. Read other books and analyse the reasons for break in Five Year Plans and implementation of Annual Plans instead of Five-Year Plans.
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### 13.4 SOCIO-ECONOMIC OBJECTIVES OF INDIAN FIVE-YEAR PLANS

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You have learnt that planning implies deliberate and scientific thinking and effort to achieve defined objectives. Then what are the objectives of Indian Plans? Though each Five-Year Plan, depending on the time and circumstances/needs, aimed at many objectives, there are some common objectives running through all the plans. It is gratifying to note that despite changes in political parties ruling at the centre and despite change of half-a-dozen Prime Ministers, continuity is maintained in some of the basic objectives. You will be first explained the common basic objectives of all the Five-Year Plans put together (i.e. 1st to 8th Plan), and later the specific objectives and important targets of the current 8th Plan will be explained. Before doing so, a salient feature of Indian Five-Year Plans calls for attention. From the beginning, Indian Plans simultaneously aimed at both economic and social goals which is otherwise known as growth with equity. Put simply, the basic goal is growth with stability and justice. This single broad goal is spelt out below under five objectives.

- 1) **Growth or accelerating the Growth Process** : It means raising the national income to improve living standards.
- 2) **Modernisation** : It means application of science and modern technology in the production of various goods and services. This goal is a complement to the first goal. Through modernisation production, especially productivity, will be stepped up.
- 3) **Self-reliance** : It may be understood as freedom from dependence on foreign countries or having capabilities to design, assemble and run required machinery to produce needed goods. It is achieved through import substitution (i.e. replacing the imported goods by domestically produced goods).
- 4) **Balanced Regional Development** : It tells that not only India as a whole should grow but parts of India (regions/states) should also develop simultaneously. As India is a federated union, this goal assumes importance. What is aimed at is not equal but equitable development of all the regions in India.
- 5) **Social Justice** : This is a very broad goal embracing many things. Its simplest meaning is caring for the weaker sections defined as the poor, unemployed and assetless. It also means reduction in inequalities (consumption, income and wealth) such that egalitarian society is established eventually.

Having spelt out the common objectives of all the Five-Year Plans, you are now taken to the specific objectives of the 8th Plan.

### **Main Objectives and Targets of the 8th 5-Yr Plan (1992-97)**

1. **Improving the Living Standards of the People** : This single prime objective implies the following :
  - a) Health for all and safe drinking water by the end of the plan.
  - b) Abolition of illiteracy among the youth in the age-bracket of 15-35.
  - c) Provision of Primary Education facility to all the people of India.
  - d) Containing population growth at 1.8%.
  - e) Abolition of scavenging services (by means of converting wet latrines into flush-out system through drainage or septic tanks).
  - f) Full employment by the turn of the century. It envisages work opportunities to all by creating 8 to 9 million jobs per annum. Employment growth is targeted at 2.6%.
2. **The Second Major Goal is** : adequate provision or strengthening of infrastructure facilities such as power, irrigation, transport and communication.

Some of its targets are : GDP (Gross Domestic Product = National Income) growth of 5.6%, Import and Export growth rates of 8.4% and 13.6% respectively; raising of Food production from 177 to 220 million tonnes; incremental Capital - Output Ratio of 4.1 (i.e. for one unit of additional output, 4.1 units of investment is needed); rate of investment at 23.2% of the GDP, of which 21.6% points from domestic resources and the rest is net inflow of capital from abroad.

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### **13.5 PRIORITIES OF VARIOUS PLANS**

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In the preceding pages, you learnt that quite a few objectives were set out in the Five Year Plans. However, in each plan all the objectives were not accorded equal importance. Some receive the highest importance or preference over others in each plan. Generally realisation of one or two objectives were given priority. They are :

**1st Plan** : Agricultural development received top most importance by receiving 37% of the total public sector outlay. Notice that except in the 1st Plan, agriculture never secured so much share of the total outlay. In all other plans, its share is around one-fourth.

**2nd Plan** : In this, Industrialisation was accorded priority. Based on the Mahalanobis model, capital goods production / heavy industries base was given top priority. It was allocated 34% of the total outlay.

**3rd Plan :** Self-reliance goal was prioritised. It was implemented through import substitution.

**4th Plan :** Equitable development of the regions or Balanced Regional Development got priority.

**5th Plan :** Minimum Needs Programmes, comprising nine components, of which eight are for rural areas (such as Rural Housing, Roads, Education, Health, Electrification, Nutrition / Sanitation, Water Supply / Irrigation, etc.). These aim at raising social consumption as a means to reduce poverty.

**6th Plan :** Direct attack on poverty and unemployment or Eradication of Poverty and Unemployment.

**7th Plan :** Energy received highest priority with an allocation of about 31%. Energy along with Poverty and Unemployment reduction were the main goals.

**8th Plan :** HRD or Development of Human Resources is the prime goal.

### Activity C

1. Give examples of

Economic Objectives

Social Objectives

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2. Understand the relation between Growth and Modernisation goals, and elucidate it in your own words.

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3. Social justice stands for

- a) \_\_\_\_\_
- b) \_\_\_\_\_
- c) \_\_\_\_\_
- d) \_\_\_\_\_

4. Improving Living Standards and HRD are one and the same. How?

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5. Give examples of infrastructure for a manufacturing unit.

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6. Link between Minimum Needs Programme and Poverty Eradication.

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7. Industrialisation hinges on heavy industries. How? Give examples of basic/heavy industries.

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8. Self-Reliance, Self-Sufficiency, Import Substitution, Minimising Foreign Aid  
- Comment on these concepts and their inter-relationships.

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## 13.6 TOTAL OUTLAY - PUBLIC AND PRIVATE SECTORS

As India is a mixed economy, both public and private sectors contribute to the total development outlay fixed for each plan. First, broad aggregate figures or relative shares may be noted. The First Five-Year Plan fixed the total outlay at Rs. 3,760 crore, comprising Rs. 1,960 crore in public and Rs. 1,800 crore in the private sectors. In each Five-Year Plan period, the outlay of the public sector was enhanced nearly by two times. In the 8th Plan, the total outlay envisaged is Rs. 7,98,000 crore, comprising Rs. 3,61,000 crore in the public sector and the remaining in the private sector. In terms of relative shares, upto 4th Plan the share of the public sector was more than 50% and from 5th Plan onwards it is less than 50%. In other words, due to shift in policy favouring higher space in economic development to the private sector, the share of the private sector has been stepped to more than 50%. Table-13.1 sums up the relative shares of the two sectors in the total outlays.

**TABLE - 13.1**  
**PUBLIC AND PRIVATE SECTORS - RELATIVE SHARES (ACTUAL)**  
(%)

Plan	Public	Private	Total
	1	2	3
1st 5-Yr Plan (1951-56)	52 (1960) @	48 (1800) @	100 (3760) @
2nd 5-Yr Plan (1956-61)	54	46	100
3rd 5-Yr Plan (1961-66)	59	41	100
4th 5-Yr Plan (1969-74)	51	49	100
5th 5-Yr Plan (1974-79)	43	57	100
6th 5-Yr Plan (1980-85)	48	52	100
7th 5-Yr Plan (1985-90)	46	54	100
8th 5-Yr Plan (1992-97)	45.2	54.8	100
(Target)	(3,61,000)	(4,37,000)	(7,98,000)

Source : Five Year Plans of India.

Note : Figures in brackets are Rs. in crores.

@ If net investment is considered, the relative shares work out to 46.4% and 53.6%. If the targeted investments are reckoned, approximately they are 50% : 50%.

The figure of Rs. 7,98,000 crore is net investment of both the sectors, of which the share of public sector is Rs. 3,61,000 crore. To this latter figure current outlay of Rs. 73,100 crore is to be added representing current outlay. Thus in the 8th Plan, the gross investment is Rs. 4,34,100 crore (=3,61,000 + 73,100). While the net investment contributes to creation of assets or new (additional) facilities, the purpose of current outlay is to maintain the existing assets. While discussing resource mobilisation and allocation, public sector outlay is to be understood in gross terms.

## Growth in Investment During the Plan Period

It is useful to understand the significance of the stepping up of investment effort during the plan period of about four decades. Compare the total outlay of 8th Plan with that of the first plan - Rs. 7,98,000 crore with Rs. 3,760 crore. The former is about eight lakh crores and the latter is about four thousand crores which means an increase of 200 times (800/4). Did India really enhance her investment so much? The answer is surely negative. This is money illusion. Since prices have been raising at about 8% p.a., Rs. 7,98,000 crore figure is to be deflated by the price index. When it is adjusted, it gets reduced to about eighty thousand crores. Thus in real terms, during the plan period, investment increased by about 20 times only (80/4) and not 200 times. A better method of comparison of investment effort during a given period is to express investment as % of GDP (Gross Domestic Product i.e. National Income). This expression is technically termed as Rate of Investment (ROI). While in the First Plan period rate of investment was 7.3% in the 8th Plan it is 23.2% of GDP. It means that India's investment effort increased by about 3 times. Rate of investment of 23.2% implies the Indians out of their income of Rs. 100, consume now about 3/4ths and invest about 1/4th for tomorrow i.e. future development.

Having understood the total outlay and within it the public sector outlay, the next issue is how does the public sector mobilise the needed outlay? This is known as financing the Five Year Plans.

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### 13.7 MOBILISATION OF RESOURCES OR FINANCING THE PLAN

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Detailed data is available only with regard to the public sector resource mobilisation. You have noted that the targeted public sector's total outlay is Rs. 4,34,100 crore (gross). Out of this, the centre's share is 57.1% and the rest is from the states and union territories (41.5% + 1.4%). Within the central sector outlay (Rs. 2,47,865 crore), budget support is 42% and IEBR (Internal and Extra Budgetary Resources) is 58.2%. It means that in the central plan, nearly 60% of the resources are contributed by the public enterprises either out of their surpluses or their market borrowings. One misunderstanding about the term "Plan Expenditure" in the annual budgets of the union government deserves clarification. For example in the 1995-96 Budget, the "Plan Expenditure" shown is Rs. 48,500 crore. This is not the total central plan outlay for 1995-96 (the "total" is actually Rs. 78,849 crores). It simply stands for the "Budgetary Support" of the union government for the central + states plans.

You may now focus attention on how the total (Centre + States + Union Territories) public sector outlay is pooled or financed. There are two main sources viz. domestic and external. In all the Five-Year Plans, domestic sources contributed to the extent of about 80% to 90% i.e., Indian Plans are financed substantially by Indians' savings. For example in the current 8th Plan, the total outlay as % of GDP is 23.2%, of which the share of domestic savings is 21.6% points and just 1.6% points (or 6.9%) is net inflow of foreign capital (foreign resources). An analysis of domestic resources of the public sector outlay is shown in Table-13.2, along with foreign resources for the 8th Plan.

**TABLE - 13.2**  
**FINANCING PATTERN OF 8TH PLAN PUBLIC SECTOR OUTLAY**  
(%)

Source	Share
A. Domestic/Internal Resources	93.4
comprising	
1) Balance from Current Revenue	8.1
2) Contribution of Public Sector Enterprises	34.1
3) Internal Borrowings	46.6
4) Deficit Financing	4.6
B. External Resources	
(Net Inflow of Capital from Abroad)	6.6
C. Total Public Sector (A + B)	100.0
	(Rs. 4,34,100 crore)

Source : 8th Five-Year Plan.

From Table-13.2 it is evident that the two major sources are public enterprises contribution and domestic borrowings. While one third of the total outlay comes from public enterprises, a little less than one-half is financed by domestic borrowings, other than ad hoc borrowing from the RBI. Deficit financing, representing credit given by the RBI to the government against ad hoc treasury bills, is targeted at about 5%. This is deceptive both from the current experience and historical trend. In the 7th Plan, its contribution was 15% and in the Five-Year Plans its share was about 10%. What is termed in the table as Balance from Current Revenue may be crudely understood as Tax-financing. To sum up, India's Five-Year Plans are financed by Tax (and non-tax) financing, public enterprises - financing, debt (internal) -financing, deficit -financing and external (debt) financing.

#### **Impact of Different Sources of Financing**

It is well known that for faster growth, volume of investment is to be raised both in absolute terms and as percentage of GDP. Indian Plans attempted both and succeeded to some extent. However, the aspect of pattern of financing is given lukewarm treatment. The impact of pattern of financing is often glossed over which led to adverse consequences. A poor country, with low level of equilibrium suffering from vicious circles, should necessarily envisage bold-ambitious outlays and should tap all the available resources judiciously. International financing, whether through borrowing or direct foreign investment as well as portfolio investment, have their own limitations. External source of financing is desirable only upto a limit. Part of the resources should be pooled from tax-financing, preferably from direct taxes. Due to severe poverty, the top segments of the people can not be taxed severely. Due to politico-economic factors, governments in India heavily depend on indirect-tax-financing (its share in the total tax revenue is about 3/4ths). Due to this, tax revenue contributing to public sector outlay also has led to inflationary pressures. Internal-debt financing, when obtained from the rich, has the disadvantage of resulting in skewed income distribution and supports rentier class. As to deficit-financing, as a source of development outlay, there are apprehensions. If properly used, it is the

cheapest and most beneficial source of financing. But the problem is that the authorities are misutilising the source for unproductive and populist purposes. Theoretically, deficit financing is non-inflationary and has the power of activating the idle abundant resources. But this powerful weapon is wrongly employed. That is why many suggest a limit on the use of this source of financing. The scope of this unit does not permit us to give a detailed analysis of the relative merits of the four sources of financing. Finally, a moot issue is to what extent the public enterprises should be asked to contribute to the development outlay. Should they be asked to operate purely on commercial principles? If not, how can they contribute a big share, as envisaged by the Eighth Plan (34% of the total public sector outlay)? These issues are not properly discussed and it appears that the targets are fixed rather arbitrarily.

### Activity D

1. Name the Sectors/Constituents of Public and Private Sectors in the context of planning at national level.

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2. First plan outlay was about Rs. 4 thousand crore and that of 8th Plan Rs. 800 thousand crore. Does it mean really India raised investment by 200 times? How do you compare?

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3. Explain :

- a) Tax-financing
- b) Deficit - financing
- c) Net Inflow of Foreign Capital

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4. Explain the impact of heavy dependence on indirect tax-financing and debt financing.

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## 13.8 ALLOCATION OF RESOURCES OR PATTERN OF INVESTMENT

Apart from the problem of pooling resources from appropriate sources at low cost with an eye on income distribution, another major issue in planning is allocation of resources among various sectors, industries, regions or purposes. Much harm is caused if the given resources are allocated improperly. It is important to ensure that discouraging or reducing investment/production in certain sectors/industries is as important as encouraging or allocating more to certain desired sectors. The former aspect is not seriously thought and implemented.

For the purpose of easy understanding of the issue of allocation of resources, the Indian economy is divided under certain broad sectors as shown in Table-13.3. The data abridged in the table pertain to targeted outlays in the 8th Plan. Actually in the Plan document, these are split into as many as 80 sub-sectors.

TABLE - 13.3  
ALLOCATION PATTERN OF PUBLIC SECTOR OUTLAY - 8TH PLAN  
(%)

	Sector or Head of Development	Allocation
1.	Agriculture, Allied Activities and Rural Development	22.2
2.	Energy	26.6
3.	Industry and Minerals	10.7
4.	Transport and Communications	18.7
5.	Social Services	18.2
6.	Others	3.6
Total Public Sector Outlay (Gross)		100.0
		(Rs. 4,34,100 crore)

Source : Eighth Five-Year Plan.

A cursory look at table reveals the broad allocative pattern. although the 8th Plan prioritised human resource development as the prime objective, the allocative pattern does not reveal the same. The pattern of resource allocation is more or less similar to the 7th Plan, with a few marginal changes. Agriculture, including irrigation and rural development, received a little more than one fifth of the total outlay. The allocation to energy is targeted at 27% and

that of industry and minerals at 11%. Transport and communications as also social services secured a little than one fifth each. The Planning Commission did not publish data relating to the allocative pattern of the private sector. From the limited data and information available, it is difficult to say whether the targeted goals will be achieved. The mid-term appraisal of the 8th Plan scheduled to have taken place in July 1995, has been postponed for unknown reasons. It is gathered that the mid-term appraisal document prepared by the Planning Commission sketched a grim picture of the development scenario. Poverty and unemployment eradication, the prime goal, appears not to have been realised. The growth rate targeted at 5.6%, realised so far is about 4% and the target is unlikely to be achieved. On the food front, the target is fairly achieved but the industrial sector is just picking up.

### 13.9 PLANNING IN INDIA - A CRITIQUE

In the preceding pages, you were explained various aspects and issues of India's Five-Year Plans, with focus on the ongoing 8th Five-Year Plan. It is now pertinent to ask the question of what has been the record of progress or success of 4½ decades of planned development? To assess its performance, one needs norms or criteria. Logic and justice demand that the norm should be its well set out objectives of socio-economic development. You may recall here the five broad objectives stated in 13.3 sub-unit and or the two principle goals stated there. Focusing on the overall growth of the economy, it is observed that the growth record is laudable relatively. You should remember here that during the British Rule, Indian economy was looted, made stagnant and dependent with a very weak industrial and agricultural bases. During the last half-century rule of the Britishers (1900-47), Indian economy grew just at 1.2%, composed of about 0.3% of agricultural growth and 2-3%, industrial growth. The average growth rate of Indian economy in the past 45 years was a little more than 4%. Upto the seventies, Indian economy grew at about 3½%, which late Raj Krishna called "Hindu Rate of Growth" and in the recent three Five-Year Plans (V, VI and VII) the growth rate hovered around 5% (vide Table-13.4) and in the recent 5 year plans at about 4%. This is not a mean achievement.

TABLE - 13.4  
PLAN-WISE GROWTH RATES - TARGETS AND ACHIEVEMENTS  
(%)

Plan	Target	Achievement
	1	2
1st plan	2.1	3.6
2nd plan	4.5	4.0
3rd plan	5.6	2.2
4th plan	5.7	3.3
5th plan	4.4	5.2
6th plan	5.2	5.2
7th plan	5.0	5.8
8th plan	5.6	---

Source : Five-Year Plans

Note : Growth Rates refer to NNP/NDP upto 4th Plan and GDP from 5th Plan onwards.

The post-independence growth record is three times higher than the 1.2% realised during the first half of 20th century. Agriculture has been growing at about 2 to 3% and industry 6-8%. As to modernisation, India fairly succeeded by modernising and commercialising agriculture, and industrialising the economy. Regarding Self-reliance objective, the achievement is quite praise-worthy. Among some 120 third-world countries, India is the only country to have achieved it. Today Indians have capabilities to design, assemble and operate various types of machines from pin to supersonic jet. In sum, India did not fail in growth, modernisation and self-reliance fronts. Its main failure is in distributing the fruits of growth. Development is to be judged from bottom percentage of the people. Both the goals of social justice and balanced regional development still remain in the books of plans. In terms of Human Development Index, India has the dubious distinction of getting 136th rank among 173 countries. Whether in agricultural or industrial development, half-a-dozen states out of 25 states claim a lion's share of over 50% - to 60%. One main reason for this dismal performance is that both the pattern of financing and the allocation of investment were not properly tuned. For a long time, planners believed in trickle-down effect to benefit the poor and unemployed. In the selection of the product-mix i.e. character of growth, India erred. Land reforms and other institutional changes were not effectively implemented. With more centralised planning upto the early 1990s social inequalities and regional disparities were allowed to grow, while under the present market-oriented planning one can only guess what would happen to the goals of self-reliance, balanced regional development and social justice. This aspect will be touched upon in the succeeding Unit.

### Activity E

I. Name the components of

a. Agriculture, its allied Activities and Rural Development.

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b. Energy

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c. Social Services.

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II. Explain trickle-down effect and give reasons for high rates of poverty and unemployment despite fairly high growth and laudable record of industrialisation.

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### 13.10 SUMMARY

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From the preceding explanation, you should have got a fair view of Indian Five year Plans. The lesson began with meaning and rationale of planning followed by a note on the origin, evolution and structure of national planning in India. Four main aspects of Indian Five-Year Plans were discussed at some length viz. objectives, public-private sectors shares in the outlay, resource mobilisation and allocation. In the concluding sub-unit, an appraisal of 4½ decades of planning was attempted. Out of the five main objectives, three goals were realised (fairly adequately). The main failure of India was not in growth front but in distributing the growth over space and classes of people.

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### 13.11 FURTHER READINGS

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1. Government of India, Eighth Five Year Plan, Vol. I, Planning Commission, Delhi, 1992.
2. Government of India, Economic Survey, 1994-95, Ministry of Finance, Delhi, 1995.
3. Recent issues of Economic and Political Weekly.
4. P.R. Brahmananda & V.R. Panchanukhi (Eds), The Development Process of Indian Economy, Himalaya, Bombay, 1990.
5. R.M. Sundaram, Growth & Income Distribution in India, Sage, Delhi, 1986.

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### 13.12 SELF-ASSESSMENT TEST

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Take the five major aspects of Indian Five Year Plans and treat them as questions to answer.

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## UNIT - 14 : LIBERALISATION AND PLANNING IN INDIA

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### Objectives

After reading this unit, you will be in a position to :

- explain the need for and implications of liberalisation
- comprehend and visualise the role of planning under liberalisation milieu
- give an account of Indicative Planning tied to liberalisation and changes in the objectives of planning
- critically appraise the growth performance and changed roles of public and private sectors

### Structure

- 14.1 Introduction
- 14.2 Liberalisation - Meaning and Aspects
- 14.3 Indicative Planning
- 14.4 Review and Critical Appraisal of Planning under Liberalisation
- 14.5 Future Prospects and Summary
- 14.6 Further Readings
- 14.7 Self-Assessment Test

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### 14.1 INTRODUCTION

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In the foregoing 13 lessons (Units), various facets of business environment in India had been explained to you. Also the units should have enabled you to comprehend the winds of liberalisation which began to blow from the 1980s and in particular from 1991. The Narasimha Rao government, which assumed office at the centre in June 1991, was compelled to effect sweeping changes covering almost all the economic-commercial activities in the Indian economy. The reasons for implementing various radical reforms are well known and about which copious literature with diverse critiques is available. This unit desists from entering into the details of the issue. Starting with trade (international) liberalisation, it was extended to other sectors and areas. It is no wonder that due to liberalisation policies of the government, the whole gamut of planning, including the philosophy of planning, underwent pronounced transformation in the last four years. The ongoing Eighth Five Year Plan drafted under the changed circumstances and policies obviously reflects, to some extent, the present philosophy of the government at the centre.

The 8th Plan, unlike its predecessors, is officially termed "Indicative Planning". Before explaining the latter which incorporates the liberalisation policies, it is useful to begin with the meaning, implications and facets of liberalisation as well as different types of planning.

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## 14.2 LIBERALISATION - MEANING AND ASPECTS

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The meaning of liberalisation is rather elastic and fuzzy. It means different things to different people. Surely, it is not an identical term with laissez faire (the latter means "let alone", do not interfere at all). However, liberalisation policies eventually may lead to laissez faire situation. Liberalisation may be interpreted to mean the least interference of the government, or governments function with minimum number of controls and regulations. People are given adequate freedom to choose economic activities best suited to their abilities and aspirations. Admittedly, liberalisation policy is premised on the well known virtues of the "Invisible Hand", propagated by Adam Smith as far back as 1776. The need for or relevance of liberalisation policies stems from the failure of controlled economies of former socialist bloc and from the perception that governments are bad businessmen. Liberalisation view gets strength from the belief that individuals are the best judges of themselves and their behaviour guided by self-interest without others' obstructions leads to welfare of all the people.

In one sense, liberalisation as practiced in India and in many other countries is a via media of the two extremes of highly centralised command economies and unfettered decentralised and market-guided capitalist economies. Liberalisation implies inviting competition both within (the nation) and abroad. The latter type of competition is part of globalisation process. Deregulation, deregulation, decontrol, and denationalisation or privatisation are the means for implementing liberalisation policies. Under it, the scope of government and public enterprises is severely restricted to the field of basic facilities, law and order, and the production and supply of social and public goods. Soon you will learn other ingredients of liberalisation and details of assigned areas of planning and functions of public sector.

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## 14.3 INDICATIVE PLANNING

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As noted earlier, the on going 8th plan may be called Indicative Planning or to be sure "moving towards Indicative Planning from a highly centralised planning system". The later expression is the terminology of the Eighth Plan document (8th Plan, Vol. I p.ii.) It is based on the belief that in many areas of activity, development can best be achieved by freeing them from unnecessary controls and regulations, and withdrawing state intervention. But at the same time, it holds that development and growth of the country can not be left entirely to the market mechanism. You should note that the Prime Minister and the Chairman of the Planning Commission, in his foreword to the 8th Plan says that "market can be expected to bring about an equilibrium between demand backed by purchasing power and supply, but it will not be able to ensure a balance between need and supply". Therefore, planning is necessary to overcome certain inherent limitations of market mechanism. All the same, it is not a choice between the market mechanism and planning. What is attempted in India is to effectively dovetail the two to serve as complementaries to each other. You are surely interested to know the features of Indicative Planning as conceived in India and how it is different from earlier planning. This is taken up in the succeeding pages.

## **Features as spelt out in the 8th Plan**

Under Indicative Planning, the role of Planning Commission of India is redefined. It is expected to play Integrative, Mediator and Facilitating roles. It sets out or give a long term strategic vision of the future with priorities. For the public sector, it goes deeply by examining the alternatives and identifies specific projects. However, for the rest of the (private) economy, it works out sectoral targets and attempts to provide promotional stimulus to the economy to grow in the desired direction. It is essentially a more flexible plan with scope for change, innovation and participation of the people by strengthening peoples' institutions. Instead of playing the major role of allocation, the Planning Commission will henceforth concentrate on optimal resource utilisation and resource mobilisation. Its job is to prepare a blue print anticipating future trends and setting out or indicate the direction in which the economy should move, keeping in view the long term objectives.

It has also to play the role of a change agent. Through a proper mix of policy instruments (fiscal, monetary, etc.), it should encourage, persuade and request the private sector to invest in the desired sectors and regions. It should be guided by the basic philosophy of growth based on market forces and liberal policies. The scope of activities of the governments and public enterprises has been severely restricted. Apart from slashing down the number of industries reserved for the public sector from 17 to 6, it was decided to close unviable public enterprises. Public sector is to withdraw from areas where no basic public purpose is served. It has to concentrate on investment in infrastructure and in sectors where private investment is not likely to come adequately. Its areas are : transport, communications, energy and irrigation. It should also augment basic resources like land, forestry, water, ecology, science and technology. It has the responsibility of meeting special needs, population control, health and education.

Under the liberalised planning, "protection", "import-substitution" and "monopoly of public sector" became obsolete terms. The liberalisation policies envisage that public sector should compete with private sector. The "caged tiger" (the Indian economy including the public sector in the pre-liberalised set-up) is at last set free to compete in the jungles of global market economy. It is believed that the increased competition resulting from liberalisation will spur the Indian industry to move from chronic infancy to maturity. The issue, whether competition necessarily leads to competitiveness or it should be complemented by something else, is deferred. Suffice to note here that putting the entire blame of inefficiency on protectionism is uncharitable. However, protectionism, controls and regulations put together can be blamed for the inefficiency of the Indian economy.

### **Strategy under Liberalised Planning**

You have noted that henceforth public sector concentrates on selective activities and one such area is infrastructure, both physical and social. It focuses on strategic, hi-tech and essential infrastructure. Even in the infrastructure, private sector is given greater role to invest in power, oil and coal, communication, fertilisers and chemicals, heavy capital goods industries and organised commercial activities. The basic strategy under liberalisation with the indicative planning is that growth and development can be achieved by concentrating on essential social and physical infrastructure. The government and planners believe that if adequate power, transport and communication facilities are provided the economy can grow fast. Its strategy comprises : a) Development of core sector through allocation of funds,

b) Ensuring growth of economy via a policy package, and c) Social sector development through assigning greater responsibility to the states. In large parts of public sector operations, the principle of market economy is accepted.

In concluding about Indicative Planning, it is useful to note its historical origin. The episodes of France and Japan are often cited. It was in 1946 that the then French Planning Minister drew a plan in consultation with the businessmen. Since then it was a great success. In France, bureaucracy in collaboration with the private sector ushers in the development of the nation. In Indicative Planning, information collection and its dissemination play important role. It is built on the assumption that more information to the economic agents will smoothen sectoral imbalances. The French indicative planners chose demand targets and used various kinds of incentives and disincentives through monetary and fiscal tools to channelise investment flows to meet the targeted demands. In Japan, indicative planning concentrates more on supply management and market coordination. The agencies involved in the Japanese indicative planning are : Ministry of International Trade and Industry, Ministry of Finance and Economic Planning Agency. Indicative Planning is what Arthur Lewis called "Planning by Inducement". Much depends on how the market guided investors and individuals behave. Its essential features in brief are : Resource allocation both through the state and market; decision-making is horizontal-vertical and partially centralised; dual market-clearing (implying state collaboration with business) and incentives, cooperative competition among economic agents.

### Activity A

Review your understanding of the following terms :

#### 1. Liberalisation

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#### 2. Globalisation

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#### 3. Privatisation/Denationalisation.

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#### 4. Deregulation/Delicensing

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#### 5. Public Sector-Composition.

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#### Activity 8

Explain Planning by Inducement and Indicative Planning.

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### 14.4 REVIEW AND CRITICAL APPRAISAL OF PLANNING UNDER LIBERALISATION

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In the pre-liberalised planned development of India, you noted five major socio-economic objectives viz. growth, modernisation, self-reliance, balanced regional development and social justice. Under the indicative planning of 8th Plan, although the planners endorse all of them, in practice two of them are given a go-bye viz. self-reliance and regional balanced development. Even social justice goal gets blurred. In essence, the present 8th Plan emphasises raising of growth rate and modernisation through competition and integrating India with the rest of the world, known as Globalisation. It underlines adequate provision of infrastructure facilities (power, transport and communication) both through the public sector and by inviting the private sector to participate including the MNCs (or truly speaking the INCs = International Corporations). Competition does not necessarily lead to competitiveness for, much else is needed. Even under liberalisation, there is need for national economic strategies. Building up national industrial capability through policy intervention is of utmost importance as India globalises. It is fallacious to think that mere unshackling of market forces is all that is needed or to think that national identity of firms is irrelevant in the globalised setting. R and D effort and establishing an adequate technology base are crucial. This is the secret of South Korea's miracle. Indian policy makers and planners are not serious about empowering the pampered domestic industry in the global perspective.

## **MRTTP Act of 1970**

MRTTP Act of 1970 was diluted and consequently one of the two prime objectives viz. reducing concentration of economic power cannot be realised. Note that social justice embraces reducing highly skewed distribution of assets concentrated in the hands of large industrial houses. As to the goal of regional balanced development, available data indicates that even under Licensing System, more than one-half of the total industrial production got concentrated in just four states (Maharashtra, Gujarat, Tamil Nadu and West Bengal). The number of licenses issued to the backward regions as proportion of total licenses declined to about 43% by 1990. The issue is whether the liberalised industrial policy can rectify the imbalance created by the Licensing System, when the interests of backward states were overlooked. The answer is anybody's guess.

It is true that until 1990, public sector was assigned the role of "control over commanding heights of the economy". It is gratifying to record that the Indian economy and the Indian industry performed fairly well until the mid sixties, vouching commendable role of the public sector. Deceleration started from the mid-sixties and continued until the close of 1980. Even now not all public sector units are inefficient or loss-making. The trouble lies in their non-accountability, mainly due to politicisation of the enterprises and pro-labour policies of the government. These are not given due importance while blaming the inefficiency of the public sector. By 1990, its contribution to GDP was about a fourth, composed of a third of Administrative Departments and two-thirds the enterprises (departmental and non-departmental). Its contribution to Gross Domestic Formation was about 47% and to that of Gross Domestic Savings about 10%. These are not mean achievements. It should be conceded that a frank appraisal of public sector indicates that by and large it has been inefficient for whatever reasons one may point out. Low utilisation of installed capacities under-utilisation of the personnel and generation of meager surpluses or undergoing losses are conspicuous.

### **Disinvestment of Public Enterprises Share Capital**

In the last four years, the government of India could obtain a sum of Rs.7,541 crore (1991-92 = Rs.3,338 crore, 1992-93 = Rs.1,912 crore, 1993-94 = Rs.2,291 crore) by way of off-loading the shares of public enterprises. The 1995-96 Budget envisaged another dose of Rs.7,000 crore of disinvestment. The aim of disinvestment is to introduce competition and to obtain funds for other purposes. The disinvestment is also expected to reduce the fiscal deficit which stood at 6.7% of the GDP in 1994-95. Unfortunately, data is not available to judge the impact of disinvestment on improving the efficiency of public enterprises.

You may now turn to examine the performance of industry and Indian economy in the post-liberalisation period.

### **Structure and Growth of Industries**

To visualise the impact of liberalisation under the present type of planning, on industries and economy, consider Tables 14.1 and 14.2.

**TABLE - 14.1**  
**STRUCTURE AND GROWTH OF INDIAN INDUSTRIES**  
**(USE-BASED CLASSIFICATION)**

Industry	Weights			Annual Average Growth Rates			
	1960	1970	1980	1991-92	1992-93	1993-94	1994-95 (Apr-Feb)
	1	2	3	4	5	6	7
1. Basic Goods	25.1	32.3	39.4	6.5	2.6	5.9	3.8
2. Capital Goods	11.8	15.2	16.5	(-) 8.6	(-) 0.1	(-) 5.3	(-) 22.5
3. Intermediate Goods	25.8	21.0	20.5	(-) 2.2	5.4	11.4	4.1
4. Consumer Goods comprising	37.3	31.5	23.6	1.5	1.8	3.1	8.0
a) Consumer Durables	5.7	3.4	2.6	(-) 10.7	(-) 0.7	15.2	10.7
b) Consumer Non-Durables	31.6	28.1	21.0	4.7	2.4	0.5	7.4
All Industries	100	100	100	0.6	2.3	4.1	8.1

Source : Economic Survey 1994-95 and CSO Press Releases.

**TABLE - 14.2**  
**STRUCTURE AND GROWTH OF INDIAN INDUSTRIES - AN**  
**ALTERNATE CLASSIFICATION**  
**(SECTOR-WISE)**

	(%)				
	Weights (Industrial Production) (1980-81=100)	1991-92	1992-93	1993-94	1994-95 (Apr-Feb)
	1	2	3	4	5
1. Mining & Quarrying	11.5	0.6	0.6	2.5	6.6
2. Manufacturing	77.1	(-) 0.8	2.2	3.6	8.2
3. Electricity	11.4	8.5	5.0	7.4	8.7
Average of all the Sectors	100	0.6	2.3	4.1	8.1
Average Growth of Agriculture		(-) 1.8	4.8	3.1	@ 2.4
Average Growth of the Economy		0.9	4.3	4.3	@ 5.3

Sources : Economic Survey 1994-95 and CSO.

Note : @ The figures are advance forecast of CSO.

The two tables should enable us to draw a few interesting inferences as to the performance of industry, agriculture and the economy as a whole in the post-liberalisation period. Admittedly, the short period of four years may not exhibit true trends. All the same, it permits to sketch an approximate scenario. Basic goods industries followed by capital goods industries improved their shares during 1960-1980s (cols 1 to 3, Table-14.1). Note that for rapid industrialisation the basic goods industries (composed of chemicals, steel, electricity, coal, cement, mining, basic metals, petroleum etc.) and capital goods industries (comprising machine producing industries including ship building and motor vehicles) should have a solid foundation. As their combined share improved to about 2/3rds from a little over 1/3rd, it is an indication of strengthening of domestic industrial effort. There appears to be a deceleration in the basic and more so in the capital goods industries in the past three years upto 1993-94. In 1994-95, while the growth rate of basic goods slowed down from 5.9% to 3.8%, capital goods recorded the highest growth rate of 22.5% from its negative growth of 5.3% in the previous year. Another disquieting feature of the past four years, industrial growth is that consumer durables (most of them are luxuries for elitist consumption) after suffering severely in the initial two-year period with negative growth, picked up very fast and recorded two digit growth rates (15.2%, 10.7%). Ignoring the sub-sectors, looking at aggregate growth of industrial production, the following observations deserve attention. For this purpose, three pre-reform years performance is compared with three post-reform years. In the pre-reforms three-year period (1988-89, 1989-90, 1990-91), the average growth was 8.5% and in the post-reform 3 years (1991-92, 1992-93, 1993-94) it was 2.1%. If 2.1% is compared with 8.5% (pre-reform), the inference is that the industrial growth slowed down. However, if 2.4% is compared with the recent 1994-95 year growth rate (of 8.1%), it is comfortable. It appears that the industries have just begun to recover.

Turning to Table-14.2, you can discern a similar picture. Relatively, the performance of Electricity sub-sector is better. With regard to agriculture and the whole economy, they suffered severely in the first post-reform year but picked up later. The overall growth of the economy on an average in the recent four years is about 4% and that of agriculture about 3%.

### **Foreign Direct Investment**

One of the purposes of liberalisation policy is to attract foreign capital for productive investment, especially in the infrastructure field. Upto 1994, over 2800 proposals involving about Rs.22,200 crore, FDI were approved. But the FDI realised so far is less than a fourth-equal to about Rs.4,000 crore. The government expected that due to its open policies a sum of US \$ 5 to 7 billion FDI will be realised. The expectations were belied as India got just a little over US \$ 1¼ billion. Lack of break up data does not permit to say whether the investment was channelised to the desired sectors of high priority or attracted by elite consumption goods sector.

### **RBI study of Companies**

The liberalisation policies encompassing deregulation and delicensing appear to have a favourable impact on the registered companies. This is vouched by the recent RBI study on the financial performance of 1,030 companies for the year 1994-95. This is the first full year after the industrial boom set in. It is heartening to note that while sales increased by 30% and profits before tax by 40%, after tax profits soared to 73%. This is in part due to

reduction in the Corporation Tax from 45% to 40% effected in the 1994-95 Budget. The real growth of the 1,030 companies work out to 20% (after adjusting for inflation). Contrary to this laudable performance, the official use-based Industrial Production Index indicates a lower growth (see Table-14.1). The reason is that the Use-Based Official index is based on the weighting system of 1980. Needless to add that the index based on 1980 industrial composition does not capture the growth of hundreds of new lines of production which emerged since then. In winding up the appraisal, you should exercise some caution. You should never draw conclusions based just on one year record. The reasons are many : fortuitous conditions, lags in the rise of labour and machinery costs (fixed capital), recession in the previous year, etc. In any case, the Indian industry appears to be recovering due to liberalisation policies of the government.

### Activity C

1. Comment on composition of Indian industries and growth performance in the pre- and post-reform periods.

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2. Distinguish competition and competitiveness. Does exposure to internal and external competition make an industry competitive?

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3. Measures needed to make liberalisation-indicative planning successful. List out them.

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## 14.5 FUTURE PROSPECTS AND SUMMARY

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You should note that on the one hand the public enterprises are assigned various social responsibilities where profitability is low and on the other hand their budgetary support is severely curtailed. They are also asked to compete with global enterprises. Surely some of the enterprises cannot compete. In the latter case, is it wise to close them? If yes, what are the social costs and what is its impact on self-reliance? The Indian industry, both public and private, is notorious with regard to R & D effort. South Korea, whose success story under liberalisation is often quoted, could withstand global competition mainly due to its concerted effort in improving its technological base. To be sure, Korea trebled R & D

expenditure as percentage of GDP between 1980 and 1990, share of private sector R & D outlay rose from 48% to 84% and research efforts quadrupled. This is missing in India. Indian industry is fond of foreign collaborations and foreign designs. They do not emulate; and are lethargic in adaptation of foreign technology. It is conceded that some degree of global sourcing is essential but in some areas product development should not be neglected. Beginning from the 1980s, while technology flowed into India more freely, the overall effect of it has been highly negative. The share of private sector in total R & D fell. The lowered entry barriers (dilution of FERA, drastically slashed import duties from over 15% to 50% etc.) succeeded in creating relatively small fragmented firms. The Indian consumers temporarily benefited due to access to a wide range of sophisticated imported products assembled domestically. Nonetheless, this is harmful to the Indian consumer and industry in the long run.

The foregoing review and critique were aimed at understanding the overall impact of liberalisation on the business community in general. National goals and industrial health as a whole were kept in view in the medium-long term perspective. As to the public enterprises; their goals have to be clearly defined with proper resource base and autonomy. To make indicative planning a success and to have beneficial impact from liberalisation policies, the policy instruments are to be tailored properly. Building technological base and raising employment growth are to be tied to the abstract growth goal. Social security/social justice is to be prioritised even at the cost of growth. The targeted employment growth rate of 2.6% (equal to 8 to 9 million jobs per annum) is not likely to be achieved for, the overall GDP growth rate target of 5.6% is falling short by 1% point (i.e. actual growth rate in the first three years of 8th Plan is about 4.5%). SSI sector which contributes nearly 2/3rds to total industrial employment (and 40% to industrial output, 35% to total exports), continues to receive meager allocations of 2% to 3% of the total public sector outlay. Both in the SSI and medium-major industries, R & D effort is too weak to innovate productive labour-intensive techniques.

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#### **14.6 FURTHER READINGS**

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1. Government of India, Eighth Five Year Plan, Vol I, Planning Commission, Delhi, 1992.
2. Government of India, Economic Survey 1994-95, Ministry of Finance, Delhi, 1995.
3. Recent Issues of Economic & Political Weekly, especially the review article of C. Sen, "Technology, Strategy and Competitiveness", EPW, 30 (28), 1995.
4. S. Jacobson & G. Alam, Liberalisation & Industrial Development in the Third World : A Comparison of the Indian and S Korean Engineering Industries, Sage, Delhi, 1994.

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#### **14.7 SELF-ASSESSMENT TEST**

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Take Liberalisation and Indicative Planning as one aspect and critique of post-reform period as another aspect. Consider them as questions and answer.

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