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S.Y.B.A. ECONOMICS PAPER III

INDIAN ECONOMY

(Revised Syllabus from academic year 2013-14 for IDOL Students)

SECTION I

Module 1 : Economic Growth (Pre and Post Reform Period) :

Changes in the growth of national income and per capita income - Changes in the sectoral composition of national income - changes in the occupational structure - Changes in the demographic features during 1951-2011 - India as an emerging economy in the world - Problem of poverty and income inequalities - Nature of unemployment - Causes of inflation - Policy measures to reduce poverty, income inequalities and inflation.

Module 2 : Agriculture and the economy :


Module 3 : Secondary and Tertiary Sector :

SECTION II

Module 4: Financial System and the Economy:


Module 5: Finances of the Government of India:


Module 6: International Trade and Payments:


References

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3. Indian Economy; A N Agrawal, New Age Publishers, Delhi
Module 1
ECONOMICS GROWTH
(PRE AND POST REFORM PERIOD)

Unit Structure:

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   1.1.2 Trends in Per Capital Income
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1.0 OBJECTIVES

- To understand the Changes in the growth of national income and per capita income.
- To understand the Changes in the sectoral composition of national income
- To acquaint with the changes in the occupational structure
- To familiar with Changes in the demographic features during 1951 – 2011 in India
• To understand the features of India as an emerging economy in the world.

1.1 INTRODUCTION

Economic growth usually refers to quantitative rise in National Income and Per Capita Income of an economy during a period of time. To understand economic growth in India, first we examine the National Income trends and then look into the trends of Per Capita Income in India during the last sixty years. India was an underdeveloped economy when it achieved independence in 1947. Even though India has started the process of economic development under the Five Year Plans, it continued to face many problems. The major issues, which India has to deal with in the 21st century, are poverty, population growth, food security, unemployment, illiteracy, lack of health facilities environmental degradation and other issues related to agriculture, industry and so on.

National income measures the money value of goods and services produced by a country during a given year. National income is usually expressed in the form of Gross National Product (GNP) or Gross Domestic Product (GDP). GDP is the money value of all the goods and services produced within the economy. When the net foreign income is added to the GDP, we have the GNP. GDP and GNP can be measured either at current prices or at constant prices. The national income prices reveals the real growth rate of an economy. The growth of national income is requisite for economic development.

The real national income of India has increased at an annual average rate of 4.5 per cent. The rate of growth initially decelerated over the years but has subsequently accelerated continuously. During the first decade, real income went up by 3.8 per cent, this rate came down to 3.5 per cent in the 1960s, 3.1 per cent in the 1970s and 5.5 per cent in 1980s. In the first three years of the 1990s, the GDP grew at 4 per cent annually. In the following four years, the growth rate jumped to 7.1 per cent but only to fall back to 5.2 per cent in the succeeding five years. The major breakthrough occurred and sustained during the period 2003-08; real GDP grew at 8.2 per cent annually in the period 2003-08. The world economy went through an unprecedented crisis in 2008-09. The slowdown
affected all the countries. By the end of the year 2008-09, India was rapidly returning to the buoyant years preceding 2008. The economy recovered to grow at 8.0 per cent during 2009-10, and further 8.6 per cent during 2010-11, with projections of 9.0 per cent during 2011-12. The Prime Minister’s Economic Advisory Council (PMEAC) lowered the economic growth projection for the year 2011-12 to 8.2 per cent from 9 per cent.

Per Capita Income is considered a better index of economic growth. In 1950-51 India’s Per Capita Income at 1999-2000 prices was Rs. 5,708. Since then it rose to Rs. 19,331 in 2004-05 and in 2009-10 it stood at Rs. 33,731. There has been more than fourfold increase in real Per Capita Income during the planning period. Growth in Per Capita Income was much less than growth in National Income because of high population growth rate. The Planning Commission expects that country’s Per Capita Income would be doubled in the next 20 years.

1.1.1 Trends In Nation Income:

The Central Statistical Organization (CSO) has changed the base year of calculate of national income at constant prices from 1993-94 to 1999-2000. The base year is revised to 2004-05 prices. The trends in national income, in terms of GDP at factor cost, are shown in Table 1.1 the national income of the country (GDP at factor cost)at current prices increase from Rs. 9,719 crore in 1950-51 to Rs. 71,57,412 crores in 2010-11, that is, by 736 times increase in national income at current prices is largely on account of rise in prices.

<table>
<thead>
<tr>
<th>Year</th>
<th>At Current Prices</th>
<th>At Constant Prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-51</td>
<td>9,719</td>
<td>2,24,786</td>
</tr>
<tr>
<td>1990-91</td>
<td>5,15,032</td>
<td>10,83,572</td>
</tr>
<tr>
<td>2010-11</td>
<td>71,57,412</td>
<td>48,85,954</td>
</tr>
</tbody>
</table>

*Source: Economic Survey 2011-12,*

The national income at constant prices shows the real increase in national income, the increase in the production of goods and services. The GDP at factor cost at prices increased from Rs. 2,24,786 crore in 1950-51 to Rs. 48,85,954 crore in 2010-11, only by 22 times during the period 1950-51 to 2010-11.
1.1.2 Trends In Per Capita Income:

Per capita income is one of the important indicators of the 'Human Development. Besides other things, it shows an increase in the standard of living. Traditionally the of per capita income has been regarded as a summary indicator of the economic well of the country. The trends in per capita income are shown in Table 1.2. The per capita at constant prices increased only by 6.3 times during the period 1950-51 to 2010-11. and Rs. 5,708 in 1950-51 to Rs. 35,993 in 2010-11.

The rise in per capita income has been very slow as compared to rise in real income. Poor growth rates coupled with rapid increase in population are the main for such dismal performance.

Table 1.2 : Per Capita NNP at Constant Prices

<table>
<thead>
<tr>
<th>Year</th>
<th>Rs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-51</td>
<td>5,708</td>
</tr>
<tr>
<td>1990-91</td>
<td>11,535</td>
</tr>
<tr>
<td>2010-11</td>
<td>35,993</td>
</tr>
</tbody>
</table>

Source: Economic Survey 2011-12

1.2 CHANGES IN THE GROWTH OF NATIONAL INCOME AND PER CAPITA INCOME

The annual average growth rate of national income (GNP at factor cost) at constant prices during the Fiver Year Plans is shown in Table 1.4. It may be noticed that after the Fourth Plan the growth rate of national income has improved steadily. During the Fifth Plan the national income has grown at 4.9 percent and thereafter the growth rates have surpassed the much sought after 5 percent. The annual average growth rate of national income during the Eighth Plan was 6.6 percent. However it was only 5.7 percent during the Ninth Plan. The growth sharply rose to 7.6 percent during the Tenth Plan and 7.9 percent during the Eleventh Plan Services contributed
as much as 68.6 percent of the overall average growth in GDP during the Tenth Plan (2002-03 to 2006-07). Practically, the entire residual contribution came from industry. The contribution of agriculture was almost nil.

An important feature of growth during the Tenth Five Year plan was the resurgence of manufacturing. There was a sharp rise in the growth of manufacturing from 3.3 percent during the Ninth Five Year Plan to 8.6 percent during the Tenth Five Year Plan. The growth in the services sector was broad based. Among the sub sectors of services, 'transport and communication' has been the fastest growing sector averaging 15.3 percent during the Tenth Five Year Plan. It was followed by 'construction'.

<table>
<thead>
<tr>
<th>Five year Plan</th>
<th>(percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Plan (51-56)</td>
<td>3.7</td>
</tr>
<tr>
<td>Second Plan (56-61)</td>
<td>4.2</td>
</tr>
<tr>
<td>Third Plan (61-66)</td>
<td>2.8</td>
</tr>
<tr>
<td>Fourth Plan (69-74)</td>
<td>3.4</td>
</tr>
<tr>
<td>Fifth Plan (74-79)</td>
<td>4.9</td>
</tr>
<tr>
<td>Sixth Plan (80-85)</td>
<td>5.4</td>
</tr>
<tr>
<td>Seventh Plan (85-90)</td>
<td>5.6</td>
</tr>
<tr>
<td>Eighth Plan (92-97)</td>
<td>6.6</td>
</tr>
<tr>
<td>Ninth Plan (97-02)</td>
<td>5.0</td>
</tr>
<tr>
<td>Tenth Plan (02-07)</td>
<td>7.6</td>
</tr>
<tr>
<td>Eleventh Plan (07-12)</td>
<td>7.9</td>
</tr>
</tbody>
</table>

Source: *Economic Survey 2011-12*

The Eleventh Five Year Plan has fixed a target of an average annual growth of 9 percent relative to 8 percent targeted by the Tenth Plan. However, the plan achieved an average growth of about 7.9 percent.

**1.3 CHANGES IN GROWTH RATES IN THE RECENT YEARS**

In the recent years especially since 2003-04 Indian economy has experienced very high growth rates in GDP.
Table 1.4: Real Growth Rates of GDP at Factor Cost (at 2004-05 Prices)

<table>
<thead>
<tr>
<th>Year</th>
<th>(percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>9.5</td>
</tr>
<tr>
<td>2006-07</td>
<td>9.6</td>
</tr>
<tr>
<td>2007-08</td>
<td>9.3</td>
</tr>
<tr>
<td>2008-09</td>
<td>6.7</td>
</tr>
<tr>
<td>2009-10</td>
<td>8.4</td>
</tr>
<tr>
<td>2010-11</td>
<td>8.4</td>
</tr>
<tr>
<td>2011-12</td>
<td>6.9</td>
</tr>
</tbody>
</table>

Per capita Gross National Income in 2010 (in dollars)

The growth rate in real GDP at factor cost was 9.5% in 2005-06, 9.6% in 2006-07 and 9.3% in 2007-08. The growth rate had fallen to 6.7% in 2008-09 due to global financial crisis. The economy had achieved a growth rate of 8.4% percent during the years 2009-10 and 2010-11 (see Table 1.5). The economy is expected to achieve a growth rate of 6.9% percent in 2011-12. The slowdown in 2011-12 was the result of global and domestic factors. The global factors were the crisis in the Euro zone area and near recessionary conditions prevailing in Europe, sluggish growth in many industrialized countries like USA and Japan and rise in international prices of crude oil. Domestic factors especially the lightening of monetary policy, led to slowing down of investment and growth.

1.4 CHANGES IN GROWTH OF PER CAPITA INCOME

Trends in Growth Rates in per capita Income during Five Year Plans

Table 1.5: Annual Average Growth Rates in Per Capita NNP at 2004-05 Prices during the Five Year Plans
It can be seen from the Table 1.6 that the average annual growth rates in per capita NNP was very low in the earlier Five Year Plans. Since Sixth Plan the growth rate of per capita income has been above 3 percent. The average annual growth rate in per capita income was 4.6 percent in the Eight Plan, 3.5 percent in the Ninth Plan, 5.9 in the Tenth Plan and 6.3 in the Eleventh Plan. There is a sharp rise in the growth of per capita income to around 6 percent per annum during the Tenth and Eleventh Plan periods.

1.5 SHORTCOMINGS IN INDIA’S GROWTH PERFORMANCE

Even though Indian economy has been growing rapidly after 1980 and especially in the post reform period, we can find the following shortcomings in the India’s growth performance.

i) Faster growth has not reduced poverty as much as it should have done.

ii) Growth has not created sufficient number of high quality jobs to satisfy the aspirations of our increasingly educated youths.

iii) Growth has not been as regionally balanced as it should have been.
iv) The deficiencies in social development indicators such as primary education, primary health care, safe drinking water, nutrition, sanitation, etc., have also continued to exist. The low level of social development is affecting the country’s economic development.

Despite progress in many areas, we are woefully lacking in providing basic services such as healthcare, education, safe drinking water, etc., to the majority of our population especially in rural areas. There is lack of infrastructure which is affecting the economic growth in the country.

1.6 CHANGES IN THE SECTORAL COMPOSITION OF NATIONAL INCOME

The different sectors have been grouped under three heads, namely, Agriculture and allied activities, Industry and services. The share of GDP originating from agriculture and allied activities has steadily declined, while that originating from industry and services sectors has increased. These changes show that Indian economy has transformed from the production structure of a backward economy to that of developing economy.

**Table 1.6 : Percentage Share of Different Sectors in GDP at Cost (At Constant 2004-05 Prices)**

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Sector</th>
<th>1950-51</th>
<th>1990-91</th>
<th>2010-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Agriculture and Allied Activities</td>
<td>56.1</td>
<td>33.3</td>
<td>16.8</td>
</tr>
<tr>
<td>2.</td>
<td>Industry</td>
<td>14.4</td>
<td>24.1</td>
<td>25.6</td>
</tr>
<tr>
<td>3.</td>
<td>Services’</td>
<td>29.5</td>
<td>42.6</td>
<td>57.6</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

*Source: Economic Survey 2011-12*

**Changes in the Sectoral Composition:**

1. **Decreasing Share of Agriculture and Allied Activities:** Agriculture has been a way of life and continuous to be the single most important livelihood of the masses. Agriculture and allied activities include agriculture, forestry and fishing, mining and quarrying. The share of agriculture and allied activities has
declined from about 56% in 1950-51 to 33.3% in 1990-91 and further to about 17% in 2010-11. The gap between the growth of agriculture and non-agriculture sector started to widen since 1996-97 because of acceleration in the growth of industry and service sectors. The continuous fall in the share of agriculture and allied activities in the GDP is partly due to the high growth in other sectors in the economy and partly to the low growth in this sector especially agriculture. During the Ninth and Tenth Five Year Plans agricultural sectoral growth rate was 2.44% and 2.3% respectively compared to 4.72% during the 8th Plan. During the Eleventh Plan agricultural growth is estimated at 3.28% against the target of 4%. Low investment, imbalance in fertilizer use, low seeds replacement rate, a distorted incentive system, low post harvest value addition and erratic rainfall continued to affect the performance of agricultural sector.

2. Rising Share of Industry: The share of industry comprising manufacturing, construction, electricity, gas and water supply has steadily increased from 14.4 percent of GDP in 1950-51 to 24 percent in 1990-1991 and further to 25.6% in 2010-11 (see Table 1.7). Industrial sector is comprised of manufacturing, construction, electricity, gas and water supply. The near stability of the share of industry in GDP indicates that the potential of this sector has not yet been fully exploited. The manufacturing is the most dominant sector within industry. The share of manufacturing in GDP remained in the range of 14-16% during the post-reform period between 1991-92 and 2011-12. The industrial sector is open to international trade environment and rapid technological change. Thus, this sector is required to be innovative and competitive.

3. Increasing Share of Services: The services sector comprises of three components, i.e., (i) Trade, hotels, transport and communication; (ii) Financing insurance, real estate and business services; and (iii) Public administration, defense and other services. The share of services increased steadily from 29.5 percent of GDP in 1950-51 to 42.6 percent in 1990-91 and further to about 57.6 percent in 2010-11. Services sector has acted as the important engine of overall growth of Indian economy for more than a decade. The Indian economy has successfully navigated the difficult years of the recent global economic crisis because of the vitality of this sector in the domestic economy.
4. Increasing Share of sub-sectors in the Services: The services sector is composed of three components and their share in the GDP have increased. This is given in Table 1.8.

a) Share of trade, hotels, transport and communication: Their share in GDP have increased from 11.3 percent in 1950-51 to 27.2 percent in 2010-11. Trade, hotels, transport and communication services have been growing rapidly in the recent years, Impressive progress in expanding railway passenger network and production of commercial vehicles, and fast addition of existing stock of telephone connections, particularly mobiles, have played key roles in such growth.

b) Share of financing, insurance, real estate and business services: Their share have grown from 7.7 percent of GDP in 1950-51 to about 17.4 % in 2010-11. This is due to the growth in financial services (comprising banking, insurance and real estate services). The progressive maturing of Indian financial markets and the ongoing construction boom has contributed to this.

c) Share of public administration and defense and other services: Their share have steadily increased from 10.5 percent of GDP in 1950-51 to 13 percent in 2010-11. The slow increase in the share of community, social and personal services, public administration and defense reflect the process of fiscal consolidation and increasing efficiency of fiscal expenditure management.

Table 1.7: Percentage Share of Different Components of Services in GDP at Factor Cost (At 2004-05 Prices)

<table>
<thead>
<tr>
<th>Components of Services</th>
<th>1950-51</th>
<th>2010-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Trade, hotels, transport &amp; communication</td>
<td>11.3</td>
<td>27.2</td>
</tr>
<tr>
<td>b) Financing, insurance, real estate and business services</td>
<td>7.7</td>
<td>17.4</td>
</tr>
<tr>
<td>c) Public administration and defense and other</td>
<td>10.5</td>
<td>13.0</td>
</tr>
<tr>
<td>Total share of services sector in GDP</td>
<td>29.5</td>
<td>57.6</td>
</tr>
</tbody>
</table>

According to the theory of economic development, the process of economic development takes place when the share of secondary and tertiary sectors in the national income increases and that of primary sector declines. Such sectoral change is taking place in India, but at a slow pace. The changes in the sectoral composition of national income bring out the effect of the process of economic development in India.

### 1.7 OCCUPATIONAL STRUCTURE IN INDIA

It has been observed that, the economic development is generally associated with changes in the occupational structure. There is some close relationship between economic development of an economy and the occupational structure of the country. According to Fisher, as the economy develops there has been a shift in employment and investment from the primary sector to secondary sector and to a large extent into tertiary activities.

Occupations are broadly divided into three types: primary, secondary, and tertiary activities. Agriculture, animal husbandry, forestry, fishery, etc., are collectively known as primary activities. They are primary because their products are essential for human existence. Mining and quarrying is included sometimes under the primary activities or under the secondary activities. Manufacturing industries and construction activities are called secondary activities. Trade and commerce, transport, communications, banking and finance, and other services are tertiary activities. They help the primary and secondary activities in the country. The occupational structure of a country shows the distribution of its workforce among the various occupations.

#### 1.7.1 Changes in Occupational Structure:

The important changes in the occupational structure of India during the period 1991-2001 can be observed from the table 2.1.

1. **Predominance of agriculture and allied activities in employment**: Agriculture and allied activities employ a very large proportion of working population. About 57% of the working population is employed in this sector in 2001. However, the dependence of the workforce on agriculture and allied activities has declined from 67.5% in 1991 to 57.3% in 2001. This brings out the underdeveloped nature of the Indian economy.

2. **Substantial fall in the share of agriculture and allied activities in the employment**: Their shares in employment have fallen from about 67% in 1991 to 56.7% in 2001. In agriculture, large percentage of the workers are either self-employed or casual workers. They suffer from job insecurity as
well as social insecurity. They are highly poor. They are also the vulnerable sections of the society.


(Percent)

<table>
<thead>
<tr>
<th>Activities / Sectors</th>
<th>1991</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Primary Sector</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture &amp; allied activities</td>
<td>66.9</td>
<td>56.7</td>
</tr>
<tr>
<td>Mining &amp; Quarrying</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td><strong>Secondary Sector</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>9.4</td>
<td>13.4</td>
</tr>
<tr>
<td>Electricity, gas &amp; water supply</td>
<td>0.4</td>
<td>0.5</td>
</tr>
<tr>
<td>Construction</td>
<td>1.9</td>
<td>3.7</td>
</tr>
<tr>
<td><strong>Tertiary Sector</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade, hotels, etc.</td>
<td>7.1</td>
<td>9.4</td>
</tr>
<tr>
<td>Transport, storage &amp; communications</td>
<td>2.8</td>
<td>4.0</td>
</tr>
<tr>
<td>Financial services, real estates, etc.</td>
<td>1.1</td>
<td>2.0</td>
</tr>
<tr>
<td>Other services</td>
<td>9.4</td>
<td>9.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Statistical Outline of India 2009-10.(Tata Services Ltd.)

3. **Significant increase in the share of secondary sector in employment**: The share of secondary sector in the employment increased from 11.7% in 1991 to 17.6% in 2001.

   This is mainly due to the following:

   (i) **Increase in employment in manufacturing**: Employment in the manufacturing increased from about 27 million in 1991 to 41.6 million in 2001. On account of this the share of manufacturing in the employment increased from 9.4% in 1991 to 13.4% in 2001. Consumer goods industries account for large percentage of employment in manufacturing. This includes a major part of small-scale sector.

   (ii) **Increase in employment in the construction**: Employment in the construction activities more than doubled during 1991-2001, from 5.5 million in 1991 to 11.5 million in 2001. This is the result of the growth of construction sector.
which is a labour intensive sector. Thus, the share of employment in the construction sector rose from 1.9% in 1991 to 3.7% in 2001.

4. **Significant rise in the share of Tertiary sector in employment:** There was significant increase in the share of tertiary sector in the employment from 20.4% in 1991 to 25.2% in 2001. The service sector is currently the faster growing sector of the economy. This was on account of:
   i) Increase in employment in trade, hotels and restaurant activities from about 7 million in 1991 to 9.4 million in 2001.
   ii) Rise in employment in transport, storage and communications from 2.8 million to 4 million during the same period.
   iii) Doubling of employment in financial services, real estate and business activities from 1.1 million to 2 million during the same period.

   In short during the decade 1991-2001 there has been rapid expansion of the service sector which has resulted in substantial increase in employment. The tertiary sector has got substantial potential for employment growth in the coming years. There is large employment potential in IT-enabled services, telecom services, tourism, transport services, health care, education and training, banking and financial services, insurance, retail services, and media and entertainment services.

5. **Shift in the occupational pattern during 1991-2001:** There was no clear shift in the work force from the primary to the secondary and tertiary sectors in the country during the period 1951-1991. The share of the primary sector in the employment declined from about 73% in 1951 to 67.5% in 1991. But during period 1991-2001 there is a decisive shift in the occupational structure towards secondary and tertiary sectors. Thus, the share of primary sector in employment has declined from 67.5% in 1991 to 57.3% in 2001. Correspondingly the share of employment in the secondary and tertiary sectors has increased from 32.5% in 1991 to 42.7% in 2001. Rapid industrialization and the consequent growth of banking, finance, trade and commerce, etc. since 1991 have started to provide more employment. These developments are also generating the process of occupational shift in favour of secondary and tertiary sectors.

6. **Change in occupational structure in some states:** There are significant changes in the occupational structure of
states like Kerala, Tamil Nadu, Maharashtra and West Bengal. In the above states the proportion of working force engaged in the primary sector has declined, and that engaged in secondary and tertiary sectors has increased.

7. **Changing trends in employment growth in organized sector:** Generally, a distinction is made between organized and unorganized sector employment. The organized sector usually refers to employment in the public sector and in private sector establishments employing 10 or more persons. It is commonly believed that wages in the organized sector are much higher than in the organized sector. The organized sector being regulated also provides greater job security and other benefits. Within the organized sector, jobs in the public sector receive much higher wages and accompanying benefits than those in the private sector for similar skills. Besides this, public sector provides greater job security than the private sector.

The employment in the organized sector, public and private sector, combined, increased at 1.20% per annum during 1983-1994. But the employment in the organized sector decelerated to 0.05 % per annum during 1994-2008 (see Table 2.2). This decline has taken place mainly due to decline in employment in the public sector units. While the employment in the private sector increased at a higher rate during 1994-2008.

<table>
<thead>
<tr>
<th>Table 1.9 : Growth of Employment in the Organised Sector ( per annum)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sector</strong></td>
</tr>
<tr>
<td>Public sector</td>
</tr>
<tr>
<td>Private sector</td>
</tr>
<tr>
<td>Total organized</td>
</tr>
</tbody>
</table>


The recent data shows that the employment growth in the organized sector, public and private combined, has increased by 1.9 % in 2010. However, it was lower than the annual growth of employment at 2.3 % in the previous year 2009. The annual growth rate of employment in the private sector was much higher than that in the public sector. However, in both sectors, annual increase in employment had slowed down in 2010 vis-a-vis 2009.
Table 1.10: Employment Growth in the Organised Sector (percent)

<table>
<thead>
<tr>
<th>Sector</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector</td>
<td>0.7</td>
<td>0.4</td>
</tr>
<tr>
<td>Private sector</td>
<td>5.1</td>
<td>4.5</td>
</tr>
<tr>
<td>Total</td>
<td>2.3</td>
<td>1.9</td>
</tr>
</tbody>
</table>


8. **Informalization of Employment**: The National Commission for Employment in the Unorganized Sector (NCEUS) makes a distinction between formal and informal employment. The informal employees do not have the benefits of social security. On the other hand, the formal employees are those who receive provident fund and social security benefits. It considers formal employees organized and informal employees as unorganized workers.

According to NCEUS, the employment in the organized sector has increased from 54.12 million in 1990-2000 to 62.57 million in 2004-05. However, the increase has been due to increase in unorganized (informal) workers in organized enterprises from 20.46 million in 1999-2000 to 29.14 million in 2004-05 (see Table 2.4). Thus, increase in employment in the organized sector has been on account of informal employment of workers. Globalisation, therefore, has led to informalisation of employment.

Table 1.11: Formal and Informal Employment in the Organised Sector (million)

<table>
<thead>
<tr>
<th>Type of Employment</th>
<th>1999-2000</th>
<th>2004-05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Informal</td>
<td>20.46</td>
<td>29.14</td>
</tr>
<tr>
<td>Formal</td>
<td>33.67</td>
<td>33.42</td>
</tr>
<tr>
<td>Total</td>
<td>54.12</td>
<td>62.57</td>
</tr>
</tbody>
</table>

Source: Eleventh Five Year Plan.
9. **Feminization of labour in low wage jobs:** The forces of globalisation have led to an increase of women’s employment in low paid jobs. Majority of women are working in the informal sector especially in export oriented low technology high labour-based industries, such as garments, shoes and electronics. They are promoted in export processing zones. Another important category of female workers are home-based labour. Employers prefer to undertake contracts with home-based workers because they are paid low remuneration for the work done by them.

The above analysis of occupational structure shows a mixed picture. On the one hand, here is an encouraging shift in the occupational pattern from primary sector to secondary and tertiary sectors. On account of shift in the production activities from primary to secondary and tertiary activities, the labour absorption capacity of the secondary and tertiary sectors has gone up. This brings about the desired shift in the occupational pattern in India. On the other hand, slow rise in employment opportunities the organized sector, informalisation of employment and feminization of labour in the low wage jobs in the recent years are causes of concern. They can lead to exploitation of labour in the country. Since 1992, because of global competition many companies have tried to cut down the cost by resorting to downsizing of workers by introducing Voluntary Retirement Scheme (VRS). According to the report of the National Commission on Labour (2002), elements of indirect compulsion pressure tactics, innovative forms of mental harassment, compelling employees to resign by seeking to terminate them and so on have been used by employers to make the workers to opt for VRS.

### 1.8 CHANGES IN THE DEMOGRAPHIC FEATURES OF INDIA

The theory of demographic transition postulates a three stage relationship between economic development and population growth. According to this theory, “as a country advances economically, its population passes through the stages of low growth to high growth and then finally to low and stable growth. India is passing through the second stage of demographic transition where a population explosion takes place due to a continuously increasing gap between birth and death rates.
In order to understand the complex inter-relationships between different factors we analyze below changes in the demographic features of India and the population policy of government of India. Many People consider the large and the growing population of the country as its critical problem.

1. Size and growth Rate of Population

As per the Population Census of India, 2001, the population of India in 2001 was 102.9 Crores. According to provisional census 2011 estimates the population of India has risen to 121.02 Crores in 2011. Next to China, India has the largest population. It is now estimated that by 2050, India will most likely overtake China to become the most populous country on the earth. India accounts for 2.4 percent of the world surface area of 135.79 million square kms and supports about 16 percent of the world population.

Table 1.12 : Population of India (million)

<table>
<thead>
<tr>
<th></th>
<th>Census 2001</th>
<th>Census 2011 (provisional)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Males</td>
<td>532</td>
<td>623.7</td>
</tr>
<tr>
<td>Females</td>
<td>497</td>
<td>586.5</td>
</tr>
<tr>
<td>Total Population</td>
<td>1029</td>
<td>1210.2</td>
</tr>
</tbody>
</table>

Source: Census of India 2011.

The size of India's population is not only large but it is increasing at a rapid rate. Population growth till 1921 was small, even negligible. After 1921, the population increased rapidly. **Hence 1921 is described as the year of ‘Great Divide’**.
Table 1.13: Population Growth (1951-2011)

<table>
<thead>
<tr>
<th>Census Year</th>
<th>Population (in million)</th>
<th>Decadal Growth (per cent)</th>
<th>Average Annual Growth (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>361</td>
<td>13.31</td>
<td>1.25</td>
</tr>
<tr>
<td>1961</td>
<td>439</td>
<td>21.64</td>
<td>1.96</td>
</tr>
<tr>
<td>1971</td>
<td>548</td>
<td>24.80</td>
<td>2.20</td>
</tr>
<tr>
<td>1981</td>
<td>683</td>
<td>24.66</td>
<td>2.22</td>
</tr>
<tr>
<td>1991</td>
<td>846</td>
<td>23.86</td>
<td>2.14</td>
</tr>
<tr>
<td>2001</td>
<td>1029</td>
<td>21.54</td>
<td>1.93</td>
</tr>
<tr>
<td>2011</td>
<td>1210</td>
<td>17.64</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Census of India, 2011.

After Independence, the growth of population accelerated at a still faster rate. The population of India increased from 361 million in 1951 to 1210 million in 2011. The average growth rate of population increased from 1.96 percent during 1951-61 to 2.22 percent during the period 1971-81. Thereafter, there has been some deceleration in the growth rate. During 1981-1991 the growth rate was 2.14 percent. The average growth rate of population has further declined to 1.93 percent during the period 1991-2001. The decadal growth rate of population during 2001-2011 was 17.64 percent.

According to Census of India 2011, India's population growth during the twentieth century can be classified into four distinct phases as follows:

1901-1921: Stagnant population
1921-1951: Steady growth
1951-1981: Rapid high growth
1981-2001: High growth with definite signs of slowing down

The census of 2011 shows that the decadal growth of population has come down from 21.54 during 1991-2001 to 17.64 percent during 2001-2011.

Birth Rate and Death Rate
The growth rate of population is a function of birth rate and death rate. Therefore, variations in birth rate and death rate are
responsible for acceleration and deceleration of population growth in India. India is following the demographic transition pattern of all developing countries from initial levels of "high birth rate - high death rate" phase to the intermediate stage of "high birth rate - low death rate" with high rates of population growth, before graduating to the "low birth rate - low death rate" phase.

Table 1.14: Important Demographic Indicators

<table>
<thead>
<tr>
<th>Indicators</th>
<th>1951</th>
<th>1981</th>
<th>1991</th>
<th>Current Levels (Year in Bracket)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Birth Rate (per1000 population)</td>
<td>40.8</td>
<td>33.9</td>
<td>29.5</td>
<td>22.1 (2010)</td>
</tr>
<tr>
<td>2. Death Rate (per1000 popln.)</td>
<td>25.1</td>
<td>12.5</td>
<td>9.8</td>
<td>7.2 (2010)</td>
</tr>
<tr>
<td>3. Total Fertility Rate (per woman on avg.)</td>
<td>6</td>
<td>4.5</td>
<td>3.6</td>
<td>2.6 (2009)</td>
</tr>
<tr>
<td>4. Infant Mortality Rate (per 1000 live births)</td>
<td>146 (51-61)</td>
<td>110</td>
<td>80</td>
<td>47 (2010)</td>
</tr>
<tr>
<td>5. Child Mortality Rate (0-4 years) (per 1000 children)</td>
<td>-</td>
<td>41.2</td>
<td>26.5</td>
<td>14.1 (2009)</td>
</tr>
</tbody>
</table>

Source: Economic Survey 2009-10 and 2011-12

The technological advances and improved quality and coverage of health care resulted in a rapid fall of death rate from 25.1 in 1951 to 9.8 in 1991 and further to 7.2 in 2010. In contrast, the reduction in birth rate has been less steep, declining from 40.8 in 1951 to 29.5 in 1991 and further to 22.1 in 2010. The infant mortality rate has come down from 110 in 1981 to 47 in 2010. The child mortality rate too has come down from 41.2 in 1981 to 14.1 in 2009. The total fertility rate, measure of the average number of children born to women during her reproductive period, has declined from 4.5 in 1981 to 2.6 in 2009. The factors such as female literacy, infant mortality rates, average age at marriage and labour force participation rate for women are believed to exert considerable influence on fertility.
Inter-State Differences

There is striking demographic diversity between states. This has led to significant disparity in current population size and growth rates. While Nagaland has registered a negative growth, Kerala, Goa and Andhra Pradesh have registered low growth rates in population during 2001-2011. On the other hand, states like Chattisgarh, Tamil Nadu, Bihar, Haryana and Uttar Pradesh have shown an upward swing in population growth rates during this period. The decadal growth of population during 2001-2011 is above 24 percent in Bihar, Arunachal Pradesh and Meghalaya. The striking inter-state differences in demographic indicators stem largely from poverty, illiteracy, and inadequate access to health and family welfare services, which co-exist and reinforce each other. In many parts of the country, the widespread health infrastructure is not responsive.

2. Density of Population

The term density of population refers to the average number of persons living per square km. The density of population has increased from 117 in 1951 to reach 325 person per sq.km in 2001 and further to 382 in 2011. The density is highest in Delhi followed by Chandigarh, Bihar, West Bengal, Kerala, UP., Tamil Nadu and Punjab.(see Table 1.16)

Table 1.15: Density and Sex Ratio

<table>
<thead>
<tr>
<th>Census Year</th>
<th>Density (per sq.km)</th>
<th>Sex Ratio (Females per 1000 Male)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>117</td>
<td>946</td>
</tr>
<tr>
<td>1981</td>
<td>216</td>
<td>934</td>
</tr>
<tr>
<td>1991</td>
<td>267</td>
<td>927</td>
</tr>
<tr>
<td>2001</td>
<td>325</td>
<td>933</td>
</tr>
<tr>
<td>2011</td>
<td>382</td>
<td>940</td>
</tr>
</tbody>
</table>

3. Sex Ratio

It shows the number of females per 1000 males. The sex ratio of the country as a whole was 933 females per 1000 males as per census 2001. According to census 2011 provisional estimates the sex ratio is 940 in 2011. This shows some improvement over the sex ratio of 933 recorded in 2001. The states, that have recorded a decline in the overall sex ratio in 2011, are Bihar, Gujarat and Jammu and Kashmir. Only Kerala and Puducherry have above parity sex ratios of 1084 and 1038 respectively.

### Table 1.17 States and Union Territories Arranged in a Descending Order of Sex-Ratio

<table>
<thead>
<tr>
<th>States / Union Territories</th>
<th>Sex-Ratio in 2011</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kerala</td>
<td>1084</td>
<td>1</td>
</tr>
<tr>
<td>Puducherry</td>
<td>1038</td>
<td>2</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>995</td>
<td>3</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>925</td>
<td>22</td>
</tr>
<tr>
<td>Haryana</td>
<td>877</td>
<td>31</td>
</tr>
<tr>
<td>Delhi</td>
<td>866</td>
<td>32</td>
</tr>
<tr>
<td>Daman and Diu</td>
<td>618</td>
<td>35</td>
</tr>
</tbody>
</table>

Source :Census of India, 2011.

The persistent tendency towards low sex ratios in India can be attributed to the following factors:
1. Sex selective female abortions,
2. Neglect of the girl child,
3. Female infanticide,
4. High maternal mortality
It is recognised that the adverse sex ratio is a reflection of gender disparity in the country. Appropriate steps will have to be taken to correct this trend.

4. Age Composition

It indicates the proportion of the labour force and of the dependant population (i.e. Children and old people) in total population. The age composition of population in 2001 is given in table 1.18.

**Table 1.18: Age Composition in 2001**

<table>
<thead>
<tr>
<th>Age group</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-14</td>
<td>35.6</td>
</tr>
<tr>
<td>15-59</td>
<td>58.2</td>
</tr>
<tr>
<td>60 and above</td>
<td>6.3</td>
</tr>
</tbody>
</table>

The Size of the labour force, i.e. those falling within the working age (15-59) constituted 58.2% of the population in 2001. The proportion of dependant population (i.e. children & old people) constituted 42%.

The age composition of population is projected to change by 2016. The population below 15 years of age is projected to decline to 28 percent, the population in the age group 15-59 years is projected to increase to nearly 64 percent and the population in the age group of 60 plus is projected to increase to nearly 9 percent by 2016.

5. Urbanization

As per census 2001, out of the total population of 1027 million, about 742 million (72.2 per cent) live in rural areas and 285 million (27.8 percent) live in urban areas. The net addition to the population over 1991-2001 was 113 million in rural areas and 68 million in urban areas. The percentage decades growth of population in rural and urban areas during 1991-2001 was 17.9 and 31.2 per cent respectively. There was a net increase of 2.1 percent in the urban population during the decade 1991-2001.

**Cities with one million plus population:** According to census 2001, cities having a population of more than one million have increased to 35 from 23 as shown by census
1991. Greater Mumbai had the highest population of 16.4 million, followed by Kolkata, Delhi, Chennai, Bangalore, Hyderabad, Ahmedabad, Pune, Surat, etc.

**Slum population:** For the first time, detailed data on slum areas in the country has been collected in Census 2001. The total slum population in the country in 2001 is 40.3 million, comprising 22.6 percent of the total urban population of cities reporting slums. Largest slum population was registered in Maharashtra in Greater Mumbai.

6. **Life Expectancy and Literacy Rate**

The quality of population can be judged from life expectancy and literacy rate. The life expectancy at birth in the country for males and females has gone up from 32.2 and 31.7 years respectively in 1950-51 to 62.6 and 64.2 years respectively in 2006-07. The life expectancy at birth for the country as a whole has increased from 32.1 in 1950-51 to 63.5 years in 2006-07. It is still quite low compared to high income countries where it is 78 years in 1999.

The literacy rate for the country as a whole increased from 18.3 percent in 1951 to 64.8 percent in 2001 and further to 74.04 percent in 2011. In 2011 the literacy rate for males stood at 82.14 percent and that for females at 65.46 percent, the highest increase in one decade. An encouraging feature is that the growth rate of literacy has been higher in case of females than males during this decade 1991-2001. The rate of growth of literacy during this decade (1991-2001) has been higher in the rural areas as compared that in urban areas. Despite these improvements literacy rate in urban areas was 80.3 percent and that in rural areas 59.4 percent in 2001.

**Table 1.19**: Literacy Rates (Fig. in percent)

<table>
<thead>
<tr>
<th>Year</th>
<th>Male</th>
<th>Female</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>27.2</td>
<td>8.9</td>
<td>18.3</td>
</tr>
<tr>
<td>1991</td>
<td>64.1</td>
<td>39.3</td>
<td>52.2</td>
</tr>
<tr>
<td>2001</td>
<td>75.3</td>
<td>53.7</td>
<td>64.8</td>
</tr>
<tr>
<td>2011</td>
<td>82.14</td>
<td>65.46</td>
<td>74.04</td>
</tr>
</tbody>
</table>

Kerala has the highest literacy rate of 93.91 percent and it occupies the top slot in both male and female literacy rates, at 96.02 and 91.98 percent respectively in 2011. Bihar has the lowest
literacy rate of 63.82 percent, along with lowest literacy rate for males at 73.39% and for females at 53.33 percent in 2011. Rajasthan has the lowest female literacy rate of 52.66 percent in 2011.

Table 1.20: India's Global Position on Adult and Youth Literacy Rates in 2002

<table>
<thead>
<tr>
<th>Country</th>
<th>Adult Literacy Rate (Per cent 15 yrs. &amp; above)</th>
<th>Youth Literacy Rate (per cent 15-24 Years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>90.9</td>
<td>98.9</td>
</tr>
<tr>
<td>India</td>
<td>61.3</td>
<td>73.3</td>
</tr>
<tr>
<td>Pakistan</td>
<td>41.5</td>
<td>53.9</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>92.1</td>
<td>97.0</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>41.1</td>
<td>49.7</td>
</tr>
</tbody>
</table>

Despite rise in literacy rate in India, India continues to lag behind several other developing countries in the region.

1.9 NATIONAL POPULATION POLICY 2000

The National Population Policy (NPP) 2000 consider population stabilization as an essential pre-requisite for sustainable human and social development with more equitable distribution. The National Population policy (NPP) was announced in February 2000. The NPP 2000 affirms government’s commitment towards voluntary and informed choice and consent of citizens while availing of reproductive health care services and continuation of the target free approach in administering family planning services. The NPP 2000 recognizes the need to simultaneously address issues of child survival, maternal health and contraception, while increasing outreach and coverage of a comprehensive package of reproductive and child health services by government, industry and the voluntary non-government sector. It recognizes the fact that population stabilization is as much a function of making reproductive health care affordable for all as other life quality improving services such as primary and secondary education, sanitation, drinking water, housing, transport, communication and empowering women and enhancing scope for their employment.
1.9.1 Objectives of NPP 2000:

The immediate objective of NPP 2000 is to address the unmet needs of contraception, health infrastructure, health personnel and to provide integrated service delivery for basic reproductive and child health care. The long-term objective is to achieve a stable population by 2045 at a level consistent with ‘the requirement of sustainable economic growth, social development and environmental protection.

To achieve the above objectives the NPP 2000 has formulated the following goals to be attained by 2010:

1. Address the unmet needs for basic reproductive and child health services, supplies and infrastructure.

2. Make school education up to age 14 free and compulsory and reduce dropouts at primary and secondary school levels to below 20 percent for both boys and girls.

3. Reduce infant mortality rate to below 30 per 1000 live births.

4. Reduce maternal mortality ratio to below 10 per 100,000 live births.

5. Achieve universal immunization of children against all vaccine preventable diseases.

6. Promote delayed marriage for girls not earlier than age 18 and preferably after 20 years of age.

7. Achieve 80 percent institutional deliveries and 100 percent deliveries by trained persons.

8. Achieve universal access to information/counselling and services for fertility regularization and contraception with a wide basket of choices.

9. Achieve 100 percent registration of births, deaths, marriage and pregnancy.

10. Contain the spread of Acquired Immuno Deficiency Syndrome (AIDS) and promote greater integration between the management of reproductive trace infection (RTI) and sexually transmitted infection (STI) and the National AIDS control Organization.

11. Prevent and control communicable diseases.

12. Integrate Indian Systems of Medicine (ISM) in the provision of reproductive and child health services, and in reaching out to households.

13. Promote vigorously the small family norms to achieve replacement levels of total fertility rates (TFR).
14. Bring about convergence in implementation of related social sector reforms so that family welfare becomes a people centered program.

1.9.2 Drawbacks or Limitations of Population Policy:

India’s population policy suffers from following limitations:

1. **Latent Demand**: There is no easy access to contraception in familiar setting as government family planning clinics are few and far between.

2. **Undue importance to Terminal Methods**: In family planning programme undue importance was given to terminal method as about 88 percent of the total contraceptive practices were in terms of terminal methods. IUDs and orals have been seriously and unnecessarily neglected. Abortion facilities are still woefully inadequate almost everywhere.

3. **Missed Opportunities**: The history of family planning programme is one of missed opportunities. Adoption of the policy of polarization drifting from one solution to another as such offered insufficient remedy to the population problem.

4) **High Infant Mortality Rate**: The family planning movement is largely influenced by social development. The mortality rate especially infant mortality rate has remained high and has therefore inhibited the acceptance of family planning.

5) **Inadequate Utilization of Infrastructure**: This has been due to the shortage of trained manpower, inefficiency of motivational work of the staff, improper maintenance of infrastructural equipment, etc.

4. **Lack of Co-ordination between Researchers and Policy Makers**: There is no mechanism whereby the results of research are automatically transmitted to the administrators and policy makers. There is inadequate research in population related areas.

5. **Costly and Inconvenient Methods**: Most family planning devices are costly, inconvenient and irksome to the common men and women. A common deficiency marked in this context relates to ‘follow-up measures’ which include provision of medicines and associated facilities.

6. **Less Use of Disincentives**: Our population control effort should contain some elements of disincentives directed at those
exhibiting tendencies towards going beyond the officially accepted norms of family size.

7. **Child Viewed as an Asset** : The lower strata of Indian population consisting of seventy to seventy-five percent of population consider large family as an asset because

a) There are more earners in a large family.

b) Children share household chores and family enterprise and release adults for full employment.

c) Large family acts as safeguard against the loss of family members.

d) In a large family, members get sustainance and company in old age.

e) There is emotional satisfaction from children.

Economic development must bring about transformation in lower strata of population so that they accept small family norm. National economic structure must be changed rapidly to guarantee the viability of 'small family. Thus economic development is the best contraceptive.

### 1.10 INDIA AN EMERGING ECONOMY IN THE WORLD

Emerging economies are considered to be in a transitional phase between developing and developed status. In the 2008 Emerging Economy Report, emerging economies have been defined as those "regions of the world that are experiencing rapid informationalization under conditions of limited or partial industrialization." Emerging economies also refer to "rapidly developing economies".

In the recent years, new terms have emerged to describe the largest developing countries such as BRIC (Brazil, Russia, India and China); these countries do not share any common agenda but enjoying an important role in the world economy. In 2006 there were around 28 emerging economies in the world and this number has risen to 40 in 2010. The economies of China and India are considered to be the largest. The eight largest emerging and developing economies either by nominal GDP or GDP (PPP) are China, Brazil, Russia, India, Mexico, South Korea, Indonesia and Turkey.
The economic expansion that has taken place in India since 1990 has made India as an emerging economy in the world. Until 1991, India followed protectionist policies that were influenced by socialist ideologies. An acute balance of payments crisis in 1991 forced the country to liberalize the economy. Since the economic reforms of early 1990s India began to remove the elements of its closed economy and Indian economy has been rapidly changing and growing.

During the global financial crisis of 2008-09, India's financial system avoided the worst of the banking woes experienced by financial institutions in the US and Europe.

Some of the important features of India as an emerging economy are explained below:

1. **Fastest Growing Economy:**

   According to International Monetary Fund as of 2011, the Indian economy is nominally worth US $ 1.676 trillion and it is the tenth largest economy by market exchange rates. In terms of purchasing power parity (PPP) India's GDP is at US $ 4.457 trillion and it is the third largest economy.

   The Indian economy responded well to changes in policy direction introduced since 1991. The GDP growth in the post reform period has increased from an average of about 5.7 percent in the 1980s to about 8 percent in the Tenth Plan Period (2002-2007), making India one of the ten fastest growing countries in the world. Even during the global financial crisis of 2008-09. Indian economy registered a growth rate of 6.7 percent.

2. **Significant Changes in the Structure of the Economy:**

   The structure of the Indian economy has undergone significant changes over time. The share of the industry sector in GDP increased by about 9 percentage points from 16.6 percent in 1950-51 to 25.9 percent in 1980-81. The services sector started to grow rapidly since 1980-81, the share of industry sector has remained in the range of 26 to 28 percent of GDP, while the entire decline in the share of agriculture has been balanced by an increase in the share of the services sector. Thus, the resilience of the economy to shocks owe to the services sector which has the largest share and most consistent growth performance.
Table 1.21: Sectoral Composition of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-51</td>
<td>53.1</td>
<td>16.6</td>
<td>30.3</td>
</tr>
<tr>
<td>1980-81</td>
<td>36.1</td>
<td>25.9</td>
<td>38.0</td>
</tr>
<tr>
<td>1990-91</td>
<td>29.6</td>
<td>27.7</td>
<td>42.7</td>
</tr>
<tr>
<td>2011-12 (AE)</td>
<td>13.9</td>
<td>27.0</td>
<td>59.0</td>
</tr>
</tbody>
</table>


3. **Large Skilled Labour Force:**
   The skilled labour force is growing in the country due to rising education and especially technical education. India has a young and rapidly growing labour force amounting to about 470 million in 2009-10. With a large system of higher education, India has a vast pool of qualified manpower. India has a brain power comprising of skilled and educated labour force. According to Economic Survey 2011-12, a large-scale expansion in university education has been initiated during the Eleventh Five Year Plan by setting up new educational institutions.

4. **Rising Middle Class:**
   The growing middle class and increasing disposable income provides many investment opportunities in India. As the middle class grows and continues to increase domestic demand, the economy will also continue to grow. This will lead more demand for better health care, education and infrastructure. The middle class also will increase its share of financial investments and thus provide a new sources of capital for companies.

5. **Attractive Destination for FDI and Business:**
   Today, FDI is allowed in virtually all sectors of the economy with exceptions being strategically sensitive areas such as defense and atomic energy. For many industries FDI is approved automatically through the RBI. The FDI ceiling range from 26% to 100% depending on the type of industry. The Foreign Investment Promotion Board (FIPB) approves all other foreign investments. Foreign Institutional investor are allowed to invest in listed and unlisted Indian companies and domestic debt securities.
Table 1.22: Foreign Investment Inflows to India (US $ million)

<table>
<thead>
<tr>
<th>(1)</th>
<th>Direct Investment (2)</th>
<th>Portfolio Investment (3)</th>
<th>Total (4 = 2 + 3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-93</td>
<td>315</td>
<td>244</td>
<td>559</td>
</tr>
<tr>
<td>1993-94</td>
<td>586</td>
<td>3567</td>
<td>4153</td>
</tr>
<tr>
<td>1994-95</td>
<td>1314</td>
<td>3824</td>
<td>5138</td>
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<tr>
<td>1996-97</td>
<td>2821</td>
<td>3312</td>
<td>6133</td>
</tr>
<tr>
<td>2001-02</td>
<td>6130</td>
<td>2021</td>
<td>8151</td>
</tr>
<tr>
<td>2003-04</td>
<td>4322</td>
<td>11377</td>
<td>15699</td>
</tr>
<tr>
<td>2006-07</td>
<td>.22826</td>
<td>7003</td>
<td>29829</td>
</tr>
<tr>
<td>2007-08</td>
<td>34835</td>
<td>27271</td>
<td>62106</td>
</tr>
<tr>
<td>2008-09</td>
<td>37838</td>
<td>13855</td>
<td>23983</td>
</tr>
<tr>
<td>2009-10</td>
<td>37763</td>
<td>32376</td>
<td>70139</td>
</tr>
<tr>
<td>2010-11</td>
<td>30380</td>
<td>31471</td>
<td>61851</td>
</tr>
</tbody>
</table>

Source: RBI - Handbook of Statistics on Indian Economy. 2010-11

It can be seen from Table 1.22, there has been substantial increase in foreign investment inflows into the country since 1992-93 due to increases in FDI and portfolio investment. Foreign investment inflows rose from $ 559 million in 1992-93 to $ 61,851 million in 2010-11. In some years FDI inflows were larger than portfolio investment.

6. Vast Opportunities for Investment in Infrastructure:
   The Planning Commission has projected that investment in infrastructure in India would almost double at US $ 1025 billion in the 12th Plan, compared to US $ 514 billion in the 11th Plan. FDI up to 100 percent under the automatic route is permitted in exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products, petroleum product pipelines, etc. in the private sector.

   The current levels of infrastructure facilities are not enough to sustain high growth in India. There is large opportunities for global investors in the fields of power, road and ports.

7. India's Growing International Trade:
   Since 1991, India adopted a policy of trade liberalization to open up the economy to foreign trade and to integrate the Indian economy into the global economy. The trade policy reforms initiated in 1991 have drastically changed the scenario and have
resulted in a shift from the inward-oriented policy to an outward-oriented policy.

India's international trade has increased drastically in the post reform period. In absolute terms, the trade volume rose from US $ 42.2 billion (both exports and imports together) in 1990-91 to US $ 621 billion in 2010-11, i.e. increased by about 15 times. The exports rose from US $ 18.1 billion to US $ 251.1 billion, i.e. by about 14 times and imports rose from US $ 24.1 billion to US $ 369.8 billion, i.e. by 15.3 times, during the same period. Thus in 2011 India was the world’s 10th largest importer and the 19th largest exporter. For more than a decade, Indian growth story has been dominated by the services sector. There was consistent increase in surplus from balance on trade in services which rose from US $ 1.7 billion in 2000-01 to US $ 48.8 billion in 2010-11.

8. Bilateral and Regional Co-operation:

India is actively engaged in regional and bilateral negotiations with her trading partner countries / blocs to diversify and expand the markets for its exports. India has Comprehensive Economic Partnership Agreement (CEPA) with Singapore and South Korea. The India-Japan CEPA was signed in February 2011 and has come into force in August 2011. The agreement covers more than 90 percent of trade, a vast gamut of services, investment and other trade related issues. India - Malaysia Comprehensive Economic Co-operation Agreement was signed in February 2011 and has come into force in July 2011.

India - ASEAN Trade in Goods Agreement has come into force in January 2010.

Negotiations on the India - ASEAN Co-operation covering Trade in Services and Investment are underway. India - EU Trade and Investment Agreements Negotiations are continuing. Similar negotiations are taking place with Canada, Newzeland and Australia. All these will have substantial effect on trade and investment in India.

Despite being an emerging economy in the world India continue to face many socio-economic challenges such as large percentage of people below poverty line, large number of children underweight and suffer from malnutrition, rise in economic inequalities, corruption, etc. In the recent years we are also facing the problem of rising trade deficit, and current account deficit, policy vacuum adversely affecting FDI and FIIs inflows into the country and so on.
1.11 QUESTIONS

1. Explain the trends in national income and per capital income in India.
2. Examine the change in sectoral composition of national income in India.
3. Write Short notes on:
   a. Sectoral Shares of national income in India.
   (b) Trends in national income
4. Analyse the nature of changes in the sectoral distribution of National income in India.
5. Discuss the changes in the growth of national income and per capita income in India.
6. Explain the changes in the occupational structure in India.
7. Discuss the existing occupational structure in India.
8. Write a note on occupational structure in India.
9. Give an account of the population policy in India.
10. Examine the changes in India's demographic features.
11. Write notes on the following:
    a. Changes in India's demographic features
12. Explain the trends in the growth rate of population since 1981.
13. Describe the important changes in India's demographic features.
14. Examine the factors on which India is considered as an emerging economy in the world.
15. Explain the meaning of emerging economies.
16. Explain the important features of India as an emerging economy in the world.
POVERTY, INEQUALITY, UNEMPLOYMENT AND INFLATION IN INDIA

Unit Structure:

2.0 Objectives
2.1 Concept of Poverty
2.2 The measurement of poverty
   2.2.1 Measurement of poverty
   2.2.2 Extent and trends in the incidence of poverty
   2.2.3 Poverty alleviation programs
   2.2.4 Limitations of poverty alleviation programmes
2.3 Concept of inequality
   2.3.1 Extent of income inequality in India
   2.3.2 Income Distribution
   2.3.3 Rural - Urban Inequality
   2.3.4 Policy measures to reduce inequality
2.4 Unemployment in India
   2.4.1 Nature of unemployment in India
   2.4.2 Extent of unemployment in India
   2.4.3 Causes of unemployment
   2.4.4 Policy strategies for employment generation in India
   2.4.5 Government policies to generate employment
2.5 Meaning of Inflation
   2.5.1 Causes of inflation in India
   2.5.2 Measures to control inflation
2.6 Questions

2.0 Objectives

- To understand the Concept & measurement of Poverty and poverty alleviation programmes in India.

- To understand the Concept of Inequality, extent of Inequality & measures to reduce inequality in India.

- To acquaint with the concept, nature of Unemployment and policy measures to alleviate unemployment.
To familiar with meaning of Inflation, its causes & measures to control Inflation in India

2.1 CONCEPT OF POVERTY

Eradication of poverty has long been the important objective of Indian economic development. The problem of poverty is now generally accepted as the biggest challenge to development planning in India. All the political parties in India, in one form or another has adopted poverty eradication as an important goal. Various schemes and programmes aimed at achieving these objectives have been launched over the years. But the problems of poverty continue to persist in India.

2.2 THE MEASUREMENT OF POVERTY

Human Development Report, 1997 has introduced a concept of "human poverty" which sees "impoverishment as multidimensional". Poverty means more than a lack of what is necessary for material well-being. It can also mean the denial of opportunities and choices most basic to human development, that is,

i) To lead a long, healthy, creative life.

ii) To have a decent standard of living.

iii) To enjoy dignity, self-esteem, the respect of others and the things that people value in life.

According to the World Bank poverty is the inability of people to attain a minimum standard of living. It is deprivation of the basic necessities of life such as food, clothing and housing. According to World Bank poverty is multidimensional in nature. In addition to low income (living on less than $ 1 a day), illiteracy, ill health, gender inequality, and environmental degradation are all aspects of being poor.

Human Development Report 1997 has introduced the human poverty index (HPI) to measure poverty in developing countries. While human development index (HDI) measures progress in a community or country as a whole, the HPI measures the extent of deprivation, the proportions of people in the community or country who are left out of progress.

The Human Development Report 2010 measures poverty in terms of a new parameter, namely, multidimensional poverty index.
(MPI). It has replaced the human poverty index (HPI) used since 1997. The MPI indicates the share of the population that is multi-dimensionally poor adjusted by the intensity of deprivation in terms of living standards, health and education. Poverty is, therefore, a multi-dimensional concept, though some facets of poverty may be more critical than others. Illiteracy, low income, unemployment, malnutrition, frequent illness, high infant and child mortality and lower life expectancy are attributes of poverty. High birth rates also co-exist with poverty, though it is not high birth rates that breed poverty but it is poverty that breeds more children.

2.2.1 Measurement of Poverty:

According to M.L. Dantwala, "the poor are those who live below what is called the 'Poverty Line', which is defined in terms of per capita household expenditure". In the Indian planning literature, the poverty line is determined by the concept of expenditure considered necessary for a minimum level of living or minimum needs. Since the prices have risen, the minimum in money terms is revised upwards from time to time.

The Task Force on Minimum Needs and Effective Consumption, constituted by the Planning Commission in 1977, defined the poverty line as a per capita monthly expenditure of Rs. 49.09 in the rural areas and Rs. 56.40 in urban areas (at 1973-74 prices), corresponding to a per capita daily calorie requirement of 2400 in rural and 2100 in urban areas. The calorie requirements represent the minimum biological needs averaged over different categories of population. The national poverty line based on Lakdawala methodology is Rs. 356 per capita per month in rural areas and Rs. 539 per capita per month in urban areas at 2004-05 prices.

It should be noted that, by not taking into consideration other basic needs besides nutrition, incidence of poverty is likely to be underestimated. Therefore measuring poverty on the basis of certain social indicators like life expectancy, illiteracy, etc. is being strongly advocated.

The methodology for estimation of poverty has been reviewed from time to time. The planning commission constituted an expert group under Prof. S.D. Tendulkar in December 2005, which submitted its report in December 2009. The Planning Commission has accepted the recommendations of the Tendulkar
Committee. As per the Tendulkar Committee, the national poverty line at 2004-05 prices was a monthly per capita consumption expenditure of Rs. 446.68 in rural and Rs. 578.80 in urban areas in 2004-05.

2.2.2 Extent and Trends in the incidence of Poverty:

The incidence (or extent) of poverty in India in the recent years is explained below by looking into the estimates of poverty given by the Planning Commission and the World Bank. The incidence of poverty is measured in terms of the percentage of the total population living below the poverty line. In other words, the percentage of population below the specified poverty line is a measure of the incidence of poverty, that is, how many are poor. It brings out the extent of poverty in the country. Several economists and organizations have conducted studies about the extent of poverty in India.

A) PLANNING COMMISSION’S ESTIMATES BASED ON THE LAKDAWALA METHODOLOGY

The Planning Commission has been estimating the incidence of poverty at the national and state levels using the methodology used in the report of the Expert Group on poverty (i.e. Lakdawala Committee). Incidence of poverty has been estimated by the Planning Commission as an integral Component of formulating appropriate growth strategies. The estimates of incidence of poverty at the national level based on Uniform Recall Period (URP) method is given in table 5.1.

<table>
<thead>
<tr>
<th></th>
<th>Rural</th>
<th>Urban</th>
<th>All India</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993-94</td>
<td>37.3</td>
<td>32.4</td>
<td>36.0</td>
</tr>
<tr>
<td>2004-05</td>
<td>28.3</td>
<td>25.7</td>
<td>27.5</td>
</tr>
</tbody>
</table>

The Planning commission’s study on poverty as given table 5.1 brings out the following facts about poverty:
1) **Steady Decline in Poverty:** The incidence of poverty has witnessed a steady decline from 36 percent in 1993-94 to 27.5 per cent in 2004-05.

2) **Wide Rural-Urban Disparities:** Wide disparities are visible in the poverty ratios between rural and urban areas. The poverty ratio is higher in the rural areas than in urban areas.

3) **Poverty Ratios in 2004-05:** The Poverty ratio is estimated at 28.3 percent in rural areas, 25.7 percent in urban areas and 27.5 percent for the country as a whole in 2004-05.

B) **PLANNING COMMISSION'S ESTIMATES BASED ON TENDULKAR COMMITTEE**

The Planning Commission set up an expert group (Tendulkar Committee) to suggest a new poverty line and estimates in December 2005. It submitted its report in December 2009. According to Tendulkar Committee, the poverty line should meet not just food expenditure requirements, but also the basic needs of education and health. It has arrived at a poverty line of Rs. 446.68 per capita monthly consumption expenditure in rural areas and of Rs.578.8 per capita monthly consumption expenditure in urban areas at 2004-05 prices. The committee arrived at new estimates of poverty.

**Table 2.2 : Tendulkar Committee Estimates of Poverty in India (percent)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Rural</th>
<th>Urban</th>
<th>All India</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993-94</td>
<td>50.1</td>
<td>31.8</td>
<td>45.3</td>
</tr>
<tr>
<td>2004-05</td>
<td>41.8</td>
<td>25.7</td>
<td>37.2</td>
</tr>
</tbody>
</table>

According to Tendulkar Committee the poverty in India in 2004-05 was 10 percent more than estimated by Planning Commission, i.e. 37 percent and the rural poverty is 42 percent instead of 28 percent in 2004-05. According to Tendulkar Committee, every third Indian lives below poverty line. These recommendations have been accepted by the Planning Commission.
C) MULTIDIMENSIONAL POVERTY

The Human Development Report 2010 measures poverty in terms of multidimensional poverty index (MPI) replacing the human poverty index (HPI) used since 1997. The MPI indicates the share of the population that is multi-dimensionally poor adjusted by the intensity of deprivation in terms of living standards, health and education. According to this parameter India's MPI is 0.296, The population below poverty line is 41.6 percent in terms of PPP $1.25 day and 28.6 percent in terms of national poverty line. Further India is not favourably placed when compared with countries like China and Sri Lanka and even Pakistan (see Table 5.4).

**Table 2.3 : Multidimensional Poverty Index**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Population Below Income Poverty Line</td>
<td></td>
</tr>
<tr>
<td></td>
<td>PPP $1.25 a day</td>
<td>National Poverty Line</td>
</tr>
<tr>
<td>China</td>
<td>0.056</td>
<td>15.9</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>0.021</td>
<td>14</td>
</tr>
<tr>
<td>India</td>
<td>0.296</td>
<td>41.6</td>
</tr>
<tr>
<td>Pakistan</td>
<td>0.275</td>
<td>22.6</td>
</tr>
</tbody>
</table>


2.2.3 Poverty Alleviation Programmes:

Poverty eradication is one of the major objectives of planned economic development. Economic growth has always been recognized as an important among various factors contributing to poverty alleviation. It is now recognized that it is not the rate of growth but the composition of growth which determines the pace of the "trickle down" effect of growth.

India's anti-poverty programmes are mainly run by the Central Government. There are three main types of poverty alleviation programmes:(1) rural works, (2) self-employment and (3) food subsidy. All three have been subject to reforms in the recent years. Plan allocations have been enhanced in areas of health, education, sanitation and other facilities in order to promote capacity building and wellbeing of the poor. Anti-poverty programmes have been strengthened and restructured through special programmes for the weaker sections of the society.
The major poverty alleviation programmes currently operating in the country are discussed below:

1) **Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGA)** February 2006.

   This flagship programme of the government aims at enhancing livelihood security of households in rural areas by providing at least 100 days of guaranteed wage employment in a financial year to every household whose adult members volunteer to do unskilled manual work. For the year 2011-12, Rs. 40,000 crore has been allotted for this programme. This has led to substantial increase in the purchasing power and has strengthened the livelihood resource base of the rural poor in India.

   During the year 2011-12, 3.80 crore households have been provided employment under the scheme till January 2012. At national level, the average wage paid under the MGNREGA has increased from Rs. 65 in 2006-07 to Rs. 120 in 2011-12.

2) **Swarnajayanti Gram Swarojgar Yojana (SGSY):** April 1999.

   It is a major ongoing scheme to help the poor rural families to cross the poverty line by assisting them to take up income-generating economic activities through a mix of bank credit and government subsidy. The scheme involves selection of key activities, planning of activity clusters, organization of the poor into self-help groups (SHGs) and building of their capacities through training and skill development, creation of infrastructure and technological and marketing support. SGSY was introduced by amalgamating former self employment programmes into a single self employment programme. Since inception of the scheme in April 1999 up to December, 2011, 42.05 lakh self-help groups (SHGs) have been formed and 168.46 lakh swarojgars have been assisted with bank credit and subsidy. The total, investment under the SGSY is Rs. 42,168.42 crore.

   **NRLM:** The SGSY has now been restructured as the National Rural Livelihood Mission (NRLM). The NRLM aims at reducing poverty by enabling poor households to access gainful self-employment and skilled wage employment opportunities.
3) **Sampoorna Grameen Rozgar Yojana (SGRY):** Sept. 2001

The objective of SGRY is to provide additional wage employment along with food security, creation of durable community, social and economic assets and infrastructure development in the rural areas. The schemes of Jawahar Gram Samridhi Yojana (JGSY) and Employment Assurance Scheme (EAS) have been fully integrated with SGRY. SGRY programme in many districts has been included in National Rural Employment Guarantee Scheme (NREGS) during 2006-07 and 2007-08. Since April 2008, SGRY programme is part of National Rural Employment Guarantee Scheme (NREGS).

4) **Pradhan Mantri Gramodaya Yojana (PMGY):**

It was launched in 2000-01 in all states and the Union Territories (UTs) in order to achieve the objective of sustainable human development at the village level. The PMGY gives additional central assistance to states and UTs for selected basic minimum services in order to focus on certain priority areas. Initially, it focused on five critical areas, i.e., primary health, primary education, rural shelter, rural drinking water and nutrition. Rural electrification has been added as an additional component from 2001-02.

5) **Pradhan Mantri Gram Sadak Yojana (PMGSY):** Dec. 2000

It is a 100 percent centrally sponsored scheme. It is a programme to provide road connectivity through good all weather roads to all the eligible unconnected rural inhabitants. 1,42,750 kms. of road works had been completed till December 2007 and an expenditure of Rs. 27,382 crore has been incurred.

6) **Antyodaya Anna Yojana:** Dec. 2000

It provides foodgrains at a highly subsidized rate of Rs. 2 per kg for wheat and Rs. 3 per kg for rice to the poor families under the Targeted Public Distribution System. Initially 25 kgs of foodgrains was made available to each family per month. This quantity has been increased to 35 kgs with effect from April 2002.

7) **Swarna Jayanti Shahari Rozgar Yojana (SJSRY):** 1997 Revised in April 2009

It aims at providing gainful employment to urban unemployed or underemployed poor by encouraging the setting up of self-employment ventures or provision of wage employment. It replaced various programmes operated earlier for urban poverty
alleviation. It is being funded on a 75 : 25 basis between centre and the states. The budget allocation for the SJSRY scheme for 2011-12 is Rs. 813 crore. A total of 3,63,794 beneficiaries have been assisted in the year 2011-12.

8) **Indira Awaas Yojana (IAY) : 1999-2000.**

It aims at providing dwelling units, free of cost, to the poor families of the Scheduled Castes (SCs), Scheduled Tribes (STs), freed bonded labourers and also the non-SC/ST persons below the poverty line in the rural areas. Upto December 2006, about 153 lakh houses had been constructed or upgraded with an expenditure of Rs. 29,246 crore.

9) **Annapurna Yojana : 2000.**

It aims at providing food security to meet the requirements of those senior citizens who, though eligible for pensions under the National Old Age Pension Scheme, are not getting the same. Foodgrains are provided at a subsidized rate. It is a 100 percent centrally sponsored scheme.

10) **Valmiki Ambedkar Awas Yojana (VAMBAY) : Dec. 2001**

It seeks to improve the conditions of the urban slum dwellers living below the poverty line who do not possess adequate shelter. The primary objective of this scheme is to facilitate construction and upgradation of dwelling units for the slum dwellers. A component of the scheme is to provide a healthy environment through community toilets.

11) **National Food For Works Programme (NFFWP) : Nov.2004**

This programme is open to all rural poor who are in need of wage employment and desire to do manual unskilled work. It is implemented as a 100 per cent centrally sponsored scheme and the food grains are provided to the states free of cost.

12) **Rural Employment Generation Programme (REGP) :**

It was launched in 1995 with the objective of creating self employment opportunities in the rural areas and small towns. Since the inception upto March 2004, 1.86 lakh projects have been financed and 22.75 lakh job opportunities have been created.
13) Prime Minister's Rozgar Yojana (PMRY):

It was started in 1993 with the objective of creating self employment opportunities to the educated unemployed youth by assisting them to set up any economically viable activity.

14) Public Distribution System and its impact on Poverty:

The Public Distribution System (PDS), seeks to enhance food security particularly for the economically weaker sections of the society. The PDS is the instrument for ensuring availability of certain essential commodities at easily affordable prices especially for the poor. A well targeted and properly functioning public distribution system (PDS) is an important constituent of the strategy for poverty alleviation. PDS with a network of about 4.74 lakh. Fair Price Shops (BPS) is perhaps the largest Distribution network of its type in the world.

In order to make PDS more responsive to the needs of the poor, the Targeted Public Distribution System (TPDS) was introduced in June 1997. This system attempts to target families below the poverty line (BPL) at heavily subsidized rates.

2.2.4 Limitations of Poverty Alleviation Programmes:

The poverty alleviation programmes in India have been criticized on following grounds:

1) **Failed to Provide Employment:** Various schemes of poverty alleviation have failed to provide employment. Our employment programmes have not realized their potential.

2) **Failure with respect to Disabled:** The poverty alleviation programmes have failed to do justice to disabled who cannot participate in normal economic activities and to women.

3) **Meagre Government Spending:** The spending by the central government on all poverty alleviation programmes amount to about to 6 to 7 percent of total government of India's budgetary expenditure, or 1 percent of GDP. This spending of central government on poverty eradication programmes is considered to be very meagre (less).

4) **Ignore Consequences of Activities:** The poverty alleviation schemes also ignore consequences of earning activities of the poor in terms of health hazards and pollution problems.
5) **Lack of Adequate Income** : Income and employment-oriented poverty alleviation programmes did not provide adequate income to meet even adequate food requirements.

6) **Inadequate Self-employment Programmes** : The self-employment and wage employment guarantee programmes may not be justified with increasing population pressures.

7) **Other Factors** : Lack of political will, unequal distribution of income and administrative inefficiency are also responsible for the poor performance of the various schemes.

On account of above reasons the impact of the poverty alleviation programmes have been very modest in scale and very ineffective. A proper growth strategy will create more job opportunities in the rural areas. It will give more importance to accumulation of human capital by the poor by addressing the inefficiencies and inequalities in the health and education sector.

### 2.3 CONCEPT OF INEQUALITY

It is the ownership of factors of production i.e. land and capital or the ability to render services i.e. labour of different types and the ability to organize business activities that enable people to earn income. Income earned by people however is not the same. For various reasons which we will discuss later, there is a vast difference in the amount of income earned.

Equitable distribution of income takes place when people receive income according to their needs and abilities. In reality, everywhere, especially in market oriented economies, a majority gets a small share of the national income and a small minority appropriates a large share. Studies by Simon Kuznets, and Irma Adelman & Cynthia Morris reveal the income inequality in different countries. According to Kuznets, the process of industrialization and urbanization lead to worsening of income distribution in developing countries because in the early stages, growth is concentrated in the modern sectors. However as development progresses inequality is reduced.

Recent studies by professor Deepak Lal have not supported the Kuznets and Adelman-Morris conclusions. His study suggests a strong general relationship at all phases between growth and inequality reduction. Another study by G Fields in 1991 concludes that:
(i) In most of the cases poverty decreases as growth increases and inequality tends to shrink rather than widen.  
(ii) Faster the rate of growth, quicker is the reduction in inequalities.  
(iii) There is no clear relationship between the degree of inequality in the initial phase and subsequent rate of growth.

### 2.3.1 Extent of Income Inequality In India:

Distribution of income is unequal in India as it is in all other countries. In the post independent period under the Five Year Plans the government has devised various means to reduce extreme inequalities in our economy. Various measures implemented made their impact felt by reducing the inequality to a certain extent both at the bottom and top levels. Inequality in the distribution of income is reflected in the percentage shares of income or consumption accruing to portions of the population ranked by income or consumption levels. The portions ranked lowest by personal income receive the smallest shares of total income. The Gini index provides a convenient summary measure of the degree of inequality.

### 2.3.2 Income Distribution:

The income inequality prevailing in the country is given in Table 6.1. The distribution of income in our country is inequitable as it is the case elsewhere. The bottom 20 percent receive about 8 percent of the national income and the top 10 percent about 31 percent in 2004-05.

<table>
<thead>
<tr>
<th>Population (percent)</th>
<th>2004-05</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-20 (bottom 20%)</td>
<td>8.1</td>
</tr>
<tr>
<td>81-100 (top 20)</td>
<td>45.3</td>
</tr>
<tr>
<td>91-100 (top 10)</td>
<td>31.1</td>
</tr>
</tbody>
</table>


Income distribution studies conducted in India by RBI, NCAER, P.O. Ohjia & V.V. Bhatt, etc. & also data from World Bank and other sources indicate that the income is inequitably distributed. The bottom 40 percent of the population receive about
20 percent of the total income whereas the top 40 percent have 
more than 60 percent of the income. The bottom and top 20 
percent reveal extreme inequalities. The top 10 percent receive 
more income than the bottom 40 percent. Over a period of time, 
inequalities tend to reduce along with development. Comparative 
Analysis of income distribution shows that there is no much 
difference in inequalities between the developed and developing 
countries.

2.3.3 Rural-Urban Inequality:

Iyenger and Brahmananda’s Study: Inequality in income 
distribution is studied not only on the basis of household groups 
throughout the economy but also on the basis of rural and urban 
sectors. They have calculated Gini-Lorenz ratios of the distribution 
of nominal per capita household consumption expenditure based 
on NSS data. It is given in table 6.2.

Table 2.5: Plan wise Average Gini-Lorenz Ratio

<table>
<thead>
<tr>
<th>Plan</th>
<th>Rural</th>
<th>Urban</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>(1951-56)</td>
<td>0.34</td>
</tr>
<tr>
<td>Second</td>
<td>(1956-60)</td>
<td>0.33</td>
</tr>
<tr>
<td>Third</td>
<td>(1961-65)</td>
<td>0.33</td>
</tr>
<tr>
<td>Fourth</td>
<td>(1969-73)</td>
<td>0.31</td>
</tr>
<tr>
<td>Fifth</td>
<td>(1974-79)</td>
<td>0.31</td>
</tr>
<tr>
<td>Sixth</td>
<td>(1980-84)</td>
<td>0.30</td>
</tr>
</tbody>
</table>

Their study reveals that:
i) The Gini Lorenz Ratios for both rural and urban sectors were 
higher in the 1950 than in the 1960s and thereafter.
ii) The Gini Lorenz Ratio by and large remained constant since 
1966 both in rural and urban sectors. The ratios stabilized 
around 0.30 and 0.33 in the respective sectors.
iii) The inequalities in both the sectors have not increased since 
1960s.
iv) Between the two sectors inequalities have been more in the 
urban than in the rural sector.

The above conclusions have not been accepted by all. The 
results are based on consumption data than the income data. The 
consumption data, it is argued, do not reveal the true picture, as a 
substantial part of the consumption of the higher income group is
not disclosed. The disparities in consumption expenditure as revealed by Iyenger and Brahmananda have remained constant since the mid 1960s. It is unclear why the consumption inequality has remained constant. As the income has been distributed in favour of the poor, it is natural that their consumption should have gone up due to the higher marginal propensity to consume among them. It is unlikely that the rich would reduce their consumption as the rich usually stick to the consumption standard that they have been accustomed to. Such a situation should have succeeded in bringing down the consumption disparities.

Hashim’s Study:

According to S.R. Hashim, income distribution in India as reflected by household consumption expenditure shows remarkable stability over the period 1951-52 to 1993-94. Lorenz ratio of consumption expenditure distribution for urban area has remained stable over this period, varying between 0.33 and 0.37 but without showing a trend over time. This can be seen from Table 2.6. Agricultural growth and stability have contributed to this.

<table>
<thead>
<tr>
<th>Year</th>
<th>Rural</th>
<th>Urban</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960-61</td>
<td>0.32</td>
<td>0.35</td>
</tr>
<tr>
<td>1970-71</td>
<td>0.28</td>
<td>0.33</td>
</tr>
<tr>
<td>1983-84</td>
<td>0.30</td>
<td>0.33</td>
</tr>
<tr>
<td>1990-91</td>
<td>0.27</td>
<td>0.33</td>
</tr>
<tr>
<td>1993-94</td>
<td>0.28</td>
<td>0.34</td>
</tr>
</tbody>
</table>

Table 2.6 : Lorenz Ratio of Consumption Expenditure Distribution


NSSO Study: NSSO has estimated the Lorenz ratio based on household consumption expenditure for the year 2004-05. A lower ratio implies a more equal distribution, while higher ratio implies unequal distribution.

Table 2.7 : Lorenz Ratio Based on Household Consumption Expenditure in 2004-05

<table>
<thead>
<tr>
<th></th>
<th>Lorenz Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural India</td>
<td>0.30</td>
</tr>
<tr>
<td>Urban India</td>
<td>0.37</td>
</tr>
</tbody>
</table>

Source: Economic Survey, 2010-11
Thus, the NSSO study clearly shows that the inequality is higher in urban India than in rural India.

Wide Rural - Urban Disparities in Inequality among the States:

According to Economic Survey 2010-11, lower inequality was seen in rural areas of Assam (0.197), Meghalaya (0.155) and Manipur (0.158) than in Kerala (0.341), Haryana (0.323), Tamil Nadu (0.315) and Maharashtra (0.310). Similarly, lower inequality was seen in urban areas of Arunachal Pradesh (0.243), Jammu and Kashmir (0.244), Meghalaya (0.258) and Manipur (0.175) than in Chattisgarh (0.439), Goa (0.405), Kerala (0.400) and Madhya Pradesh (0.397).

2.3.4 Policy Measures To Reduce Inequality:

It is necessary for the government to formulate and implement certain policy measures to mitigate inequality in income distribution. The measures may be in the form of:

1) Fiscal Measures: Fiscal policy through its budgetary instruments can attempt to redistribute income. The important instruments are:

   a) Progressive Direct Taxes: Income tax, wealth tax, capital gains tax, gift tax and estate duty, when levied in a progressive manner, help withdraw more money from the rich. The poor will be exempted from these taxes by exempting minimum income or wealth from tax. The success of all these tax instruments depends on its effective implementation. Loopholes in tax laws enable the taxpayers to legally avoid tax payments. If tax evasion cannot be checked effectively, income inequalities may aggravate.

   b) Subsidies: Cost of agricultural inputs like fertilizers, water supply, electricity, pumps and other equipment can be subsidized so that small and marginal farmers may produce more. Measures should be taken to safeguard the misuse of subsidies. Education and medical services can be provided to those below poverty line at a highly subsided rate or almost free.

   c) Indirect Taxes: Taxes on commodities and services may turn out regressive if they are levied indiscriminately. They may help reduce inequality if such taxes are selective. Consumer durables, specially the luxurious ones like air conditioners, cars etc. and services in five star hotels, when taxed heavily help to mop up excess income of the top rich.
2) Monetary Measures: One of the reasons why the bottom section of the income group has remained so poor is their inability to acquire money capital for improving their income. Monetary policy through discriminatory rate of interest can provide the minimum required money capital at a very low rate of interest. Treating them under the priority sector will help those secure loans at the right time with minimum and simple procedure.

3) Public Distribution System: The real income of the bottom income group could increase if they are supplied with essential consumer items through ration and fair price shops. Such public distribution should be confined only to the lowest income group.

4) Social Security Measures: The low income group comprise agricultural and industrial labourers, old people without any regular source of income and the unemployed. Social security measures go a long way in providing either minimum or some additional income to supplement their meagre income. The social security may comprise:

   (i) Old Age Pension: Old people with no source of income can be provided a regular monthly income by the government to enable them to subsist.

   (ii) Unemployment Benefits: With the increasing number of unemployed vis-a-vis limited employment opportunities the government is expected to support the jobless.

   (iii) Social Security Insurance: Under this scheme, workers and their dependants are covered. The scheme can also be accepted by households voluntarily for a price, even by those who belong to higher income group. Medical, disablement and maternity benefits are provided under this schemes.

5) Employment Schemes: Employment in rural and urban areas are provided through various schemes like National Food for Works Programme, (SGSY), (SGRY), (PMGY), and many other schemes. In order to wipe out absolute poverty and extreme inequality it is necessary that the government provide permanent employment to at least one member of an absolutely poor family.

6) Institutional Changes: Land reforms are the example of institutional changes whereby land is distributed among the landless and ownership is given to the tiller. Such institutional reforms bring a change in the distribution of income earning assets in favour of the poor.
7) Self Employment: Unemployed specially the educated can be trained and assisted to set up tiny, cottage and small industries, service oriented jobs like electricians, machine repairers etc. Promoting self employment schemes besides providing employment reduces inequality too.

8) Rural Development: Rural India has a larger share of unemployment and poverty. The situation leads to the migration of people to the urban area aggravating the urban problems. Promoting rural development through providing infrastructure and rural industrialization would help preventing migration, providing employment and reduction in economic inequality.

All these measures cannot bring a lasting solution to the inequality of income distribution. In our country these measures must be combined with rapid economic growth and effective control of population growth in order to have the desired result. Otherwise we may end up distributing poverty instead of promoting equality.

2.4 UNEMPLOYMENT IN INDIA

The problem of unemployment, as the problem of poverty, is considered to be a biggest challenge to development planning in India. A high rate of unemployment in rural areas is expected to accelerate migration to urban areas and it is likely to increase the pressure on limited infrastructure. At the same time, the capability of the state to create jobs for people in general or even for certain vulnerable sections of population is extremely limited in the present climate of economic liberalization.

2.4.1 Nature of Unemployment in India:

In India the unemployment is a multi-dimensional phenomenon. It is a widespread problem affecting almost every segment of the society. The nature of unemployment in the country is analysed by classifying the unemployment into 1) Rural Unemployment and 2) Urban unemployment.

1. Rural Unemployment:

Since large percentage of Indian population reside in the rural sector with the main occupation as agriculture and allied activities. The rural unemployment is generally divided into Disguised, Seasonal and Open Unemployment.

(a) Disguised Unemployment: It is a state of unemployment in which more people are engaged in agricultural operations than required. The marginal productivity of such workers is zero. It means that all the workers are not needed to maintain the existing level of production.
(b) **Seasonal Unemployment:** Agriculture by its very nature is a seasonal activity. For a significant part of the year the Indian farmers are out of work. In the absence of supplementary sources of employment, they remain unemployed during the slack agricultural season.

(c) **Open Unemployment:** Those who do not have any work come under this category.

They are able and willing to work, but there is no work for them. Such unemployment is in the nature of involuntary idleness. With the decline of cottage industries and handicrafts, many rural people have no alternative means of livelihood.

The main causes responsible for rural unemployment are high growth rate of population, illiteracy, dependency on monsoon, lack of rural development and infrastructural facilities, lack of mobility of people, and so on.

2. **Urban unemployment:**

In urban areas, the main occupations are related to secondary and tertiary sectors in which generally semi skilled and skilled labourers are engaged. The main two types of unemployment in the urban sector are industrial and educated unemployment.

(a) **Industrial Unemployment:** Industrial unemployment is the result of slow growth of industrial development vis-a-vis growth of labour force. Further, unemployment in the industrial sector has increased due to low growth rate of employment in the organised sector.

(b) **Educated Unemployment:** An important aspect of urban unemployment is the lack of job opportunities for the educated people. With increasing literacy level, the problem of educated unemployment is becoming severe.

2.4.2 **Extent of Unemployment in India:**

In India the National Sample Survey Organization (NSSO) provides information about unemployment and employment. The NSSO uses three different concepts:

(i) **Usual Principal Status (UPS) unemployment:** It is measured in number of persons. It shows number of persons who remained unemployed for the major part of the year. The UPS unemployment rate is regarded as the measure of chronic open unemployment during the reference year.
(ii) **Current Weekly Status (CWS) unemployment**: It is also measured in number of persons. It shows the number of persons who did not find even an hour of work during the survey week. It is also a measure of chronic unemployment, but with reduced reference period of a week.

(iii) **Current Daily Status (CDS) unemployment**: It is measured in person days. It shows the number of persons who did not find work on a day or some days during the survey week. The CDS captures the unemployed days of the chronically unemployed, the unemployed days of the usually employed who become intermittently unemployed during the reference week and unemployed days of those classified as employed according to the current weekly status criterion.

The extent of unemployment in India is explained below:

1. **Magnitude of Unemployment**: The magnitude of unemployment has brought out by various rounds of NSSO Surveys. Table 7.1 indicates that the CDS estimate of unemployment is the highest. The higher unemployment rates according to the CDS approach compared to the weekly status and usual status approaches indicates a high degree of intermittent unemployment. It can also be observed from Table 7.1 that overall unemployment rates were lower in 2009-10 under each approach as compared to 2004-05.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1 UPSS</td>
<td>1.6</td>
<td>3.4</td>
<td>2.0</td>
<td>2.3</td>
</tr>
<tr>
<td>2 CWS</td>
<td>3.3</td>
<td>4.2</td>
<td>3.6</td>
<td>4.4</td>
</tr>
<tr>
<td>3 CDS</td>
<td>6.8</td>
<td>5.8</td>
<td>6.6</td>
<td>8.2</td>
</tr>
</tbody>
</table>

*Source: Economic Survey 2011-12.*

2. **Unemployment rates in rural and urban areas**: Unemployment rates are traditionally higher in urban areas than in rural areas. However, according to 66th Round NSS in 2009-10, urban unemployment was higher under the UPS and CWS but rural unemployment was higher under the CDS approach (see Table 7.1). This may indicate that there is higher intermittent or seasonal unemployment in rural than urban areas. In the urban areas the greater dominance of the
organised sector forces people to be either employed or unemployed.

3. **Higher and Increasing unemployment incidence among females**: The incidence of unemployment is significantly higher among females than males, both in rural and urban areas.

   **Table 2.9 : Unemployment rates (by UPS) (percent)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Rural Males</th>
<th>Rural Females</th>
<th>Urban Males</th>
<th>Urban Females</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993-94</td>
<td>2.0</td>
<td>1.4</td>
<td>4.5</td>
<td>8.3</td>
</tr>
<tr>
<td>2004-05</td>
<td>2.1</td>
<td>3.1</td>
<td>4.4</td>
<td>9.1</td>
</tr>
</tbody>
</table>


4. **Unemployment Across age groups**: According to Planning Commission, higher unemployment rates in the younger age group reflect the phenomenon that new entrants into the labour force, except those from the lowest income groups, may be more likely to wait until they find a job which matches their aspirations.

   **Table 2.10 : Unemployment rates on CDS basis across age groups (percent of labour force)**

<table>
<thead>
<tr>
<th>Age (years)</th>
<th>1993-94</th>
<th>1999-2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>15-29</td>
<td>10.1</td>
<td>12.1</td>
</tr>
<tr>
<td>All age</td>
<td>6.0</td>
<td>7.3</td>
</tr>
</tbody>
</table>


5. **Unemployment by the level of Education**: Unemployment rate of graduate and above female population is much higher in rural areas than in urban areas. This indicates lack of opportunities in rural India and lack of mobility of this population segment.

6. **Unemployment among Educate Youth**: The unemployment rates on the usual status basis among the educated youth are given in Table 7.4
Table 2.11: Unemployment rates among Educated Youth (15-29 years) on US Basis

<table>
<thead>
<tr>
<th>Year</th>
<th>Secondary and above</th>
<th>Education and above</th>
<th>All types of Technical Education</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993-94</td>
<td>18.5</td>
<td></td>
<td>27.3</td>
</tr>
<tr>
<td>1999-2000</td>
<td>14.8</td>
<td></td>
<td>23.7</td>
</tr>
</tbody>
</table>


The high rate of unemployment among the educated youth is the core of the problem because it creates a sense of despair across a wide section of the population including not only the educated youth but their parents and families.

7. **Wide variations in unemployment across states**: The rate of unemployment varies sharply across states. This is shown in Table 7.5.

Table 2.12: Unemployment Rates (per 1000) in Major States in 2009-10
(According to Usual Status Adjusted)

<table>
<thead>
<tr>
<th>States</th>
<th>Rural</th>
<th>Urban</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Andhra Pradesh</td>
<td>12</td>
<td>31</td>
</tr>
<tr>
<td>2. Assam</td>
<td>39</td>
<td>52</td>
</tr>
<tr>
<td>3. Bihar</td>
<td>20</td>
<td>73</td>
</tr>
<tr>
<td>4. Gujarat</td>
<td>8</td>
<td>18</td>
</tr>
<tr>
<td>5. Haryana</td>
<td>18</td>
<td>25</td>
</tr>
<tr>
<td>6. Himachal Pradesh</td>
<td>16</td>
<td>49</td>
</tr>
<tr>
<td>7. Karnataka</td>
<td>5</td>
<td>27</td>
</tr>
<tr>
<td>8. Kerala</td>
<td>75</td>
<td>73</td>
</tr>
<tr>
<td>9. Madhya Pradesh</td>
<td>7</td>
<td>29</td>
</tr>
<tr>
<td>10. Maharashtra</td>
<td>6</td>
<td>32’</td>
</tr>
<tr>
<td>11. Odisha</td>
<td>30</td>
<td>42</td>
</tr>
<tr>
<td>12. Punjab</td>
<td>26</td>
<td>48</td>
</tr>
<tr>
<td>13. Rajasthan</td>
<td>4</td>
<td>22</td>
</tr>
<tr>
<td>14. Tamil Nadu</td>
<td>15</td>
<td>32</td>
</tr>
<tr>
<td>15. Uttar Pradesh</td>
<td>10</td>
<td>29</td>
</tr>
<tr>
<td>16. West Bengal</td>
<td>19</td>
<td>40</td>
</tr>
<tr>
<td>All India</td>
<td>16</td>
<td>34</td>
</tr>
</tbody>
</table>

8. **Extent of Underemployment:** Under-employment arises due to two kinds of factors. First, the labour time of a person classified as employed over the reference period may not be utilized fully. This kind of under-employment among the employed persons is *visible* and hence, it is called visible underemployment. Second, the income from work, over the reference period, is not adequate and, hence, it causes under-employment. Such underemployment is referred to as *invisible* under-employment.

On the basis of CWS we can observe the following trends in under-employment.

(i) The under-employment rate declined gradually with a faster rate in general, and for females in particular.

(ii) The problem of under-employment is seen to be more serious among usually employed females than among employed males and more in rural than in urban areas.

### 2.4.3 Causes of Unemployment:

The important causes of unemployment are the following:

1. **Population Growth and Increase in Labour force:** The most important cause of unemployment is of course the population explosion, which in turn causes an increase in labour force. In rural areas agriculture is becoming more crowded without the corresponding increase in productivity. Indian agriculture has thus become a reservoir of ever increasing underemployed and surplus population.

<table>
<thead>
<tr>
<th>Year</th>
<th>Labour Force (in million)</th>
<th>Period</th>
<th>Growth in Labour Force (percent per annum)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>263.82</td>
<td>1983 to 1993 -94</td>
<td>2.28</td>
</tr>
<tr>
<td>2004-05</td>
<td>419.65</td>
<td>1999-2000 to 2004-05</td>
<td>2.84</td>
</tr>
<tr>
<td>2009-10</td>
<td>428.9</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


2. **Inappropriate Technology:** The increasing population and labour force against inadequate supplies of capital inputs has
made Indian economy labour abundant and capital scarce. The technologies used in many sectors are capital intensive. These distortions lead to hiring of more capital and less labour worsening the employment situation.

3. **Inappropriate Educational System**: The Educational system of India is still inappropriate. The physical capacity of the existing training institutes is limited and the quality of the training provided is also not up to the mark. Training courses in government run institutes are often not sufficiently reflective of market demand.

4. **Slow Economic Growth**: The overall economic development in Indian economy has not been adequate to create sufficient employment opportunities in the country. Thus, job creations were always falling short of the number of job seekers causing backlog of unemployment.

5. **Lack of Infrastructural Facilities**: Lack of transportation, electricity, etc. creates Underutilized capacity. This means that even if the productive unit has capacity to achieve 100% employment, but due to lack of infrastructure, it is unable to provide more employment.

6. **Protective Labour Laws in India**: Since Independence, labour laws for the workers in the organised sector in India have mainly emphasized worker protection and welfare. In the public sector, there is little incentive to work hard which results in poor productivity. If we want a rapid increase in employment and in real earnings per employee, then there is an urgent need to reform the labour laws in India.

**2.4.4 Policy Strategies for Employment Generation in India:**

The policy strategy to generate employment must try to achieve two objectives.

1. Create more employment opportunities to absorb the net addition to the labour force.

2. Improve the quality of existing employment in several sectors so that real wages rise through improved productivity.

The Planning Commission’s Task Force on Employment Generation has recommended the following policy strategy for employment generation.

1. **Accelerating Economic Growth**: The higher the rate of economic growth, the larger will be the resultant employment.
Achieving a growth rate of 8 and sustaining the growth of rate into the future over a period 10 years will require an appropriate macro-economic policy framework.

2 **Sector Specific Policies:** It is necessary to focus on policies in specific sectors which are critical for employment generation and for the quality of employment. Thus, special policy intervention is needed in sectors such as agriculture and allied activities, Food Processing, Small-scale industries (SSIs), & Services Sector.

3. **Special Employment Programmes:** There should be special programmes catering to the specific needs of landless labourers, marginal farmers, village artisans, tribal people living in remote areas of the country and also people in hilly areas.

4. **Skill Development and Reforms in Educational System:** Focused training will help to improve the capabilities of labour force. As the economy grows and diversifies, we will need people with varied skills.

5. **Improving employment situation in poorer states:** A regionally balanced employment strategy requires a much faster growth rates of state domestic product in the poor states.

6. **Reform of Labour Laws:** Our labour laws are widely regarded as being too rigid.

   They therefore have the effect of discouraging growth of employment in the organised sector. Such reforms in labour laws can generate more employment and higher earnings per employee.

**Conclusion:** Accelerating growth is essential to expanding employment opportunities. We need to take measures both from the demand and supply sides in order to generate more employment.

2.4.5 **Government Policies to generate Employment:**

   The government has been financing various types of special programmes designed to create additional employment opportunities to supplement the employment generated by the economy in the normal course. Some of the important programmes explained below:-

1. **Employment programmes for the Rural Poor:** The major ongoing employment programme for the rural poor are the Swarnajayanti Gram Swarozgar Yojana (SGSY), which is a self employment programme involving merger of the erstwhile IRDP and various component programmes, and Sampoorna
Grameen Rozgar Yojana (SGRY), which is a wage employment programme involving integration of the schemes of Jawahar Gram Samriddhi Yojana (JGSY) and Employment Assurance Scheme (EAS). National Food For Work Programme (NFFWP), Rural Employment Generation Programme (REGP), The Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS).

2. Employment Programmes For the Urban Poor: Along with the effort in rural areas, there have been special employment programmes for urban areas focusing on both wage employment as well as self employment for the urban poor. This will help them to gain collective strength to tackle the issues of poverty facing them and participate in the effective implementation of urban poverty alleviation programmes.

3. Self Employment for Educated Youth: In addition to the above programmes strategy was also tried to provide employment opportunities for growing number of educated youth who may not be from poor families but who face severe difficulties in finding gainful employment.

4. Khadi and Village Industries: An important element in the Government's strategy to promote employment in rural areas is the support provided for Khadi and for a number of traditional village industries including beekeeping, handmade paper, ghari oil, pickle, masala, dalia, aggarbatthi, leather products, soap, etc.

5. Other Programmes: Other programmes of centre and states which are primarily for generating self employment among special sectors of labour force are:

   i) National Minorities Finance and Development Corporation
   ii) National Backward Classes Finance and Development Corporation
   iii) National SC/ST Finance and Development Corporation
   iv) National Handicapped Finance and Development Corporation
   v) Support for Training and Employment Programme, and
   vii) National Credit Fund for Women.

2.5 MEANING OF INFLATION

Inflation is a persistent rise in the general price level rather than a once-for-all rise in it. Inflation is one of the most closely monitored economic variable in India since it has considerable impact on the average consumers. Inflation refers to a general rise in prices.
Price stability is an essential condition for economic growth and well-being of the people. Inflation is estimated as the percentage rate of change in a price index over the reference time period. The variations in prices and hence inflation are usually measured in terms of the wholesale price index (WPI) or consumer price index (CPI). In India inflation is measured in terms of WPI.

The Central Statistic Office (CSO), Ministry of Statistics and Programme Implementation, has introduced a new CPI series on base 2010 = 100 for All-India separately for rural, urban and combined with effect from January 2011.

**Headline Inflation:** It is a measure of total inflation within an economy taking into consideration all the commodity groups in the price index. Thus, in India it is shown by WPI inflation. Headline inflation is more useful for households because it reflects changes in the cost of living, while core inflation is used by central banks. The WPI has three commodity groups: (a) primary articles, (b) fuel, power, light and lubricants and (c) manufactured products with respective weights of 20.12 percent, 14.91 percent and 64.97 percent respectively.

**Core Inflation:** It is a measure of inflation that excludes items that face volatile price movements, specially food and energy. Therefore, it is a preferred tool for framing long-term policy. The core inflation was 0.55 percent in November 2009. It increased to 8.07 percent in April 2010. Some economists criticize using core inflation as measure of inflation. As food and fuel are important items for consumption they should not be excluded from the inflation measure. Therefore, policy makers focus on both headline and core inflation for their policy making.

**Food Inflation:** It can be defined as the consistent rise in the prices of food items. The food price index consists of two sub-components, namely primary food articles and manufactured food products. The overall weight of the composite food index in the WPI is 24.31 percent, comprising primary food articles with a weight of 14.34 percent and manufactured food products with a weight of 9.97 percent. The primary food articles inflation was very high during 2009-11. It remained at an average level of 16.75 percent in 2010-11 and 15.27 percent in 2009-10, mainly due to rise in prices of fruits and vegetables, milk, eggs, fish and meat. During 2011-12, the major drivers of food inflation were milk, egg, meat, fish and edible oils.
2.5.1 Causes of Inflation in India:

Inflation, at the macro level, can be traced to imbalances in aggregate demand and supply. Some of the important factors which is responsible for inflation in India are explained below.

1. **Fluctuations in agricultural output**: Agricultural growth is characterized by sharp fluctuations and remains vulnerable to the vagaries of nature. Such fluctuations in the output of foodgrains in certain years were a major factor in the rise of foodgrains prices as well as of general prices.

2. **Hoardings of essential commodities**: There is also an upward pressure on agricultural prices due to large hoardings by farmers, middlemen, traders and black marketers and even by farmers too.

3. **Rise in oil prices and rise in global commodity prices**: Inflationary pressures were also created by rise in the price of crude oil. Persistently high international crude petroleum prices, during the calendar of 2011, averaging around US $ 111 per barrel as compared to US $ 80 per barrel in 2010 has contributed to domestic inflation.

4. **Upward revision of administered prices**: There has been regular upward revision of several administered prices of petrol, diesel, steel, cement, coal, etc. This had created cost push inflation in the country.

5. **Agricultural price policy of the government**: In order to provide incentive to the farmers the government has been announcing price support for various agricultural products. The minimum support price (MSP) system has also an important role on the prices. During 2000-01 to 2006-07, the rise in the basic MSP had been gradual, in 2008-09 the MSP in almost every crop had witnessed increases of about 30 percent or more.

6. **Rise in government expenditure**: The government expenditure has been steadily rising in India. This has led to growing public demand for goods and services and consequent rise in prices.

7. **Rising fiscal deficit**: Rising fiscal deficit is an important cause of inflation. Large fiscal deficits of the government are met by borrowing from the banking system. This tends to increase the money supply in the economy and hence raise the demand in the economy.
9. **Black money:** There is large unaccounted money in the hands of tax evaders, builders, corrupt politicians, government servants and so on. A large part of it is used for hoarding of many essential good such as cereals, pulses, sugar, edible oil, etc. Thus, black money does play an important role in pushing up the prices.

10. **Huge capital inflows:** The growing integration of the Indian economy with the rest of the world has led to large capital inflows. This has led to rise in liquidity and consequent effect on demand and price levels in the economy in certain years during the post reform period.

11. **Structural shift in the consumption pattern of consumers:** According to Engel's Law, as the consumers become richer their consumption pattern changes leading to an increase in consumption of protein-rich commodities like fish, meat, eggs and mille The NSSO surveys have shown such shift in consumption pattern in India leading to rise in demand and prices of such goods.

    Thus, Inflation in India is structural as well as a monetary phenomenon. In the medium to long-term, the movements of monetary aggregated such as money supply and interest rates have influenced aggregate demand and consequently the changes in price levels in the economy.

### 2.5.2 Measures To Control Inflation:

Inflation must be controlled at an appropriate level. Uncontrolled inflation may turn into hyper inflation. Control of inflation requires a combination of monetary, fiscal and other measures.

1) **Monetary measures:**

   An increase in money supply without the corresponding increase in supply of goods and services creates excess demand causing inflation. Monetary authorities through monetary instruments could increase the cost of credit and reduce the money supply. For this purpose the central bank of the country applies **quantitative** and **qualitative** methods.

**Quantitative instruments:** They are bank rate, repo rate, open market operations, CRR, SLR and selective credit controls. Increase in bank rate, repo rate CRR, SLR and open market sale of securities can make money costlier, reduce the quantity of money in circulation and limit the ability of commercial banks to create credit.
Selective credit controls: These measures comprise of margin requirements, consumer credit controls, directives, rationing of credit and any other method whereby a selective approach can be adopted in supplying credit. Selective credit controls discriminate in favour of essential activities and discourage demand for credit for non-essential uses.

Monetary measures by themselves are not enough to control inflation. The RBI has taken suitable measures to moderate demand side of inflation in the recent period. It has raised the key policy rates specially repo and reverse repo rates several times during 2011-12. RBI's monetary measures were aimed at moderating demand to levels consistent with the capacity of the economy to maintain its growth without provoking price rise.

(2) Fiscal measures:
Inflation cannot be controlled by monetary measures alone. They should be supported by fiscal measures. The government manipulates the budget to reduce the private as well as the public expenditure to check demand for goods and services and encourage production of essential commodities.

The fiscal instruments are taxation, public borrowing and public expenditure.

i) Direct and indirect taxes are levied to reduce the disposable income of the people.

ii) Public borrowing can be undertaken to reduce the quantity of money with the public.

iii) Compulsory saving or any other forced saving scheme and deferred payment (a part of the payment is credited to the employees provident fund accounts, thus blocking its current use) are some of the instruments to reduce excess demand.

iv) Public expenditure is the major source of injecting money into the economy.

Though it is difficult to cut down public expenditure the government should attempt to avoid all unproductive expenditure.

(3) Direct (administrative) measures:
Direct measures comprise of price controls or ceiling on prices especially of essential commodities. Rationing and fair price shops are the channels through which the public distribution system is operated. Imports of essential commodities may be required to maintain the supply.
The following important administrative measures were taken since 2010-11 to control inflation especially food inflation.

(i) Export of non-basmati rice, edible oils and pulses banned.

(ii) Future trading in rice, urad and tur suspended by the Forward Market Commission.

(iii) Levy obligation in respect of all imported raw sugar and white refined sugar removed.

(iv) Minimum export price was used to regulate export of onion and basmati rice. Prohibited export of milk powders. Export of onion is controlled by government to control its prices.

In addition to above measures government has emphasized on the PDS, distribution of essential commodities at below market prices through state public-sector units (PSUs), anti-hoarding operations, and strengthening of supply chain efficiency.

Attempts to control inflation by any particular type of measures are bound to fail. A judicious combination of all methods is a must to achieve success. A dear monetary policy must be supported by a reduced fiscal deficit along with necessary direct measures.

2.6 QUESTIONS

1. Examine the extent of poverty in India and bring out the trends in it.
2. Explain the various poverty alleviation programmes in operation in India currently.
3. Discuss the meaning and extent of poverty in India.
4. What are the various limitations of the poverty alleviation programmes?
5. What are the factors responsible for the fall in the incidence of poverty in India?
6. Explain the poverty eradication programmes of the government currently in operation?
8. Critically examine the recent measures taken by the government to reduce the incidence of poverty in India.
9. Discuss the extent of income inequality in India. Is inequality of income more in India than in other countries?
10. Explain the extent of inequality in income in the rural-urban sector in India. Suggest measures to reduce it.
11. "Inequality in income distribution is a global phenomenon" Comment.
12. Write Short notes on:
   (a) Rural-urban income distribution in India. (b) Measures to reduce inequality in Income.
13. Discuss the pattern of distribution of income and bring out the extent of inequalities in India.
14. Explain the nature of unemployment in India.
15. Examine the extent of unemployment in India.
16. Explain the extent and nature of unemployment in India.
17. What are the causes of unemployment in India.
18. Suggest suitable measures to increase employment opportunities in India.
19. Discuss the government policies to generate employment in India in the recent years.
20. Write notes on:
   (a) Causes of unemployment in India
   (b) Employment measures of the government
   (c) Employment generation programmes of government
21. Suggest suitable policy strategy for employment generation in India.
22. Explain the meaning of inflation.
23. Explain the important causes of inflation in India.
24. Explain the important measures to control inflation.
25. Write notes on:
   (a) Inflation in India
   (b) Causes of inflation in India
   (c) Measures to control inflation
MODULE 2
AGRICULTURE AND THE ECONOMY

UNIT STRUCTURE
3.0 Objectives
3.1 Nature of India’s Agriculture
3.2 Roll of agriculture in Indian economy
3.3 Land Reforms
3.4 New Agricultural Strategy
3.5 Trends in Agricultural production and productivity
3.6 Summary
3.7 Questions

3.0 OBJECTIVES

- To study the nature of India’s Agriculture
- To study the importance of agriculture in Indian economy
- To study the changes brought about in Indian agriculture through Land Reforms
- To study the meaning, role and achievement of New Agricultural Strategy in Indian agriculture.
- To study the recent trends in agricultural production and productivity.

3.1 NATURE OF INDIA’S AGRICULTURE

At the time of independence, India’s agriculture was in a state of backwardness. Productivity per hectare and per worker was extremely low. The techniques employed were age-old and traditional. Because of low productivity, agriculture merely provided subsistence to the farmers. Following causes explains the backward and traditional nature of Indian agriculture.
1. Feudal relations of production:
   At the time of Independence, three types of land tenure system were prevalent in the country – zamindari, mahalwari and ryotwari. The zamindari system was based on exploitation since zamindars pressurized peasants in a variety of ways. Ryots in the Ryotwari system also leased out their land to tenants for cultivation and these tenants were also subjected to the exploitation. After Independence, the State governments enacted laws to abolish the intermediaries. However, these were entirely inadequate to have any drastic impact on the agrarian structure.

2. Usurious capital and rural indebtedness:
   During the pre Independence period, moneylenders charge exorbitant rate of interest, manipulate accounts to their advantage and often seize the land of small and marginal farmers on one or the other pretext. Since long the Indian peasant has been living the life of bonded land slave. After Independence, the government has initiated a number of steps to curb their activities. One of the important policy measures being the development of cooperative credit institutions and the increasing participation of banks in providing rural credit. However, because of a number of factors, the small and marginal farmers continue to depend on moneylenders for fulfilling their credit.

3. Labour market dualism:
   Because of the excessive pressure of population on land, wages in the agricultural sector tend to be considerably lower as compared to the modern (industrial) sector. This leads to a labour market dualism. This dualism is explained by the fact that large number of workers remain sticking to traditional agriculture despite low wage due to either to ignorance of better opportunities outside agriculture, or to their inability to obtain a modern sector job despite wishing to do so, or to the cost of moving being unacceptably high in relation to the expected wage premium. These cheap labour leads to the adoption of labour intensive methods of production.

4. Outmoded farming techniques:
   Most of the Indian farmers continue to use outmoded farming techniques. The traditional agriculture depends on the biological sources of energy, rains and drug manure. Returns to farmers under this technique of production are very meager and the nature of farming is appropriately described as subsistence farming. However, with the advent of the new agricultural strategy in 1966,
modern techniques of production and new high-yielding varieties of seeds, agricultural productivity registered substantial increases in these areas. However, since large areas of the country continue to use outmoded agricultural techniques.

1. Fluctuations and instability in crop output: The Indian agriculture has rightly been called a ‘gamble in monsoons.’ Even now as much as 60 per cent of gross cropped area continues to depend on rainfall. Therefore, nature continues to play a major role in determining the level of agricultural production.

2. Diversities in the agricultural sector and the problem of generalization: India is a large country having substantial agricultural diversities. Different regions exhibit entirely different characteristics so that no one plan can be conceived for all agricultural regions of the country. For e.g., take a case of rainfall. Western Rajasthan and a part of the Thar Desert have a very uncertain rainfall of 4 to 5 inches a year, whereas Cherrapunji in Assam has an annual rainfall of more than 450 inches. While considerable areas face drought conditions in a particular year, some areas encounter the fury of floods. Some areas face the problems of water logging and salinity. There are substantial regional inequalities in regard to sub-division and fragmentation of holdings.

The presence of large diversities in the agricultural sector makes it necessary to devise separate agricultural policies for different regions. It is not possible to generalize and formulate a single agricultural policy for the nation as a whole.

3.2 ROLL OF AGRICULTURE IN INDIAN ECONOMY

Indian agriculture in the pre-Independence period can be correctly described as a subsistence occupation. Britishers pursued a typical colonial policy in India and did nothing to develop agriculture. They created a class of intermediaries known as zamindars who sucked the blood out of the rural poor. A substantial part of the produce was taken away by this parasitic class and the actual cultivator was left only with subsistence income. Some farmers started adopting agriculture on a commercial basis only after Independence and more specifically when planning era and Green Revolution started.
1. Share in National Income: After the initiation of planning in India, the share of agriculture has persistently declined on account of the development of the secondary and tertiary sectors of the economy. From 55.3 per cent in 1950-51, the share of agriculture in GDP at factor cost declined steadily to 37.9 per cent in 1980-81. The share of agriculture and allied activities in GDP at factor cost was 14.0 per cent in 2011-12 (at 2004-05 prices).

   The share of agriculture in national income is often taken as an indicator of economic development. As the country progresses, the dependence on agriculture declines.

2. Provision of food: The demand for food increases at a fast rate in India as there is heavy pressure of population. Domestic demand for food grain was placed at 270 million tonnes in 2004-05 and about 235.4 million tonnes in 2011-12. This is expected to increase further to 280.6 million tonnes by 2020-21. Meeting this requirement would require an increase of about 2% per annum in food grain production. This is likely to be a challenging task as is clear from the fact that during the recent 10 years period 1997-98 to 2006-07, food grain production increased annually by a meagre 0.48%.

3. Largest employment providing sector: In 1951, 69.5 per cent of the working population was engaged in agriculture. This percentage fell to 56 per cent in 2001. In 2004-05, agriculture provided employment to 52.1 per cent of the work force. However, with rapid increase in population the absolute number of people engaged in agriculture has become exceedingly large. Development of the other sectors of the economy has not been sufficient to provide employment to the increasing additions to working population forced to fall back upon agriculture even if their marginal productivity on land is zero or nearly so. This gives rise to the familiar problem of underemployment and disguised unemployment.

4. Contribution to capital formation: Since agriculture is the largest sector in India, it must play an important role in pushing up the rate of capital formation. Unless the rate of capital formation increases to a sufficiently high degree, economic development cannot be achieved. To extract surplus from agriculture, the policies advocated are: (i) transfer of labour and capital from farm to non-farm activities; (ii) taxation of agriculture in such a way that the
burden on agriculture is greater than the government services provided to agriculture.; (iii) turning the terms of trade against agriculture by imposing price controls on agricultural products, taxation or the use of multiple exchange rates that discriminate against agriculture.

5. Providing raw materials to industries: Agriculture provides raw materials to various industries of national importance. Sugar industry, jute industry, cotton textile industry, vanaspati industry are examples of some such industries which depend on agriculture for their development. The entire range of food processing industries is similarly dependent on agriculture.

6. Market for industrial products: Since more than two thirds of the population of developing countries like India lives in rural areas, increased rural purchasing power is a valuable stimulus to industrial development. If steps are taken to expand agricultural output and productivity, the income of the rural sector will increase which will increase demand for industrial products.

7. Importance in International trade: For a number of years the three agriculture-based exports of India – cotton, textiles, jute and tea accounted for more than 50 per cent of export earnings of the country. Total exports increased to around 70 to 75 per cent if we add the export of other agricultural commodities like cashew kernels, tobacco, coffee, vanaspati oil, sugar etc. This heavy dependence reflected the underdeveloped nature of the economy. The share of agricultural exports in total exports was 44.2 per cent in 1960-61. This fell to 30.7 per cent in 1980-81 and 10.2 per cent in 2004-05. As far as composition of imports is concerned, capital goods, industrial machinery, petroleum and petroleum products and maintenance imports have accounted for the bulk of imports.

Development of agriculture is a virtual precondition of sectoral diversification and development itself. A growing surplus of agricultural produce is needed in the country to

- Increase supplies of food and agricultural raw materials at non inflationary prices.
- Widen the domestic market for industrial goods through increased purchasing power within the rural sector.
- Facilitate inter sectoral transfers of capital needed for industrial development.
• Increase foreign exchange earnings through agricultural exports.

❖ Check Your Progress:

1. Nature of India’s Agriculture is backward and traditional – Give reasons.

2. Explain the changing role of agriculture in Indian economy.

3.3 LAND REFORMS

Changes brought about in the agrarian structure through direct intervention are characterized as land reforms. The need for direct intervention in the form of land reforms was required in India because of the exploitative nature of the land tenure system prevailing during the pre Independence period. There were three types of land tenure systems prevailing in the country:

A) Zamindari system or the Landlord-Tenant system:

In this system the ownership of the land is separated from the managerial and labouring function. Here the landlord acts as an intermediary between the State and the actual tiller, and is responsible for the payment of land revenue to the State.

B) Mahalwari system or Communal system of farming:

Under this system the ownership of land is maintained by a collective body usually the village serves as a unit of management, land is distributed among individual peasants, revenue is collected from them and paid to the government by the body.

C) Ryotwari or the Owner-cultivator system:

Under this system, the bulk of the rights of use and control of land are held by the family which provides the primary labour force
on the farm. The Owner –Cultivator is responsible directly to the State and pays land revenue.

- **Objectives of Land Reforms in India:**
  In India the land reforms programme has remained one of the major policies for rural development ever since the inception of the planning process. The major objectives are as follows -

  - Restructuring of agrarian relations to achieve egalitarian social structure;
  - Elimination of exploitation in land relations;
  - Improvement of socio-economic conditions of rural poor by widening their land base;
  - Actualization of the goal of ‘land to the tiller’
  - Increasing agricultural production and productivity;
  - Facilitating land base development of rural poor;
  - Infusion of a greater measure of equality in local institutions.

**Progress of Land reforms in India:**

1. **Abolition of the Zamindari system:** The Zamindari system manifested absentee landlordism and was largely responsible for the deteriorating conditions of tenant-farmers. Immediately after Independence, every State enacted its own legislation for the abolition of intermediary interests. The legislation brought about 20 million cultivators into direct contact with the State. A considerable area of cultivable wasteland and private forests belonging to the intermediaries has been vested in the State. This has facilitated the distribution of 57.7 lakh hectares to landless agriculturists.

2. **Tenancy Reform Legislation** : Tenants can be classified into (i) Occupancy tenants, (ii) sub-tenants, (iii) tenants-at-will. Occupancy tenants enjoy permanent rights like the owner and do not face the fear of eviction as long as they pay rent on time. Whereas tenants-at-will and sub-tenants existence depends on the mercy of landlords. Therefore, to protect these people special laws have been enacted and implemented.

   A. **Regulation of rent:** In the pre-Independence period, the rent charged by Zamindars from the tenants was exorbitant.
Legislations were enacted after 1947 to regulate the limits of rents and reduce the burden on tenants. The Fifth Five Year Plan stated that maximum rent should be fixed at one-fourth or one-fifth of the total produce. Except Punjab, Haryana, Jammu and Kashmir, Tamil Nadu and Andhra Pradesh, this limit generally observed by all the States. However, legislations fixing maximum limit of rent have been violated. Because of the strong socio-economic and political hold of the landowners in the countryside, they have been able to extract considerably more rent from the peasants than the rent fixed by the legislations.

B. Security of tenure: legislation for security of tenure had three essential aims: (i) ejectments do not take place except in accordance with the provisions of the law; (ii) land may be resumed by an owner, if at all, for personal cultivation only; (iii) in the event of resumption, the tenant is assured of a prescribed minimum area. However the degree of protection to tenants afforded by the law in a particular area depends upon the following factors:

a) Definition of the term tenant
b) The circumstances in which landowners are allowed to resume tenanted land for cultivation
c) Definition of the term personal cultivation
d) Status of land records.

In all tenancy laws of the country persons cultivating the lands of others on payment of rent are treated as tenants. However, in some States like U.P. and west Bengal, sharecroppers are not regarded as tenants. Thus all laws aiming at protecting tenants do not help them. The right of resumption combined with flaws in the definition of personal cultivation rendered all tenancies insecure. The landlord could eject any tenant on the plea of personal cultivation. Many landlords compelled their tenants to give up the tenancies on their own accord. In this manner they succeeded in circumventing the tenancy laws because no laws can help the tenants if they give up their right voluntarily

Laws relating to security of tenure can be implemented effectively only if correct and up-to-date land records are available. A person can claim that he is a tenant only if his name appears as such in the land records. However, it has been observed that in
many States either no records of tenancy exists or are incomplete and out-of-date.

C. Ownership Rights of tenants: Some tenants have passed legislations to confer right of ownership on tenants. In some states the laws fall short of expectation. West Bengal, Karnataka and Kerala have achieved more success than the other States. It has been observed that for a long period of time, many tenants did not exercise their rights to purchase ownership of land they cultivated, because either they could not afford to pay the purchase price or many tenants were unwilling to purchase land.

D. Land Rights of Women: Historically, land reform has excluded women. But in some second generation land reform movement in India, women raised the demand for land to be allotted in their names. Women's ownership of land becomes necessary condition for adequate use of credit and necessary flexibility in management of farm resources.

E. Ceilings on Land Holdings: By a ceiling on land holdings mean the fixing of the maximum size of holding that an individual cultivator or a household may possess. Beyond this maximum size all land belonging to the landlords is taken over by the government to be redistributed among the landless labourers. The basic objective of such a measure is to reduce wide disparities of income and wealth found in the agrarian structure.

Progress of Ceiling Legislation:

- **The unit of application:** A family is the unit of application of ceilings. The family is defined as consisting of husband, wife and children.

- **The level of ceilings:** For lands which have an assured supply of water and where at least two crops are raised, the ceiling depending upon the productivity of land and other factors, has been fixed at 10 to 18 acres. In places where irrigation is done by private sources, for purposes of fixation of ceiling 1.25 acres is to be the equivalent of on acre of land irrigated by public sources, but this is subject to the condition that in both the cases the upper limit does not exceed 18 acres. In areas where there is a provision for irrigation for the raising of only one crop, the upper limit of the ceiling has been fixed at 27 acres. For the remaining types of land, the upper limit is 54 acres.
• **Performance:** The success of the ceiling laws is judged by the area of surplus land that becomes available for redistribution among landless, marginal and small farmers. The area actually declared surplus is only a small part of the area that should have been available as surplus. The wide disparity between official estimates and State Government’s declarations of surplus land has come to light after a comparison between data from the different Agricultural Censuses with the State’s estimates.

F. **Consolidation of Holdings:** A major cause of low agricultural productivity is the fragmentation and sub-division of holdings, resulting in uneconomic holdings. The average size of a holding can be raised through consolidation of holdings. Legislation to prompt consolidation of holdings has been enacted in different States after Independence where agrarian reforms had already been undertaken. While separate organizations were set up for this work in Punjab, Haryana and U.P. and the entire area of these States was covered by plans of consolidation, the work was done by normal agencies of revenue administration in other States with varying degrees of intensity. It has been recommended in the recent plans that consolidation should be made compulsory in the command of the large irrigation projects.

G. **Land Records:** Correct and up-to-date land records are an essential condition for effective implementation of land reforms programme. It is also necessary to ensure smooth flow of credit and agricultural inputs to landholders. States are increasingly paying attention to this vital aspect of the programme. Land records are now being computerized, throughout the country, although the progress is slow.

### 3.4 NEW AGRICULTURAL STRATEGY

The new strategy of agricultural production came to be introduced around the period between the Third Plan and Fourth Plan (i.e. 1961-1969). The first stage of new strategy pertaining to the **Intensive Agricultural District Programme**. It was started in 1960-61 in three districts and was subsequently extended by stages to another thirteen. Later, the **High-Yielding Varieties Programme** (HYVP) was also added and the strategy was extended to cover the entire country. This strategy has been called by various names: modern agricultural technology, seed-fertiliser-water
technology, or simply green revolution. As a result of the new agricultural strategy, area under improved seeds has gone up since 1966. The new varieties are of a short-term duration and therefore it is possible to grow more than one crop during a year. Wheat production has increased tremendously in Punjab, Haryana, Delhi, Rajasthan and Western U.P. for the New Mexican varieties like Lerma Rojo, Sonara-64, Kalyan and P.V.18. Traditional agriculture relies heavily on indigenous inputs such as the use of organic manures, seeds, simple ploughs and other primitive agricultural tools, bullocks, etc. Modern technology, on the other hand, consists of chemical fertilisers, pesticides, improved varieties of seeds including hybrid seeds, agricultural machinery, extensive irrigation, use of diesel and electric power, etc. Since 1966, the use of modern agricultural inputs has increased at a compound rate of 10 percent per annum in contrast to the traditional inputs rising at the rate of only one percent per annum during the same period.

3.4.1 **Achievements of the New Agricultural Strategy:**

**i) Boost to the production of cereals:**

The major achievement of the new strategy is to boost the production of major cereals, viz., wheat and rice. The production of rice increased from 35 million tonnes in 1960-61 to 93 million tonnes in 2006-07. The yield per hectare has also recorded an improvement from a little more than 11 quintals in 1960-61 to nearly 21 quintals now. The production of wheat increased from 11 million tonnes in 1960-61 to 75 million tonnes in 2006-07. The green revolution was confined only to High Yielding Varieties (HYV) cereals, mainly rice, wheat, maize and jowar.

**ii) Increase in the production of commercial crops:**

The green revolution was mainly directed to increase the production of food grains. It did not affect initially the production of commercial crops or cash crops such as sugarcane, cotton, jute, oilseeds and potatoes; these crops did not record any significant improvement initially. However, significant improvement in the output of sugarcane took place after 1973-74. Likewise, there was considerable improvement in the production of other cash crops such as oilseeds, potatoes etc.
iii) **Significant changes in crop pattern:**

As a result of the green revolution, the crop pattern in India has undergone two significant changes. Firstly, the output of cereals has risen at the rate of 3 to 4 percent per annum but the output of pulses has remained stagnant or even declined. This has resulted in a decline in the importance of pulses in food grain output from 16 percent in 1960-61 to 6 percent in 2006-07. Cereals, on the other hand, have risen in importance from 84 percent to 94 percent during the same period.

Secondly, among cereals, the proportion of rice in total cereal output has come down from 48 percent to 46 percent between 1950-51 and 2006-07. During the same period, however, the importance of wheat has more than doubled, i.e., from 15 percent to 37 percent. The share of coarse grains has gone down from 37 percent to 17 percent of the total cereals. The rising output of wheat indicates a substitution of coarse grains with wheat, on the side of production as well as consumption.

iv) **Boost to agricultural production and employment:**

The successful adoption of the new agricultural technology has led to continuous expansion in area under crops, increase in total production and rise in agricultural productivity. Impressive results have been achieved in wheat, rice, maize, potatoes, etc. the adoption of new technology has also given a boost to agricultural employment because of diverse job opportunities created by multiple cropping and shift towards hired workers. At the same time, there has been displacement of agricultural labour by the extensive use of agricultural machinery.

v) **Forward and backward linkages strengthened:**

The new technology and modernisation of agriculture have strengthened the linkages between agriculture and industry. Even under traditional agriculture, the forward linkage of agriculture with industry was always strong, since agriculture supplied many of the inputs of industry; but backward linkage of agriculture to industry – the former using the finished products of the latter was weak. However, agricultural modernisation has created a larger demand for inputs produced and supplied by industries to agriculture and thus the backward linkage has also become quite strong. In this way, the linkage between agriculture and industry has got strengthened.
3.4.2 Weaknesses of New Strategy:

The new agricultural technology has made the farmer market-oriented. The farmers are largely dependent on the market for the supply of inputs and for the demand for their output. Modern technology proved superior over traditional technology only in those areas where appropriate conditions prevail. These conditions prevail only in certain selected areas.

i) Indian agriculture is still a gamble in the monsoon:

After introduction of the green revolution in the early 1960s, food grains production has increased to 108 million tonnes in 1970-71. But immediately for the next year i.e. in 1972-73, it has reduced to 95 million tonnes. Sharp fluctuations in the latter years were observed in the food grains production. After many fluctuations, the output increased to 176 million tonnes in 1990-91 and 213 million tonnes in 2001-02. Due to extensive drought conditions it declined steeply to 174 million tonnes during 2002-03 it then touched to 231 million tonnes in 2007-08. Two conclusions can be drawn from fluctuations of output of cereals in India since the introduction of new agricultural strategy:

a) Output of cereals as well as other agricultural products is still subject to weather conditions as in the past;

b) The maximum and minimum total outputs, however, are now much higher than in the past.

ii) Growth of Capitalistic Farming in Indian Agriculture:

The new agricultural strategy consisting of IADP and HYVP necessitated heavy investment in seeds, fertilisers, pesticides and water. These heavy investments are beyond the capacity of small and medium farmers. The vast majorities of rural households with little or no land, with poor finances and poor creditworthiness have not gone in for the new technology in a big way and have benefited the least from the green revolution. Regions which have been well endowed with resources like Punjab, Haryana and Western U.P. have benefited the most from the use of modern technology and have prospered. Other regions have remained backward and underdeveloped. Regional disparities have thus increased.
ii) **Widening disparities in income:**

Technological changes have contributed to widening the disparities in income between landowners on one hand and landless labourers and tenants on the other.

iii) **New Strategy and Socio-economic relations in rural areas:**

Often small and marginal farmers are forced to take some land on lease; in some cases, they are pure tenants. Rising rents in recent years and/or the tendency of landowner to resume land for personal cultivation. It has actually led to an absolute deterioration in the economic condition of the small owner-cum-tenant cultivator class.

iv) **Problem of labour displacement:**

Two types of technological innovations were introduced under the Green revolution – biological and mechanical. The term biological innovations refer to the changes in inputs that increase productivity of land. The introduction of high yielding varieties and use of fertilisers, fall in this category. The mechanical innovations refer to the introduction of new appliances which displaces human or bullock labour. Thus, biological innovations are labour-absorbing, mechanical innovations are labour-saving. The effect of mechanisation can be seen in the wheat growing areas of Punjab. Nearly 55 percent of the total labour displaced was expected to be caused by tractors and pump-sets and 37 percent by threshers and reapers. This shows that the technical changes causes labour displacement.

◇ **Check Your Progress:**

1. State the three types of systems of land tenure prevailing in India.
2. Discuss the achievements of New Agricultural Strategy in India.
3.5 TRENDS IN AGRICULTURAL PRODUCTION AND PRODUCTIVITY

To know the performance of Indian agriculture sector it is important to discuss the production and productivity trends in agriculture. Agricultural production has two components: i) Foodgrains ii) Non-Foodgrains. The trends in agricultural production and productivity are presented in Table no- 3.1 and 3.2 respectively.

Let us consider Table no-3.1 first ,

Table no-3.1
Trends in Agricultural Production
(1950 to 2010-11)
(In million units)

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<tr>
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<td>11.1</td>
<td>10.3</td>
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<td>11.7</td>
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<td>12.5</td>
<td>13.3</td>
<td>13.1</td>
<td>13.3</td>
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<tr>
<td>Total Foodgrains</td>
<td>50.8</td>
<td>63.2</td>
<td>74.0</td>
<td>81.0</td>
<td>87.8</td>
<td>103</td>
<td>118.1</td>
<td>138.1</td>
<td>155</td>
<td>189</td>
<td>202.9</td>
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<tr>
<td>Oilseeds</td>
<td>6.2</td>
<td>5.5</td>
<td>6.7</td>
<td>7.3</td>
<td>7.2</td>
<td>8.3</td>
<td>8.9</td>
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<td>21.9</td>
<td>21.2</td>
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<tr>
<td>Sugarcane</td>
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<td>Cotton</td>
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<td>5.5</td>
<td>5.9</td>
<td>6.8</td>
<td>7.5</td>
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<td>12.2</td>
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<tr>
<td>Jute</td>
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<td>4.4</td>
<td>5.7</td>
<td>4.9</td>
<td>5.5</td>
<td>5.2</td>
<td>6.4</td>
<td>8.9</td>
<td>8.1</td>
<td>9.6</td>
<td>10.1</td>
</tr>
</tbody>
</table>

Source:- Economic Survey-2010-11.

As far as Foodgrains output is concerned, the total production increased from 58.8 million tones in 1959-51(1st Five Year Plan) to 202.2 million tones in 2002-07 (10th Five Year Plan). The period of 10th Plan witnessed considerable fluctuations in Foodgrains output, because of drought conditions in the first year of this plan(200-03)
The average Foodgrains production during 10th plan as a whole was 202.2 million tones. Foodgrains production touched the record level of 241.6 million tones in 2010-11, and accordingly to third advance estimates for the year 2011-12, is likely to exceed 252 million tones in 2011-12.

In the non-Foodgrains group Jute showed slow and halting progress in the above periods. The production of Oilseeds rose considerably in the letter half of 1980s and 1990s. The production of oilseeds has increased from 6.2 million tones in 1st plan to 23.2 million tones in 10th plan. Production of cotton rose from 3.0 million tones in 1st plan to 16 million tones in 10th plan. Sugarcane registered a more or less steady growth during the entire period 1950-51 to 2002-03 but its production fell sharply in 2003-04 and 2004-05. However, it rose to 277 million tones in 10th plan.

Table 3.2 gives increases in yield per hectare. This table shows that over the period 1950-51 to 2010-11, yield per hectare of all Foodgrains has increased by three –and- a-half times from 552 kgs per hectare in 1950-51 to 1,921 kgs per hectare in 2010-11. Most significant increase has been recorded by wheat with its yield increasing from 655 kgs. Per hectare in 2010-11. As far as coarse cereals are concerned, while the productivity of maize has increased significantly during recent years, the productivity of Jowar and Bajra has increased relatively slowly. Most disappointing has been the performance of pulse. In fact productivity of pulse was only 655 kgs. Per hectare in 2010-11. Which was only 27.8 per cent higher than the productivity in 1960-61.

Table no-3.2

Yield Per Hectare of Major Crops
(Kgs. Per Hectare)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Rice</td>
<td>668</td>
<td>1013</td>
<td>1123</td>
<td>1336</td>
<td>1740</td>
<td>1901</td>
<td>2240</td>
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<tr>
<td>Wheat</td>
<td>655</td>
<td>851</td>
<td>1307</td>
<td>1630</td>
<td>2281</td>
<td>2708</td>
<td>2938</td>
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<tr>
<td>Jowar</td>
<td>353</td>
<td>533</td>
<td>466</td>
<td>660</td>
<td>814</td>
<td>764</td>
<td>956</td>
</tr>
<tr>
<td>Bajra</td>
<td>288</td>
<td>286</td>
<td>622</td>
<td>458</td>
<td>658</td>
<td>688</td>
<td>1069</td>
</tr>
<tr>
<td>Maize</td>
<td>547</td>
<td>926</td>
<td>1279</td>
<td>1159</td>
<td>1518</td>
<td>1822</td>
<td>2507</td>
</tr>
<tr>
<td>Pulses</td>
<td>441</td>
<td>539</td>
<td>524</td>
<td>473</td>
<td>578</td>
<td>544</td>
<td>689</td>
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<tr>
<td>Total Foodgrains</td>
<td>552</td>
<td>710</td>
<td>872</td>
<td>1023</td>
<td>1380</td>
<td>1626</td>
<td>1921</td>
</tr>
<tr>
<td>Oilseeds</td>
<td>481</td>
<td>507</td>
<td>579</td>
<td>532</td>
<td>771</td>
<td>810</td>
<td>1159</td>
</tr>
<tr>
<td>Cotton</td>
<td>88</td>
<td>125</td>
<td>106</td>
<td>152</td>
<td>225</td>
<td>190</td>
<td>510</td>
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<tr>
<td>Jute</td>
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<td>1186</td>
<td>1245</td>
<td>1833</td>
<td>2026</td>
<td>2344</td>
</tr>
</tbody>
</table>

3.5.1 Causes of Low Productivity

A comparison of productivity levels in Indian agriculture with the levels in other countries shows the low level of productivity in Indian agriculture. Productivity of wheat in India is about 34 percent of the productivity in U.K. and 67 percent of the productivity in China. As far as rice is concerned, productivity in India is 49 percent of the productivity in China and 40 percent of the productivity in USA. The productivity of seed cotton in India is about one-fifth as compared with China and less than one-half as compared with USA and Pakistan. As far as groundnut is concerned, productivity in India is 26 percent of the productivity in USA and 36 percent of the productivity in China. India happens to be one of the largest growers and producers of most of the agricultural crops but ranks very low in terms of yield. The causes of low productivity in Indian agriculture can be divided into the following categories:

A. General causes.
B. Institutional causes.
C. Technical causes.

A. General causes:

1. Social environment: The Indian farmer is illiterate, superstitious, conservative and non responsive to the new agricultural techniques of production which helps to increase productivity. This type of social environment of villages is often stated as an obstacle in agricultural development.

2. Pressure of population on land: There is heavy pressure of population on land in India. Increasing pressure on land is partly responsible for the subdivision and fragmentation of holdings. Productivity on small economic holdings is low.

3. Land degradation: Government of India has recently estimated that almost 43 percent of the land suffers from high degradation resulting in 33-67 percent yield loss while 5 percent is so damaged that it has become unusable.

B. Institutional causes:

1. Land tenure system: In the pre independence period, the agrarian structure depended solely on the presence of a few big landlords and zamindars. The status of the actual cultivator was not
more than a slave or serf, had no incentive to increase productivity. In the post independence period, legislations were passed to abolish intermediaries. But it only changes their garb and became big landowners. Regulation of rent, security of tenure, ownership rights for tenants, etc. did not make the position of tenants better. In this land tenure system, it is difficult to increase productivity only through technological means.

2. Lack of credit and marketing facilities: In spite of large trading being carried out by the government agencies like Food Corporation of India and the NAFED, continues to be faulty. In case of the credit finance system, services of regional rural banks and NABARD are inadequate.

3. Uneconomic holdings: According to National Sample Survey, 52 percent holdings in 1961-62 had a size of less than 2 hectares. In 1995-96, 80 percent of the total holdings fell under this category. Most of these holdings are not only extremely small they are also fragmented into a number of tiny plots so that cultivation on them can be carried out only by labour intensive techniques. This results in low productivity. Until the excessive labour employed on agriculture is transferred to alternative jobs and the holdings are consolidated, modern techniques of production cannot be adopted and the possibilities of increasing agricultural productivity will remain limited.

C. Technical causes:

1. Outmoded agricultural techniques: most of the Indian farmers continue to use outmoded agricultural techniques. Wooden ploughs and bullocks are still used by a majority of farmers. Use of fertilizers and new high yielding varieties of seeds is also extremely limited.

2. Inadequate irrigation facilities: Despite substantial expansion of irrigation, even now 60 percent of the gross cropped area continues to depend on rains. Rainfall is often insufficient, uncertain and irregular. Accordingly, productivity is bound to be low in all those areas which lack irrigation facilities, and are totally dependent on rains. Even in areas having irrigation facilities, potential is not wholly utilised because of defective management. The costs of irrigation are also increasing continuously and the small farmer is, therefore, unable to make use of available irrigation facilities.
3.6 SUMMARY

- At the time of independence, India’s agriculture was in a state of backwardness. Productivity per hectare and per worker was extremely low. The techniques employed were age-old and traditional.

- Agriculture plays an important role in the economical development process in India.

- The share of agriculture in national income is often taken as an indicator of economic development. As the country progresses, the dependence on agriculture declines.

- The share of agriculture and allied activities in GDP at factor cost was 14.0 per cent in 2011-12 (at 2004-05 prices).

- The demand for food increases at a fast rate in India as there is heavy pressure of population.

- Agriculture is a largest employment providing sector in India. In 1951, 69.5 per cent of the working population was engaged in agriculture. In 2004-05, agriculture provided employment to 52.1 per cent of the workforce.

- Agriculture play an important role in pushing up the rate of capital formation. It provides raw materials to various industries of national importance.

- The need for direct intervention in the form of land reforms was required in India because of the exploitative nature of the land tenure system prevailing during the pre-Independence period.

- In India the land reforms programme has remained one of the major policies for rural development ever since the inception of the planning process.

- The New Agricultural Strategy was introduced around the Third Plan and Fourth Plan (1961 to 1969). It has been called by various names: modern agricultural technology, seed-fertiliser-water technology, or simply green revolution.

- The new agricultural technology is not free from weaknesses. It has made the farmer market-oriented. The farmers are largely dependent on the market for the supply of inputs and for the demand for their output.
3.7 QUESTIONS

1. Nature of India’s Agriculture is backward and traditional – Give reasons.
2. Explain the changing role of agriculture in Indian economy.
3. Explain the importance of Land Reforms in Indian agriculture.
4. Explain the Progress of Land reforms in India
5. Explain the achievements of the New Agricultural Strategy.
6. Focus on the weaknesses of the New Agricultural Strategy.
7. Focus on the Trends in Indian Agricultural production and productivity
8. Discuss the various causes of low productivity in Indian agriculture.
RURAL CREDIT

UNIT STRUCTURE:
4.0 Objectives
4.1 Introduction
4.2 Sources of rural credit in India
4.3 Role of NABARD in Rural Development
4.4 Agricultural marketing
4.5 Agricultural Price Policy in India
4.6 Issue of Food Security
4.7 WTO and agriculture
4.8 Summary
4.9 Questions

4.0 OBJECTIVES

- To understand the need of rural credit.
- To study the various sources of Rural credit.
- To study the role of NABARD in rural development.
- To study the present system, defects of agricultural marketing.
- To study the measures to improve the system of agricultural marketing in India.
- To study the working provisions and defects of Agricultural Price Policy.
- To study the meaning and definition, objectives of Food Security Policy in India.
- To know the WTO agreements on Indian agriculture.
4.1 INTRODUCTION

Credit needs of the Indian farmers can be classified into three types depending upon the period and the purpose for which they are required:

(a) Farmers need funds for **short periods of less than 15 months** for the purpose of cultivation or for meeting domestic expenses. For e.g., they want to buy seeds, fertilisers, fodder for cattle, etc. They may require funds to support their families in those years when the crops have not been good or adequate for the purpose.

(b) The farmers require finances for **medium period ranging between 15 months and 5 years** for the purpose of making some improvement on land, buying cattle, agricultural implements, etc. These loans are larger than short-term loans.

(c) The farmers need finances for the purpose of buying additional land, to make payment improvements on land, to pay off old debt and to purchase costly agricultural machinery. These loans are for **long periods of more than 5 years**.

4.2 SOURCES OF RURAL CREDIT IN INDIA

There are two sources of credit available to farmers:

**A) Institutional sources:-**

Institutional credit refers to loans provided to farmers by i) co-operative societies and ii)co-operative banks, and iii)commercial banks including regional rural banks (RRBs) and iv) the apex institution at the national level for agriculture is NABARD.

**B) Non institutional sources:-**

Private or Non institutional sources include i) money-lenders, ii) traders and commission agents, iii) relatives and landlords. Non institutional sources accounted for 93 percent of the total credit requirements in 1951-52 and institutional sources including the government accounted for only 7 percent of the total credit needs in that year.
A) **Institutional sources:**

The need for institutional credit arises because of the weakness or inadequacy of private agencies and their exploitative nature of credit. The basic motive of Institutional credit is to help the farmer to raise his productivity and maximise his income. The rate of interest is not only relatively low but can be different for different groups of farmers and for different purposes.

As far as institutional sources are concerned, the first institutions established and promoted was the institutions of Co-operative credit institutions. History of co-operative credit is very old in India. The organization of rural co-operative credit institutions in India can be clear from Chart no-4.1.

**Chart no-4.1**

![Diagram of Co-operative Credit Institutions](attachment:image)

- **Co-operative Credit Institutions**
  - **Rural Co-operative Credit Institutions** (95,765)
  - **Urban Co-operative Credit Institutions**
  - **Short Term (95,048)**
    - **State Co-Operative Banks** (31)
    - **District Central Co-Operative Banks** (370)
    - **Primary Agricultural Credit Societies** (94,647)
  - **LongTerm (717)**
    - **State Co-Operative Agricultural & Rural Development Banks** (20)
    - **Primary Co-Operative Agricultural & Rural Development Banks** (697)
1. Rural Co-operative Credit Institutions:

The rural co-operative movement was started in over 100 years back largely with a view to providing agriculturists funds for agricultural operations at low rates of interest and protect them from the clutches of moneylenders

The organisation of the co-operative credit for short period is as following ,

◆ Short Term Rural Credit :

a) Primary Agricultural Credit Society (PACS):

It may be started with ten or more persons, normally belonging to a village. The value of each share is generally nominal. PACS deal directly with farmer-borrowers, grant short term and medium term loans and also undertake distribution and marketing functions. The management of the society is under an elected body consisting of President, Secretary and Treasurer. Profits are not distributed as dividends to shareholders but are used for the welfare of the village .The usefulness of PACS has been rising steadily.

In 1950-51, they advanced loans worth Rs. 23crores, which increased to Rs. 200crores in 1960-61 and further to Rs. 34,520crores in 2000-01. This progress has been spectacular but not adequate considering the demand for finance from farmers.

The number of PACS had come down from 2,12,000 in 1960-61 to 1,61,000 in 1970-71 and recently number of PACS are 94,647. At the end March 2006 with estimated membership of over 10crore farmers. Most of the PACS are dependent on the finance provided by Central Cooperative Banks(CCBs). In case the CCBs are weak, the PACS are starved of finance which affects the credit functions of PACS. At the end of March 2006, the loans and advances outstanding for PACS were about Rs. 51,780crores.

b) District Central Co-operative Banks (DDCBs):

These are federations of primary credit societies in specified areas normally extending to a whole district. These banks have a few private individuals as shareholders who provide both finance and management. They may accept deposits from the general public but their main task is to lend to village primary societies.
By the end of March 2007, there were 370 District Central Cooperative Banks. The loans outstanding came to Rs. 79,200 crores. They act as an intermediaries between the State Co-operative Bank on the one hand and the village primary credit societies on the other.

The Reserve Bank – now NABARD has formulated a scheme for the rehabilitation of weak central co-operative banks. NABARD is providing liberal assistance to the State Governments for contributing to the share capital of the weak Central Co-operative Banks selected for the purpose.

c) State Co-operative Banks (STCBs):

The STCB finances and controls the working of the District Central Cooperative banks in the State. It serves as a link between NABARD from which it borrows and the cooperative central banks and village primary societies. There are 31 State Cooperative Banks (STCB) in the country.

The State Cooperative Bank not only interested in helping the rural cooperative credit movement but also in promoting other co-operative ventures and in extending the principles of cooperation. During 2005-06 the 31 state cooperative banks had lent about Rs. 48,260 crores to District Central Co-operative Banks.

◆ Long Term Rural Credit :

Cooperative Agriculture and Rural Development Banks (CARDBs):

The long term requirements of the farmers were traditionally met by the money-lenders. Initially, land mortgage banks were organised for the purpose of providing long term credit to farmers. These banks were later called land development banks. In recent years, they have been renamed as Cooperative Agricultural and Rural Development Banks (CARDBs). These were classified into;

- Primary Co-operative Agricultural and Rural Development Banks (PCARDBs)
- State Co-operative Agricultural and Rural Development Banks (SCARDBs).

The number of PCARDBs and their branches increased from 286 in 1950-51 to 697 in 2006-07, while that of SCARDBs
increased from 5 to 20 during the same period. Total loans advanced by PCARDBs during 2005-06 were Rs. 2,250 crores and the loans outstanding at the end March was Rs. 12,740 crores. On the other hand, SCARDBs had sanctioned loans worth Rs. 2,900 crores in 2005-06 and the amount outstanding at the end March 2006 was Rs. 17,710 crores.

**Finance and Loan operations of CARDBs:**

CARDBs obtain their funds from share capital reserves, deposits and issue of bonds or debentures. Debentures are long term loans which are issued by SCARDBs, carrying fixed interest and for fixed periods, generally up to 20 years. They are subscribed by the LIC, the commercial banks, the State bank of India and its subsidiaries and by the Reserve Bank of India. SCARDBs also float rural debentures for periods up to 7 years which are subscribed by farmers and panchayats and by the Reserve Bank of India.

CARDBs provide credit for a variety of purposes such as redemption of old debts, improvement of land, purchase of costly agricultural equipment, construction of wells and erection of pumps, etc. Though land development banking has made considerable progress in recent years, it has not really contributed much to the improvement of the financial position of the farmers.

Following factors are responsible for its ineffectiveness:

- Overdues have caused innumerable financial problems to the capacity of banks to lend.
- Enough attention was not paid to build up the manpower capable of shouldering the increasing volume of business.
- Landless labourers, village artisans and marginal farmers who could take up certain productive activities are not able to secure credit from the CARDBs mainly because they do not possess land or adequate security to offer against loans.

**Commercial Banks and rural Credit:**

After nationalisation was introduced in 1969, a rapid expansion in bank branches in rural areas was started. By July 1969, all commercial banks had over 1,860 branches in rural and semi-urban areas which have increased to over 30,585 by June 2006.
Role of Commercial Banks in Rural Credit:

In the initial period of nationalisation, the banks concentrated their attention on large cultivators and other special category farmers such as those engaged in raising high-yielding varieties of food grains. At present short term crop loans account for nearly 42 to 45 percent of the total loans disbursed by the commercial banks to farmers. Term loans for varying periods for purchasing pump sets, tractors and other agricultural machinery, for construction of wells and tube-wells, for development of land for the purchase of fruit and garden crops, or leveling and development of land for the purchase of plough animal, etc. are provided. These term loans accounted for 35 to 37 percent of the total loans disbursed by the commercial banks.

Commercial banks extended loans for activities like dairying, poultry farming, piggery, bee keeping, fisheries and others which accounted for 15 to 16 percent. Commercial banks are financing co-operative societies to enable them to expand their production credit to the farmers. Commercial banks are providing indirect finance for the distribution of fertilisers and other inputs.

Commercial banks also extend their credit to manufacturing or distribution firms and agencies and co-operatives engaged in the supply of pump sets and other agricultural machinery on a hire purchase basis. They finance operations of the Food Corporation of India, the State Government and others in the procurement, storage and distribution of food grains. Finally commercial banks subscribe to the debentures of the central land development banks and also extend advances to the latter.

There are 5, 50,000 villages spread throughout the country. To reach all of them with only about 47,000 banking offices is a difficult task. To overcome from this problems commercial banks have introduced some unique schemes to reach to the farmers in rural areas.

- **Lead Bank Scheme (LBS):**

  Towards the close of 1969, the Reserve Bank of India adopted the area approach to nationalised banks and finalised a lead Bank scheme for all the 380 districts in the country. Under the scheme, all the nationalised banks and a few private sector banks were allotted specific districts and were asked to play the lead role.
The basic aim of the Lead Bank Scheme is that in a district for coordinating credit deployment in a district.

Under the scheme, the Lead Banks act as lenders to bring about a coordination of co-operative banks and other financial institutions in their respective districts to bring about rapid economic development. They make a quick survey of their lead districts, identify unbanked centers and prepare a phased programme for branch expansion in the district. On the basis of the surveys, the Lead Banks estimate the deposit potential and the credit gap and take steps to tap the deposit potential and fill the credit gap. It will result into deposit mobilisation and also in the expansion of finance to agriculture and small industries.

- **Regional Rural Banks (RRBs):**

  In pursuance of the aspect of the New Economic Programme that the Government of India set up Regional Rural Banks. The main objective of the RRBs is to provide credit and other facilities particularly to the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs so as to develop agriculture, trade, commerce, industry and other productive activities in rural areas.

  Initially, five RRBs were set up on October 2, 1975 in Uttar Pradesh, Haryana, Rajasthan and west Bengal. Each RRB had an authorised capital of Rs. 1crore, and issued and paid up capital of 25lakhs. The share capital was subscribed by the Central Government (50%), the State Government concerned (15%) and the sponsoring commercial bank (35%).

- **Change In Relative Share of Institutions:**

  After the nationalisation of 14 major banks in 1969, the commercial banks have consistently increased their share in institutional credit to agriculture from 38.4% in 1980-81 to 74.3% in 2010-11. As a result the relative share of co-operative institutions has declined from 61.6% in 1980-81 to 15.7% in 2010-11. RRBs have contributed about 8 to 10% of agricultural credit over the years, it is shown in table no-4.1.
Table no-4.1

Institutional Credit to Agriculture: Relative Share of Different Institutions

<table>
<thead>
<tr>
<th>Year</th>
<th>Scheduled Commercial Banks</th>
<th>Co-Operative Societies</th>
<th>RRBs</th>
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<tr>
<td>1970-71</td>
<td>----</td>
<td>100.00</td>
<td>----</td>
</tr>
<tr>
<td>1980-81</td>
<td>38.4</td>
<td>61.6</td>
<td>----</td>
</tr>
<tr>
<td>1990-91</td>
<td>47.6</td>
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<td>3.4</td>
</tr>
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<td>2000-01</td>
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<td>2004-05</td>
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<td>2007-08</td>
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<td>9.2</td>
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<tr>
<td>2010-11</td>
<td>74.5</td>
<td>15.7</td>
<td>9.8</td>
</tr>
</tbody>
</table>


B) Non institutional sources:-

i) Money Lenders: are of two types:

Money Lenders are of two types; Landlords or rich farmers who combine farming with money lending and professional money lenders. The cultivators depend upon the money-lenders for their requirements of cash. The moneylenders freely supplies credit for productive and non-productive purposes. They provide credit for short term as well as long term requirements of the farmers. The moneylenders are easily accessible and maintains a close and personal contact with the borrower, often having relation with family extending over generations. His methods of business are simple and elastic. He has local knowledge and experience and therefore can lend against promissory notes. He knows how to protect himself against default, through legal and illegal methods.

ii) Landlords and others:

Traders and commission agents supply funds to farmers for productive purposes much before the crop mature. They force the farmers to sell their produce at low prices and they charge a heavy commission for their dealings. Farmers often borrow from their own relatives in cash or in kind for their temporary requirements. They
carry low or no interest and they are returned soon after the harvest. Farmers, particularly small farmers and tenants, depend upon landlords and others to meet their financial requirements for they charged exorbitant interest rates.

### 4.3 ROLE OF NABARD IN RURAL DEVELOPMENT

A National Bank for Agricultural and Rural Development (NABARD) or the National Bank was set up in July 1982 by an Act of Parliament to take over the functions of the Agricultural Refinance Development Corporation (ARDC) and the refinancing functions of RBI in relation to co-operative banks and RRBs. NABARD is linked originally with the RBI by the latter contributing half of its share capital and the other half being contributed by the Government of India and nominating three of its Central Board Directors on the board of NABARD, besides a Deputy Governor of RBI being appointed as Chairman of NABARD.

#### 4.3.1 Resources of NABARD:

The authorised share capital of NABARD was Rs. 500 crores and its paid-up capital was Rs. 100 crores, contributed equally by the Central Government and the Reserve Bank. The resources of the National Agricultural funds were transferred to NABARD. World Bank and IDA have also been providing funds to NABARD for implementation of the projects financed by them. The most important source of NABARD's funds is RIDF deposits, closely followed by market borrowings.

#### 4.3.2 Functions of NABARD:

NABARD has a dual role to play (a) as an apex institution and (b) as a refinance institution. NABARD has inherited its apex role from RBI i.e. it is performing all the functions formerly performed by RBI with regard to agricultural credit. At the same time, NABARD has taken over the functions of ARDC and thus provides refinance facilities to all banks and financial institutions lending to agriculture and rural development.

i) NABARD services as a **refinancing institution** for all kinds of production and investment credit to agriculture, small scale industries, cottage and village industries, handicrafts and rural crafts and real artisans and other allied economic activities with a view to promoting integrated rural development.
ii) It provides short term, medium term and long term credit to State Co-operative Banks (SCBs), RRBs, LDBs and other financial institutions approved by RBI

iii) NABARD gives long term loans (up to 20 years) to State Governments to enable them to subscribe to the share capital of co-operative credit societies

iv) NABARD gives long term loans to any institution approved by the Central Government or contribute to the share capital or invests in securities of any institution concerned with agriculture and rural development

v) NABARD has the responsibility of co-ordinating the activities of Central and State Governments, the Planning Commission and other all India and state level institutions entrusted with the development of small scale industries, village and cottage industries, rural crafts, industries in the tiny and decentralized sectors, etc.

vi) It has the responsibility to inspect RRBs and co-operative banks, other than primary co-operative societies

vii) It maintains a Research and Development Fund to promote research in agriculture and rural development, to formulate and design projects and programmes to suit the requirements of different areas and to cover special activities.

4.3.3 Working of NABARD:

NABARD is performing the various functions assumed by it smoothly and efficiently. It sanctioned short term credit limits worth Rs. 8,820 crores during 2003-04 and Rs. 16,100 crores during 2006-07 for financing seasonal agricultural operations at the concessional rate of 3 percent below the Bank rate. During 2010-11 NABARD sanctioned total credit limit aggregating 35,273 crores Rs. as against 25,661 core Rs. During 2009-10 for various short-and medium-term purposes to STCBs and RRBs and long-term loans to the state government.

NABARD has attempted to ensure the flow of credit to weaker sections of society under the new 20-point programme by making it obligatory for banks to disburse a specified percentage of short term loans to small and marginal farmers and other economically weaker sections.
NABARD provides two types of refinance. The first is extended to RRBs, Apex Rural Credit Institutions, viz., State Co-operative Banks and state Governments. The second type of refinance is extended to provide resources for ground level deployment of rural credit. Purpose-wise, minor irrigation has continued to occupy an important place in scheme lending of NABARD i.e. about 13 percent of the schemes sanctioned in recent years consisted of minor irrigation works.

NABARD has vigorously continued its efforts in promoting investments in the agricultural sector in the less developed / under-banked states – U.P., Bihar, M.P., Rajasthan and Orissa have been the biggest beneficiaries.

4.3.4 NABARD and Rural Infrastructure Development Fund (RIDF)

RIDF –I was established in 1995-96 with the major objective of providing funds to state governments and state owned corporations to enable them to complete various types of rural infrastructure projects. RIDF has been continued on an annual basis. The annual allocations of funds under the RIDF has gradually increased from Rs.2000 crore in 1995-96 to Rs.18000 crore in 2011-12. Aggregate allocations have reached Rs.1, 34,000 crore. The budget allocation for RIDF for 2012-13 has been raised further to Rs.20, 000 crore.

As against the total allocation of Rs.1,34,000 crore, encompassing RIDF-I to RIDF-XVII, sanctions aggregating Rs.1,32,808 crore have been accorded to various state governments and an amount of Rs.86, 631 crore disbursed up to end December 2011. This shows that the proportion of disbursements in relation to sanctions has been only 65 %.

❖ CHECK YOUR PROGRESS:

1. Discuss the non-institutional sources of agricultural credit.
2. What are the institutional sources of agricultural credit?
3. Explain the role of NABARD in brief.
For a very long period of time or from the beginning of the 20th century, Indian agriculture was mostly in the nature of “Subsistence Farming”. The farmer sold only a small part of his produce to pay off rents, debts and meet his other requirements. Such sale was usually done immediately after harvesting of crops since there were no storing facilities. The poor and illiterate farmers took his small produce to the markets where he was exploited and cheated by strong traders and dealers. So the agricultural marketing system was very unsafe and exploitative. Accordingly the Govt. has to undertaken various steps after Independence to improve the system of agricultural marketing in India.

The important types of agricultural markets in India are as follows:

1. **Primary or local markets**: These markets are organised by Village Panchayats, who charge some rent from shopkeepers for the space occupied. These markets are known as ‘shandies’, in southern states, or ‘chuna’ in Kerala, hat, painth or bazar in northern and north eastern states, held once or twice in a week in the neighborhood of a group of villages. More than 50 percent of the total marketed surplus is sold at these markets.

2. **Secondary markets**: Business in these markets is transacted regularly throughout the year. The markets provide facilities of storage, handling and banking services, and are well served by roads and railways. These are also known as ‘wholesale’ or ‘assembling’ markets and are called mandis. A number of middlemen operate in these markets.

3. **Terminal markets**: These markets perform the function of carrying goods to consumers, final buyers or to places of processing. Such markets are located in big cities or at ports.

4. **Fairs**: held at religious occasions at pilgrim centers are important sources of marketing of agricultural produce in India. Such fairs are held annually and are organised by district officers, local bodies or private agencies. They are very popular in states like Bihar, Orissa, U.P., Maharashtra, W. Bengal and Rajasthan.

5. **Regulated markets**: These have been set up by the Government for the purpose of checking fraudulent practices which
are generally practiced by traders in the primary and secondary markets. Government rules and regulations govern the market practices.

6. **Cooperative marketing**: These markets function on the basis of principles of cooperation. A cooperative marketing society can carry the agricultural produce direct to the consumers, thus dispensing with a large army of middlemen and intermediaries.

7. **State Trading**: in agricultural produce has become an important element of agricultural marketing in India. State agencies, like the Food Corporation of India, set up their exclusive centers in and around villages and mandis at harvest time to procure produce from peasants at Government-fixed prices.

4.4.1 **Defects of agricultural marketing:**

a. In the agricultural marketing in India there are a **large number of middlemen** indulging in widespread malpractices.

b. **Lack of proper warehousing facilities** in the villages, therefore the farmer was compelled to store his products in pits, mud-vessels, kutcha storehouses etc. These unscientific methods of storing led to considerable wastage.

c. There was **not any provision for grading**, thus there was no incentive to use better seeds and produce better varieties.

d. **Transportation facilities** were also **highly inadequate** and only a small number of villages were joined by railways and pucca roads to mandis. The produce was carried on slow moving transport vehicles like bullock-carts which could not be used to carry produce to far-flung places and the farmer force to sell his produce in nearby market at low prices.

e. **Farmers are illiterate** and they are not aware about the prices of their produce in different markets, so there is no option for them but to accept the price offered to them by the middlemen.

f. Indian **farmer is poor** and lack staying power, so he tried to sell his produce immediately after harvest at less prices.

g. There was a total **lack of institutional sources of credit** and the farmers were almost totally dependent on the moneylenders whose sole objective is to exploit the farmers by forcing them to sell produce to them at low prices than the market prices in turn for the loans granted to them.
4.4.2 Government measures to improve agricultural marketing system in India:

An efficient agricultural market may lead to increase in efficiency of farmers and provide an incentive to produce more. Following measures have been adopted by Government to overcome the defects of agricultural marketing.

1. Establishment of Regulated markets:

Regulated markets are places where transactions are governed by various rules and regulations. The market committees consist of representatives of growers, traders and the government, who look after functioning of these markets. These committees are responsible for the enforcement of fair grading practices, licensing of market functionaries, stopping the deduction of unauthorised market charges, introduction of the open auction system of sales and enforcement of standard weights and to secure impartial arbitration in case of disputes. The markets provide yards, godowns, sheds, etc. Reliable and up-to-date market news are made available to the farmers. There are 7,161 regulated markets in the country.

2. Private terminal markets:

Private parties are being permitted to set up terminal markets for agricultural produce. These markets are being set up by corporate, other private enterprises and cooperatives. The facilities provided at the markets include electronic auction, cold chain and logistics support from the primary collection centers located at convenient places.

3. Provision for Storage and Warehousing facilities:

Improved storage performs the function of regulating supply in relation to demand, stabilisation of prices and maintenance of buffer stocks. A warehouse is a godown where goods are stored on the journey from places of manufacture or consumption. Storage and warehousing facilities for agricultural crops on commercial basis are available both in the public and private sectors. The main institutional agencies providing these facilities are the Central and State Warehousing Corporations, the Food Corporation of India and the Cooperatives.
4. Corporate marketing:

Corporate are more capable of undertaking risks and can face financial losses than small and medium farmers. The corporate buy the produce on contract basis from farmers, and pay them the prevailing market prices. The farmers can sell their produce elsewhere if they get a better price. The corporate are paying detailed attention to several aspects of retail chain right from seed distribution, fertiliser application, improving irrigation technologies, facilitating credit, processing and setting up cold storage, transporting and finally selling the produce.

5. Standard weights and Grading:

The Standard weights and Measures Act was brought into force in 1958. Under the Act, only Government weights and measures can be used for transactions. Grading of agricultural produce is done under the provisions of the Agricultural Produce (Grading and Marketing) Act, 1937, for which purpose the insignia AGMARK is used. This insignia is the hallmark of quality. Grading standards have been laid down for 150 agricultural and allied commodities. Compulsory grading before export is carried out in respect of 41 commodities.

6. Market information:

Relating to agricultural products collected by public agencies and co-operatives is made available to farmers. For dissemination of information all sorts of media, like display boards, radio, television, weekly, monthly and yearly publications, conferences, etc. are used. This information service is a part of the infrastructure that is needed for a healthy functioning of the market. Further, during 2005-06, a scheme for Marketing Research and Information Network, AGMARKNET, was implemented to provide electronic connectivity to important wholesale markets in the country for collection and dissemination of price and market related information.

7. Transport arrangements:

In an integrated road development programme, rural roads have been assigned a higher priority so as to bring lakhs of our villages into the national mainstream. As at the beginning of the Tenth Plan, 61,947 villages out of a total of 67,915 villages with a population of 1,500 and above had been connected by all-weather roads. Similarly, 40,551 villages out of a total of 57,859 villages with a population between 1,000 and 1,500 had been so connected.
8. State Trading in Food-grains:
   It has been introduced mainly with the object of providing food-grains to the deficit States. However, it has also been adopted as a measure to support the farmers in securing reasonable prices. It is carried out partly by the Food Departments and partly by the FCI.

9. Market Intervention Scheme (MIS):
   In order to protect the growers of the horticultural / Agricultural commodities which are perishable in nature, from making distress sales in the event of bumper crop during peak arrival period when prices fall to very low level, Government implements MIS for a particular commodity on the request of a State Government concerned. Losses suffered are shared on 50:50 basis between Central and the State. The NAFED has been appointed as a Central Nodal Agency which operates the scheme through the State designated agencies i.e., State Marketing Federations.

10. Marketing Inspection, Research and Training:
    The government has paid attention to the requirements of adequate arrangements for market inspection, research and training. Occasional surveys of markets can help in identifying problems and finding solutions for them. The directorate of Marketing and inspection undertakes inspection and research of major agricultural products.

11. Cooperative marketing:
    It requires that individual farmers organise themselves into a cooperative society; they pool their produce together, and market it collectively. The sales proceeds are distributed among the individual members in proportion to their share in the produce marketed. Cooperative marketing as a separate institution came to be developed during the second plan. The National Cooperative Department and Warehousing Board was set up in 1956. It was expected to plan and promote programmes for the production, processing, marketing, storage, warehousing and import of agricultural produce through cooperative societies with financial assistance from the Government of India. This board was subsequently replaced by National Cooperative Development Corporation (NCDC) which was set up in March, 1963.
4.5 AGRICULTURAL PRICE POLICY IN INDIA

Agricultural Price Policy in India has moved through two distinct phases during the last five decades. In 1965, the Agricultural Price Commission (since then designated as the Commission on Agricultural Costs and Prices CACP) was set up.

1. Organisation of food zones: To introduce an element of stability in agricultural prices, food zones were organised in March 1964. The country was divided into eight wheat zones. Rice zones were formed in South India. On the failure of this experiment, each State was made a separate zone. Movement of food-grains within a zone was free but restrictions were imposed on movements from one zone to the other. The Government took upon itself the task of procuring food-grains from the surplus States and distributing them to the deficit-States through the public distribution system.

2. Fixation of minimum support prices and procurement prices by the government: The agricultural Prices Commission was, accordingly, set up in January 1965. It was renamed Commission for Agricultural Costs and Prices (CACP) in 1985. Ever since its inception, the Commission has been announcing minimum support prices, procurement prices and issue prices for a number of agricultural commodities. Minimum support prices are in nature of a long term guarantee to the producers. Procurement prices are fixed at a higher level as compared to the minimum support prices and are meant essentially for the purchase of quantities needed by the government for maintaining the public distribution system and for building up buffer stocks. Issue prices indicate the prices at which the government supplies food-grains through fair price shops and ration depots.

3. Rationing and sale through fair price shops: The public distribution system in our country operates through a network of ration shops and fair price shops. Fair price shops are intended to meet the minimum needs of the vulnerable sections of society. However, these shops are at present meeting the requirements of all. For their extra need of food-grains, the consumers can turn to the free market. The total number of fair price shops has increased from 2.39 lakh in March 1979 to about 4.75 lakh.
4. **Other steps**: The government initiated a number of other steps to ensure favourable returns to the farmers and reasonable prices to the consumers. These included building up of buffer stocks, State trading, nationalisation of wholesale trade in wheat and rice, procurement from wholesalers, import of food-grains, etc.

4.5.1 **Shortcomings:**

1. **Inadequate coverage**: The facility of official procurement reaches only a handful of farmers. It covers hardly 15% of the total food-grains production. It has only benefited those farmers who have surpluses and had a negative impact on small farmers in underdeveloped regions.

2. **Rising burden of subsidies**: The remunerative price and/or subsidised inputs have failed to keep pace with the rate of increase in costs. It has had two consequences. Firstly, the farmer is discouraged from producing the maximum level of output and secondly, the government is taking upon itself a huge burden of subsidies.

3. **Transmitted wrong signals**: The current prices of inputs and outputs in India send a wrong signal to the farmers that conserving social and water resources are inefficient and depleting them is efficient.

4. **Ineffective Public Distribution**: A large section of the poor people is outside the purview of the Public distribution System. Therefore the system has failed to serve the objective. It has just increased the burden on the national exchequer.

5. **Large price spend**: There is an important issue of wide difference between prices received by the producers and prices paid by the consumers. In this context, issues relating to the network of regulations and costs associated with it, incidence of octroi, increase in transportation costs, over fragmentation of the distribution network, etc. are some of the issues that need a careful and detailed study.

6. **Neglect of linkages**: Agricultural Price Policy measures take into account only the relationship between agricultural inputs and the product prices. The relationship between agricultural raw materials and the finished products is not adequately examined.
Agricultural Price Policy ignored the backward and forward linkages of agricultural crops. It caused a serious limitation in achieving the objectives of equity and productivity and may jeopardize other economic objectives like promotion of exports. Lack of integrated approach is a serious weakness of the APP as practiced in India.

4.5.2 Suggestions for Reorientation of Agricultural Price Policy:

Following suggestions can be made in regard to reorientation of the APP.

1. **Minimum Support Prices:** Two economic criteria should govern the operations based on MSP. a) MSP should only cover the cost of production of an efficient producer; b) Farmers should make profits by responding to market signals and c) MSP should help the farmers in making the necessary adjustments and not in obviating their need.

2. **Procurement Price:** Procurement prices are fixed at a higher level as compared to the MSP and are meant for the purchase of quantities needed by the government for maintaining the public distribution system and for building up buffer stocks. A lower procurement price would serve the purpose of procurement well enough.

3. **Maximum price:** The primary responsibility of the government in relation to the fixing of maximum level for the price of a commodity is (a) to keep in check the inflationary forces bringing about increases in the overall price level, (b) elimination of collusive and manipulative practices leading to artificial scarcity and high prices for particular commodities.

4. **Reforms of the Institutions:** Two important institutions are directly connected with the management of the food economy viz., the CACP and the FCI. The CACP should retain its expert character rather than trying to be representative of various interests. The FCI should be decentralised and debureaucratised and the states should be made major stakeholders.

Above all, it should be recognised that price policy measures can, at best, be supplementary to other policy measures and institutional interventions
4.6 ISSUE OF FOOD SECURITY

Ensuring food security ought to be an issue of great importance for a country like India where more than one-third of the population is estimated to be absolutely poor and one-half of all children malnourished in one way or another. There have been many emerging issues in the context of food security in India in the last two decades.

World Development Report (1986) defined food security as- “access by all people at all times to enough food for an active, healthy life.”

Food and Agriculture Organisation (FAQ) defined food security as - “Ensuring that all people at all times have both physical and economic access to basic food they need.”

◆ Stages of Food Security:

The concept of food security depends on the stages of its economic development.

- **Stage I**: Food security in the first stage implies adequate quantity of cereals available to all.

- **Stage II**: In the second stage food security includes adequate availability of cereals and pulses.

- **Stage III**: Food security in the third stage cereals, pulses, milk and milk products.

- **Stage IV**: Food security in the fourth stage includes cereals, pulses, milk and milk products, vegetables, fruits, fish, eggs and meat.

◆ Objectives of Food Policy in India

a) To avoid localised and widespread famine and open under-nutrition;

b) To maintain remunerative prices to farmers, encourage them to use modern inputs and technology;

c) To stabilise prices due to market distortions;

d) To provide price support when there is a rapid fall in food-grain prices;
e) To attempt through administrative means to keep down prices when there is a strong upward pressure
f) To supply vulnerable classes with food-grains at below market prices;
g) To procure food-grains for public distribution at below market prices;
h) To build and maintain a buffer stock of food-grains to facilitate government operations;
i) To use the agricultural price policy to resist general inflationary forces in the economy.

◆ **Performance**

Attainment of self sufficiency in food grains at the national level is one of the country’s major achievements in the post-independence period. After remaining a food deficit country for about two decades after independence, India became largely self-sufficient in foodgrain production at the macro level. There have hardly been any foodgrain imports after the mid-1970s. Foodgrain production in the country increased from about 50 million tonnes in 1950-51 to around 233.9 million tonnes in 2008-09. The growth rate of foodgrains has been around 2.5 per cent per annum between 1951 and 2006-07.

The production of oilseeds, cotton, sugarcane, fruits, vegetables, and milk has also increased appreciably. The experience of the last two decades shows that growth rates of production and yield have declined for crop groups/crops during the period 1996-2008 as compared to the period 1986-97 (Table 4.2). The growth rate of foodgrain production declined from 2.93 per cent to 0.93 per cent during the same period. The growth rate of production was much lower than that of population in the latter period. Similarly, growth rate of yields of foodgrains declined from 3.21 per cent to 1.04 per cent. There was also a decline in growth rates of production and yields for cereals, pulses, oilseeds, rice, and wheat (Table 4.2)
Table no - 4.2

Trend Growth Rates in Production and Yields of Foodgrains and Oilseeds (% per annum)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<tbody>
<tr>
<td>Foodgrains</td>
<td>2.93</td>
<td>0.93</td>
<td>3.21</td>
<td>1.04</td>
</tr>
<tr>
<td>Cereals</td>
<td>3.06</td>
<td>0.97</td>
<td>3.36</td>
<td>1.19</td>
</tr>
<tr>
<td>Pulses</td>
<td>1.32</td>
<td>0.36</td>
<td>3.66</td>
<td>2.25</td>
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<tr>
<td>Oilseeds</td>
<td>6.72</td>
<td>1.99</td>
<td>3.32</td>
<td>1.49</td>
</tr>
<tr>
<td>Rice</td>
<td>3.06</td>
<td>1.02</td>
<td>1.02</td>
<td>1.02</td>
</tr>
<tr>
<td>Wheat</td>
<td>4.09</td>
<td>0.65</td>
<td>2.93</td>
<td>0.34</td>
</tr>
</tbody>
</table>

Source: CACP, Ministry of Agriculture (2009)

4.6.1. Instruments of Food Policy:

The various instruments of food policy in India can be explained under three sections,

A) Production and Supply of food-grains
B) Consumption of food-grains
C) Distribution of food-grains.

A) Production and Supply of food-grains:

The basic objective of agricultural planning in India has been to achieve self reliance in production of food-grains.

1. Production: Production of food-grains in particular, and agricultural production in general, has been sought to be raised through the adoption of a package of measures which can be grouped under three heads, viz., technological improvements, institutional and infrastructural reforms, and support services. Technological improvements and institutional reforms have aimed at providing infrastructure that proves conducive to the goal of a rapid increase in agricultural production. Minimum support prices guarantees the producers that the prices will not be allowed to fall below the minimum economic levels. Since 1977-78, the support prices have been raised from year to year.
2. Supply: Domestic production of food-grains has always been sought to be supplemented by imports, whenever warranted by the domestic situation. The primary objective of imports as of the food policy in general has been to help sustain the public distribution system and to protect the interests of the weaker sections of society.

B) Consumption of food-grains:

There are two aspects of consumption of food-grains in India:

- There is increasing number of mouths to be fed.

- The consumption patterns of people have been loaded in favour of cereals, specially wheat and rice.

1. Population Policy: The aim of the Government policy in this regard has been to give the facilities and incentives to people to check the size of their families. The family welfare planning programme which forms a part of the nation’s population policy has striven hard to bring down the fertility rate.

2. Nutrition policy: The National nutrition Policy, formulated in 1993, recognises the significance of short term measures such as nutrition interventions for special vulnerable groups, fortification of food items, control of micro-nutrient and protein-energy deficiencies through inter-sectoral programmes such as universalisation of supplementary feeding for pre-school children and expectant and nursing mothers through Integrated Child Development Scheme, basic minimum services including mid-day meals for school going children, child survival and safe motherhood programme to extend nutrition and universal immunisation. To achieve these, the National Plan of Action was initiate in 1995.

C) Distribution of food-grains:

1. Public Distribution System (PDS): The basic objective of the public distribution system in India is to provide essential consumer goods at cheap and subsidised prices to the consumers. To run this system, the government resorts to levy purchases of a part of the marketable surplus with traders / millers and producers at procurement prices. The grain thus procured, is used for distribution to the consumers through a network of ration / fair price shops and / or building up buffer stocks. PDS has been also used in India for the distribution of edible oils, sugar, coal, kerosene and
cloth. The most important items covered under PDS in India have been rice, wheat, sugar and kerosene. Together these four items have accounted for 86 percent of the total PDS sales. PDS distributes commodities worth more than Rs.30,000 crore annually to about 160 million families and is perhaps the largest distribution network of its kind in the world.

The main agency providing food-grains to the PDS is the Food Corporation of India (FCI) set up in 1965. The primary duty of the Corporation is to undertake the purchase, storage, movement, transport, distribution and sale of food-grains and other foodstuffs. It ensures on the one hand that the farmers get remunerative prices for their produce, and on the other hand, the consumers get food-grains from the central pool at uniform prices fixed by the government of India.

2. **Buffer stocks:** This is the stock which would enable the Government to maintain the supply line even in a year of crop failure. The primary objectives of buffer stocks are price stabilisation and achievement of stability of farm incomes. These objectives determine the optimum size of buffer stocks that the Government should hold. The holdings of food-grains involve costs in the form of interest lost, go-down rentals and wastage in storage. These costs have been estimated to have gone up from Rs.77.55 per quintal in 1991-92 to Rs.390.0 per quintal in 2005-06 and are estimated to be rising at the rate of 15 percent per annum.

3. **Procurement:** Buffer stock operations can be successfully maintained only if these are supported by a proper procurement of food-grains by the government. The following systems of procurement have been adopted in India in recent years:
   - A monopoly purchase in which the whole of the marketable surplus is to be sold to the State only;
   - A graded levy on producers on his total land holdings and with a certain weightage for irrigated land;
   - A levy on millers / dealers;
   - Purchase through licensed wholesale dealers including millers;
   - Support purchase in open market.

4.6.2. **Problems in PDS / Food Security System:**

The PDS which is the main constituent of food security in India is criticized for its flaws as under:
1. Limited Benefit to poor from PDS: The rural as well as urban poor have not benefited much from the PDS as their dependence on the open market has been much higher than on the PDS for most of the commodities. A large number of poor who are homeless and without proper residential proof are left out of the food security system as they did not possess ration cards.

2. Regional disparities in PDS benefits: There are considerable regional disparities in the distribution of PDS system. In 1995, the four Southern States of Andhra Pradesh, Karnataka, Kerala and Tamil Nadu accounted for almost one-half of total PDS off-take of food-grains in the country while their share in all India population below the poverty line in 1993-94 was just 18.4 percent. As against this, the four Northern states of Bihar, M.P., Rajasthan and U.P. having as much as 47.6 percent of all India population below poverty line in 1993-94 accounted for just 10.4 percent of all India off-take of food-grains from PDS in 1995.

3. The question of urban bias: It has been observed that the off-take in the urban areas was about 85 percent of the total off-take from the PDS. There was indeed an urban bias in PDS in the 1960s and 1970s as its coverage was confined to major cities and a few states. However, with the expansion of PDS in rural areas in later period, this bias has been corrected.

4. The burden of food subsidy: PDS is highly subsidised in India and this put a severe fiscal burden on the government. Subsidy on PDS arises from the difference between the issue price and the economic cost of FCI. From Rs. 662 crore in 1980-81, food subsidy increased to Rs.2,850 crore in 1991-92 and further to Rs.25,800 crore in 2004-05.

5. Inefficiencies in the operations of FCI: The economic cost of FCI food-grains operations has been rising on account of increase in procurement prices and other costs which include procurement incidentals, distribution cost and carrying cost. The inefficiencies in the operations of FCI are due to its highly centralised and bureaucratic mode of operation.

6. PDS results in price increases: It has been criticised that PDS have resulted in all round price increase. This is due to the reason that large procurement of food-grains every year by the government actually reduces the net quantities available in the open market. Taking advantage of this the traders indulged in speculation raising the food-grains prices in the open market.
4.6.3 Reorganisation of Food Security System:

To overcome the shortcomings and weaknesses in the PDS, following suggestions have been made:

1. **Targeted Public Distribution System (TPDS):** The key features of TPDS as adopted by the Government of India are as follows:
   
   **A) Targeting:** This policy introduced the targeting by dividing the entire population into below poverty line (BPL) and above poverty line (APL) categories, based on poverty line defined by the Planning Commission. From January 2006, the monthly entitlement of food-grains for BPL families was reduced to 35 to 30 kg per household per month. For APL families their entitlement was reduced from 35 to 20 kg per household per month.

   **B) Dual prices:** The PDS now has dual central issue prices: prices for BPL consumers and prices for APL consumers. A third price, introduced in 2001, is for the beneficiaries of the Antyodaya Scheme. It was announced in the Budget 2000 that central issue prices i.e. prices at which the Food Corporation of India sells grains for the PDS to State governments will be set at 50% of ‘economic cost’ of FCI for BPL families and 100% of the ‘economic cost’ for APL families.

   **C) Centre-State control:** PDS is designed and managed by State governments, and State governments differ with respect to entitlements, the commodities offered, retail price and so on. With the TPDS now, the size of the BPL population and the entitlement for the BPL population are decided by the central government.

2. Linking of PDS with Public works Programmes: The main objective of PDS is to work as a ‘Safety net’ for the poor by providing adequate quantities of food-grains at affordable prices. Rural works Programmes (RWP) like Employment Guarantee Scheme (EGS) in operation in Maharashtra, Jawahar Rozgar Yojana (JRY), Employment Assurance Scheme (EAS) and Sampoorna Grameen Rozgar Yojana (SGRY) which provide employment to the poor sections are also powerful safety nets for the poor.
3. Adoption of a Food Stamps / Food Credit Cards Programme: Tenth Five Year Plan, 2002-07, strongly advocates the adoption of a food stamps / food credit cards programme. In this context it calls for removing all restrictions on inter-State movement of food-grains once for all; strengthening the system of private trade and marketing of food-grains; and discontinuing the practice of having fair price shops throughout the length and breadth of the country and providing food subsidy through normal food supply shops. The plan calls for introduction of food stamps or the food credit card system. It advocates the adoption of the food stamps programme in phases. Under the system of food stamps, the State governments could issue a subsidy entitlement card (SEC) instead of issuing ration cards. The SEC will indicate the total number of food stamps a family is entitled to every month.

4. Decentralisation of the Food security System: Critics of PDS advocate decentralisation of this system. The basic level organisation in the proposed system would be panchayats and other local level participatory organisations. They would serve as an apparatus for reaching food to the poor. They would identify the poor, monitor their conditions and implement programmes to meet their employment and food needs. The Second tier in the food security system would be located at the State's development planning and policies. It would implement the price policy formulated at the national level and hold operational stocks of food-grains in dispersed locations to ensure intra-year stability of prices and to reach food-grains to areas where normal trade channels are weak or inoperative.

5. National Food Security Mission, 2007: On May 29, 2007, the government announced the launch of a scheme to double the growth rate in agriculture to 4 percent over the 11th Plan period. The Centre would provide Rs.25,000 crore for new farm initiatives launched by States. It also announced a time bound Food Security Mission to counter rising prices of food products by enhancing production of wheat, rice, pulses and edible oil to ensure visible changes in their availability over three years.

6. Blueprint for Development of Agriculture Sector: For Centre: (i) Food Security Mission to be launched for wheat, rice and pulses over four years. (ii) Additional 8 million tonnes of wheat, 10 million tonnes of rice and 2 million tonnes pulses to be produced over base year (i.e. 2006-07). (iii) New Additional Central assistance scheme with Rs. 25,000 crore funding over 4 years. (iv) hike in AIBP
funding. (v) restructuring of RIDF funding pattern to strengthen rural infrastructure / boost research. (vi) Direct Fertiliser Subsidy to farmers.

For States:

(i) District-based plans for optimum resource use.

(ii) AIBP Projects to be completed on priority in consonance with farm production targets.

(iii) Highest Priority to seed production.

(iv) Major KVK expansion planned.

4.7 WTO AND AGRICULTURE

The World Trade Organisation (WTO) was established on 1St Jan 1995 replacing General Agreement on Tariffs and Trade (GATT). GATT was a multilateral agreement to govern trade in goods only. WTO is based on principles of non-discrimination, free trade and promotions of fair completion among other member countries. About 95% of the global trade is governed by the rules and regulations of WTO. WTO agreements are permanent and ratified by the parliaments of member countries. WTO is directed by a Ministerial Conference which meets at least once every two years.

Actually WTO is having a wider scope and coverage than GATT. Under the Uruguay round, all member nations of GATT participating in negotiations committed themselves to a widespread reductions in tariffs, removal of quantitative restrictions and opening up their economies to international competitions in most fields of economic activity. Thus the new international economic order that is taking shape under the aegis of WTO is likely to pull-down drastically the levels of domestic protection in all areas of economic activity.

◆ WTO And AGREEMENTS ON AGRICULTURE (AoA):

The Agreement on Agriculture (AoA) provides frame work for the long term reform of agricultural trade and domestic policies over the years to come, with the objective of introducing increase market orientation in agricultural trade. AoA deals specifically with:
A. Providing Market Access

As far as providing market access is concerned AoA required that the prevailing non-tariff barriers in agriculture, which were considered trade distorting, were to be abolished and converted into tariffs so as to provide the same level of protection and subsequently the tariff were to be progressively reduced by a simple average of 36% by the developed countries over 6 years (Year ending 2000) and by 24% by the developing countries over 10 years (year ending 2004). From the following table it would be clear;

Table no.4.3

Reduction Commitments under AoA

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Tariff cut for Agricultural products</td>
<td>24 %</td>
<td>36 %</td>
</tr>
<tr>
<td>- Domestic Support</td>
<td>13 %</td>
<td>20 %</td>
</tr>
<tr>
<td>- Export Subsidies (Budgetary Outlays)</td>
<td>24 %</td>
<td>36 %</td>
</tr>
<tr>
<td>- Volume of subsidized export</td>
<td>14 %</td>
<td>21 %</td>
</tr>
</tbody>
</table>

B. Reducing Domestic Support:

As far as the issue of reducing domestic support is concerned AoA divides domestic support into two categories;

1. Trade Distorting:
2. Non-trade Distorting:

1. Trade Distorting:

All trade distorting domestic support has been put in the Amber Box. This has to be quantified in accordance with the Aggregate Measure Of Support (AMS) and removed. The AMS consist of two parts.
• **Product Specific Support:** This is the difference between domestic support price and external reference price, multiplied by the quantity of production which get such support.

• **Non-Product Specific Support:** This is the subsidy on the various agricultural inputs like fertilisers, electricity, irrigation and credit.

    AoA stipulated the reduction of total AMS by 20% for the developed countries over a period of 6 years, while the developing countries were required to reduce the total AMS by 13% over a period of 10 years.

    Least developed countries need not make any cuts. This category of domestic support is called Amber Box.

2. **Non-trade Distorting:**

    As far as non-trade distorting domestic support measures are concerned, they have been divided into three categories;

• **Green Box Support:**

    The green box measures include assistance given through environmental assistance programmes, services such as research training and extension, marketing information, certain type of rural infrastructure etc. The support under Green Box is excluded from any reduction commitments and is not subject to any upper limit.

• **Blue Box Support:**

    It is product limiting subsidy mainly pertaining to developed countries. Blue Box subsidies are certain direct payments made to farmers where the farmers are to limit production. It includes certain government assistance programmes to encourage agriculture and rural development in developing countries and other support on a small scale. It is exempted from reduction commitment under WTO. The developed countries subsidies their agriculture mainly under the green and blue boxes.

• **Special and Differential Treatment Box Support:**

    It includes investment subsidy to agricultural sector for farm development work. It also includes agriculture input services to poor farmers. This support is mainly related to developing countries and is exempted from reduction commitment under WTO.
C. Export Subsidies:

As far as export subsidized are concerned, as is clear from table 4.3, the developed countries were required to reduce the volume of subsidized exports by 21% over 6 years and the budgetary outlays for export subsidies by 36% with respect to the base period 1986-90. Developing countries were required to reduce the volume by 10% and budgetary outlays by 24% over 10 years.

✧ India’s Position On AoA:

The WTOs Agreements On Agriculture (AoA) has some mixed experience for agricultural trade in India.

1. Market Access:

India was required to replace all types of non tariff barriers (NTBs) by 2005. India used to maintain Quantitative Restrictions (QRs) on the import of 825 agricultural products. According to WTO commitments India has eliminated QRs on import of all items on 1st April 2001.

India has opened up its market and has made the farming community vulnerable to the imports of highly subsidized commodities of developed countries. Cheap imports of skimmed milk powder, edible oils, sugar, tea, apples, coconuts etc have flooded Indian market.

2. Domestic Support:

India does not support any product specified support other than market price support. Product specific support is calculated for 1995-96 for almost all products for example Rise, Wheat, Coarse Cereals, Pulses, Cotton, Tobacco etc. are negative.

The non-product specific support in 1995-96 represents 7.52% of the corresponding total value of agricultural products. India is not required to reduce its domestic subsidies. The aggregate measures of support in India’s case worked out to be 22.5% of the total value of agricultural production. It is much less than the stipulated ceiling of 10%. Almost all developed countries provide much higher support to their farmers.

3. Export Subsidies:

India does not have export subsidies. In India exporters of agricultural commodities do not get a direct subsidy. The only subsidies available to export are in the form of ;
1. Exemption of profit export sales in income tax and,
2. Subsidies on cost of freight on export shipments of certain agro-based products like fruits, vegetables and flowers.

The income tax exemptions that exporters get from export profits are not covered under the list of subsidies given by the WTO.

4.8 SUMMARY

- The credit needs of the Indian farmers can be classified as
  - Short term credit (for the period up to 15 months)
  - Medium term credit (for the period between 15 months to 5 years)
  - Long term credit (for the period exceeding 5 years)
- There are two sources of credit available to farmers
  - Institutional sources: It refers to loans provided to farmers by
    - co-operative societies and co-operative banks
    - Commercial banks including regional rural banks (RRBs)
  - Private sources: Private or Non institutional sources include;
    - Money-lenders
    - Traders and commission agents
    - Relatives and landlords.
- A National Bank for Agricultural and Rural Development (NABARD) or the National Bank was set up in July 1982 as an apex institution and a refinance institution.
- The various types of agricultural marketing in India can be classified as
  - Primary markets.
  - Secondary markets.
  - Terminals & fairs.
  - Regulated markets.
  - Co-operative markets.
  - State trading corporations etc
There are many defects in agricultural marketing in India and the Government of India has adopted several measures to correct these defects.

The agricultural Prices Commission was, accordingly, set up in January 1965. It was renamed Commission for Agricultural Costs and Prices (CACP) in 1985.

World Development Report (1986) defined food security as “access by all people at all times to enough food for an active, healthy life.”

The various instruments of food policy in India can be explained under three sections
- (A) Production and Supply of food-grains.
- (B) Consumption of food-grains.
- (C) Distribution of food-grains.

The basic objective of the Public Distribution System (PDS) in India is to provide essential consumer goods at cheap and subsidized prices to the consumers.

To overcome the shortcomings and weaknesses in the PDS, Targeted Public Distribution System (TPDS) have been suggested.

The World Trade Organisation (WTO) was established on 1st Jan 1995 replacing General Agreement on Tariffs and Trade (GATT).

WTO is based on principles of non-discrimination, free trade and promotions of fair completion among other member countries.

The Agreement on Agriculture (AoA) provides frame work for the long term reform of agricultural trade and domestic policies.

AoA deals specifically with:
- Providing Market Access
- Reducing Domestic Support
- Export Subsidies

The Green Box measures include assistance given through environmental assistance programmes, services such as research training and extension, marketing information, certain type of rural infrastructure etc.
Blue Box is product limiting subsidy mainly pertaining to developed countries. Blue Box subsidies are certain direct payments made to farmers where the farmers are to limit production.

4.9 QUESTIONS

Short Questions:
1. What are the Institutional Sources of rural credit?
2. Non-Institutional Sources of rural credit.
3. Write the Functions of NABARD.
4. What is meant by Food Security?
5. Explain the need for Food Security in India.
6. Write Short Note on PDS.
7. Green Box and Blue Box.
8. AoA of WTO.

Answer in Brief:
1. What are the sources of rural credit in Indian agriculture?
2. Write a brief note on NABARD.
3. Discuss the different types of Agricultural markets in India.
4. What are the defects of agricultural markets in India?
5. What measures can be suggested to correct the defects of agricultural marketing.
6. Explain the Agricultural Price Policy in detail.
7. Examine the Food Policy in India.
8. India and AoA of WTO.
MODULE 3
SECONDARY AND TERTIARY SECTOR

Unit Structure :

5.0 Objectives
5.1 Introduction
5.2 Trends in Industrial production and productivity
5.3 Changes in Industrial Structure.
5.4 Industrial Policy 1991
5.5 Disinvestment Policy
5.6 Special Economic Zones (SEZ)
5.7 Summary
5.8 Questions

5.0 OBJECTIVES

- To know the trends in industrial production and productivity in India.
- To know the Changes in Industrial Structure.
- To know the objectives and performance of Industrial Policy 1991.
- To know the process of Disinvestment Policy.
- To understand what is Special Economic Zones (SEZ).
- To study impact of SEZ on Indian economy.

5.1 INTRODUCTION

Industrialisation has a major role to play in the economic development of the underdeveloped countries. The government of India has recognized the significant contribution of industrial sector could achieve the goal of speedy growth of the economy. Thus the government of India launched the process of industrialisation in early 50s.
At the time of independence, India was industrially an underdeveloped economy. The poor industrial sector was dominated by consumer goods industries. The important industries were, by and large agro-based, like cotton textile, jute, sugar, paper, salt, and soap & leather goods. The capital goods industries hardly made their presence felt. One of the important reasons for weak industrial sector was the negligence during the British period. The British considered India as a source of supply of raw material and market for British manufacturers.

5.2 TRENDS IN INDUSTRIAL PRODUCTION AND PRODUCTIVITY.

The study of industrial production and productivity trends can be studied in following two periods:

5.2.1 Trends in industrial production before 1990s (The pre-reform period-1947-1990):

5.2.2 Trends in industrial production after 1991 (The post-reform period-1991 onwards):

We can study the growth in industrial production in India before the periods of 1990s;

5.2.1 Trends in industrial production before 1990s (The pre-reform period-1947-1990):

In the post independence period, India embarked upon economic development under the Five Year Plans. It was accepted, that rapid development of the nation would only be possible through the establishment of a strong and diversified industrial base. The major changes in the industrial growth & structure during the planning period (pre-period) can be analyzed by dividing the planning period into three phases.

(i) Phase I (1951-65):

The First Plan (1951-56) did not envisage any large-scale programmes of industrialization. Only Rs.55 crore out of the total expenditure of Rs. 1,9602 Crore (2.8 per cent) was spent on ‘Industry & Minerals’ in the First Plan.
The Second Plan (1956-1961) accorded top priority to programmes of industrialization as would be clear from the fact that the expenditure on industry and minerals was liked to Rs 938 crore under this plan which was 20.1 per cent of the total expenditure of Rs.4,627 crore. Based on the Mahalanobis Model, the Second Plan set out the task of establishing basic and capital goods industries on a large scale so that a strong base for industrial development in the future could be built. Three steel Plants of one million tonnes capacity each were set up in the public sector at Bhilai, Rourkela & Durgapur besides the expansions and modernization programmes undertaken in the private sector.

The Third Plan (1961-1966) also pressed forward with the establishment of basic capital and producer goods industries – with special emphasis on machine buildings programmes – so that the growth of the economy in the subsequent plans could become self sustaining. Expenditure on industry in the Third Plan was Rs.1, 726 crore which was 20.1 per cent of the total expenditure of Rs.8577 crore under the plan. On an average growth rate of Industrial output during this phase was about 7% per annum.

(ii) Phase II (1965-1980):

This phase was marked by industrial deceleration and structural retrogression. The industrial growth rate declined to less than an annual average of 5%. The slow growth was attributed to inadequate investment in infrastructure sectors such as power transportation, etc. Slow growth in agricultural sector caused a decline in demand from this sector to industrial products. Restrictive policy through licensing policy, MRTP & FERA Acts had an adverse effect on private investment. Besides, the 1965 & 1971 wars, oil shock (oil price rise) in 1973, drought in 1965-66 had their effect on the growth rate.

The industries where the growth rate has been moderately high belonged either directly or indirectly to the consumption goods sector For e.g. the out put of man-made fibers ,beverages ,perfumes and cosmetics ,watches and clocks ,cloths etc. increased largely

✓ Causes of Deceleration and Retrogression:
- The war of 1965 and 71.
- Drought conditions.
Financial problems.
Wrong industrial policies.
Bureaucratic system of Licensing.


The period of 1980s can be broadly termed as a period of industrial recovery. The rate of industrial growth was 6.4% per annum during 1981-85, 8.5% per annum during the Seventh plan (1985-90) and 8.3% per annum in 1990-91. This growth was impressive. The study of R. Nagaraj shows the growth rate in value added in registered manufacturing to be 7.6% per annum in phase-II and 10.4% per annum in phase-III. The industrial growth in phase-III is substantially higher than the industrial growth in the earlier periods.

As noted by Vijay Kelkar and Rajiv Kumar, “this is a marked upturn from growth rates of around 4% achieved during the latter half of sixties and the seventies. This performance is also an improvement upon the growth rates achieved during the First and Second Plan periods.”

Increase in investment, especially in the public sector, that too in infrastructure, helped the industrial sector to get into a recovery phase. Measures like increase in license capacity scheme, fiscal incentives extension of broad banding, liberalization of import of foreign technology and many more liberal measures resulted into more investment and increased demand.

5.2.2 Trends in industrial production after 1991(The post-reform period-1991 onwards):

The period after 1991 is referred to as period of Post-Reform. The Government of India announced the New Industrial Policy in 1991. A number of liberalization measures such as scrapping of the licensing system, dilution of the role of public sector, encouraging private investment in various fields, allowing foreign direct investment (FDI) liberally in various sectors etc. led to marked acceleration registered by the capital goods sector. The average annual growth rate of industrial production was 5.7% annum during 1990-2000. The industrial growth rate was only 2.3% in 1992-93. It rose to 6.0% in 1993-94.
The rate of growth shot up to as much as 13.0% in 1995-96 but fell to 6% in the next year 1996-97. Some of the causes of unsatisfactory industrial performance are: (a) exposure to external competition (b) the infrastructural constraint (c) sluggish growth in export (d) slow down in investment especially to agriculture etc.

After 2002-03, the industrial sector was on the path of the revival. The growth rate of industrial production was 5.7% in 2002-03, and picked up considerably to 7.0% in 2003-04, 804% in 2004-05, 8.2% in 2005-06 & to as high as 1.5% in 2006-07. For the 8th plan as a whole it comes out to 8.2% per annum.

This revival in the industrial growth rate can be attributed to;
(a) Growth of infrastructure industries
(b) Building up of heavy & capital goods industries
(c) Rapid growth of consumer durables
(d) Heavy foreign direct investment & portfolio investment etc.

However a question that has engaged the attention of the economists in recent times is what has been the effect of these liberalization measures on the performance of the industrial sector in the post reform period? To answer this question we have to study the following table containing the figures which compares the performance of the industrial sector during the pre-reform decade and post-reform period.

**Table no-5.1**

**Average Annual Growth Rate of Production in Pre-reform and Post-reform Period**

<table>
<thead>
<tr>
<th>Functional Classification</th>
<th>Pre-Reform. (1980-91)</th>
<th>Post-Reform Period (1991 onwards)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Goods</td>
<td>7.4</td>
<td>6.8</td>
</tr>
<tr>
<td>Capital Goods</td>
<td>9.4</td>
<td>8.9</td>
</tr>
<tr>
<td>Intermediate Goods</td>
<td>4.9</td>
<td>8.5</td>
</tr>
<tr>
<td>Consumer Goods</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Durables</td>
<td>6.0</td>
<td>6.6</td>
</tr>
<tr>
<td></td>
<td>10.8</td>
<td>13.4</td>
</tr>
<tr>
<td>2. Non-Durables</td>
<td>5.3</td>
<td>4.8</td>
</tr>
<tr>
<td>General Index</td>
<td>7.8</td>
<td>7.4</td>
</tr>
</tbody>
</table>

The Period of 1990s:

Important facts regarding industrial growth trends in this period are as follows:

- The average annual growth rate of industrial production which was 7.8% in 1980-1991 fell to 5.7% during the period 1992-2000.

- The rate of growth of industrial production in the Eighth plan (1992-97) was 7.4% per annum which was the same as the targeted rate of growth. So the performance was satisfactory on this count.

- The rate of growth of industrial production in the Ninth plan (1997-02) was only 5.0% per annum which was considerably less than the targeted rate of 8.2% per annum. That means the performance of industrial sector was highly unsatisfactory during the period of the second half of 1990s.

- The industrial sector registered a dismal performance in the last year of the Ninth plan, 2001-02 with its rate of growth being just 2.7%. This is the worst performance of the industrial sector over the entire decade 1992-93 to 2001-02 excepting the year 1992-93 when the rate of industrial growth was 2.3%.

- The post-reform period was marked by considerable fluctuations and thus showed a total lack of consistency in the industrial growth performance.

The Period Since 2002-03:

The period of the Tenth plan (2002-07) witnessed revival of industrial growth. The rate was 5.7% in 2002-03 and picked up considerably to 7.0% in 2003-04, 8.4% in 2004-05, 8.2% in 2005-06 and to as high as 11.5% in 2006-07. For the plan as a whole, the average rate of growth of industrial production comes out to be 8.2% per annum. Though it is less than the targeted rate of growth yet it marks a considerable increase over earlier plans.

The year 2009-10 witnessed some recovery with the rate of industrial growth climbing to 5.3%. This recovery was sustained in 2010-11 and the rate of growth of industrial production rose to 8.2%.
5.3 CHANGES IN INDUSTRIAL STRUCTURE.

The process of industrial growth in India has been accompanied by substantial diversification. Thus some structural changes have seen in industrial growth. Some important changes have discussed below:

1. **Share of Industrial Sector in GDP:**
   Over the planning period the share of industrial sector in GDP (Gross Domestic Product) has increased slowly but consistently. In 1950-51 the share of industry in GDP at factor cost was 15.1% which increased by 26.5% in 2007-08 and 27.9% in 2010-11. That means the share of industry in GDP at factor cost is increasing constantly.

2. **Infrastructure Industries:**
   Infrastructural development is the essential part of the economical development because industrial development cannot be experienced without infrastructural development. It includes Electricity, Coal, Crude petroleum, Steel, Cement, etc. These infrastructure industries have a weight of 37.9 in total industrial output.
   - The rate of **Electricity** generation rose from 5.1 billion KWH in 1950-51 to 811 billion KWH in 2010-11.
   - The production of **Coal** rose from 32.3 million tonnes in 1950-51 to 570.8 million tonnes in 2010-11.
   - The production of **Steel** rose from 1.04 million tonnes in 1950-51 to 66.0 million tonnes in 2010-11.
   - The production of **Crude petroleum** rose from 0.3 million tonnes to 37.7 million tonnes in 2010-11.
   - The production of **Cement** rose from 2.7 million tonnes in 1950-51 to 209.7 million tonnes in 2010-11.

3. **Heavy and Capital Goods Industry:**
   Heavy investment have taken place in this sector with the result that the industrial base of the economy is now much more stronger than it was in 1950-51. A wide range of engineering goods, iron and steel, metals and metal based products etc., are now produced within the country itself and dependence on the other countries has been considerably declined and in these product the status of India is much stronger than it was in 1950-51.
4. **A well diversified industrial structure:**
   After independence food products, textile, wood and furniture, and metal these four industries accounted for two-third of production. However their share has now declined considerably while the share of the machinery sector, chemicals, transport equipment sector etc., has risen at a fast rate. Thus the country now has a well diversified industrial structure.

5. **Rapid growth of consumer durables:**
The government of India has introduced the liberalisation policy in 1991, due to this policy the output of consumer durables has expanded at a very fast rate. The rate of growth in consumer durables segment was 14.4% per annum which rose by 10.7% per annum in the year 2001-02 and 14.2% in 2010-11. That means in these years the growth in consumer durables sector registered double digit growth.

6. **Emergence of public sector:**
Public sector enterprises play a pivotal role in the production of Fuels, Metals, Fertilisers, and Communication Equipments etc. The post-Independence period saw the emergence and massive expansion of public sector. The number of central public sector units at the commencement of the First plan was only 5 with a total capital of only Rs.29 crore. The numbers of public sector enterprises shot up to 248 in 2010-11. Cumulative investment in all these enterprises stood at Rs.6,66,848 crore in 2010-11.

❖ **Check your progress:**
❖ Write Short Notes:
1. Trends in industrial production before 1990s
2. Trends in industrial production after 1991
3. Structural changes in industrial sector.
5.4 INDUSTRIAL POLICY 1991

With the introduction of Industrial Policy Resolution 1956, the public sector became dominant sector and driver of economic growth. However in the course of time it was realized that excessive controls & restrictions have led to red-tapism, corruption and inefficiency in the public sector. During 1980s the government slowly started liberalizing the industrial policy along with its foreign trade policy. Liberalization took further steps under the Congress Government headed by Rajiv Gandhi.

In 1991, when Congress government came to power the country was in an economic crisis particularly the balance of payment situation was precarious. In a changing world economic scenario the Government realized the need for liberalization to overcome the damage done by the so called —License-Permit Raj • system. Accordingly, the New Industrial Policy was announced on July 24, 1991 as a part of the economic reform programmes. It was a radical departure from the earlier industrial policies. It substantially deregulated the industrial sector. It aimed at removing the distortions of the past and increasing the gains already made, improving productivity and gainful employment and also increasing the competitiveness of Indian Industries.

The policy was announced in two parts. The first one was concerned with medium and large industries; the second one was concerned with development of Small Scale Industries (SSI). While the earlier industrial policies emphasized the role of the public sector, the new industrial policy assigned a priority role to the private sector. It also envisaged the use of market mechanism to achieve the various objectives.

❖ Objectives of New Industrial Policy, 1991:

1. Full utilization of indigenous capabilities of entrepreneurs and thereby employment generation.
2. Improvement in efficiency & productivity.
4. Greater investment in Research & Development and bring new technology to attain international standards.
5. Removing existing government regulations and restrictions on industry.
6. Encouraging competition.
7. Development of backward areas and the small-scale sector.
8. Improving efficiency of the public sector.
9. Open the economy to the global market.

❖ **Highlights of New Industrial Policy (NIP) 1991:**

In order to achieve the above mentioned objectives, government took a series of initiatives in the following areas:

1. **Abolition of Industrial Licensing:**
   The licensing policy was introduced by the Government through the Industrial (Development and Regulation) Act 1951, with the objective of regulating the industrial sector and bringing about proper economic development. In reality however, it had resulted in delays in decision-making, corruption, red-tapism, efficiency etc. The NIP, 1991 abolished all industrial licensing, irrespective of the level of investment, except for 18 industries related to security & strategic concerns, social reasons, over riding environment reasons, hazardous chemical items of elitist consumption.

   Delicensed industries do not need government approval any more, but entrepreneurs are required to submit an Industrial Entrepreneur Memorandum (IFM) to the Secretariat of Industrial Approval. The 18 industries for which licensing was kept necessary were as under coal and lignite; petroleum (other than rude) and its distillation products; distillation, and brewing of alcoholic drinks; sugar; animal fats and oils; cigars and cigarettes; asbestos and asbestos-based products; plywood & other wood based products; raw hides, skins and leather; tanned or dressed fur skins; motor cars; paper & newsprint; electronic aerospace & defense equipments; industrial explosives; hazardous chemicals; drugs and pharmaceuticals; entertainment electronics; and white goods (domestic refrigerators, washing machines, air conditioners, etc).

   With the passage of time, most of these industries have also been delicensed. Now, only five industries require licensing. These are alcohol, cigarettes, hazardous, chemicals, electronics aerospace and defense equipment & industrial explosives.

2. **Public Sector’s Role Diluted:**
   The 1956 Policy Resolution had reserved 17 industries for the public sector. The 1991 (NEP) , reduced this number to 8 (a)
arms & ammunition. (b) atomic energy, (c) coal & lignite, (d) mineral oils, (e) mining of iron are, manganese are, chrome are, gypsum, sulphur, gold & diamond, (f) mining of copper, lead, zinc, fin, molybdenum and wolfram, (g) mineral specified in the schedule to the atomic energy and (h) rail transport.

The NIP, 1991 also announced a greater degree of autonomy to PSUs through the system of Memorandum of Understanding (MOUs). The sick public sector units had to be rehabilitated and reconstructed after getting the advice from the Board for Industrial & Financial Reconstruction (BIFR). The intention of the government to offer a part of its equity in PSUs to the public, financial institutions, and workers etc. also announced in this policy. A beginning in this direction was made in 1991-92 itself by divesting part of equities of selected PSUs.

3. MRTP Limit Goes:

The government enacted the Monopolies and Restrictive Trade Practices (MRTP) Bill in 1969 w.e.f. from 1970. The MRTP firms were originally defined as enterprises or interconnected firms that had assets of Rs. 20 crore or more or a dominant market share (33% or more). In 1984, the dominant share was reduced to 25% and in 1985, the asset limit was raised to Rs.100 crores such firms were not allowed to expand their activities or appoint director without the Government's permission.

There were several restrictions on mergers and amalgamation and takeovers in case of such firms. All this restricted the growth, productive expansion and efficiency of firms. Thus the NIP, 1991 scrapped the threshold limit of assets in respect would now be on par with other firms. They would also not require prior approved from the Government for investments in delicensed industries. The new Act aims at protecting the welfare of consumers by preventing and restricting unfair trade practices.

4. Free Entry to Foreign Investment and Technology:

The NIP, 1991, widened the scope of foreign capital in Indian Industries. This was done with the objective of improving the balance of payments position, making advanced technology available to domestic industries, modernizing industries and improving their competitiveness. The policy specified a list of high technology, high investment priorities industries wherein automatic approval was to be given for direct foreign investment up to 51% of
foreign equity. It consisted of industries like capital goods, entertainment electronics, food processing etc.

The foreign Investment Promotion Board has been constituted with the primary objective of speeding up the approval process for in India. Similarly, the use of foreign brand name or trademark for sale of goods in India permitted. Foreign equity upto 100% is particularly encouraged in export oriented units (EOUs), power sector, electronics & software technology parks.

Moreover, foreign equity up to 24% permitted in small scale enterprises. Foreign capital invested in India is allowed to be repatriated with capital appreciation after payment of taxes. No permission would be required for hiring foreign technicians and foreign testing of indigenously developed technologies. Remittances for technical services fees, subject to RBI approval can be made by companies.

**EVALUATION OF NEW INDUSTRIAL POLICY 1991:**

The new industrial policy (NIP), 1991, has given a new direction to the development of the industrial sector. Industrial growth has picked up in recent years, after initial periods of adjustment. Domestic and foreign investment in almost every industrial sector has increased manifold. The economy is growing at healthy rate after reforms were introduced. However, the industrial growth has been erratic & fluctuating & has not resulted in corresponding rise in employment.

(A) Positive Impacts of the New Industrial Policy:

1. **Reduction in project cost & time:**
   The Policy changes related to licensing foreign investment and foreign technology agreements have freed industries from excessive government control. Thus time and money spent to acquire licenses & approvals have been reduced resulting in low project cost as well as less time required to complete the project. In other words the gestation period has been shortened & efficiency has increased.

2. **Availability of foreign capital and technology:**
   Policies in the area of foreign investment and foreign technology agreements would bring in more capital, technology and
managerial and technical performed from abroad. This would increase the availability of such resources. The inflow of foreign direct investment in 1991-92 was US $129 million which increased to $43.29 billion in 2006. Telecommunications, electrical equipments and services are the sectors that are attracting foreign investment.

3. Performance of Public Sector:
   Changed in the public sector policy would bring about better allocation of public funds and improve efficiency of the public funds and improve efficiency of the public sector. Closures, liquidation or rehabilitation of sick public sector units will free resources for more productive use. Greater efficiency and accountability of units in the public sector should be ensured through implementations of Memorandum of Understanding (MOUs). The performance of public sector enterprises has improved considerably in recent years. The reliance of this sector on budgetary resources declined while their gross internal resources increased. The accumulated losses of Control Public Sector Enterprises have also been declining.

4. Restrictive Trade Practices:
   Amendments in the MRTP Act would curb anti competitive behavior and thus promote competition. Indian firms are now able to expand and grow with greater ease after the amendment.

5. Benefits to Consumers:
   The NIP and subsequently policy changes have made the Indian market more competitive. This has benefited Indian Consumers, who can now choose from a wide variety of good quality products at competitive prices. Companies are now able to change their product mixes to match changing consumer demand. Easier capacity expansion has reduced shortages of essential industrial items to large extent.

6. Internationalization of Indian Industries:
   As Indian industries have become internationally competitive, they are increasing their export orientation as well as making their global presence felt through mergers and acquisitions.

7. Autonomy to the Public Sector Undertakings (PSUs):
   This will lead to better performance, as there will be less interference from the government and bureaucrats. Moreover, this
dilution of the public sector will help the government to divert its attention to other essential sectors. While the NIP 200 can promote growth and efficiency, it has certain limitations also.

(B) Adverse impacts of the New Industrial policy:

1. Dominance of Multinational Firms:
   According to H.K. Paranjape, certain sectors of the economy, which have been opened to direct foreigner investments, include areas where Indian firms have been well established for years. Besides, these industries are in a position to develop indigenous technology through R and D efforts. Inviting foreign investment in these industries would make it possible for transnational and multinational firms to dominate these sectors of the Economy. The multinational firms would emerge as the most dominant one and will destroy indigenous research and development.

7. Unsuitable and Inferior Foreign Technology:
   Use of foreign technology and managerial inputs may not be suitable for Indian business conditions. MNCs are often reluctant to use their state-of-the-art technology in their subsidiaries in developing countries.

8. Unemployment:
   The issue of employment generation has been overlooked by this policy. Most of the industries encouraged by the NIP are capital intensive, energy and import intensive. Moreover use of foreign technology and excessive competition has increased capital intensity in production process. This has had an adverse effect on employment generation in the industrial sector. The MNCs have very low absorption capacity of labour. The employment generation capacity in the organized manufacturing sector has also reduced since 1991.

9. Dilution of the Public Sector:
   The dilution of the public sector from certain key areas like infrastructure development has resulted in increased user charges for many services like, power & roads, adversely affecting the poor. Besides employment generation and job security provided by the public sector has become a thing of the past.
10. **MRTP Act:**
The amendment of the MRTP Act and the relaxation of regulations related to mergers, amalgamations and acquisitions have resulted in emergence of large monopolies. This has increased concentration of economic power and has adversely affected small business.

11. **Social Problems:**
The policy has brought with social problems that are a direct result of increasing unemployment and reduced job security. The interests of workers who have been rendered jobless have not been successfully dealt with by the government.

12. **Industrial Sickness:**
The NIP has not been able to tackle the growing industrial sickness which continues to remain a major problem especially in the small scale sector. Thus the NIP has both positive as well as negative aspects. It is a mixed bag. In the era of liberalization and globalization. India cannot afford to have a policy of protection. While liberalization in good to improve competition and efficiency, certain problems, which affects labour have to be adequately dealt with.

### 5.5 DISINVESTMENT POLICY

The term ‘Disinvestment’ is used to indicate the process of privatization. Since the beginning of 1980s the functioning of the public sector began to questioned. It was held that the public sector performed well only when protected through state monopolies, entry reservations, high tariff and quotas, etc. Since quite a large number of public enterprises incurred losses year after year, it was argued that the state should not be called upon to meet the losses of these enterprises out of tax payer money since in our country. In this situation the question of privatization of the public sector was debated. Disinvestment is the process through which privatization could take place.

In order to restructure public sector investment and make it more rational it was thought to be necessary to improve profitability, efficiency and accountability of this sector. Disinvestment policy was adopted after 1991 as the process that would ensure this objective.
5.5.1 **Meaning of Disinvestment Policy:**

Disinvestment refers to the sale of the public sector equity to the private sector and the public at large. Thus disinvestment leads to privatisation. Privatisation is a process by which the government transfers the productive activity from the public sector to the private sector.

Thus the term disinvestment is used to indicate the process of privatization. Privatisation refers to any process that reduces involvement of the state or the public sector in economic activities. It has been argued by the supporters of privatisation that privatisation and therefore disinvestment of public sector units, leads to competition and efficiency which results into profitability. Thus the projects become viable and reduce burden of the government.

5.5.2 **Objectives and need for disinvestment:**

- To improved efficiency and performance of public sector.
- Through disinvestment of public enterprises the government expects to raise resources to pay for the cost of closing down of enterprises.
- To improve responsibility and accountability of public sector
- To provide better services to consumers.
- To modernize the public sector and upgrade technology with the help of resources generated.
- To eliminate political interference.

5.5.3 **Disinvestment Process And Performance:**

Some economists argued that the fiscal crisis of 1991 was a result of the public sectors inability to generate adequate returns on investment. The government attitude also changed markedly as is clearly demonstrated in the following statement made in the New Industrial Policy, 1991. —After the initial exuberance of the public sector entering new areas of problems are observed in the insufficient growth in productivity, poor project management, over manning, lack of continuous technological upradation, and inadequate attention to research & development (R&D) and human resource development. In addition, public enterprises have shown a very slow rate of return on the capital investment. This has inhibited their ability to regenerate themselves in terms of new investments as well as in technology development. The result is that many of
the public enterprises have become a burden rather than being as asset to the government, 1991, advocate privatisation of public sector enterprises.

The main approach of the government in this regard is bring down its equity in all non strategic public sector undertakings to 26% (or lower) and close down those public sector undertakings which cannot be revived. The disinvestment programme began in 1991-92 and government states in different public sector companies have been sold in varying degrees by 2007-08. Till 1998-99, the government use to sell minority states through domestic or international issue of shares in small tranches every year. From 1999-2000 to 2001-05, the focus shifted to the method of strategic sale involving an effective transfer of control and management to a private entity, the argument being that the government would get a better price from the private sector if it is ceding actual control. The prominent companies that have witnessed strategic sale in the recent past include modern foods, BALCO, CMC, VSNL, IBP, ITDC Hotels, IPCL, Maruti Udyog Ltd etc. After 2004-2005, disinvestment realisations have been through sale of small portions of equity.

5.5.4 Government Policies on Disinvestment:

The Government of India's policy on disinvestment was announced in the new industrial policy of 1991 and subsequently through the budget. The important policy measures are discussed below:

(i) New Industrial Policy, 1991:

The announcement of the New Industrial Policy, 1991, can be considered as the starting point of policy initiative taken by the government in the direction of disinvestment. In order to provide greater autonomy to public enterprises and make them more accountable, the government introduced the concept of Memorandum of Understanding (MOU). MOUs are contract between the government and PSUs that determine the project time, cost and functioning of the PSUs.

(ii) Committee on the Disinvestment of share in PSEs (Ramgarajan Committee) April 1993:

The Committee recommended substantial disinvestments and suggested that the best method for disinvestment is by offering shares of PSEs to the general public at a fixed price. It state that
the percentage of equity to be divested could be up to 49% for industries exclusively reserved for the public sector, so that the government can retain managing control by holding 51% equity. In other cases, percentage of equity diverted could be 74%, where an enterprise has dominant market share.

(iii) Disinvestment Commission:
The government set up the disinvestment commission in 1996 for working out terms and conditions related to disinvestment of government equity in PSEs and PSUs. The commission presented 13 reports till January 2002.

(iv) Greater Autonomy to Navaratnas and Miniratnas:
In 1997-98 greater autonomy was granted to Nine PSEs referred to as ‘Navaratnas’ (IOC, IPCL, ONGC, BPCL, HPCL, NTPC, SAIL, VSNL AND BHEL). GAIL and MTNL have also been given the same status. These enterprises, subject to certain guidelines, have full freedom to make capital expenditure decision regarding joint ventures and setting up of subsidiary offices abroad for technological and strategies alliance. Greater functional and operational autonomy has been granted to 97 other PSUs referred to as ‘Miniratnas’.

(v) New Privatisation Policy 1998:
On August 7, 1998 a New Privatisation Policy was announced. Following are the major features of the policy.

(a) Government to offload above 51% in strategic sales. This is now raised to 74%.
(b) Disinvestment price to be market determined and not pre fixed.
(c) Structural mechanism to speed up disinvestment process to be put in place. Under the structural mechanism, PSUs selected for disinvestment will be freed from administrative control of the parent ministry and placed under a new body, to be created for piloting the process.

(vi) Recent Developments:
In September 2003, the Supreme Court, in its judgement in the case of disinvestment in Hindustan Petroleum Corporation Ltd. (HPCL) and BPCL restrained the Central Government from proceeding with disinvestment of those two oil companies. Several
cases were filed, challenging strategies sale of PSUs in various high courts. In May 2004, with the congress led UPA coming to power it has been decided that chronically loss making companies will either be sold off, or closed after all the workers have got their legitimate due and compensation. However this government does not favour privatisation of profit making public sector companies. The existing Navaratnas companies will not be privatised, though they can raise resources from the capital market. This was because the Central Government was formed with the help of left parties. Since 2009, UPA has come to power again this time without the support of left parties. Thus it is expected that the process of disinvestment will get more momentum.

The government has decided to establish a Board for Reconstruction of public sector enterprises to advise the government on ways and mean for strengthening PSEs and make them more autonomous and professional. The government has also approved the constitutions of a National Investment Fund (NIF), made from the proceeds from disinvestments. This fund will make investments and social projects and in selected profitable and revivable PSEs.

5.5.5 Disinvestment Process or Methodologies:

The disinvestment policy of the government has been evolved and over a period of time. Disinvestment of government equity in Central Public Sector Enterprises (CPSEs) began in 1991-92. The following methods were adopted;

(i) Sale of Minority Shares: From 1991-92 to 1999-2000. Disinvestment was primarily through sale of minority share in small lots. Under this method beginning of 1991-92, the government offered shares for sale in bundles involving a combination of equity from poor and good performers. In practice, rather than help the government divest shares in loss making PSUs at reasonable prices, bundling resulted in the government obtaining a very low average price for each bundle, implying that prime shares were handed over at rock bottom prices. In 1992-93, the government abandoned the bundling of shares and sold shares of each company separately by the auction method.

(ii) Strategic Sale: Since 1999-2000, government shifted to another method the strategic sale of a PSU to a private sector company. Under this method the government sells major portion of its own stake to a strategic buyer an also hands over the management control. The government resorted to strategic sale of a number of companies Modern Foods India Ltd, VSNL, IPCL, BALCO, CMC LTD, HTL LTD, IBP, ITDC (13Hotels), Hotel corporation of India PTL, Hindustan Zinc Ltd, Maruti Udyog
Ltd etc. During 2003-2004, government accumulated Rs 15547 crs. Proceeds from disinvestment.

(iii) **Listing of shares on domestic stock exchanges:** At present the policy is to list large profitable CPSEs on domestic exchanges.

(iv) **Cross holdings:** In the cases of cross holdings, the government would sell a part of its share in one PSU to one or more other PSUs.

(v) **Warehousing:** Under the model of warehousing, government owned financial institutions are expected to buy the governments state in selected PSUs and hold them until, any third buyer emerged.

(vi) **Golden Share:** The golden share concept was designed to protect the government's interest in the PSUs. In this model, the government retains a 26% state in the PSUs, but a lesser stake does not make it a minority stake holder. Instead, this 26% share will continue to give the government the status of majority shareholder.

5.5.6 **Performances of Disinvestment Process:**

The disinvestment process began in 1991-92. Since then, upto year 2011-12 the performances of the disinvestment process can be explained with the help of following table.

**Table no.5.1**

Disinvestment of Equity in Public Sector Enterprises

<table>
<thead>
<tr>
<th>Year</th>
<th>Target</th>
<th>Realization</th>
<th>Cumulative</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>2500</td>
<td>3038</td>
<td>3038</td>
</tr>
<tr>
<td>1992-93</td>
<td>2500</td>
<td>1913</td>
<td>4951</td>
</tr>
<tr>
<td>1993-94</td>
<td>3500</td>
<td>-----</td>
<td>4951</td>
</tr>
<tr>
<td>1994-95</td>
<td>4000</td>
<td>4843</td>
<td>9794</td>
</tr>
<tr>
<td>1995-96</td>
<td>7000</td>
<td>168</td>
<td>9962</td>
</tr>
<tr>
<td>1996-97</td>
<td>5000</td>
<td>380</td>
<td>10,342</td>
</tr>
<tr>
<td>1997-98</td>
<td>4800</td>
<td>910</td>
<td>11,252</td>
</tr>
<tr>
<td>1998-99</td>
<td>5000</td>
<td>5371</td>
<td>16,623</td>
</tr>
<tr>
<td>1999-2000</td>
<td>10,000</td>
<td>1860</td>
<td>18,483</td>
</tr>
<tr>
<td>Year</td>
<td>Target</td>
<td>Proceeds</td>
<td>Realization</td>
</tr>
<tr>
<td>--------</td>
<td>--------</td>
<td>----------</td>
<td>-------------</td>
</tr>
<tr>
<td>2000-01</td>
<td>10,000</td>
<td>1871</td>
<td>20,354</td>
</tr>
<tr>
<td>2001-02</td>
<td>12,000</td>
<td>5658</td>
<td>26,012</td>
</tr>
<tr>
<td>2002-03</td>
<td>12,000</td>
<td>3348</td>
<td>29,360</td>
</tr>
<tr>
<td>2003-04</td>
<td>14,500</td>
<td>15,547</td>
<td>44,907</td>
</tr>
<tr>
<td>2004-05</td>
<td>4000</td>
<td>2765</td>
<td>47,672</td>
</tr>
<tr>
<td>2005-06</td>
<td>No Target Fixed</td>
<td>1570</td>
<td>49,242</td>
</tr>
<tr>
<td>2006-07</td>
<td>No Target Fixed</td>
<td>-----</td>
<td>49,242</td>
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<tr>
<td>2007-08</td>
<td>No Target Fixed</td>
<td>4181</td>
<td>53,423</td>
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<tr>
<td>2008-09</td>
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<td>-----</td>
<td>53,423</td>
</tr>
<tr>
<td>2009-10</td>
<td>No Target Fixed</td>
<td>23,553</td>
<td>76,976</td>
</tr>
<tr>
<td>2010-11</td>
<td>40,000</td>
<td>22,763</td>
<td>99,739</td>
</tr>
<tr>
<td>2011-12</td>
<td>40,000</td>
<td>13,911</td>
<td>1,13,650</td>
</tr>
</tbody>
</table>

Source: Dept. of Disinvestment Ministry, Govt. of India.

Table 5.1 gives us target and realization of proceeds of disinvestment since 1991-92. It was the year 2009-10, that saw highest (Rs 23,553 cr) accumulation as proceeds.

A study of the data presented above shows that the performance on the disinvestment front has been dismal. Only in four years 1991-92, 1994-95, 1998-99, and 2003-04, the targets for disinvestment were exceeded. In all other years, realizations from disinvestment were much less than the targets. The main reasons for this poor performance were as follows:

1. The disinvestment policy failed to realize not only the best values but also the other objectives of the disinvestment programme because the disinvestment programme was implemented in a very unplanned and hesitant way.

2. The methods adopted by government to oversee the disinvestment of public sector shareholding were not suitable.

3. The techniques and methods adopted by finance ministry were resulted in far lower realization than justified.

4. Adequate efforts were not made to build up the strong linkage between the public enterprises and capital market.
6 Critical Evaluation of Disinvestment Process:

Disinvestment Process was supposed to improve efficiency and performances, provide better service to customers, do away with political interference and raise adequate resources for government to meet its diverse needs. However, after twenty years of disinvestment process, the policy has not been quite satisfactory. Critics have argued that the very mechanism of disinvestment followed in India was hasty and unplanned, leading to undervaluation of PSUs' assets and thus raising inadequate funds for the government. The limitations/drawbacks of disinvestment policy can be explained as below:

(i) Undervaluation of Assets:

In the table 5.1, given above, the performance of disinvestment over the period of 1991-92 to 2011-12 is represented. The overall picture is very dismal. Only in four years—1991-92, 1994-95, 1998-99, and 2003-04, the targets for disinvestment were exceeded. However, in all the other years, realizations from disinvestment were much less than the targets. The reasons behind this have discussed above.

(ii) Problem of Unemployment:

One of the objectives of disinvestment was to increase employment opportunity. However, after almost fifteen years of disinvestment programmes, rather than increase in employment, there is actually a fall in employment opportunities.

(iii) Substitution of monopoly power:

At times sale of a PSU to a private company can only result in the substitution of a public monopoly by a private monopoly. In such cases, inefficiencies and monopoly power will merely be transferred to the private sector, with the costs being borne by the consumers. This is also termed as ‘Monopolistic Exploitation’ by efficient private owners replaced the inefficiencies of public ownership. Hence it is not ownership that promotes efficiency but competition. It is competitive environment, rather than ownership, that promotes allocative efficiency.

(iv) Increasing Deficits:

The fiscal and revenue deficits have been rising regularly instead of decreasing after adoption of disinvestment policy since 1991. The government has not used the disinvestment proceeds to finance expenditure on capital accounts; i.e., the disinvestment...
policy has resulted in revenue expenditure rather than capital generation. Administrative costs of the disinvestment process have also been unduly high. Thus disinvestment itself is not the solution to all problems faced by a developing country. In a country where the market mechanism functions poorly, privatisation is not likely to achieve much, unless it is accompanied by competitive environment and adequate social security measures. India is yet to achieve both.

5.6 SPECIAL ECONOMIC ZONES (SEZ)

India was one of the first countries in Asia to reorganize the effectiveness of Export Processing Zones (EPZ) model in promoting export, with Asia’s first EPZ set up in Kandla in 1965. Seven more zones were set up thereafter. However, the zones were not able to emerge as effective instruments for export promotion on account of the multiplicity of controls and clearances, the absence of world class infrastructure, and an unstable regime.

The idea of SEZS is borrowed from China where such zones are operation efficiently and are contributing nearly 40 percent of total exports. The concept of special economic zones (SEZS) was suggested by the commerce and industry minister late Mr. Murasoli Maran while introducing third revision to EXIM policy 1997-2002. The SEZs are in addition to EPZs and FTZs operating in India. A scheme for setting up SEZs in country to promote export was announced by the government in the EXIM policy announced on 31st March, 2000. The SEZs intend to provide an internationally competitive and hassle free environment for export and are expected to give a further boost to the country’s exports.

The SEZ scheme is expected to give a further boost to country’s exports. The state governments are expected to participate in export promotion by starting SEZs in their states. The SEZs can be set-up in the public, private joint sector or by state governments.

The government policy is to provide convenient infrastructure facilities and various incentives to such SEZS so as to make them key engines of export growth.
5.6.1 Concept of SEZ:

The concept of SEZ would be clear from the following description given by Arwind Pangariya,

“Conceptually, SEZs operate like foreign entities within the territory of a country. They are usually separated by physical barriers from each other and from the rest of the country. They have no trade barriers. The countries trade barriers apply strictly within the area excluding the SEZs, which is called the domestic tariff area (DTA). Any goods sold by agents within the DTA to agent inside the SEZ are treated as export of the country, and those purchased by agents in the DTA from those in the SEZ, as imports subject to custom duty. Any trade between the SEZ and the outside world is allowed to bypass all customs requirements applicable to the DTA. That is foreign goods enter the SEZ free of customs duty, and exit abroad without being subject to any domestic taxes or customers regulations.”

5.6.2 FEATURES OF SEZ

The following are the features of special economic zones.

(a) Domestic sales/purchases: Goods going into the SEZ area from DTA (Domestic Tariff Area) shall be traded as deemed exports and goods coming from the SEZ area into DTA shall be treated as if the goods are being imported.

(b) Export and import of goods: SEZ units may export goods and services including agro-products, partly processed jewellery, sub-assemblies and components. It may also export by products, rejects, waste-scrap arising out of the production process.

SEZ units import without payment of duty, all types of goods, including capital goods, whether second hand or new. The SEZ units can import goods free of cost or loan from clients.

(c) Net foreign exchange earning (NFE): A SEZ unit shall be a positive net foreign exchange earner. NFE shall calculate cumulatively for a period of five years from the commencement of commercial production.

(d) Domestic tariff area (DTA) sales and supplies: Sales of SEZS from DTA are to be treated as exports. Sales to DTA from SEZ are to be exempted from special additional duty (SAD).
This would make the sales to DTA from SEZ 4% cheaper than import. DTA sale by service/trading units shall be subject to achievement of positive NFE.

(e) Export through status holder: A EZ units may also export goods manufactured by it though a merchant exporter/status holder or any other EOU/EPZ/SEZ units.

(f) Inter-limit transfer: Transfer of manufactured goods or imported goods from one SEZ units to another EPZ/E0U/SEZ unit is allowed, but not counted towards export performance.

(g) Administration and setting up of SEZ: SEZ will be under the administrative control of development commissioner. A SEZ may be set up in the public, private or joint sector. The existing EPZS may also be converted into SEZ by the ministry of commerce and industry.

(h) Export proceeds: SEZ unit can bring back their export proceeds in 360 days as against normal period of 180 days and can retain 100% of the proceeds in the EEFC Account.

5.6.3 INCENTIVES TO UNITS IN SEZS

The SEZ offers to entrepreneurs as attractive package of incentives and concessions, gradually introduced over a period of time.

(1) All imports into the zone such as capital goods, raw materials, packing materials, components, office equipment etc. are permitted duty free entry into the zone.

(2) Indigenous goods such as capital goods, raw materials and other production requirement can be procured from domestic tariff area (DTA) into the zone free of central excise duty.

(3) Central excise is also exempted on the products manufactured within the zone for export purposes.

(4) A five year tax holiday is the most significant fiscal benefit to units.

(5) The import policy permits sales up to 25% of their annual production in the home market without requirement of import license.

(6) For attracting foreign investors equity participation even up to 100% is permitted in the industrial ventures promoted in SEZ.
(7) Repatriation of dividends and profits is freely permitted, subject to payment of taxes as applicable.

(8) For export promotion, units in SEZ are given a special facility of blanket permits.

(9) Units in SEZ can given a longer credit period of up to 360 days.

5.6.4 Special Economic Zones In India:

Since the SEZ Act and rules were notified in February 2006, formal approvals have been granted for setting up 583 SEZs out of which 380 have been notified. Out of the employment provided to 8,15,308 persons in SEZs as a whole, incremental employment generation after Feb. 2006 when SEZ Act came into force was 6,80,609 persons. This is apart from million maydays of employment created by the developer for infrastructure activities.

Physical export from the SEZs have increased from Rs.2.20.711 crore in 2009-10 to Rs.3,15,868 crore in 2010-11, registering a growth of 43.1% in rupee term. There has been overall growth of exports of 2180% over the past eight years (2003-04 to 2010-11)

The total investment in SEZs till Dec.31, 2011 was Rs.2.49.631 crore. As per the provision of the SEZ Act 2005, 100% foreign direct investment (FDI) is allowed in SEZs through the automatic route. A total of 154 SEZs are making exports, out of which 88 are IT, 17 multiproduct and 49 sector-specific SEZs. The total number of units in these SEZs is 3,400.

5.6.5 Benefits of SEZs:

- As per the above explanation SEZ helps to boost the export. Export from the SEZs have increased from Rs.2.20.711 crore in 2009-10 to Rs.3,15,868 crore in 2010-11.
- Through the promotion of SEZs it would become possible to provide world-class infrastructure.
- Due to SEZ the employment level in India have been increasing contently specifically in rural area.
- SEZ can reduce procedural complexities, bureaucratic hassles and barriers raised by monetary, trade, fiscal, taxation, tariff and labour policies.
SEZ offers numerous benefits like: 1) tax incentives, 2) provisions of standard factories at low rent, 3) provision of world class infrastructure, 4) single window clearance, 5) simplified procedures, 6) exemptions from various restrictions etc,. These benefits create a business environment to attract local and foreign investment.

SEZ are expected to give big push to export, employment and investment.

SEZ helps to boost economic growth at a extremely fast rate.

SEZ provide large number of jobs in manufacturing and other services.

SEZ attract global manufacturing and technological skills.

SEZ attracts private and public sector investment from both home and foreign.

SEZ can make Indian firms more competitive and efficient.

SEZ helps to slow down rural-urban migration.

5.6.6 Arguments Against SEZs:

SEZ Act will lead to a large land acquisition by developers, displacement of farmers, meagre compensation and no alternative livelihood for them.

SEZs will be built on the prime agricultural land. This is bound to have serious implications for food security in India.

Tax concessions, incentives, exemptions etc. being granted to units set up in SEZ will result in huge revenue loss to the government.

Companies will simply relocate to SEZs to take advantage of the tax concessions being offered and little net activity will be generated.

Providing Benefits and incentives to units in SEZ would result in lower operational efficiency.

SEZs are being set up in states where there is already a strong tradition of manufacturing and export. This will aggravate regional disparities.

SEZs can provide jobs to technically skilled persons but it will fail to provide employment facilities to the rural unskilled labours.
5.7 SUMMARY

- Industrialisation has a major role to play in the economic development of the underdeveloped countries.
- The study of industrial production and productivity trends can be studied in following two periods:
  - Trends in industrial production before 1990s (The pre-reform period-1947-1990):
- The pre-reform period-1947-1990 can be analyzed by dividing the planning period into three phases.
  - Phase I (1951-65)
  - Phase II (1965-1980)
  - Phase III (1980-1991)
- The New Industrial Policy was announced on July 24, 1991 as a part of the economic reform programmes.
- The New Industrial Policy-1991 has positive as well as some adverse effects on economy.
- The term ‘Disinvestment’ is used to indicate the process of privatization.
- Disinvestment policy was adopted after 1991.
- The main objective of Disinvestment policy is to restructure public sector investment and make it more rational, to improve profitability, efficiency and accountability of this sector.
- The SEZs intend to provide an internationally competitive and hassle free environment for export and are expected to give a further boost to the country’s exports.
- Physical export from the SEZs have increased from Rs.2.20.711 crore in 2009-10 to Rs.3,15,868 crore in 2010-11.
- The total investment in SEZs till Dec.31, 2011 was Rs.2.49.631 crore.
- A total of 154 SEZs are making exports, out of which 88 are IT, 17 multiproduct and 49 sector-specific SEZs.
5.8 QUESTIONS

◆ Write Short Notes:

1. Trends in industrial production before 1990s.
3. Structural changes in industrial sector.
5. Positive Impacts of the New Industrial Policy.
7. What is SEZ?

◆ Answer in Brief:

1. Examine the trends in industrial production after Independence.
2. Discuss the changes in industrial structure.
4. Critically discuss the Disinvestment programme of the Govt. of India.
5. Discuss the impact of SEZ on Indian economy.
SMALL SCALE INDUSTRIES AND WTO-INDUSTRY

Unit Structure:

6.0 Objectives
6.1 Introduction
6.2 Meaning and Classification of Small Scale Industries (SSI)
6.3 Significance of Small Scale Industries.
6.4 Problems of SSI Units.
6.5 SSI Policy of the Government of India.
6.6 WTO and Industry.
6.7 Contribution of Service Sector in Economic Development of India.
6.8 Role of Infrastructure in Economic Development.
6.9 Summary
6.10 Questions

6.0 OBJECTIVES

- To know the Meaning and Classification of Small Scale Industries.
- To examine the Significance of Small Scale Industries in economic development.
- To understand the Problems of Small Scale Industries and measures taken by government to solve them.
- To know the SSI Policy of the Government of India.
- To understand the impacts of WTO on industrial sector of India.
- To know the Contribution of Service Sector in Economic Development of India.
- To examine the Role of Infrastructure in Economic Development.
6.1 INTRODUCTION

The small scale industries played a very significant role in the socio-economic development of India. Planners recognized the importance of this sector soon after independence and accordingly the sector was given a strategic position in the country's industrial policy. The sector has contributed significantly to the economic growth in terms of Gross Domestic Product, employment generation and exports. Such industrial units are easy to start and manage, as they require very little capital investment in comparison with large industries.

6.2 MEANING AND CLASSIFICATION OF SMALL SCALE INDUSTRIES (SSI)

In order to frame policies for the sector, the government needs to identify small units and address their problems. For the purpose government had defined small scale enterprises on the basis of following criteria.

◆ Labour Force Criteria:

The Industrial (Development and Regulation) Act, 1951, exempted units employing less than 50 workers, with power, and less than 100 workers, without power, from registration. These exempted sectors came to be referred to as the small scale sector.

◆ Fixed Capital Investment Criteria:

In 1966 the small scale enterprise were defined as units having investments in fixed assets not exceeding Rs.7.5 Lakh and in case of ancillary units not exceeding Rs 10 Lakh. In the year 1975 the limit was raised to Rs 10 Lakh for small scale units and Rs.15 Lakh for ancillary units. In April 1991 the investment limit was further raised to Rs 60 Lakh and Rs. 75 Lakh respectively. In addition a tiny sector was identified and defined as units having investment limit of less than Rs 5 Lakh.

In 1997 the investment limit of the small scale and ancillary units was raised to Rs 3 crore and that of tiny units to Rs 25 Lakh. In 1999, the investment limit of the small industries was brought down to Rs 1 crore, but the limit of investment in tiny units has been restrained as Rs 25 Lakh.
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Under The Micro, Small and Medium Enterprises Act, 2006 Act, enterprises have been categorized broadly into two categories:

(A) Manufacturing Enterprises:

- A Micro enterprise, where the investment in plant & machinery does not exceed Rs.25 Lakhs;
- A Small enterprise, where the investment in plant and machinery is more than Rs 25 Lakh but less than Rs.5 crore;
- A Medium enterprise, where the investment in plant and machinery is more than Rs 5 crore but does not exceed Rs.10 Core.

(B) Service Enterprises:

- A Micro Enterprises, where the investment in equipment up to Rs.10 Lakhs;
- A Small Enterprises, where the investment in equipment is more than Rs 10 Lakhs but does not exceed Rs.2 crore;
- A Medium Enterprises, where the investment in equipment is more than Rs 2 crores but does not exceed Rs.5 Cores.

6.3 SIGNIFICANCE OF SMALL SCALE INDUSTRIES

The significance and performance of SSI units can be explained as follows:

1. Share in Employment:

SSI units play an important role in employment generation. These units are labour intensive and therefore have the potential to generate large scale employment. The employment in the SSI units increased from 260 lakh in 2002-03 to 313 lakh in 2006-07. Labour intensity in the SSI units are estimated to be almost four times higher than the large enterprises.

2. Number of units and share in industrial output:

The number of units in the SSI sector stood at 109.5 lakh in 2002-03. This number rose to 258.2 lakh in 2008-09. Output of the SSI sector in 2002-03 was Rs.3,06,771 crore and this rose to Rs.5,32,979 crore in 2007-08. The rate of growth of output exceeded 12% in 2005-06, 2006-07, and 2007-08.
According to the fourth census of SSI units conducted in 2006-07 there are about 260 lakh MSMEs (medium, small and micro enterprises) in the country and they contribute about 8.0 % of GDP and about 45.0 % of manufactured output.

3. Contribution to National Income:
   The SSI units as well as cottage industry contribute to the national income. This is accomplished because of the following two considerations.
   - The ownership of the SSI is more widespread than the ownership of large scale industries.
   - They possess a much larger employment potential as compared to the large scale industries.
   So that we can say that the SSI units ensure a more equitable distribution of national income and wealth.

4. Rural development:
   SSI units facilitate rural development because these units are normally located in rural areas and they provide employment and other benefits in rural areas. It also helps to provide some modern infrastructural facilities in the rural area like roads, electricity, water, hospitals, educational institutions etc.

5. Share in Capital Formation:
   SSI units facilitate capital formation in the country by providing employment to a large number of people. SSI units therefore encourage savings of the people. The saving can be effectively utilised for productive purpose. With growth in the savings rate the investment rate will grow leading to growth in the capital formation rate and economic growth.

   The SSI units also facilitate capital formation by reinvesting the profits in the business.

6. Reduces Regional Disparities:
   One of the important objective of the industrial policy in India is to achieve regional development and SSI units help to reduce regional disparities. The large scale industries prefer to concentrate in urban areas however the SSI units are located not only in urban areas but also in rural areas. Due to support of state government SSI units are located in all states but large scale industries prefer to locate in the industrially developed states like Maharashtra, Gujrat, West Bengal, Tamil nadu.
7. **Less Industrial Disputes:**

Unlike the large scale industries SSI units are free from strikes lock outs and other industrial disputes. Therefore there is no loss of output. In Cottage industries dispute don’t arises as they are managed by family members.

8. **Supports Large Scale Industries:**

The SSI units support medium and large scale industries as they manufacture and supply intermediate goods to them. The SSI units provide spare parts, nuts, bolts, steel plates, and other inputs to the large scale industries. Thus SSI units complements large units.

9. **Supports to the Agriculture Sector:**

In the form of supply of inputs, processing facilities and consumer goods for the consumption in the rural area the SSI units provides support to agriculture sector.

Rural based cottage industry provide employment to surplus labour from agriculture this helps in overcoming the problem of seasonal unemployment to some extent.

10. **Service Sector Development:**

SSI units are responsible for the service sector development. Due to expansion of SSI units the banking sector, transport, electricity, roads, telecommunication sector and other service sectors get a boost.

11. **Contribution to Export:**

In the post-Independence period the contribution of the SSI units in export earnings has increased. It consist of such non-traditional items like readymade garments, sports-goods, finished leather, woolen garments, processed food, chemicals and large number of engineering goods.

The total export of SSI products increased from Rs.155 crore during 1971-72 to Rs.2,02,017 crore in 2007-08. This meant an increase in the share of the SSI in the total export of the country from 9.6 % in 1971-72 to around 31.0 % in 2007-08.
6.4 PROBLEMS OF SSI UNITS

As compared to large scale industries SSI units face a number of problems, many times these problems force these units to close down. The main problems of SSI units are:

1. Industrial Sickness:
The small nature of operation is the biggest problem for SSI units. Industrial sickness is rampant in this sector. As on 31st March, 2003, there were 1.69 lack sick units. Lack of adequate credit and power shortage are the two major factors responsible for industrial sickness in these industries.

2. Financial Problems:
The SSI units face the problem of finance. They find it difficult to raise working capital as well as fixed capital needs. The SSI units and cottage industries face worst financial problems in rural areas, as they have to depend upon money lenders because it is difficult for them to obtain financial assistance from the banking sector.

Inadequate and irregular finance leads to production loss and thereby, reduces the profit margin. In due course the unit becomes sick and in the long-run leads to closure of the units.

3. Problem of Raw Material:
Availability of raw material has been another important obstacle in the way of smooth development of SSI sector. SSI units face the problem of shortage of raw material, and as such, the production cycle gets affected which in turn create problems for delivery of goods in the market.

High domestic cost of raw material and shortage of foreign exchange of import of raw material rendered many units into loss making units.

4. Use of Outdated Technology:
Many SSI units use outdated technology. A good number of them purchase second hand machinery. This outdated and second hand machinery affects quality and quantity of production and increases the cost, due to increase in wastages, loss due to breakdowns, high maintenance of machines, etc.
5. Lack of Research and Development:
To improve the quality, product features, and to reduce cost of product the Research and Development (R & D) is a need to undertake by SSI units. But SSI units hardly give importance to R & D. Year after years they continues to manufacture the same type of goods. There is hardly any innovation in product features, packaging, and so on. Lack of R & D not only affects the quality of products but also the units continue to make goods at higher cost.

6. Problem of infrastructure:
A number of SSI units are set up in rural or semi-urban areas. In these areas SSI units face the problems of shortage of good infrastructural services like transport, electricity, roads, telecommunication, banking etc., Due to this the performance of SSI units gets affected.

7. Poor Marketing:
The SSI units have the problems of effective marketing. Due to lack of adequate funds they may not undertake effective advertising .These units are not in a position to hire the services of the marketing experts hence the quality of goods produced by SSI units are poor. As a result of all these things their sales do get affected.

8. Under Utilisation of Plant Capacity:
The capacity utilization of SSI units is not optimal. This is due to lack of demand for their products. The SSI units go for plant expansion without proper analysis of market demand for their products. It is observed that 50 % of their installed capacity is not utilised by SSI units in India.

9. Tax Burden:
The SSI units are subject to several taxes and duties and octroi duty which responsible for increasing their financial burden. These taxes badly affect the major part of the profit of SSI units.

10. Problem of Pricing:
The pricing system of SSI units are defective as their prices are not competitive .Some times for big profit many SSI units charges high price and as such their sale do get affected. Some times to increase sale of products, SSI unit’s charges lower price even though the profit get affected.
11. **Problem of Distribution:**

Most of the SSI units do not have good network of dealer’s. Due to poor relationship with dealers the SSI units have to face the problems regarding sale and profit. As a result of this the dealers shows uninterested to stock and promote the products of SSI units.

12. **Adverse effects of economic reforms and globalization:**

As a part of globalization opening up the market for domestic and international competition, lowering of tariffs, removal of quantitative restrictions, these reforms have had an adverse effects on SSI sector. Cheaper and better quality imported goods are posing a serious threat to SSI units operating in various industries like chemicals, silk, auto components, toys, sports goods, footwear, etc.

The most serious threat is being posed by cheap Chinese imports as the so called ‘China Price’ (a rock-bottom price) is forcing many SSI units to close down.

13. **Other Problems:**

The SSI units do face several other problems such as;

- Lack of Marketing Research.
- Poor Packaging and Design of Product.
- Competition from the large industries.
- Problem of Skilled Labour.
- Poor Customer Relationship, etc.

All these constraints have resulted in a skewed cost structure, placing this sector at a disadvantage vis-a-vis the large industries, both in domestic and export markets.

### 6.5 SSI POLICY OF THE GOVERNMENT OF INDIA

The small-scale have been assigned an important place by the Government since Independence. A number of measures have been taken to strengthen the SSIs. The policy decisions or measures taken by Government in this regard can be broadly classified into two parts:

(i) Policy Prior to 1991 &
◆ Policy Prior to 1991:

A large number of steps were initiated by the Government of India after Independence for the development of small scale and cottage industries. These included the building up of organizational structure, increase in the outlay for the development & small scale and cottage industries, reservations for production, credit and marketing facilities, concessions, exemptions etc.

A) Organizational Structure:

To promote growth of small-scale industries, Government started setting up various boards and corporations since Independence.

(1) A Cottage Industries Board was set up in 1947 itself. This was split into the following three boards during the First Five Year Plan – All India Handloom Board, All India Handicraft Board and All India Khadi and Village Industries Board. In addition, three more boards were set up. These were the Small Scale Industries Board, Coir Board and Central Silk Board. Thus at the end of the First Five Year Plan, there were six boards covering the entire field of small scale and cottage industries. Together, they constituted the organizational structure through which the promotional and developmental efforts of the State were to be carried out.

(2) National Small Industries Corporation Ltd. (NSIC) was set up in 1955 to provide machinery to small-scale units on hire-purchase basis and to assist these units in procuring orders from government departments and offices.

(3) Four Regional Small Industries Service Institutes, with a number of branches, were set up to provide technical assistance to the small scale industries.

(4) Small Industries Development Organization (SIDO) was set up in 1954. It functions as an apex body in the formulations of policies and co-ordination of institutional activities for sustained and organized growth of small-scale industries. It has a large network of small industries service institutes, branch institutes, tool rooms etc. SIDO has been renamed Micro, small and Medium Enterprises Development Organization.
(5) The programme of Industrial Estates was initiated in 1955. The programme aimed at providing factory accommodation and a number of facilities like power, water, transport, etc., at one place.

(6) The Programme of District Industrial Centre (DICs) was introduced in May 179. The idea was to establish one agency in each district called the DIC to provide and arrange a package of assistance and facilities for credit guidance, raw materials, training, marketing etc including the necessary help to unemployed educated young entrepreneurs in general and custom services. At present there are 422 DICs operating in the country covering 431 districts (except Delhi, Mumbai, Calcutta & Chennai)

B) Reservation for SSIs:
To protect small-scale units from competition from large-scale units, government has reserved the production of a large number of items for the small-scale sector. The list of reserved items was expanded from 77 (first plan) to 873 items in Oct.1984 of lately the number of reserved items has come down after economic reforms.

C) Financial Assistance for SSIs:
Several schemes were introduced to provide financial assistance to Small-Scale Industries. These include the Small Industries Development Fund (SIDF) in 1986, National equity Fund (NEF) in 1987 and the Single Window Scheme (SWS) in 1988. Financial assistance to the small-scale sector is provided through institutions like State Finance Corporations, National Small industries Corporation, Commercial banks, NABARD (in rural areas through co-operative banks and Regional Rural Banks) and Small Industries Development Bank of India (SIDBI).

Small Industries Development Bank of India (SIDBI) was set up in 1989 with a view to ensuring larger flow of assistance to the small-scale units, the immediate thrust of SIDBI was on (i) initiating steps for technological up gradation and modernization of existing units; (ii) expanding the channels for marketing the products of small scale sector; and (iii) promotion of employment-oriented industries especially in semi-urban areas to create more employment opportunities. The major activities of SIDBI are : (i) refinance of loans and advances; (ii) discounting and re-discounting of bills; (iii) extension of seed capitals soft loans; (iv)granting direct assistance and refinancing of loans; (v) providing services like
factoring, leasing etc. and (vi) extending financial support to State Small Industrial Development Corporations.

D) Other Measures:
A number of other measures were introduced from time to time to promote the growth of small-scale and cottage industries. Some of these measures were as follows:

(i) A Council for Advancement of Rural Technology (CART) was set up in Oct. 1982 to provide the necessary technical input to the rural industries.

(ii) Price and purchase preference was granted to products manufactured in the small-scale sector in government purchase programme.

(iii) Excise concessions were granted to both registered and unregistered units on a graded scale depending on turnover up to Rs.300 Lakh.

(iv) Full exemption was granted up to a turnover of Rs 30 lakh and concessional rate of excise duty was levied for a turnover exceeding Rs.30 lakh but not exceeding Rs 75 Lakh.

◆ New Small Enterprise Policy, 1991 (Post Economic Reforms):

The government announced a policy package for small, tiny and village industries in August 1991 with the primary objective of importing more vitality and growth impetus to this sector. Important measures announced in this policy were as under:

(i) The investment limit for tiny units was raised from Rs.2 lakh to Rs 5 lakh. In 1997 this limit was further raised to Rs 25 lakh. Moreover, the locational restrictions were done away. With this opened up the way for tiny units within the new movements limit & located in bigger towns (population of more than 50000) to become a part of the =tiny group=.

(ii) The 1991 policy proposed a separate package for the promotion of tiny enterprises. While these enterprises were to be mainly entitled to one time benefits (like preference in land allocation /power connections, access to facilities for skill/technology up gradation.)
(iii) The third major change related to equity participation. Equity participation by other industrial units upto 24% or in SSIs was allowed. It was expected that this measure would provide a better link between the small and large industries.

(iv) A new concept of Limited or Restricted Partnership was introduced. Under this, one partner will have unlimited liability and others will have limited liability. This was considered as a positive measure as it would result in more inflow of capital especially from kith and kin of small-scale entrepreneurs.

(v) Some other features of the policy were:

1. The policy proposed to meet the entire demand of the small and tiny units. The emphasis was shifted from ‘cheapness of credit’ to ‘adequacy of credit’.
2. The scope of the National Equity Fund (NEF) scheme and Single Window Scheme (SWS) was enlarged.
3. The policy provided for according priority to the tiny sector in the government purchase programme.
4. Easy credit facilities have been offered by the Government to SSIs under priority lending. Procedures and conditions for obtaining credit from banks were liberalized.
5. In 1994, Integrated Infrastructure Development Centers (IIDCs) were established for the better linkage between agriculture and industry.
6. The Ninth Five Year Plan emphasized dereservation as it argued that dereservation would help a number of SSI units to upgrade their technology, improve quality of their products, expand their scale of operations and boost their exports. A number of rules and regulations related to finance have been liberalized by the Government. The plan also suggested the establishment of specialized branches to serve SSIs. Local areas banks to be managed by SSI associations and involving the banking finance companies in extending credit to SSIs.


A comprehensive policy package for the small-scale sector was announced on August 30, 2000. The main highlights of this policy are as follows:
(i) The excise duty exemption limit was increased from Rs.50 lakhs to Rs.1 crores.

(ii) Concessional loans were extended to certain industries for technology up gradation. (iii) Initiating the census of small scale industries after a gap of 12 years and it was supposed to cover the sickness of SSIs and the causes for same.

(iv) Raising the limit of composite loans from Rs.10 lakh to Rs 25 lakh.

(v) Increasing the coverage of Integrated Infrastructure Development (IID) scheme to progressively cover all areas in the country with 50% reservation for rural areas and 50 per cent of plots earmarked for tiny sector, etc.

(vi) In recent years, the government has been following policy of dereservation as it believes that this will help the SSI units to upgrade their technology and improve the quality of their products. As a result of this policy, the number of items reserved for the SSI sector came down from 836 in July 1989 to 114 in March 2007 and further to only 35 in February 2008.

❖ Check Your Progress:

A) Define Small Scale Industries.

B) Importance of SSI Units.

C) Problems of SSI Units.

6.6 WTO AND INDUSTRY

After the II world war many countries got down together to work on ways and means to promote international trade. As a result, the General Agreement on Tariff and Trade (GATT) was signed by 23 countries in 1947. India was one of the founder member of GATT. In 1994 the membership of GATT rose to 118 countries. The
main purpose of GATT is to promote the international trade through tariff reduction by evolving rules to counter protectionism.

Eight rounds of Multilateral Trade Negotiations were held under the auspices of GATT. Then Director General of GATT, Arther Dunkel came up with draft which was known as Dunkel Draft. The signing of the final Act of the Uruguay Round by member nations of GATT in 1994, paved the way for setting up the World Trade Organisation (WTO), an agreement which was signed by 104 members. The WTO agreement came into the force on 1st Jan, 1995. GATT was not really an organisation, it was merely a legal agreement. On the other hand, the WTO is a new international organisation set up as a permanent body and is designed to play the role of a watchdog in the spheres of trade in goods, trade in services, foreign investment, intellectual property rights, etc.

The highest body of WTO is the Ministerial Conference. This will consist of representative of all members and will meet at least once in the two years. There will also be a General Council consisting of representative of all members which carry out the functions of the Ministerial Conference. WTO provides a forum for negotiations to resolve disputes among the member countries. For this purpose, a Dispute Settlement Body (DSB) has been constituted. The General council will also convene the Trade Policy Review Body. Under the General Council three separate councils are also established. A Council for the Trade in Goods, Council for Trade in Services and a council for Trade Related Intellectual Property Rights.

In WTO framework Ministerial Conference is the highest decision making body, which has to meet at least once in two years. Following Ministerial Conferences have been held; so far viz. Singapore (9 – 13 December 1996), Geneva (18 – 20 May, 1998), Seattle (30 Nov. – 3 Dec., 1999); Doha (9 – 14 Nov. 2001); Cancun (10 – 14 Sept. 2003); Hong Kong (13 – 18 Dec. 2005). The seventh WTO Ministerial meeting was held in Geneva from Nov 30 – Dec. 3, 2009.

◆ WTO agreements
The main WTO agreements can be divided into the following categories.
1) **Agreement on agriculture:** - This provides a frame work for the long term reform of agricultural trade and domestic policies over the years to come, with the objective of introducing increased market orientation in agricultural trade. It provides for commitments in the area of market access, domestic support and export competition. The members have to transform their non-tariff barriers like quotas into equivalent tariff measures. The tariffs resulting from this transformation, as well as other tariffs on agricultural products, are to be reduced on an average by 36 percent in the case of developed countries and 24 percent in the case of developing countries. The least developed countries were not required to make any commitment for reduction.

2) **Agreement on trade in textiles and clothing (Multi-fiber Arrangement):** - This provides for phasing out the import quotas on textiles and clothing in force under the multi-fiber arrangement since 1974 over a span of 10 years, i.e. by the end of the transaction period on January 1, 2005. As a result, quotas on textiles and clothing have now been abolished.

3) **Agreement on Market Access:** - The Member nations will cut tariffs on industrial and form goods by an average of about 37 percent. The USA and the European Union will cut tariff between them by one half.

4) **Agreement on TRIMs:** The Agreement on Trade Related Investment Measures (TRIMs) calls for introducing national Treatment of foreign investments and removal of quantitative restrictions. It identifies 5 investment innersoles which are in consistent with the GATT provisions of according national treatment and general elimination of quantitative restrictions.

5) **Agreement of TRIPs:** Trade Related Intellectual Property Rights (TRIPs) pertain to patents and copyrights. Whereas earliest on process patents were granted to food, medicines drugs and chemical products. The TRIPS Agreement now provides for granting product patents also in all these areas. Protection will be available for 20 years for patents and 50 years for copyrights.

   A transition period was allowed to all developing countries to give effect to the provision of the TRIPs Agreement. The period expired on January 1, 2005. Thus the regime of product patents has now been introduced.
6) Agreement on Service: For the first time trade in services like banking, insurance, travel, maritime transportation, mobility of labour etc. was brought within the ambit of negotiations in the Uruguay Round. The GATS (General Agreement on Trade in Services) provides a multilateral frame work of principles and services which should govern trade in services under conditions of transparency and progressive liberalization. It spells out certain obligations like grant of MFN status to the other member nations with regard to trade in services, maintained of transparency and also a commitment for liberalizations in general terms.

7) Disputes Settlement Body: Settlement of Disputes under GATT was a never ending process. There was ample scope for procedural delays, objections could be vanished at each stage of the dispute settlement process, and penal reports could be rejected by the offending party. The Disputes Settlement Body (DSB) set up under WTO seeks to plug these loopholes and thus provided security and predictability to multilateral trading system. It has now been made mandatory to settle a dispute within 18 months. The findings of the Disputes Settlement panels will be final and binding on all parties concerned.

◆ India’s Commitments To WTO

The Government of India has made a number of Commitments to WTO. The main commitments are in the following fields.

1) Tariff Lines:
   As a member of the WTO, India bound about 67 percent of its tariff lines where as prior to the Uruguay Round only 6 percent of the tariff lines were bound for non-agricultural goods, with few exceptions ceiling bindings of 40 percent ad valorem on finished goods and 25 percent on intermediate goods machinery and equipment were undertaken. The phased reduction to be undertaken over the period of March 1995 to the year 2005.

2) Quantitative Restrictions (QRs):
   QRs on imports maintained on balance of payments ground were notified to WTO in 1997 for 2,714 tariff lines at the eight digit level in view of the improvements in India’s balance of payments the committee on balance of payments Restrictions had asked India for a phase out for the QRs. An agreement between USA and India was reached which envisaged the phasing out of all QRs by
India by April 1, 2001. In line with this agreement India removed QRs on 714 items in the EXIM policy announced on March 31, 2000 and on the remaining 715 items in the EXIM policy announced on March 31, 2001.

3) Trade Related Intellectual Property Rights (TRIPs):
The ruling of the two WTO dispute settlement panels following the complaints made by the USA and European Union that India had failed to meet its commitments under article 70.8 (requiring the setting up of the mail Box system) and Article 70.9 (granting of Exclusive Marketing Rights) made it obligatory for the Government of India to make appropriate amendments to the Patent Act, 1970 by the April 19, 1999. The Patents (Amendment) Act, 1999 was passed by the Parliament in March, 1999 to provide for Exclusive marketing Rights. This was followed by the adoption of patents (Amendment) Act, 2002, in May 2002. In order to meet its commitment to the WTO to introduce product patents by January 1, 2005, the Government of India promulgated an ordinance on December 23, 2004.

This was followed by the adoption of patents (Amendments) Act in March 2005. The new patent regime provides for patents in drugs and farm products.

4) Trade Related Investment Measures (TRIMs):
Under the TRIMs Agreement, developing countries had a transition period of 5 years up to December, 31, 1999 during which they could continue to maintain measures inconsistent with the Agreement provided these were duly notified. The Government of India notified two TRIMs viz., that relating to local content requirement in case of investment in 22 categories of consumer items.

5) General Agreement on Trade in Services (GATS):
Under the General Agreement on Trade in Services (GATS), India made commitments in 33 activities. Foreign Service providers will be allowed to enter these activities. According to the activities has been guided by consideration of national benefit (viz, the impact on capital) inflows, technology, and employment).
Impact Of WTO On Indian Economy

1. Benefits from Expansion in Trade:

The most important advantage of WTO that is claimed is that it will add considerably to world trade. According to the GATT Secretarial, the largest increases are expected to be in the areas of clothing, agriculture, forestry and fishery products and processed food and beverages. According to the Government of India since our countries existing and potential export competitiveness lies in these product groups, it is logical to believe that India will obtain large gain in these sector. Assuming that India’s market share in world export improves from 0.5 % to 1 %, and that we are able to take advantages of the opportunities thus created, the government believes that the trade gains may conservatively be placed at 2.7 billion US dollars extra exports per years. A more generous estimate will range from 3.5 to 7 billion US dollars per year.

2. Benefits from Phasing Out of the MFA:

According to WTO, the phasing out of Multi-Fibre Arrangement (MFA) by 2005 will benefit India as the exports of textiles and clothing’s will increase. While the developed countries had demanded a 15 year period, the developing countries like India had insisted on a 10 year period. The phasing out schedule favored the developed countries as a major proportion of quota regime to the extent of 49 % was required to be removed only during the 10th year i.e., by 2005. Thus the Uruguay Round did not provide an immediate market access for the Third World textile exports.

However many observers argue that India’s export of textiles and clothing’s will increase considerably and Indian export of these products will Flood the US and European markets. But in this respect China is expected to fare much better than India, because of its cost and quality of these products.

3) Trade Related Intellectual Property Rights (TRIPs):

Protection of Intellectual property rights has been one of the major concerns of WTO. The Agreement on TRIPS at the Uruguay Round weighs heavily in favour of multinational corporations and developed countries as they hold a very large number of patents. Agreement on TRIPS will work against India in several ways and will lead to monopoly of the WTO, India has to comply with the standards of the TRIPs and the changes should be in order latest by the year 2004.
The Agreement on TRIPs goes against the Indian Patent Act, 1970 in the following ways:

- **Pharmaceutical Sector:**
  Under the Patent Act, 1970, only process patents are granted to chemicals, drugs and medicines. This implies that an Indian pharmaceutical company only needed to develop and patent a process to produce a drug and it need not have invented the drug. The company could legally manufacture once it had the product patent. This proved beneficial for Indian pharmaceutical companies as they were in a position to sell good quality medicines at low prices. The Industry has grown rapidly after the passing of the patent Act in 1970 and is now an exporter of drugs to other nations. But under the Agreement on TRIPs product patents will also be granted. This will benefit the MNCs and it is feared that they will raise prices of medicines considerably keeping it out of reach of the poor.

  However, it should be noted that 97 percent of all drugs manufactured in India are off patents and so will remain unaffected. These cover most life savings drugs as well as drugs for common diseases.

- **Agriculture:**
  The Agreement on TRIPs also extends IPRs to agriculture through the patenting of plant varieties. This will have serious implications for Indian agriculture, where government bodies and agricultural universities carry out plant breeding and seed production patenting of plant breeding and seed production patenting of plant varieties would transfer all gains in the hands of MNCs who will be in a position to develop almost all new varieties with the help of their huge financial resources. It is also believed that once the MNCs develop plant varieties they will also take over seed production and will eventually control food production. In a country where a large majority of the poor depend on agriculture for their livelihood, these development will have serious consequence.

- **Micro Organisms:**
  Under TRIPs Agreement, patenting has been extended to the large area of micro-organisms as well. Research in such life forms are closely linked with the development of agriculture, pharmaceuticals and Industrial biotechnology. Patenting of micro-organisms will again benefit large MNCs that either already have
patents in these areas or will acquire them at a much faster rate now. Thus the development of these three vital sectors will also be in the hands of the MNCS.

4. Trade Related Investment Measures (TRIMs):

Agreement on TRIMs provide for treatment of foreign investment on par with domestic investment. This Agreement too weighs in favour of developed countries. There is no provision in the Agreement to formulate international rules for controlling restrictive business practices of foreign investors. In case of developing countries like India complying with Agreement on TRIMs would mean giving up any plan or strategy of self-reliant growth based on locally available technology and resources.

5. General Agreement on Trade In Services (GATs):

One of the major features of the Uruguay Round was the inclusion of trade in services in the negotiations. This too will go in favour of developed countries. It has been estimated that the size of the world market in services was $1000 billion in 1993 of which the share of developed countries was 95 percent. As far as India is concerned the service industry here is developing rapidly and is not as underdeveloped as in other developing countries.

According to the Agreement, India needs to open up its banking and insurance sectors. As a result of these social obligations, Indian firms will have to compete with giant foreign firms in the service sector. Besides, the foreign firms will be face to remit profits, royalties and interests to the parent country, causing foreign exchange burden for India.

◆ Singapore Issues and Doha Declaration:

Ever since the inception of WTO, the developed countries have been pressuring for expansion of negotiating agenda. The major issues and developments are:

- **Singapore Issues:**

  In the first ever Ministerial Conference held in Singapore in 1996 itself where developed countries demanded that the negotiating mandate of WTO be broadened to include trade and investments, trade and competition policy, government procurement, trade facilitation, labour standards and environment standards. Developing countries resisted these demands and managed to put labour standards and environment off the WTO
agenda for the time being. The remaining four issues viz. (i) investment (ii) competition policy (iii) Government Procurement and (iv) trade facilitation are known as Singapore Issues.

Over these issues there are considerable differences of opinion between developed and developing countries and between developed countries as well. Developing countries like India argued that all the four issues, i.e. Singapore issues have a strong development dimension which focused organizations like the WTO is not competent to handle.

Because of considerations such as these Singapore issues emerged as a bone of contention between the developed and the developing countries first at the Doha Meeting in 2001 and then at Cancun Meeting in 2003. Because of developed countries reluctance to reduce agricultural subsidies and provides more market accession their agricultural to developing countries have been taking cover behind the Singapore issues resulting in a breakdown of all negotiations.

- **Doha Declaration:**

  The main features of the Doha Declaration (held at Doha, Qatar, in Nov. 2001) are as follows:

  (i) **TRIPs and Public Health:**
  The major success claimed by developing countries (particularly by India) was in the field of TRIPs and Public Health. The separate declaration adopted on the issue stated that the —TRIPS Agreement does not and should not prevent members from taking measures to protect public health. In other words, the Declaration made it clear that any member of the WTO has a right to knock off patents on pharmaceutical products on public health grounds.

  (ii) **Environment And Labour Issues:**
  Another area of conflict in WTO negotiations are Environment and Labour related issues. Developing countries demand that the rich nations should reduce carbon emission and developed countries are blaming the rising developing economics for high carbon emission. Again developed countries have been asking the developing countries to introduce labour laws and make them market friendly.
Cancun Fiasco:

The fifth WTO Ministerial Conference was held in Cancun, Mexico between 10th to 14th Sept. 2003. The debate at Cancun was focused on Two Issues:

(a) liberalization of Agriculture and 
(b) developing new multilateral disciplines on the Singapore Issues.

However with both developed and developing countries stuck to their points, the final outcome was a breakdown in negotiations. Though Cancun Conference ended in a fiasco. India played a key, constructive role in building developing country unity and assertion of the WTO, whose concrete forms are a G 20 nation alliance on agriculture (known as G 20) whose chief spokesman in Brazil and G 16, on the Singapore Issue led by Malaysia.

Subsequently, there have been further conferences but the deadlock countries on agricultural subsidies, environment, labour issues and market access to the developing countries. The only silver lining in these subsequent WTO conferences is that developing countries have become more united and assertive which helps them negotiate in a healthy and competitive way.

❖ Check Your Progress:

A) What is WTO?
B) What are the main Agreements in WTO?
C) Write Short Note on Doha Declaration.
D) India and WTO.
CONTRIBUTION OF SERVICE SECTOR IN ECONOMIC DEVELOPMENT OF INDIA

According to the economic theories as the country develops, the share of the service sector increases in the national income. At present the Indian economy is experiencing this. Service sector is the most dominant sector of the Indian economy. In the years to come, this sector is going to be the major driver of the economy.

The importance of the service sector in the economic development can be studied with the help of following points:

◆ Importance of Service Sector:

1. Contribution to the national income:
   The contribution of service sector to the national income has been increased from 29.6% of the GDP in 1950-51 to 50.3% of the GDP in 2000-01 and today in 2010-11 the share of service sector in GDP is rose by 57.7%.

2. Growth Rate:
   At present the service sector is the fastest growing sector in the economy. Since 1991 the sector has been growing at an average annual rate of 7% but till year 2010-11 this annual growth rate has increased by 9%.

   The main reason behind this growth is the contribution of information technology (IT), information technology enabled services (ITES), real estates, BPOs, entertainment and telecommunication services.

3. Employment:
   It is observed that employment growth rate in this sector has been the highest in recent years compared to the other sectors of the economy. The only service sector provides 25% of the total employment. Within the service sector the employment growth is highest in the case of trade, constructions, financial services, transport and communication. As far as ITES and other related areas are concerned there is a shortage of skilled workers.

4. Revenue to the Government:
   After introducing service tax in 1994 since then the revenue generated from service sector has been growing. In 1994-95,
service tax contributed Rs.407 crore in tax revenue, this amount rose to Rs.23,055 crore in 2005. On April 2006 99 services are covered under this service tax.

5. Helpfull to the primary and secondary sector:
   The development of the primary and secondary sector is incomplete without service sector as service sector provides support to both these sectors by providing essential services in the form of financial services, software, logistics and consultancy, telecommunication etc.,

6. Contribution to Export:
   The service sector has contributed significantly to the export earnings of the country. Services export has been growing at the rate of 20 % per annum since 1991. In 2004-05, software export grew by 34 % to US $ 17.2 billion. In 2005, India was ranked 11th in the world commercial services export.

7. WTO and the services sector:
   As we know that with the objective of liberalizing trade in services GATT has introduced GATS (The General Agreement on Trade and Services). GATS provide new opportunities for export of general services but in particular Knowledge Process Outsourcing (KPO). India has emerged as a major centre for services like super specialty hospitals, satellite mapping, legal services, clinical research, accounting and auditing services.

8. Changes in the Educational System:
   The rapid growth in the service sector has forced changes in the Indian educational system. Today vocational courses have become buzzword. The courses in Banking and Finance, Insurance, Retail, Hospitality, Health care, and aviation etc has been demanded at a very high interest.

   **GROWTH AND CONTRIBUTION OF SERVICES SECTOR IN INDIA:**
   The Indian economy has grown at a robust rate during the last few years and a striking feature of this growth performance has been the strength of the services sector. This is clearly brought out by a glance at Table no.6.1
Table no 6.1
Sectoral Growth Rates (% per Year)

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<tr>
<td>Agriculture</td>
<td>2.1</td>
<td>4.4</td>
<td>4.8</td>
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<td>2.5</td>
<td>5.8</td>
<td>-0.1</td>
<td>0.4</td>
<td>6.6</td>
</tr>
<tr>
<td>Industry</td>
<td>5.3</td>
<td>6.8</td>
<td>7.3</td>
<td>4.3</td>
<td>9.2</td>
<td>9.7</td>
<td>4.4</td>
<td>8.0</td>
<td>7.9</td>
</tr>
<tr>
<td>Services</td>
<td>4.5</td>
<td>6.6</td>
<td>7.3</td>
<td>7.9</td>
<td>9.3</td>
<td>10.3</td>
<td>10.1</td>
<td>10.1</td>
<td>9.4</td>
</tr>
<tr>
<td>GDP at factor cost</td>
<td>3.5</td>
<td>5.8</td>
<td>6.6</td>
<td>5.5</td>
<td>7.8</td>
<td>9.3</td>
<td>6.7</td>
<td>8.4</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Sources: Handbook of Statistics on Indian Economy 2010-11.

It is clear from above table that service sector grown very slower than industry between 1050 and 1990. After 1990s the service sector accelerated when it averaged 7.3 % per annum. The slowdown in the Ninth Plan (1997-2002) was conformed to agriculture and industry with the services registering a remarkable rate of growth of 7.9 % per annum.

After year 2002-03 the expansion of services accelerated further. Over the Tenth Plan period (2002-07), services grew at a rate of 9.3 % in GDP but this growth rate declined to 6.7 % in 2008-09 due to economic slowdown following global recession. However services grew at a robust rate of 10 % and 10.1 % and 9.4 % respectively in these years.

**Share of Services In GDP:**

Because of the relatively high growth rate of services in recent times, their share in GDP has registered a marked increase. This is clear from Table no 6.2

Table no 6.2
Sectoral Share of GDP in Per Cent (% per Year)

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<tr>
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<td>50.8</td>
<td>44.3</td>
<td>37.9</td>
<td>31.4</td>
<td>23.9</td>
<td>15.7</td>
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<td>14.4</td>
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<tr>
<td>Industry</td>
<td>15.1</td>
<td>18.8</td>
<td>22.1</td>
<td>24.1</td>
<td>25.9</td>
<td>25.8</td>
<td>28.0</td>
<td>28.1</td>
<td>27.9</td>
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<tr>
<td>Services</td>
<td>29.6</td>
<td>30.4</td>
<td>33.6</td>
<td>38.0</td>
<td>42.7</td>
<td>50.3</td>
<td>56.3</td>
<td>57.3</td>
<td>57.7</td>
</tr>
</tbody>
</table>

Sources: Handbook of Statistics on Indian Economy 2010-11.
As it is clear from this table that there has not been much change in the share of industry in GDP since 1980-81 and the entire decline in the share of agriculture has been due to a rapid increase in the share of services from 38% of GDP in 1980-81 to 42.7% in 1990-91 and further to as high as 57.7% in 2010-11. After liberalisation policy the share of service sector has increased very rapidly.

**Contribution of services to Growth:**

Table no 6.3 gives the information on the contribution of agriculture, industry and services to growth. In 1960-61 agriculture contributed almost half to GDP growth, industry contributed about 30% and services about one-fifth. During the five years period 1991-92 to 1996-97, services contributed half of the total growth in GDP. In 2001-02 the contribution of services to GDP growth was as high as 68%.

It is important to notice that after 1990-91 the contribution to GDP growth by the services sector begins to outpace its sectoral share.

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</thead>
<tbody>
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<td>Agriculture</td>
<td>34.9</td>
<td>48.2</td>
<td>23.8</td>
<td>21.1</td>
<td>11.5</td>
<td>7.0</td>
<td>6.5</td>
</tr>
<tr>
<td>Industry</td>
<td>35.5</td>
<td>29.2</td>
<td>35.2</td>
<td>29.0</td>
<td>20.2</td>
<td>29.3</td>
<td>26.9</td>
</tr>
<tr>
<td>Services</td>
<td>29.6</td>
<td>22.6</td>
<td>41.0</td>
<td>49.8</td>
<td>68.3</td>
<td>63.6</td>
<td>66.6</td>
</tr>
<tr>
<td>GDP at factor cost</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Sources: Handbook of Statistics on Indian Economy 2010-11.

During the 1990s the service sector had experienced phenomenon growth. The sector emerged as the most dominating sector of the economy. However there are some problems faced by this sectors are as follows;

**Problems faced by Service sectors:**

- **The employment generation** by service sector is **inadequate**. Compare to the share in the national income the service sector only provides employment to 25% of the work force.
The fruits of benefits have been tested only by urban areas; the rural areas are yet to taste the same. Means only the urban areas have benefited by service sector.

Yet there is shortage of trained and skilled workers in the rapidly growing service sector.

Huge investment and mergers in this sector will lead to monopoly of the few.

Rapid growth of finance and real estate has resulted in speculative activities and inflation.

A large segment of the service sector like transport, retail and real estate, remains unorganized.

Due to unorganized nature there are many problems related data collection and formulation of policies.

Unfortunately the socially benefitable but economically weaker sections have been ignored in the development process.

6.8 ROLE OF INFRASTRUCTURE IN ECONOMIC DEVELOPMENT.

Infrastructure plays an important role in the economic development of a country. Infrastructure refers to basic services, which are required to understand economic and social activities. Infrastructure services consist of:

- Energy - Coal, Electricity, Oil.
- Transport - Railways, Roadways, Waterways.
- Communications - Post and Telegraphs, Telecommunications.
- Irrigation and Water Supply.
- Banking and Insurance.
- Education, Health and Sanitation.
For the rapid economic growth the availability of appropriate infrastructure services is very important. For instance, development of agriculture depends on irrigation facilities, industrial progress is depend upon power and electricity, financial services, transport and communication etc. Obliviously, if proper attention is not paid to the development of infrastructure, it is likely to act as severe constraint on the economic development process in the country. The government of India has attached great importance to growth and development of infrastructure sector. Keeping this in mind the various plans have focused attention on the expansion of infrastructure facilities.

In approach to the 12\textsuperscript{th} Five Year Plan the planning commission has projected an investment of over Rs.45 lakh crore during the 12\textsuperscript{th} Plan (2012-17).

\textbf{Role and Impotence of Infrastructure in Economic Development}

Infrastructure plays an important role in the economic development of a country. In the context of Indian economy, infrastructure is important in the following areas:

1. \textbf{Proper Functioning of Economy}:

   The existence of infrastructure is a pre-condition for economic development without efficient infrastructure there cannot be growth and development of an economy. Means greater the infrastructure facilities, the greater are the economic development and vice-versa.

   Proper functioning of any economy depends upon the infrastructural facilities. For instance efficient means of transport would be enable proper movement of men, materials and finished goods from one place to another .Proper availability of electricity and power would keep the wheels of production moving. Other infrastructural facilities including social overheads like education, health are vital for economic development.

2. \textbf{Employment Generation}:

   For generating employment in the country infrastructure is help full .It provides employment in Direct or Indirect way. Direct employment is generated within the infrastructure sector itself and indirect employment can be generated in the agriculture, industry and the service sector like banking, tourism, hotels ect.
3. Investment Opportunities:
   Infrastructure facilitates investment in industry and other sectors. If a good infrastructural facility has been provided by government, the businessmen would like to go for more investment in various sectors as these facilities give boost to industrial development. This encourages the business people to invest in expansion and diversification of their business activities. Due to the absence of such infrastructure facilities the businessmen would not be interested to go for further investments.

4. Industrial Development:
   Industrial development cannot be done without infrastructure facilities. Infrastructure like roadways, transport, communications, water, banking can help the industry in providing raw material, machinery, manpower, distribution of goods and services etc.

5. Regional Development:
   Infrastructure helps in regional development process for any country. In India states like Maharashtra, Gujrat, West Bengal, Tamil Nadu, Karnataka do have good infrastructure facilities and so these states are more developed as compared to others. Thus we can say that there can be regional development in India due to the availability of infrastructure facilities.

6. Social Development:
   Infrastructure facilities like education and health can bring about social development in the country. In the absence of social overheads, there would be low social developments and as such there can be various social problems including anti-social activities.

7. Rural Development:
   Infrastructure facilitates rural development also. In rural areas the facilities like irrigation, power generation, roads and transport, communication can create new employment opportunities this is helpful in poverty eradication in rural areas as well as this can help to reduce migration to towns and cities.

◆ Status of Constituents of Infrastructure in India:
   In this segment we are going to focus on the status of following constituents of infrastructure in India:
   - Electricity and power generation.
   - Coal.
   - Oil and Gas.
Transport.
Communications.

**ELECTRICITY AND POWER GENERATION**

Electricity and power generation play a crucial role in economic development. The future development of the country, therefore, will depend upon the rate of growth of power generation capacity.

- **Expansion of Generation Capacity:**

  There has been considerable expansion in generation capacity during the period of planning as would be cleared from the fact that the total installed generating capacity in the country rose from only 2,300 MW in 1950 to as high as 1,82,690 MW as at the end of October 2011.

  Electricity generated rose from 55.8 billion KWh in 1970-71 to as high as 394.5 billion KWh in 1996-97 and further to 811.1 billion KWh in 2010-11.

  During the period from 1990-91 to 2010-11, electricity generated grew at the rate of 5.8 % per annum. The target for additional capacity creation in the 12th Plan has been kept at 1, 00,000 MW.

- **Problems of Electricity Sector:**

1. There has been an inordinate delay in installing and commissioning of projects. The cause of these delays are land acquisition , inter-state water disputes , poor project management, late deliveries of steel, cement, and power equipments labour disputes, etc.

2. State Electricity Boards (SEBs) faced a number of problems like poor financial and commercial performance which has crippled their capacity to finance future projects.

3. From the level of Rs.13,860 crore in the financial year 2007, the aggregate losses of SEBs rose to Rs.44,470 crore in the financial year 2010-11 with subsidy.
4. **Cost recovery in distribution is very poor.** In most of the states revenues from selling electricity fall short of buying or producing it.

5. Many state Governments are providing electricity at a very low rates to the agriculture sector with the result that the **burden of subsidy is very high.**

**COAL**

Coal has been considered as the major source of energy in India. Coal based generation of power constitutes around 80 % of thermal generation and around 66 % of the total generation of power. The geological coal reserves of the country have been estimated at 276.81 billion tonnes as on April 1, 2010.

The Seventh Plan has fixed the target for the coal production at 226 million tonnes. This required an annual growth rate of 8.9 % during the Seventh Plan. However the actual annual increase in the output of coal turned out to be only 6.4 % during the Seventh Plan. The Tenth Plan kept the coal production target in 2006-07 at 405 million tonnes while actual achievement was 431.0 million tonnes.

The demand for coal has risen by about 8.0 % per annum during the Eleventh Plan and may rise by about the same magnitude during the Twelfth Plan .Coal output expanded at the rate of 7.0 % per annum in the five year period of 2004-05 to 2009-10. However the actual production of coal in 2011-12 is estimated at only 554 million tonnes.

** Measures taken to increase the production of Coal: **

- New **Coal Distribution Policy** notified on 18th October 2007.

- To ensure the free play of market forces, a system of **E-Auction** for sale of about 20 % of the total production has been introduced.

- 218 Coal blocks with geological reserves of about 50,000 million tonnes have been allocated to Public / Private companies.
• For increasing the output of washed coking and non-coking coal, CIL (Coal India Ltd.) has envisaged setting up of 20 new coal washeries with an estimated capital investment of Rs.2,500 crore.

• For increasing production from underground mines, initiatives like identification of high capacity underground mines for development with latest technology, forming joint ventures with reputed mining companies, introduction of high wall mining and up gradation of equipment size, etc., are being undertaken.

OIL AND GAS

Though the reserves of Oil and Gas in India are limited, the dependence on these sources has been increasing considerably over the years. To undertake the task of oil exploration on an extensive scale to established adequate indigenous resources The Oil and Natural Gas Corporation (ONGC), and Oil India Limited (OIL) were established in 1955 and 1959 respectively.

The production of crude oil was around 0.25 million tonnes in 1950-51, it has risen considerably over the years and stood at 37.7 million tonnes in 2010-11. Dependence on crude oil imports was as high as 76.4 % in 2010-11 implying that less than 20 % of consumption of crude oil is being met by domestic production. The dependence on oil imports is expected to rise further to 80.0 % by 2016-17 i.e., the end of the 12th Plan. This heavy dependence on import has considerably increased the pressure on the balance of payments. At the same time, it has made India vulnerable to changes in international oil prices. The effective refining capacity at the end of March 1999 was 69.1 million tonnes in term of crude throughput . It rose to 193.4 million tonnes as on 1st January 2012.

The net recoverable reserves of gas are presently placed at 1,119.55 billion cubic meters . The proportion of India’s gas reserves to the world gas reserves is only 0.5 %. The production of gas was 7.23 billion cubic meters in 1984-85. It rose to 32.8 billion cubic meters in 2008-09. However, India depends considerably on imports of natural gas for meeting its domestic requirements. Import dependence was 19.0 % in 2010-11 and this is expected to go up to 28.4 % by the end of the 12th Plan.
The major reforms introduced in the oil and gas sector in recent years are:

A) Allowing Private sector participation in exploration and production of oil and natural gas.
B) Dismantling the Administered Pricing Mechanism (APM).
C) Allowing domestic companies to acquire international oil and gas reserves.

The transport is an important infrastructure sector. It helps in speedy economic development through movement of goods, manpower, raw material, etc. The transport sector broadly comprises of:
- Railways
- Roadways
- Water transport
- Civil aviation.

Transport sector has recorded a significant growth over the years both in spread of network and in output of the system. With the Indian economy is expected to grow at around 8 % per annum, the transport sector is expected to grow at 10.0 % per annum.

❖ RAILWAYS:-
Indian Railways began its operations in April 1853, when the first train was set off from Mumbai to Thane. Over the years, the Indian railways have grown to be the largest in Asia and fourth largest in the world after US, Russian and Chinese railways. The total route length of Indian railways at the end of March 2010 was 63,974 kms.

During 2010-11 railways carried out 7,651 million passengers and 921.7 million tonnes of revenue earning freight traffic. The railways operate services on three gauges—The Broad gauge (1.676 meters), The Meter gauge (1.00 meters) ,The Narrow gauge (0.762 meters) .The Broad gauge network is the largest operating system (52,808 kms) in the country and accounts for the bulk of traffic, both freight and passenger.

❖ ROAD TRANSPORT:-
India has the second largest road networks in the world,aggregating to about 41 Lakhs Kilometers at present.
However this network is not adequate for speedy and efficient transportation.

Roads are normally classified into four categories:

- **National Highways**: Which connect large cities and industrial centers.
- **State Highways**: Which connect important business centers of the state and national highways.
- **District Roads**: Which connect important business centers of a district and state highways.
- **Rural Roads**: Which connect one village with other villages and town.

The National Highways which are arterial roads have currently a network of 70,934 kms. Although they carry nearly 40 % of the goods and passenger traffic, the National Highway network constitutes only 1.7 % of the total road network. Presently, 60 % of the freight movement and 87.4 % of the passenger movement depends on roads.

**Important Initiatives in Road Transport:**
Three important initiatives in the road sector were undertaken in recent years:

1. The National Highway Development Project (NHDP): It deals with building high quality highways.
2. Pradhan Mantri Bharat Jodo Pariyojana (PMBJP): It deals with linking up major cities to the NHDP highways.

**Importance of Road Transport:**
- Road transport provides **door-to-door service**, which cannot be provided by any other transport other than road.
- Road transport is also **flexible in nature**. The road transport can be diverted in case of any emergency or an accident.
- Road transport is **more economical**, especially for short distance, as compared to other forms of transport.
- Road transport is more **suitable for carrying perishable and less bulky goods**.
- Road transport **does not require heavy capital expenditure** as compared to other forms of transport.
• Road transport provides feeder services to other forms of transport such as airways, railways, and waterways.
• Road transport is having less loading and unloading charges as compared to other forms of transport, because road transport normally requires one time loading and unloading.

WATER TRANSPORT

Water transport can be broadly divided into two groups:
1. Inland water transport.
2. Shipping.

1. Inland water transport:-

   India has got about 14,500 kms of navigable waterways. Inland water transport includes natural modes as navigable rivers and back waters and artificial modes such as canals. Cargo transportation by Inland water transport mode has been increasing over the years, and has reached the level of 79 million tonnes in 2010-11. Inland Waterways Authority of India (IWAI) was constituted in 1986 for the development and regulation of inland waterways for shipping and navigation.

   Today there are five waterways that has declared as National Waterways (NW) namely;
   ▲ Ganga from Haldia to Allahabad (1,620 kms)
   ▲ Brahmaputra from Dhubri to Sadiya (891 kms)
   ▲ West Cost canal from Kottapuram to Kollam (205 kms)
   ▲ Chabatia-Dharma stretch along with Mahanadi delta river system (585 kms)
   ▲ Kakinada-Puducherry stretch of canal and stretches of river Godavari and Krishna.(1,028 kms)

   The Inland water transport policy approved by the government in January 2001 aims at giving a boost to the development of this mode of transport.

2. Shipping:

   Shipping is divided into two categories:

   • Coastal Shipping:-

   India has a long coastline of 7,517 kms ,a number of ports (12 major and 200 non-major ports )and a vast hinterland .Therefore the coastal shipping holds a great promise more so
because it is the most energy efficient and cheapest mode of transport for carriage of bulky goods over a long distance.

- **Overseas Shipping:**
  
  Because of the importance of the overseas shipping in international trade, considerable attention has been paid to increase the shipping tonnage in the planning period. As a result, the share of Indian overseas trade has increasing considerably in the planning period. Presently almost 95% of the country’s trade volume is moved by sea. India has one of the largest merchant shipping fleet among the developing countries and ranks 16th amongst the countries with the largest cargo carrying fleet with 10.67 million gross tonnages as on 31st May 2011.

**AIR TRANSPORT**

Air transport is the most modern and quickest addition to the modes of transport. In India, a beginning in air transport was made in 1920 when the government first decided to prepare air routes between Mumbai and Kolkata and Kolkata and Rangoon. The civil aviation works actually started in 1924-25, but progress was very slow until the Second World War. During the first two Plans Rs.24 crore was spent on civil aviation.

During the 10th Plan an outlay of Rs.12,928 crore was provided to the Ministry of Civil Aviation out of which Rs.7,792 crore was spent.

The 11th Plan has laid down the following objectives for the civil aviation sector:

1. Providing world class infrastructure facilities.
2. Providing safe, reliable and affordable air services so as to encourage growth in passenger and cargo traffic.
3. Providing Air connectivity to remote and inaccessible areas with special reference to north-eastern part of the country.

Air India and Indian Airlines operating in the international sector and domestic sector respectively since 1953 were merged on 27th August 2007 to form National Aviation Company of India Ltd (NACIL). Presently there are 3 companies in the public sector, NACIL, Air India Charters Ltd, and Alliance Air. The total projected
outlay for the Ministry of Civil Aviation in the 11th Plan has been kept at Rs.43,560 crore at 2006-07 prices.

**COMMUNICATION**

Communication means the imparting or transmission of information. The difference between transport and communication is that, while the former implies the conveyance of goods, the latter implies the conveyance of information. The most important means of communications are Postal services, telephone, Radio and Television and Internet, etc.

- **Postal Services:**
  
The Indian postal network is the largest in the world. Modern postal system in India dates back to 1837 when postal services were thrown open to the public. After Independence the postal service’s came to be recognized as an essential infrastructure of development. At the time of independence there were only 23,344 post offices available which increased by 1, 54,979 as on 31st March 2010. Now on an average a post office serves 7,176 persons and covers an area of 21.21 sq.kms.

  Quick Mail Services was introduced in 1975 and the Speed Post Service introduced on 1st August 1986. To provide better services to the consumers mechanisation and computerization of postal operations is being progressively introduced.

- **Telecommunication:**
  
  A well spread telecommunication network provides a great boost to the economic growth in a country. The Indian telecom network is now second largest in the world after China. From only 76.54 million telephone subscribers in 2004, the number increased to 926.55 million at the end of December 2011. Telecom Regulatory Authority of India (TRAI) was set up on 20th February 1997 which works as a regulatory authority in telecommunication sector.

  The liberalisation efforts of the government are evident in the growing share of private sector in total telephone connections, which has increased from 39.2 % in 2004 to 86.0 % in December 2011.
The number of broadband subscribers rose from 0.2 million in 2005 to 13.30 million as on 31st December 2011. The number of Internet subscribers stood at 20.99 million at the end of March 2011.

**Check Your Progress:**

A) Role of Service Sector in economic development.

B) Problems faced by Service Sector.

C) Role of Infrastructure in economic development.

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**6.9 SUMMARY**

- The small scale industries played a very significant role in the socio-economic development of India.

- In manufacturing enterprises a Small enterprise means, where the investment in plant and machinery is more than Rs 25 Lakh but less than Rs.5 crore.

- In Service enterprises a Small Enterprises means, where the investment in equipment is more than Rs 10 Lakhs but does not exceed Rs.2 crore.

- The sector has contributed significantly to the economic growth in terms of Gross Domestic Product, employment generation, rural development, support to agriculture and large scale industries and exports.

- The SSI units are facing some major problems like industrial sickness, financial problems, problems regarding marketing, raw material, infrastructure, tax burden etc.
The policy decisions or measures taken by Government in this regard can be broadly classified into two parts:
- Policy Prior to 1991 &

After the II world war many countries got down together to work on ways and means to promote international trade.

As a result, the General Agreement on Tariff and Trade (GATT) was signed by 23 countries in 1947.

The WTO agreement came into the force on 1\textsuperscript{st} Jan,1995.

The main WTO agreements can be divided into the following categories.
1) Agreement on agriculture 2) Multi-fiber Arrangement 3) Market Access 4) TRIMs 5) TRIPs 6) Agreement on Service 7) Disputes Settlement Body

Service sector is the most dominant sector of the Indian economy. In the years to come, this sector is going to be the major driver of the economy.

The service sector has contributed significantly to the economic growth in terms of Gross Domestic Product, employment, support to primary and industrial sector, educational system and exports.

The service sector grew at a robust rate of 10 % and 10.1 % and 9.4 % respectively in the year 2008-09, 2009-10, and 2010-11.

6.10 QUESTIONS

1. Explain the role of small scale industries in the Indian economy.
2. Discuss the problems faced by SSI units in India.
4. What is WTO? Focus on the important agreements of WTO.
5. Discuss the various impacts of WTO agreements on Indian economy.

6. Explain the importance of the service sector in the economic development.

7. Discuss the role of service sector in the growth of GDP in India.

8. Explain the importance of infrastructure in the economic development.
Module 4

FINANCIAL SYSTEM AND THE ECONOMY

Unit Structure:

7.0 Objectives

7.1 Indian Financial System.
7.2 Nationalization of Commercial Banks.
7.3 Performance of the Commercial Banks in the pre-reform Period.
7.4 Narasimham Committee Report (1991) on Banking Sector Reforms
7.5 Narasimham Committee Report (1998) on Banking Sector Reforms
7.6 Progress of Commercial Banks in the Post Reforms Period
7.7 Questions

7.0 OBJECTIVES

- To understand the Indian Financial System.
- To appreciate the reasons behind bank nationalization and know performance of the banks before 1991.

7.1 INDIAN FINANCIAL SYSTEM

A financial system is an institutional mechanism that intermediates between ultimate borrowers and ultimate lenders. In an economy, there are different class of borrowers and lenders. Accordingly, the components and sub-components of the financial
markets come into existence. Broadly, on the basis of purpose, the financial system can be classified into industrial finance, agricultural finance, development finance and government finance. The Indian Financial System consists of two markets: the Money Market and the Capital Market. The Indian money market is the market in which short term funds are borrowed and lent. The Indian capital market is the market for medium and long term funds. The Indian money market is further classified into organized and unorganized markets. The organized sector consists of commercial banks and foreign banks. The unorganized sector consists of indigenous bankers. The organized banking system is classified into three categories: the central bank known as the Reserve bank of India which is the monetary authority or the apex bank, commercial and cooperative banks. Commercial banks are further classified into scheduled and non-scheduled banks. As an apex bank, the RBI is responsible to control the banking system in India.

According to the RBI Act of 1934, commercial banks are classified into scheduled and non-scheduled banks. The scheduled banks are those which are entered in the Second Schedule of RBI Act 1934. The scheduled banks have a paid-up capital and reserves of not less than Rs. Five lakhs and which satisfy RBI that their affairs are carried out in the interests of their depositors. The Indian capital market is classified into market for government securities or the gilt-edged market, industrial securities market, development finance institutions and non-banking financial companies.

7.2 NATIONALIZATION OF COMMERCIAL BANKS IN INDIA

In 1950-51, there were 430 commercial banks in India. In order to strengthen the banking system, the RBI adopted a policy of mergers and amalgamation. Accordingly, small banks were merged with big banks. As a result, the number of non-scheduled commercial banks declined from 256 in 1960-61 to a mere four in 1980-81. In 2007-08, there were 172 scheduled commercial banks in India. On 19th July 1969, 14 major banks were nationalized by the Government of India. Commercial banks in India were not functioning according to the development requirements of the people of India. The banks were controlled by a group of industrialists and business men who had used bank funds to build their private industries. Small industrial and business units were
ignored in spite of the Government of India’s policy to help the small sector. Agricultural credit was non-existent. Due to these reasons, the Government of India decided to nationalize fourteen big commercial banks in July 1969. In 1980, the Government of India took over another six commercial banks. The State Bank of India and her associates were taken over by the Government in 1955. The New Bank of India was merged with Punjab National Bank in 1993 and the number of nationalized banks excluding the SBI group today stands at nineteen.

The nationalized banks are banks in which the central government is a major share holder. The State bank of India group includes the State Bank of India and seven associate banks. The 19 nationalized banks and the eight banks in the SBI group put together are known as the Public Sector Banks.

### 7.3 PERFORMANCE OF COMMERCIAL BANKS IN THE PRE-REFORM PERIOD

After nationalization, commercial banks in India have made commendable progress. The performance of commercial banks in the post nationalization period i.e. between 1969 and 1991 can be assessed with reference to the following issues:

1. **Expansion of Branches.** After nationalization, there was a rapid growth in the number of bank branches. The expansion of branches was undertaken to provide banking facilities to the largest possible number of people in the country. The government used the banking system as an instrument of economic development. The Lead Bank Scheme which came into existence in the year 1969 also contributed to the banking development and branch expansion effort. The major achievements in this regard are stated below.

   a) During the period July 1969 to June 1991, the total number of offices of commercial banks increased from 8262 to 60,220 which means during this period 2362 bank offices were added every year.

   b) Banking development was initiated in the rural areas. The percentage of bank offices in rural areas was only 22.2 per cent in June 1969. This figure rose to 58.5 per cent bank offices in June 1991.

   c) Regional inequalities in banking development was considerably reduced during this period by bringing about rapid expansion of bank branches in the States of Assam, Orissa, Bihar, Madhya Pradesh and Uttar Pradesh.
2. **Deposit Mobilization.** The total bank deposits in March 1999 were Rs.7,37,003 Crore as against Rs.4,665 crore in July 1969. Out of the total deposits of Rs.12,45,919.42 crores in the year 2001-02, the nationalized banks accounted for about 50 per cent of these deposits followed by State Bank of India and her associates with a share of 28.2 per cent. Private sector banks accounted for 13.6 per cent, foreign banks 5.2 per cent and Regional Rural banks had a share of 3.4 per cent. This rise in bank deposits cannot be entirely attributed to the performance of the banking sector. Rise in national income and price rise are the other important factors which have greatly contributed to the rise in bank deposits.

3. **Bank Lending.** Total bank credit in March 1998 was of the order of Rs.3,21,813 crore. In July 1969, this figure was Rs.3,399 crore. This huge growth in credit was due to massive deposit mobilization and also inflationary expansion of money supply. The credit deposit ratio in March 1998 was 53.5 per cent.

4. **Sectoral Deployment of bank Credit.** In March 1968, large and medium industries had accounted for 60.6 per cent of aggregate credit while agricultural sector received only 2.2 per cent of the total bank credit. After nationalization, credit to the agricultural and small industry sectors was given greater emphasis by the government. In March 1997, the share of the priority sector consisting of small scale industries and the agricultural sector was 32 per cent. Different innovative schemes such as village adoption, agricultural development branches and equity funds for small units etc were introduced for the potential disbursement of bank credit. In order to the banking sector an integral part of he planning process, credit planning was introduced. Accordingly, banks have to prepare quarterly credit budgets to bridge the gap between demand and supply of credit in the country.

5. **Regional Rural Banks.** The Working Group on rural banks under the chairmanship of Mr. M Narasimham recommended the setting up of regional rural banks as part of a multi-agency approach to rural credit. It was found that the commercial banks and credit co-operative societies were not adequately catering to the credit requirements of the small and marginal farmers, agricultural laborers and artisans in the rural areas. The small income groups required low cost credit. The employees of the RRBs were to be recruited from the neighboring areas to understand the local needs and problems of the people. Accordingly, in the year 1975, five RRBs were set up. At present there are 196 RRBs. The RRBs can be set up when a public sector bank sponsors them. The branches of RRBs increased from 17 in 1975 to 14,516 in 1996. The RRBs have played a significant role in mobilizing rural savings. Advances to the weaker sections account for more than 40 per cent of the
total advances of RRBs. The RRBs conduct all types of banking business within one to five districts. The RRBs have been facing various organizational and recovery problems. Most of the RRBs incurred huge losses and became unviable. In 1991, the Narasimham Committee had recommended that RRB may be give a choice to maintain a separate identity or to get merged with the sponsor banks as rural subsidiaries. Of late, the performance of the RRBs has considerably improved and their net profits stood at Rs.607.88 crores in 2001-02.

7.4 NARASIMHAM COMMITTEE REPORT (1991) ON BANKING SECTOR REFORMS

The banking sector reforms were a part of the new economic policy adopted by the government of India in July, 1991. The government appointed a Committee on the financial system under the Chairmanship of Mr. M Narasimham in August 1991. The Committee submitted its report within three months and made the following recommendations.

1. Prudential Regulation and Supervision. Both supervision and regulation are required for the sound and healthy growth of the banking system. The Narasimham Committee had recommended that banking supervision must be strengthened and prudential regulation should be introduced. The government accepted this recommendation and the RBI issued guidelines in April 1992 for income recognition, asset classification and provisioning and adopted the Basle capital adequacy standards. Non-performing loans have been defined as credit facility in respect of which interest has not been received for 180 days. These loans are classified as sub-standard, doubtful and lost depending on how long they have been non-performing. Provisioning has to be made at 10 per cent for sub-standard loans, 20-50 per cent for doubtful loans and 100 per cent for lost loans. Banks were required to have a capital adequacy ratio of 9 per cent. Out of the 27 public sector banks, 25 banks had capital to risk asset ratio above nine per cent in March 2002. Similarly, out of the 30 private sector banks, 28 had a capital to risk asset ratio of 9 per cent and above in March 2002. The Board of Financial Supervision has been constituted as a supervisory authority.

2. Rehabilitation of Public Sector Banks. By the year 1991, the banking system had become weak due to the accumulation of non-performing assets. NPAs accounted for 24 per cent of the total lendings. Half of the public sector banks made huge
losses and the net profit to assets ratio was in the range of minus 6.8 to plus 0.5 per cent. In order to restore the net worth of the banks, the government decided to recapitalise them. Recapitalization required direct infusion of capital to the banks from the Union budget and the NPAs were left in the books of the banks. The recommendation of the Committee to set up Asset Reconstruction Fund was not accepted by the government. Instead special recovery tribunals were set up by the government. By March 1997, the cost of recapitalisation operation was about Rs.14000 crore. As a result, the capital adequacy ratio of all the banks improved.

3. Reduction in the SLR and the CRR. The Statutory Liquidity Ratio and the Cash Reserve Ratio were very high in the pre-reform period. High SLR and CRR reduced the profitability of banks in India. The Narasimham Committee recommended a reduction in the SLR to 25 per cent by 1996 and an unspecified reduction in the CRR. The government accepted this recommendation and brought down the SLR on total net demand and time liabilities to 25 per cent in 1996 from a high of 38.5 per cent in 1991. However, investment in government securities by commercial banks was 41.4 per cent of their net demand and time liabilities in December 2003 whereas the statutory requirement was only 25 per cent. The CRR being an instrument of monetary policy was reduced in a phased manner. The CRR was reduced to 13 per cent in May 1996 and by early 1997 it was reduced to 10 per cent. It was further reduced to 9.5 per cent in November 1997. Since there was excess liquidity in the banking system, the CRR was raised to 11 per cent in August 1998. After reviewing the monetary and credit situation, the RBI reduced the CRR to 10.5 per cent in March 1999, 10 per cent in May 1999, nine per cent in November 1999 and in June 2003; the CRR was lowered to 4.5 per cent.

4. Deregulation of Interest Rates. Interest rates in India before the reforms were administered by the Central Bank i.e. they were not market determined. The administered interest rate system in India had become complex due to the multiplicity of interest rates. The policy of giving concession loans to the different disadvantaged sections of the society at a variety of interest rates reduced the profitability of commercial banks in India. The Narasimham Committee recommended phasing out of the system of concession interest rates. It argued that “interest rates should increasingly be allowed to perform their main function of allocating scarce loanable funds among alternative users. For them to do so, rates will have to be allowed broadly to be determined by market forces”. The government accepted the recommendation and adopted measures to deregulate them. From April 1992, the interest rates were liberalized and banks were allowed to determine interest rates on all term deposits of maturity of above 30
days and were free to determine the prime term lending rate for term loans of three years and above.

5. Phasing out of Directed Credit. Directed credit was introduced in India on the grounds of equity and efficiency. However, they reduced the profitability of commercial banks and also failed to promote both equity and efficiency. According to Hans Binswanger and SR Khandekar, directed credit had marginal effect on output but had neutral effect on employment in the agricultural sector. In the agricultural sector, large and medium farmers took away large part of the concession credit and subsidies. Further, the small scale industries were given subsidized credit on the grounds of market failure for more than 25 years. However, they could not come out of their cocoon. Concession credit therefore lost its argument of equity and efficiency. The Narasimham Committee recommended phasing out of the directed credit program. The government accepted the recommendation but is yet to take measures of phasing out the directed credit program.

6. Competition. In order to make the banking industry more competitive, it was made open to the private sector. As a result, ten new private sector banks came into existence. However, the RBI had imposed restrictions on these new private sector banks to open branches.

7.5 NARASIMHAM COMMITTEE REPORT (1998) ON BANKING SECTOR REFORMS

The Government of India appointed a Committee on Banking Sector reforms under the chairmanship of Mr. M Narasimham in the year 1998. The committee submitted its report in 1998. Important recommendations of the committee were as follows:

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

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

3. The Committee recommended new and higher norms for capital adequacy. It suggested that the minimum capital to risk assets ratio be increased to 10 per cent from the earlier level of 8 per cent.
4. Budgetary support for recapitalization should be stopped and Legal framework for credit recovery should be strengthened

5. Net NPAs for all banks be brought down to below 5 per cent by the year 2000 and to 3 per cent by 2002.

6. There should be rationalization of branches and staff.

7. Bank Boards should be depoliticized under the RBI supervision.

8. The policy of licensing new private banks may be continued.
9. Foreign banks may be allowed to set up subsidiaries or joint ventures in India and treated on par with other private banks and subject to the same conditions with regard to branches and directed credit as the private banks.

10. There has to be an integrated system of regulation and supervision to regulate and supervise the activities of banks, financial institutions and non-bank finance companies. The agency for this purpose to be renamed as the Board for Financial Regulation and Supervision (BFRS).

    In response to the recommendations, the RBI announced a number of measures in October 1998. These measures related to phased introduction of risk weight for government approved securities, risk weight for government guaranteed advances, general provision for standard assets and higher capital to risk assets ratio for banks. In 2002, Securitization, Reconstruction of Financial Assets and Enforcement of Security Act was passed to provide a satisfactory legal framework for the recovery of bank credit.

7.6 PROGRESS OF COMMERCIAL BANKS IN THE POST REFORMS PERIOD

    The banking system in India is more than 200 years old. The General Bank of India was founded in 1786 (now defunct) was the first ever bank in India. The oldest surviving bank in the country is State Bank of India (SBI), which was established as “The Bank of Bengal” in 1806. Subsequently more banks were in operation, like Allahabad Bank, Punjab National Bank, Bank of India etc.
After India’s independence, the larger commercial banks were nationalized in 1960s to enable the government in controlling credit delivery. By 1995, the liberalization policy of the government allowed private sector participation in banking industry. This was followed by foreign direct investment (FDI) in banks. As of now, there are 27 public sector banks (with Government of India holding a stake), 22 private banks (without Government stake but listed in stock exchanges), 31 foreign banks and a large number of medium and small co-operative banks. The Reserve Bank of India (RBI) is India’s central bank and it is the ultimate authority for control of banking operations. At both BSE and NSE, several public sector banks (State Bank of India, Punjab National Bank, Indian Bank etc.) as well as private sector banks (ICICI Bank, HDFC Bank, Kotak Bank etc.) are listed.

Productivity of Commercial Banks.

The performance of the banking system has substantially improved in the post-reforms period in India. Deregulation of interest rates, increased competition and greater accountability has improved the profitability of commercial banks in spite of the fall in interest rates and resultant fall in interest spreads. If you look at the indicators of performance such as the business per employee and the profits per employee amongst the various categories of banks as given in Table 1.1, you will notice that over the fifteen year period, the business per employee undertaken by the public sector banks has increased from Rs.88.5 lakhs to Rs.1013.63 lakhs. In terms of profits per employee, the improvement is more than 800%. Thus the performance of the public sector banks during the period under consideration has been spectacular. Over the fifteen year period, the performance of the private sector banks both in terms of business per employee and profits per employee have fallen and again risen. While in the case of foreign banks, the performance is outstanding both in terms of business per employee and profits per employee.
Table 7.1: Performance Indicators of the Banking Industry in India.

(Rs. Lakhs)

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</thead>
<tbody>
<tr>
<td>1. Public Sector Banks.</td>
<td>Business Per Employee</td>
<td>88.5</td>
<td>471.18</td>
<td>1013.63</td>
<td>0.7</td>
<td>2.76</td>
<td>5.93</td>
</tr>
<tr>
<td>2. New Private Sector Banks.</td>
<td>Profits Per Employee</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Foreign Banks</td>
<td></td>
<td>529.4</td>
<td>974.77</td>
<td>1559.74</td>
<td>4.5</td>
<td>16.13</td>
<td>27.59</td>
</tr>
</tbody>
</table>

Source: RBI reports on trends and progress in banking industry in India.

Profitability of Commercial Banks.

For obvious reasons, the profitability of new private sector banks and foreign banks is better than public sector banks (See Table 1.2). In the post reforms period, the profitability of public sector banks has also improved substantially. The interest income of public sector banks went up from Rs.1,64,185 Crores in 2006-07 to Rs. 3,66,318 Crores in 2011-12 which is a more than cent per cent rise. In case of private sector banks, the performance is almost similar whereas in the case of foreign banks the interest income had increased by about sixty per cent. The interest expended of public sector banks in 2006-07 was Rs. 1,01,960 Crores and in 2011-12, it was Rs. 2,31,153 Crores which is a more than cent per cent increase. The CAGR for public sector banks on account of interest income and interest expended were 22.2 and 22.7% respectively. However, in the case of private sectors, the CAGR was 18.2 and 14.2 % respectively. The growth in interest expended was less than the growth in interest income in the case of private sector banks, thereby indicating a better performance as compared to public sector banks. The performance of the foreign banks was similar to that of private sector banks.

The net profit ratio or the Return on Assets (RoA) remained constant at 1.0 % during the period 2006-07 to 2011-12 in case of public sector banks and from 1.0 to 1.50 in case of private sector banks with foreign banks registering decline from
200

2.25 to 1.75%. Thus only the private sector banks registered an improvement in the net profit during the period under consideration.

The net interest income or the interest rate spread in case of public sector banks registered a CAGR of 21.4%, new private sector and foreign banks registered 24.2 and 14.8 % respectively during the period. In conclusion, the profitability of commercial banks has substantially improved during the period 2006-07 to 2011-12.

Table 7.2: Profitability Indicators of Banking Industry in India.

<table>
<thead>
<tr>
<th>Profitability Indicator</th>
<th>Public Banks</th>
<th>New Private Sector Banks</th>
<th>Foreign Banks</th>
</tr>
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<tbody>
<tr>
<td>Interest Income</td>
<td>164185</td>
<td>366318</td>
<td>17924</td>
</tr>
<tr>
<td></td>
<td>22.2%</td>
<td>18.2%</td>
<td>14.8%</td>
</tr>
<tr>
<td>Interest expended.</td>
<td>101960</td>
<td>231153</td>
<td>32856</td>
</tr>
<tr>
<td></td>
<td>22.7%</td>
<td>14.8%</td>
<td></td>
</tr>
<tr>
<td>Net Profit/ RoA</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spread(Net interest income)</td>
<td>62225</td>
<td>135165</td>
<td>16711</td>
</tr>
<tr>
<td></td>
<td>21.4%</td>
<td>24.2%</td>
<td></td>
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</tbody>
</table>

Source: RBI Reports on Trends and progress in Banking in India.

Financial Soundness.

The capital adequacy ratio or the capital to risk-weighted assets ratio (CRAR = Total capital/RWAs) reflects financial soundness of banks. The prescribed CRAR is 9 per cent. A higher ratio indicates better financial soundness. The CRAR of public sector banks has increased from 11.2 per cent in 2001 to 11.8 per cent in 2011. In case of private sector banks, it has increased from 11.5 % to 15.1 per cent and in the case of foreign banks, the ratio has increased from 12.6 per cent to 17.7 per cent during the period. The CRAR for all scheduled commercial banks was at a comfortable level of 13.0 per cent in 2011 (See Table 1.3).
Table 7.3: Capital to Risk Weighted Asset Ratio of the Banking Industry in India.

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<tbody>
<tr>
<td>1. Public Sector Banks.</td>
<td>11.2</td>
<td>12.9</td>
<td>12.2</td>
<td>12.4</td>
<td>12.5</td>
<td>12.3</td>
<td>12.1</td>
<td>11.8</td>
</tr>
<tr>
<td>2. New Private Sector Banks.</td>
<td>11.5</td>
<td>12.1</td>
<td>12.6</td>
<td>12.0</td>
<td>14.4</td>
<td>15.1</td>
<td>16.7</td>
<td>15.1</td>
</tr>
<tr>
<td>3. Foreign Banks</td>
<td>12.6</td>
<td>14.0</td>
<td>13.0</td>
<td>12.4</td>
<td>13.1</td>
<td>15.1</td>
<td>18.1</td>
<td>17.7</td>
</tr>
<tr>
<td>4. All scheduled commercial banks</td>
<td></td>
<td></td>
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Asset Quality.

The ratio of non-performing assets (NPA) to total assets indicates the quality of assets of a commercial bank. A lower ratio indicates better quality and vice-versa. The ratio of net NPAs to net advances and gross NPAs to gross advances have declined across the banking sector in the post reform period. The public sector banks registered a marginal rise in gross NPAs in the year 2010. However, the net NPAs have remained constant at 1.09% in 2010 as compared to 2009. In the year 2010, the gross NPAs of all commercial banks were below the prescribed three per cent limit. (See Table 1.4).

Table 7.4: Gross and Net NPAs of the Banking Industry in India.

<table>
<thead>
<tr>
<th>Category of Banks</th>
<th>Total NPAs as % to Total Advances</th>
<th>Net NPAs as % to Net Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2009</td>
<td>2010</td>
</tr>
<tr>
<td>1. Public Sector Banks</td>
<td>2.19</td>
<td>2.23</td>
</tr>
<tr>
<td>2. New Private Sector Banks</td>
<td>2.74</td>
<td>2.25</td>
</tr>
<tr>
<td>3. Foreign Banks</td>
<td>4.26</td>
<td>2.54</td>
</tr>
<tr>
<td>4. All scheduled commercial banks</td>
<td>2.39</td>
<td>2.25</td>
</tr>
</tbody>
</table>
Customer Services.

A variety of financial services are being offered by Indian commercial banks to their customers. Provision of these services has made banking more efficient and more comfortable. For instance, under Core Banking Solutions, services such as ‘anywhere banking’, ‘everywhere access’ and ‘quick transfer of funds’ are provided to the customers. Public Sector banks are also providing CBS to their customers and the number of branches of PSBs who have started providing CBS have increased from 35,464 in 2008 to 44,304 in 2009. More and more banks are providing ATM facility to their customers. The foreign banks are leading in terms of provision of ATMs, followed by private sector banks and the public sector banks. However, the public sector banks have a long way to go before they provide ATMs to every branch in the country. The ATM penetration level was 40.2% for the nationalized banks and 29% for the SBI group. The private sector banks had a penetration level of 296.6% indicating that every branch had about three ATMs. The foreign banks with the highest penetration level of 357.3 percent had on an average three and a half ATMs for every branch (See Table 1.5). Computerization of public sector banks is almost complete with only 6.3 per cent of the branches remaining to be computerized as on end March 2009.

Table 7.5: Number of ATMs of Commercial Banks

(March 2011).

<table>
<thead>
<tr>
<th>Category of Bank</th>
<th>Number of ATMs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Public Sector Banks.</td>
<td>49,487</td>
</tr>
<tr>
<td>2. New Private Sector Banks.</td>
<td>23,651</td>
</tr>
<tr>
<td>3. Foreign Banks</td>
<td>1,367</td>
</tr>
<tr>
<td>4. Total</td>
<td>74,505</td>
</tr>
</tbody>
</table>

Financial Inclusion.

The percentage of population having deposit accounts had gone up from 55.8 to 61.2 % between 2009-10 and 2010-11. The percentage of population having debit cards had gone up from 15.2 to 18.8 % and that of credit cards from 1.53 to 1.49 % during the two year period. The credit deposit and credit GDP ratio has also gone up during the period. The percentage of people having credit accounts has also gone up marginally from 9.3 to 9.9 per cent. All these figures indicate that financial inclusion is improving in the country. Financial inclusion will complete when cent per cent of the population has deposit accounts. (See Table 1.6).

Table 7.6: Progress of Financial Inclusion

<table>
<thead>
<tr>
<th>No.</th>
<th>Indicator</th>
<th>2009-10</th>
<th>2010-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Credit-GDP</td>
<td>53.4</td>
<td>54.6</td>
</tr>
<tr>
<td>2.</td>
<td>Credit-Detp</td>
<td>73.6</td>
<td>76.5</td>
</tr>
<tr>
<td>3.</td>
<td>Population per Bank Branch</td>
<td>14,000</td>
<td>13,466</td>
</tr>
<tr>
<td>4.</td>
<td>Population per ATM</td>
<td>19,700</td>
<td>16,243</td>
</tr>
<tr>
<td>5.</td>
<td>Percentage of Population having deposit accounts*</td>
<td>55.8</td>
<td>61.2</td>
</tr>
<tr>
<td>6.</td>
<td>Percentage of Population having credit accounts*</td>
<td>9.3</td>
<td>9.9</td>
</tr>
<tr>
<td>7.</td>
<td>Percentage of Population having debit cards</td>
<td>15.2</td>
<td>18.8</td>
</tr>
<tr>
<td>8.</td>
<td>Percentage of Population having credit cards</td>
<td>1.53</td>
<td>1.49</td>
</tr>
</tbody>
</table>


7.7 QUESTIONS

1. Explain the performance of commercial banks in the pre-reform period.
2. Explain the performance of commercial banks in the post reform period.
3. Write a note on banking sector reforms.

❄️❄️❄️
ISSUES IN MONETARY ECONOMICS

Unit Structure:

8.0 Objectives
8.1 Measures of Money Supply and Liquidity.
8.2 Constituents of the Money Market.
8.3 Money Market Reforms.
8.4 Monetary Policy of the RBI.
8.5 Monetary Policy
8.6 Questions

8.0 OBJECTIVES

- To understand the measures of money supply and liquidity.
- To appreciate the constitution of Indian money market and money market reforms.
- To understand the monetary policy of the Reserve Bank of India.

8.1 CONCEPT OF MONEY SUPPLY

Money supply refers to the amount of money which is in circulation in an economy at any given time. It is the total stock of money held by the people consisting of individuals, firms, State and its constituent bodies except the State treasury, Central Bank and Commercial Banks. The cash balances held by the Federal and federating governments with the Central Bank and in treasuries are not considered as part of money supply because they are created through the administrative and non-commercial operations of the government. Further money supply refers to the disposable stock of money. Therefore money supply is stock of money in circulation. Money supply can be looked at from two points of views, namely, money supply as a stock and money supply as a flow. Thus at a given point of time,
the total stock of money and the total supply of money is different. Money supply viewed at a point of point is the stock of money held by the people on a given day whereas money supply viewed overtime is viewed as a flow. Units of money are spent and re-spent several times during a given period. The average number of times a unit of money circulates amongst the people in a given year is known as Velocity of Circulation of Money. The flow of money is measured by multiplying the stock of money with the coefficient of velocity of circulation of money.

8.2 CONSTITUENTS OF MONEY SUPPLY

There are two approaches to the constituents of money supply. They are the traditional and the modern approaches.

1. Traditional Approach. According to the traditional approach, the money supply consists of currency money consisting of coins and notes and bank money consisting of checkable demand deposits with commercial banks. The currency money is considered high powered money because of the legal backing of the State. The Central Bank of a country issues currency notes and coins because it has the monopoly of note and coin issue. The supply of money in a country depends upon the system of note issue adopted by the country. For instance, India adopted the Minimum Reserve System in 1957. Under this system, the Reserve Bank of India has to maintain a minimum reserve of Rs.200 Crores consisting of gold and foreign securities. Out of this, the value of gold should not be less than Rs.115 Crores. With this reserve, the Reserve Bank of India has the power to issue unlimited amount of currency in the country.

Checkable demand deposits of commercial banks are used in the settlement of debt. Payments made through checks change the volume of demand deposits by creating derivative deposits. The creation of demand deposits is determined by the credit creation activities of the commercial banks. Bank money is considered as secondary money whereas cash money is known as high powered money. Thus according to the traditional approach, the total supply of money is the sum of high powered money and secondary money or currency and bank money. The ratio of bank money to currency money depends upon the extent of monetization, banking habits and banking development in a country. In advanced countries, ratio of bank
money to currency money is high whereas in poor countries the ratio of currency money to bank money is high.

2. The Modern Approach. According to the modern approach, money supply includes currency money and near money. Money supply therefore consists of coins, currency notes, demand deposits of commercial banks, time deposits of commercial banks, financial assets, treasury bills and commercial bills of exchange, bonds and equities.

8.3 RESERVE BANK OF INDIA’S APPROACH TO THE MEASUREMENT OF MONEY SUPPLY

According to the Reserve Bank of India since its inception in 1935, money supply in the narrow sense of the term was the sum of currency with the people and demand deposits with the commercial banking system. Narrow money was denoted by the RBI by M₁. In 1964-65, the concept of broad money or aggregate monetary resources was introduced. Broad money was considered equal to M₁ + Time deposits with commercial banks. In March, 1970 the RBI accepted the report of the Second Working Group on Money Supply. This report was published in the year 1977 and it gave a broad definition of money supply. Accordingly, four measures of money supply were brought into effect.

These four measures are as follows:

1. \( M_1 = \) Currency with the public + Demand deposits with the commercial Banks + Other deposits with the RBI.
2. \( M_2 = M_1 + \) Post Office Savings Bank Deposits.
3. \( M_3 = M_1 + \) Time deposits with the commercial banks.
4. \( M_4 = M_3 + \) Total Post Office Deposits (excluding NSCs).

The Reserve Bank of India gives importance to narrow money (\( M_1 \)) and broad money (\( M_3 \)). Narrow money excludes time deposits because they are not liquid and are income earning assets while broad money includes time deposits because some liquidity is involved in it as these assets earns interest income in future. Since time deposits have become convertible in recent times, they have become more liquid than what they were before. The \( M_2 \) and \( M_4 \) measures of money supply include post office savings and other deposits with the post offices.
The third working group on money supply recommended the following measures of monetary aggregates through their report submitted in 1998:

1. **M₀** = Currency in circulation + Bankers’ deposits with the RBI + Other deposits with the RBI. (**M₀** is compiled on weekly basis).

2. **M₁** = Currency with the public + Demand deposits with the banking system + Other deposits with the RBI = Currency with the public + Current deposits with the banking system + Demand liabilities Portion of Savings Deposits with the banking system + other Deposits with the RBI.

3. **M₂** = **M₁** + Time liabilities portion of saving deposits with the banking System + Certificates of deposits issued by the banks + Term Deposits [excluding FCNR (B) deposits] with a contractual maturity of up to and including one year with the banking system = Currency with the public + current deposits with the banking system + Savings deposits with the banking system + Certificates Of Deposits issued by the banks + Term deposits [excluding FCNR (B) deposits] with a contractual maturity up to and Including one year with the banking system + other deposits with the RBI.

4. **M₃** = **M₂** + Term deposits [excluding FCNR (B) deposits] with a Contractual maturity of over one year with the banking system + Call borrowings from Non-depository financial corporations by the banking system. (**M₁**, **M₂**, & **M₃** are compiled every fortnight).

In addition to the monetary measures stated above, the following liquidity aggregates to be compiled on monthly basis were also recommended by the working group:

1. **L₁** = **M₃** + All deposits with the Post Office Savings Banks (excluding National Savings Certificates).

2. **L₂** = **L₁** + Term deposits with Term lending institutions and refinancing Institutions (FIs) + Term borrowing by FIs + Certificates of Deposits issued by FIs.

3. **L₃** = **L₂** + Public deposits of Non-banking Financial Companies. (**L₃** is compiled on quarterly basis).

8.3.1 Money Market:

Money market is a short term credit market for short term funds. Money market deals in financial securities whose period of maturity is in the range of one day to one year. Money market financial securities or assets are near substitutes of money. In the
money market, the commercial banks are the major lenders of money. The central bank is the controlling authority of the money market.

**8.3.2 Components of Indian Money Market**

The Indian money market is divided into two parts, namely; the organized and the unorganized money markets. Interest rates are different in both the markets and there is no relationship whatsoever between the two markets. The unorganized sector consists of indigenous bankers, money lenders and unregulated non-bank financial intermediaries such as finance companies, chit funds and nidhis. Farmers, artisans and other small time producers and traders borrow money from the unorganized money market. The interest rate charged is highly exploitative and therefore entrapping the borrowers into a debt trap. The organized money market is the formal market for money regulated by the central bank with commercial banks being the main players. Foreign banks, co-operative banks, Discount and Finance House of India, finance companies, provident funds, Securities Trading Corporation of India, Public Sector Undertakings and mutual funds are the other institutions which operate in the formal Indian money market. The Reserve Bank of India is the monetary authority controlling the formal money market.

The formal Indian money market is well organized and integrated. Mumbai, Kolkata, Delhi, Chennai, Ahmedabad and Bangalore are the main centers of the organized sector. Out of these, the Mumbai money market is the largest.

**8.3.3 The Organized Sector of the Indian Money Market**

The components of the organized Indian Money Market are as follows:

1. The Call Money Market.
2. The Treasury Bill Market.
3. The Repo Market.
4. The Commercial Bill Market.
5. The Certificate of Deposit Market.
7. Money Market Mutual Funds.

These components are briefly explained below.

1. **The Call Money Market.** In India, the Call Money Market is located mainly in Mumbai, Kolkata and Chennai. The Mumbai Money Market is the main market in the country. In this market, borrowing and lending transactions are carried out for one day. These loans are called Call Loans. They may not be renewed on the following day. It is also known as the Inter-bank Call
Money Market. Scheduled commercial banks, co-operative banks and DFHI operate in it. The Unit Trust of India, the Life Insurance Corporation of India, the General Insurance Corporation of India, the Industrial Development Bank of India and the National Bank of Agriculture and Rural Development also operate in the Indian money market as lenders. The State Bank of India being the largest commercial bank in the country also operates on the lenders side. Brokers bring borrowing and lending banks together. In the banking system, there are no permanent borrowers and permanent lenders. The cash position of banks keeps on changing by the hour. The Call Money Market is a mechanism whereby temporary surplus of some banks is made available to others who have a temporary deficit. It is a very sensitive market and hence reflects the liquidity condition of the money market. The Reserve Bank of India monitors the call money market to make day to day adjustment in its monetary policy.

2. The Treasury Bill Market. In India, treasury bills have maturity periods ranging from 14 days to 364 days. They are short term liabilities of the central government. The different maturity periods are 14 days, 91 days, 182 days and 364 days. Out of these, the auction of 14 days and 182 days treasury bills was discontinued from May 2001. Treasury bills are issued for meeting temporary deficits which a government faces due to its excess of expenditure over revenue. Treasury bills are issued at a minimum amount of Rs.25000 and in multiples of Rs. 25000. They are issued at a discount to face value and are redeemed at par. Unfortunately, in India treasury bills had become a permanent source of funds for the central government. Every year the central government had been issuing more new bills and every year a part of the treasury bills held by the RBI was converted into long term bonds. From 01st April, 1997 ad-hoc treasury bills have been replaced by ways and means advances for financing the central government’s temporary deficits. The Treasury bill market in India is in a state of underdevelopment. The RBI is a captive holder of the bills issued by the Central government. The RBI rediscounts treasury bills presented by other banks. This has resulted in monetization of public debt and has become a cause of expansion of money supply and price rise. Commercial banks, State governments and semi-government bodies also hold treasury bills but in small quantities. Non-bank Financial Intermediaries like the LIC and UTI and private firms do not hold treasury bills.
3. **The Repo Market.** Repo is a repurchase agreement in which the seller sells a security under an agreement to repurchase at a pre-determined date and rate. It is a money market instrument which enables short term borrowing and lending through sale and purchase operations. The Repo was introduced in the year 1992. Under a reverse repo transaction, securities are purchased with a simultaneous agreement to resell at a pre-determined rate and date. The Reverse Repo was introduced in the year 1994 by the RBI. In the beginning, repos were permitted in the Central government treasury bills and dated securities created by converting some of the treasury bills. In order to make the repo market a balancing force between the money market and the government securities market, the RBI allowed repo transactions in all government securities and treasury bills of all maturities. Finally, State government securities, public undertakings’ bonds and private corporate securities have been made eligible for repos to broaden the repo market. According to the Report on Currency and Finance 1999-2000, repos help to manage liquidity conditions. They are used to provide banks an opportunity to invest funds generated by capital inflows. During times of foreign exchange volatility, repos have been used to prevent speculative activity as the funds tend to flow from the money market to the foreign exchange market.

4. **The Commercial Bill Market.** The commercial bill market is the market for short term bills of three months duration. It provides short term finance to trade and industry. The commercial bills are used to finance the transactions of goods taking place between different companies. When goods are sold on credit, companies which receive the goods become liable to make payment on a specific date in future. The companies who sell the goods can wait till the specified date or can make use of commercial bill of exchange. The seller of the goods draws the bill and the buyer accepts it. Once the bill is accepted, it becomes a marketable instrument. The drawer or the seller of goods can approach a commercial bank and get the bill discounted. The discount rate is the rate of interest charged by the bank for discounting the bill and paying the drawer the balance amount of the bill. The commercial banks in turn can rediscount these commercial bills with the Reserve Bank of India. The commercial bills are self liquidating in character and they have a fixed term to maturity called *usance* during which the drawee is likely to recover the cost of goods from the sale enabling him to make payments. The commercial bill market is the sub-market in which the commercial bills are transacted. In India, the commercial bill market is underdeveloped. The reasons being: i) popularity of cash credit
system in bank lending and ii) the absence of will of the buyer to follow the discipline with regard to payment. The other factors being lack of uniformity in drawing bills, high stamp duty on usance bills, the practice of sales on credit without specified time limit and absence of a secondary market for commercial bills. The RBI has tried to develop the bill market in India. The two schemes initiated by RBI were not very successful. The bill market scheme of 1952 was not properly designed and hence was not successful. The RBI introduced a new bill market scheme in 1970. The important features of this scheme are: (i) the bills covered under the scheme are genuine trade bills and (ii) the scheme provides for their rediscounting. However, the bill market had failed to take off in India. In order to promote the market, the RBI advised banks in 1997 that at least 25 per cent of inland credit purchases of borrowers should be through bills. However, the outstanding amount of commercial bills rediscounted by the commercial banks with different financial institutions have been below rupees one thousand crore.

5. The Certificate of Deposit Market. The certificate of deposit is a short term money market instrument introduced in the year 1989. Certificate of Deposits are issued by banks against the deposits kept by individuals, companies and institutions. Certificate of Deposits are issued at a discounted rate and the discount rate is market determined. They are freely transferable by endorsement and delivery. CDs are a marketable and negotiable instrument. The CDs were issued by scheduled commercial banks in multiples of Rs.25 lakh subject to the minimum size of an issue being rupees one crore and the maturity ranged between 3 months and one year. CDs were permitted to be issued by the term lending financial institutions like IDBI, ICICI and IFCI in 1991-92 for a maturity period of more than one year and up to three years. In 1993, SIDBI and EXIM bank of India were permitted to issue CDs. Banks pay a high interest rate on CDs and CD holders prefer to hold them till maturity and hence secondary activity in CDs is non-existent. Total outstanding CDs amounted to Rs.5438 crore in June 2004 and the rate of interest on CDs in June 2004 was in the range of 3.96 to 6.75 per cent.

6. The Commercial Paper Market. The Commercial paper was introduced by RBI in March 1989 and was made effective in January 1990. The CPs was introduced to provide companies with good credit rating a source of short term borrowing. The CPs is issued in the form of unsecured usance promissory notes by the companies with good credit rating at a discount and the discount rate is market determined. They are freely
transferable and negotiable. The issuance of CP is not related to any underlying self liquidating trade and hence the maturity of CP is flexible. Generally, borrowers and lenders adapt the maturity of a CP to their needs. Highly rated corporates which can obtain funds at a cost lower than the cost of borrowing from banks are interested in issuing CPs. Institutional investors also find CPs as an attractive outlet for their short term funds. Any person, bank, company and other registered bodies incorporated and unincorporated, NRIs can invest in CPs. However, NRIs can invest in CPs on a non-repatriable basis. In Sept 96, the primary dealers were allowed to issue CPs. In April 2001, the banks, financial institutions and primary dealers were advised to make fresh investments and hold CPs in the dematerialized form. The CP can be issued by a listed company which has a working capital of not less than Rs.5 crore. With maturity ranging from three months to six months they would be issued in multiples of Rs.25 lakh subject to the minimum size of Rs.1 crore. The company wanting to issue CP is required to obtain every six months a specified rating from an agency approved by the RBI. According to the RBI’s guidelines, a company will have to obtain P2 rating from Credit Rating Information Services of India Limited or A2 rating from Investment Information and Credit Rating Agency of India Limited. Maturity period of CP issued by various companies ranged from 3 months to 6 months and the effective interest rates were in the range of 9.35 to 20.9 per cent per annum.

7. **Money Market Mutual Funds.** A scheme of money market mutual funds was introduced by the Reserve Bank of India in April 1992. The objective of the scheme was to provide one more short term avenue to the individual investors. Banks, public and private Financial Institutions were allowed to set up MMMFs in 1995. In April 1996, MMMFs were allowed to issue units to corporate enterprises and others on par with other mutual funds. The lock-in period was reduced from 45 to 15 days. Resources mobilized by MMMFs are required to be invested in call money, CDs, CPs, Commercial bills arising out of genuine trade transactions, treasury bills and government dated securities having an unexpired maturity up to one year. The MMMFs have been brought under the purview of SEBI regulations from March 2000. Banks are now allowed to set up MMMFs only as a separate entity in the form of a trust.

8.3.4 The Unorganized Sector of the Indian Money Market:

The constituents of the unorganized sector of the Indian Money Market are as follows:
1. **Non-Banking Financial Companies (NBFCs).** These companies assume various forms. Some of the prominent forms of NBFCs are loan/finance companies, chit funds and nidhis. Finance or loan companies are spread across the country. A large number of partnership firms and individuals are involved in the business of lending money. Finance companies are capable of raising considerable resources in the form of deposits. These companies offer loans to retailers, wholesale traders, artisans and self employed persons. They charge very high rates of interest ranging from 36 to 48 per cent. The Chit funds are saving institutions. A Chit fund has regular members who make periodic subscriptions to the fund. The periodic collection is given to some member of the chit fund selected on the basis of agreed criterion. Each member of the fund is assured of his/her turn before the second round starts and any member becomes entitled to get periodic collection again. The chit fund business is conducted all over the country but Tamilnadu and Kerala accounts for the largest share of the business. The RBI has no control over the activities of chit funds. The Nidhis are also largely located in south India. Their dealings are limited to their members. The main source of their funds is deposits from members. The loans are given members at reasonable rates of interest for purposes of house construction, repairs etc. These loans are secured. They are single office institutions. The RBI has started regulating NBFCs engaged in equipment leasing, hire purchase finance, loan and investment, residuary non-banking companies and the deposit receiving activity of miscellaneous non-banking financial companies. According to the amendment to the RBI Act in 1997, the NBFCs are obliged to apply for a certificate of registration. By June 2004, the RBI had received 38050 applications from NBFCs for registration of which the RBI approved 13671 applications.

2. **Indigenous Bankers.** Individual Bankers are individuals or private firms that receive deposits and give loans. These bankers have been engaged in the banking business from ancient times. On account of the emergence of modern banking system and its rapid development, the role of indigenous bankers have considerably reduced. However, indigenous bankers continue to thrive in some parts of the country. There are four main sub groups of indigenous bankers. They are: Gujarati shroffs, Multani or Shikarpuri Shroffs, Chettiars and Marwari Kayas. The Gujarati shroffs operate in Mumbai, Kolkata and in the cities of Gujarat. The Marwari shroffs operate in Kolkata, Mumbai, tea gardens of Assam and other parts of north east India. The Multani or Shikarpuri shroffs operate in Mumbai and Chennai and the Chettiars are found in
the south. Out of these, the Gujarati shroffs are the most prosperous bankers.

3. Money Lenders. They are three types of money lenders. They are: professional money lenders, itinerant money lenders like pathans and Kabulis and non-professional money lenders. Money lenders do not receive deposits. Their funds are generally their own. The borrowers from money lenders are poor people like agricultural laborers, marginal farmers, artisans, mine and factory workers and small traders i.e., those who are not capable and eligible to access the organized money market take recourse to money lenders. These money lenders charge exploitative rates of interest indulge in manipulation of loan records and extract free labor from the poor borrowers. They also use arm twisting methods to force the debtors into bondage. They are not regulated or supervised by the government.

The unorganized money market survives and flourishes in India because of two important factors. They are: (1) a large amount of unaccounted wealth and income floats in the country and the creamy section of the black economy both on the lenders and the depositors side operate in this market, and (2) the poor who cannot access the organized market for want of securities look at the unorganized market as the lender of last resort. Several legislative measures have been passed to prevent exploitation of the borrowers by moneylenders but these measures have remained on paper. Exploitation of the poor borrowers will come to an end only if micro-finance system covers the entire population of poor in the country.

8.4 MONEY MARKET REFORMS IN INDIA

According to the former Governor of Reserve Bank of India, Dr. VY Reddy, the main reforms initiated to develop the money market in India are as follows:

1. Setting up of the DFHI in 1988 with the purpose of imparting liquidity to money market instruments and helping the development of secondary market in these instruments.

2. Launching of commercial paper, certificates of deposits and inter-bank participation certificates in 1988-89 with the purpose of increasing the range of money market instruments.
3. Deregulation of money market interest rates from 1988-89.

In the post reforms period, the following initiatives were undertaken to develop the money market in India:

1. **Stamp Duty Reform.** In August, 1989, the government remitted stamp duty on usance bills which was considered to be a major administrative constraint in the use of bill system. However, this measure did not help in the increased usage of bills. According to experts, only if the cash credit system is abandoned, the use of commercial bills will increase.

2. **Liberalization of Money Market Interest Rates.** Money market interest rates were liberalized from 01st May 1989 by the RBI. Accordingly, all ceilings on money market interest rates were removed. This initiative was expected to infuse flexibility and transparency in the money market transactions.

3. **Reforms in the Call Money and Term Money Markets.** The call/notice money market was an interbank market till 1990. Only the UTI and LIC were allowed to operate as lenders from 1971. Currently, banks and primary dealers are operating as both lenders and borrowers and a number of non–bank financial institutions and mutual funds are also operating as lenders in this segment of the money market. The term money market in India has not been very active. A number of defects in the system which retarded the development of the market were removed by the RBI in the post reform period. However, the volume of operations in the term money market continues to be small.

4. **Introducing New Money Market Instruments.** New money market instruments such as the 182 day treasury bills, certificates of deposits, commercial paper and 364 day treasury bills have been introduced. The 182 day treasury bills were promoted by the DFHI and were the first security sold by auction for financing the fiscal deficit of the Central Government. The DFHI also developed a secondary market for these bills. In 1992-93, the 364 day treasury bills were introduced and the auction of 182 day treasury bills was discontinued from 14 May 2001.

5. **Repurchase Agreements (Repos).** The repos were introduced in December, 1992. A repo is an instrument of repurchase agreement between the RBI and commercial banks.
The repo or the repurchase rate is the rate at which the Central Bank provides funds to banks. At present, the repo rate is 4.75%. The reverse repo rate is the rate at which the Central Bank takes funds from banks. At present the reverse repo rate is 3.25%. Repos are used by banks for short term liquidity management. The repo has become popular and it can now be effected between banks and between banks and financial institutions.

6. **Refinance by RBI.** Refinance is used by central banks to meet liquidity shortages in the system, to control monetary and credit conditions and direct credit to selective sectors. There are two refinance schemes in operation. They are export credit refinance and general refinance. The RBI is pursuing a policy of linking the refinance rate with the bank rate.

7. **Money Market Mutual Funds.** MMMFs were introduced in India in April, 1991. These institutions provide an additional short term avenue to investors and bring money market instruments within the reach of individuals. The portfolio of MMMFs consists of short term money market instruments.

8. **The Discount and Finance House of India.** The DFHI was set up on 25th April, 1988. Its task is to bring the entire financial system into the fold of money market so that their short term surpluses and deficits are equilibrated at market related rates through inter-bank transactions in case of banks and through money market instruments in the case of banks and other financial institutions.

9. **Liquidity Adjustment Facility.** The RBI introduced the Liquidity Adjustment Facility in June 2000 for adjusting liquidity through repos and reverse repos. The RBI is using repos and reverse repos to adjust liquidity in the money market in order to stabilize the short term interest rates. LAF is now used as a major instrument of monetary policy.

10. **The Clearing Corporation of India limited (CCIL).** The CCIL came into existence in April 2001. It was registered under the Companies Act and SBI is the chief promoter. The CCIL clears all transactions in government securities and repos reported on the Negotiated Dealing System of RBI and also Rupee/USD spot and forward deals. All trading in government securities below Rs.20 crore is mandatorily settled through CCIL and
those above Rs.20 crore have the option to settle through the RBI or the CCIL.

8.5 MONETARY POLICY

Monetary policy can be defined as the policy of the Central Bank that seeks to influence the cost and availability of credit in an economy. By influencing the cost and availability of credit, by controlling inflation and by maintaining equilibrium in the balance of payments, monetary policy plays an important role in increasing the growth rate of the economy. Monetary policy is an important macro-economic instrument through which the macro-economic objectives of a country is sought to be achieved. The broad objectives of monetary policy are to obtain economic growth, price stability, full employment, exchange rate stability and equilibrium in the balance of payments. Monetary policy influences the supply of money and the rate of interest in order to stabilize the economy at full employment or near full employment level by changing the level of aggregate demand in the economy. Business cycles are sought to be controlled with the help of the tools of monetary policy. Thus during recession, money supply is increased and interest rates are brought down to increase the level of aggregate demand in the economy because it is the level of aggregate demand that determines the level of employment, output and income in an economy. Conversely, during the times of high inflation, price rise is sought to be controlled by reducing the money supply and raising the interest rates which brings about a fall in the aggregate demand and prices. In the context of a developing country like India, monetary policy aims to achieve sustained economic growth in the different sectors of the economy.

All countries have a central bank or a reserve bank which formulates and implements the monetary policy. For instance, in India, it is the Reserve Bank of India which is the apex monetary authority of the Indian monetary system. In the United Kingdom, it is the Bank of England whereas in the United States, it is the Federal Reserve Bank, popularly known as the Fed. The objectives of the Fed are no different from the objectives of any other central bank. Similar to the Reserve Bank of India, the Fed’s objectives include economic growth according to the expansion potential of the economy of United States, a high level of employment, stable prices and moderate long term interest rates. The objectives of the Reserve Bank of India as according to the Chakravarty Committee Report are economic expansion and inflation control. While economic expansion ensures growing levels of employment, inflation control ensures price stability and
moderate interest rate. C Rangarajan, the ex governor RBI has emphasized that the inflation rate must be controlled within the range of 6 to 7 per cent per annum whereas the Chakravarty Committee (1985) had suggested that inflation must be controlled within the four per cent range. A low inflation rate in the range of zero to three or four per cent per annum can only impart price stability in a globalized economy. The Reserve Bank of India was established on 01st April, 1935. The Government of Free India felt that a State-owned Central Bank will be more conducive to pursue the macro-economic objectives of the government and hence the Reserve Bank of India was nationalized on 01st January, 1949.

Monetary management by the RBI involves three things. They are: control of currency, control of credit and short term liquidity management. In this chapter, we will be looking at control of credit vis-à-vis changes in the monetary policy and short term liquidity management.

8.5.1 CHANGING TRENDS IN MONETARY POLICY IN INDIA:

The instruments of monetary policy used by the Reserve Bank of India to achieve its macro-economic objectives of price stability, economic growth and exchange rate stability are: 1) Bank Rate policy, 2) The Repo and Reverse Repo Rates, 3) Open Market Operations, 4) Cash Reserve Ratio, 5) Statutory Liquidity Ratio and 6) Selective credit control. The RBI can also directly influence the lending policy of the commercial banks, rates of interest, forms of securities against loans and portfolio distribution. The changing trends in the use of these instruments of monetary policy are discussed here.

1. The Bank Rate Policy. Bank rate is the rate at which Reserve Bank provides loans to the commercial banks in the country. It is also called the discount rate because the Central Bank provides finance to commercial banks by rediscounting bills of exchange. Through changes in the bank rate, the central bank can influence the demand for credit. For example, when the central bank raises the bank rate, the cost of borrowings by commercial banks from the central bank would rise. This would discourage the commercial banks to borrow from the central bank and force them to increase their lending rates. When the lending rate rises, demand for money falls and inflation is checked. Thus when the economy is going through price rise, the bank rate is raised to control demand for credit. The bank rate in India was 10 per cent in the 1980s. It was raised to 12 per cent in October 1991. The bank rate was not a very effective in controlling money supply in the pre-reform period. However, in the post reform period, the bank rate has been made more effective and in keeping with the objective of low inflation and
high economic growth, the bank rate was reduced to 6 per cent in April 1998 and it continues to be retained at 6 per cent according to the First Quarter Review of Monetary Policy released on 11th July 2010 by the Governor, Reserve Bank of India. The bank rate however went up to 9.5 % as on 29th March 2012 on account of inflationary pressures in the Indian economy. In September 2012, the bank rate was brought down to 9%.

2. The Repo and Reverse Repo Rates. The bank rate as a credit control instrument is losing importance. The repo and reverse repo rates are becoming important in deciding interest rate trends in the Indian economy. The Repo (sale and repurchase agreement) is a swap deal involving the immediate sale of securities and simultaneous purchase of those securities at a future date at a predetermined price. These swap deals take place between the RBI and financial institutions. The repo rate is the rate at which the Central Bank provides funds to banks. Continuing with its anti-inflationary monetary policy stance, between March, 2010 and April, 2011, the RBI has raised the policy rates six times. The repo rate was 5% in March 2010 and in April, 2011 the repo rate went up to 6.75%. The repo rate was further raised to 8.5 % on 25th October, 2011 on the occasion of the Second Quarter Review of the Monetary Policy for the year 2011-12. However, in September 2012, the repo rate was brought down to 8%. The reverse repo rate is the rate at which the Central Bank takes funds from banks and the reverse repo rate in March 2010 was 3.5% and in April, 2011 was 5.75 per cent. In October, 2011, the reverse repo rate was raised to 7.5 per cent. And in September 2012, it was brought down to 7%.

3. Open Market Operations. Open market operations means the buying and selling of securities by the central bank. The sale of securities leads to contraction of credit and purchase of securities lead to credit expansion. When the central bank sells securities in the open market, it receives payment in the form of a check on one of commercial banks. If the purchaser is a bank, the check is drawn against the purchasing bank. The effect is same in both the cases i.e. the cash balance of the concerned bank with the central bank is reduced by that extent. With the reduction of its cash, the commercial bank has to reduce its lending. Thus credit contracts. When the central bank purchases securities, the effect is opposite, in that the supply of credit increases.
In India, changes in bank rate were found to be lacking effectiveness due to the under-developed nature of money market and hence open market operations became important in complementing the changes in bank rate. The RBI uses switch operations for buying and selling government securities. Switch operations involve purchase of one loan against sale of another. The use of switch operations prevents unrestricted increase in money supply. Recently, in January 2011, when the SLR was reduced from 25% to 24%, the RBI neutralized the excess liquidity through OMOs.

4. **The Cash Reserve Ratio.** The CRR is an effective instrument of credit control. It refers to the cash which the banks have to maintain with the Reserve Bank as a certain percentage of their demand and time liabilities. Changes in the CRR bring about changes in the loanable resources of the banks, particularly the commercial banks. The RBI has powers to impose penal interest rates on banks if they fail to maintain the prescribed CRR. The penal interest rate is 3 per cent above the bank rate for the first week of default and 5 per cent for the subsequent weeks till the default is made good. CRR was generally used in the 1970s and 1980s to control inflation. In the late 1980s, there was a rapid growth in money supply and hence the CRR was raised from 10 per cent to 15 per cent.

In the post reform period, the CRR was brought down according to the recommendation of the Narasimham Committee on Financial Sector reforms to below the 10 per cent level. However, in August 1994, the CRR was raised to 15 per cent to control the inflationary trends in the economy. Since then inflationary pressures were reduced in the economy and accordingly the CRR was progressively reduced to 4.5 per cent in June 2003. The RBI had to increase the CRR to five per cent in October 2004 and further to 7.5 per cent in October 2007. In August 2008, the CRR was raised to nine per cent. As part of the anti-recessionary policy in the wake of global financial crisis of 2008-09, the CRR was reduced to five per cent in January, 2009. It was raised to 5.75 per cent in February, 2010 and further to six per cent in April 2010 as inflationary pressures started building in the economy on account of the huge fiscal stimulus that was given by the government in the aftermath of the financial crisis of 2008-09 and its negative impact on economic growth in India. In the first quarter review of the monetary policy for the year 2010-11, released in July 2010, the
CRR was retained at 6 per cent by the RBI. Subsequently, the CRR was reduced to 4.75 per cent in March 2012 to ease liquidity conditions in the money market and further to 4.5% in September 2012 indicating further liquidity easing in the Indian economy.

5. **The Statutory Liquidity.** The SLR helps the Reserve Bank of India to impose secondary or supplementary reserve requirements on the commercial banks. The SLR enables the Reserve Bank to restrict expansion of bank credit and augment investment of the banks in government securities. Banks are not allowed to sell government securities for expanding commercial credit. The Banking Regulation (Amendment) Act 1962 provides for maintaining a minimum SLR of 25% by the banks against their net demand and time liabilities. The SLR is fixed at 25% for co-operative banks, non-scheduled banks and the regional rural banks. In case of commercial banks, it can be raised to 40%. The RBI has used this instrument quite often during the 70s and 80s. In September 1990, the SLR was raised to 38.5 per cent and it remained at this level up to January 1993. This was done to control inflationary pressures and make larger resources available to the government. The Narasimham Committee recommended reduction of SLR to 25 per cent and accordingly the SLR was reduced to 25% in a phased manner in October, 1997. However, holding of government securities by commercial banks in June 2004 was 44.5 per cent of their net demand and time liabilities which was much greater than the SLR requirement of 25%. In November 2008, the SLR was further reduced to 24 per cent and in October, 2009, the SLR was restored to 25 per cent once again. However, in December 2010, the SLR was once again reduced to 24% and it continues to be 24 % to this day. In September 2012, the SLR was further reduced to 23%.

6. **Selective Credit Control.** Selective credit control or qualitative instruments of credit control are the most effective technique of credit control in a developing economy like India. The following types of selective credit controls are used by the RBI:

   a) Margin requirements for loans against securities.
   b) Determination of maximum amount of advances, and
   c) Differential interest rates.

   The RBI may give directions to banks in general or even particular banks regarding disbursal of loans for various purposes. Selective credit controls are used to regulate credit for specific purposes. The RBI can prevent speculative hoarding of essential
goods and check their prices. The RBI has used the instrument of margin requirements to check the hoarding of essential goods. Since 1973-74 strict selective credit controls were introduced and kept in force for more than two decades. These controls covered six broad categories of goods namely; food grains, oilseeds, sugar, gur and khandasari, vegetable oil, cotton and kapas. The rate of interest on advances against the security of these commodities was generally kept higher than on loans against securities not covered under selective controls. Under the Credit Authorization scheme of 1965, the RBI regulated the quantum and the conditions on which credit flowed to the different large borrowers so that credit is directed to genuine productive purposes, the credit is in accord with the needs of the borrower and there is no undue channeling of credit to any single borrower or group of borrowers. The minimum limit for prior authorization for borrowers in the private sector was initially fixed at Rs. 1 Crore and raised since then several times. This scheme was liberalized in July 1987 to allow for greater access to credit to meet genuine demands in productive sectors without the prior sanction of the RBI. In 1996-97, the selective credit controls were liberalized on bank advances against a large number of price sensitive commodities such as pulses, coarse grains, and oilseeds, oils including vanaspati, sugar, gur, khandasari and cotton.

### 8.6 QUESTIONS

4. What is money supply? Explain the traditional and modern approaches to money supply.
5. Explain the RBI’s measures of money supply and liquidity.
6. What is money market? Explain the organized and unorganized sectors of Indian money market.
7. Explain the constituents of the organized sector of the Indian money market.
8. Explain the constituents of the unorganized sector of the Indian money market.
9. Explain the features of India’s money market.
10. Explain money market reforms in India.
11. What is monetary policy? Explain the changing trends in India’s monetary policy.
9

INDIAN CAPITAL MARKET

Unit Structure :

9.0 Objectives

9.1 Indian capital market.
9.3 Capital Market Developments During 2008-09 To 2011-12
9.4 Capital Market Reforms.
9.5 Role of SEBI
9.6 Growth of Insurance Business in India
9.7 Questions

9.0 OBJECTIVES

- To understand the Indian capital market and its growth since 1980.
- To appreciate capital market reforms and the role of SEBI.
- To know the growth of insurance business in India and the role of IRDA.

9.1 CAPITAL MARKETS

The capital market is a part of the financial market consisting of the money and capital markets. It deals with medium and long term credit requirements of medium and large scale industries for purposes of investment. The capital market deals with long term credit with more than one year maturity period. It functions as an institutional arrangement to channelize long term funds from those who save to those who need them for productive purposes. It is a medium created to bring together entrepreneurs who want investible resources and households who save. In India, the capital market includes financial institutions such as the insurance companies, commercial banks, specialized financial institutions like
IFCI, IDBI, SIDCs, SFCs, UTI etc, merchant banking agencies, mutual funds and individual investors.

9.2 GROWTH OF CAPITAL MARKET SINCE 1980

The Pre-reform Period:

In the pre-reforms period, the capital market in India was completely controlled by the Government. The Controller of Capital Issues was the regulating authority. The CCI determined the price and quantity of IPO and trading practices. However, there was lack of transparency in the capital market dealings. During the pre-reform period, the primary role of the financial system in India was to channel resources from the areas of surplus to the areas of deficit. The role of technology was limited and customer relationship and service was not a priority. Risk management procedures and prudential norms were weak, affecting asset portfolio and profitability.

The Bombay Stock Exchange (BSE), the oldest and the largest stock exchange in India, traded for two hours in a day with an open outcry system. The exchange was managed in the interests of individual members. A large proportion of stocks listed on the exchange were not actively traded. There was minimum supervision from the exchanges. There were regional exchanges which were unconnected and engaged in open outcry system of trading. Each exchange had a board representative nominated from the Capital Markets division of the Ministry of Finance, the then regulator of the capital markets. The capital market reforms were based on improving two basic aspects. These were the improvement in the legal reporting system and the improvement in technology.

The Post Reform Period:

There have been significant reforms in the regulation of the securities market since 1992 along with the economic and financial reforms. An important element of the reform strategy was building a strong independent market regulator. The SEBI Act, which came into force in early 1992, established SEBI as an autonomous body. The apex capital market regulator was empowered to regulate the stock exchanges, brokers, merchant bankers and market intermediaries. The Act provided SEBI the necessary powers to ensure investor protection and orderly development of the capital
markets. The introduction of free pricing in the primary capital market has significantly deregulated the pricing control instituted by the CCI. While, the issuers of securities can now raise capital without seeking consent from any authority relating to the pricing, however the issuers are required to meet the SEBI guidelines for Disclosure and Investor Protection, which, in general, cover the eligibility norms for making issues of capital (both public and rights) at par and at a premium by various types of companies. The freeing of the pricing of issues led to an increase in activity in the primary capital market as the corporate mobilized huge resources. However, it did expose the inadequacies of the regulations. In order to address these inadequacies, SEBI strengthened the norms for public issues in April 1996.

The disclosure standards were improved to improve transparency and uphold the objective of investor protection. The issuers are now required to disclose information on various aspects, such as, the track record of profitability, risk factors, etc. Issuers now also have the option of raising resources through fixed price floatation or the book building process. Clearing houses have been established by the stock exchanges and all transactions are mandatorily settled through these clearing houses and not directly between the members, as was practiced earlier. The practice of holding securities in physical form has been replaced with dematerialized securities and now the transfer is done through electronic book keeping, thereby eliminating the disadvantages of holding securities in physical form. There are two depositories operating in the country. The margin system, limits on intra-day, trade and settlement guarantee fund are some of the measures that have been undertaken to ensure the safety of the market. The trading and settlement cycles have been significantly reduced. The cycles were initially shortened from 14 days to 7 days. The settlement cycles were further shortened to T+3 for all securities in 2002. The settlement cycle is now T+2.

Listed companies are required to furnish unaudited financial results to the stock exchanges and also publish the same on a quarterly basis. To enhance the level of disclosure by the listed companies, SEBI decided to amend the Listing Agreement to incorporate the segment reporting, accounting for taxes on income, consolidated financial results, consolidated financial statements, related party disclosures and compliance with accounting standards. The last few years have seen significant interaction with
the international capital markets. A major step towards that was the inclusion of Foreign Institutional Investors (FIIs) such as mutual funds, pension funds and country funds to operate in the Indian markets. In response to the globalization of Indian capital market, Indian firms have also raised capital in international markets through issuance of Global Depository Receipts (GDRs), American Depository Receipts (ADRs), Euro Convertible Bonds (ECBs), etc. The SEBI’s regulatory system includes merchant bankers, registrars, share transfer agents, underwriters, mutual funds and various other advisors and market intermediaries. There have been efforts made to increase transparency in the takeover process and interests of minority shareholders.

**Derivatives Market:**

The important achievement of the Indian capital markets since the beginning of economic reforms has been the development of the derivative market. It has significantly enhanced the sophistication and maturity of the market. In India, derivative trading began in June 2000, with trading in stock index futures. By 2001, each of India’s two largest exchanges had four equity-derivative products: futures and options for single stocks, and futures and options for their respective stock indices. The NSE has become the largest exchange in single stock futures in the world, and by June 2007, it ranked fourth globally in trading index futures. Market liquidity has also increased since 1992. This was because of the settlement rules and the introduction of derivatives trading. The move from fixed period to rolling settlements, shortened settlement periods, and a huge increase in derivatives trading contributed to steadily increasing market liquidity.

**Technology:**

The introduction of technology to the markets has been because of the National Stock Exchange (NSE). NSE introduced the screen based trading and settlement system, supported by a state-of-the –art technology platform. To fulfill the commitment to adopt global best practices and bring about more transparency to the capital markets functioning, SEBI also assumed the responsibility of monitoring the markets and stock exchanges. A significant step towards that initiative was the launch of the Integrated Market Surveillance System (IMSS) in 2006. The IMSS equipped the regulator to identify doubtful market activity. The IMSS’s primary objective is to monitor the market activities across
various stock exchanges and market segments including both equities and derivatives. IMSS collects and analyses data not only from the stock exchanges but also from National Securities Depository, Limited (NSDL), Central Depository Services (India) Limited (CDSL), clearinghouses, and clearing corporations. The RBI introduced the electronic funds transfer system, “The Reserve Bank of India National Electronic Funds Transfer System” (referred to as "NEFT System" or "System"). The objective of the system is to establish an electronic funds transfer system to facilitate an efficient, reliable, secure and economical system to funds transfer and clearing in the banking sector throughout India and to relieve the stress on the paper based funds transfer and clearing system.

9.3 CAPITAL MARKET DEVELOPMENTS DURING 2008-09 TO 2011-12

The Primary Market:

The equity market experienced a sharp decline in mobilizing capital in the year 2011-12 (up to 31 December 2011). The cumulative amount mobilized as on 31 December 2011 through equity public issues was Rs.9683 crore as compared to Rs. 48,654 crore in 2011-11 and Rs. 46,736 crore in 2009-10. During the financial year 2011-12, thirty new companies were listed at the NSE and BSE with Rs.5043 crore against 53 companies with Rs.35,559 crore listed in the previous year. The average IPO size for the year 2011-12 was Rs.168 crore as compared to 671 crore in 2010-11. Further only Rs.4791 crore were mobilized through debt issue as compared to Rs.9451 crore in 2010-11. The amount of capital mobilized through private placement in corporate debt in 2011-12 was Rs.1,88,530 crore as compared to Rs.2,18,785 crore in 2010-11 (See Table One).

Mutual Funds:

During 2011-12 (up to 30 November 2011), mutual funds mobilized Rs.1,10,338 crore from the market as compared to Rs.49,406 core liquidation in 2010-11 (see Table Two). The market value of assets under mutual fund management stood at Rs.6,81,655 core on 30 November 2011 compared to Rs.6,65,282 core as on 31 March 2011 indicating an increase of 2.5 per cent.
Secondary Market:

As on 31 December 2011, the Indian benchmark indices, BSE and Nifty decreased by 20 per cent and 20.7 per cent respectively over the closing value of 2010-11. Nifty junior and BSE 500 also decreased by 22.6 and 26.1 per cent respectively during the same period (See Table 3). The market capitalization of all the indices came down in the year 2011-12. Nifty went down by 20 per cent, the BSE Sensex went down by 18.6 per cent, Nifty Junior by 21.8 per cent and BSE 500 went down by 22 per cent over the previous year. The P/E ratios of Nifty, Sensex, Nifty Junior and BSE 500 as on 31 December 2011 were 16.8, 16.4, 13.5 and 16.2 respectively. These figures were down by 24.2 per cent, 23.4 per cent, 22.4 per cent and 15.9 per cent respectively over 2010-11.

During 2011-12, the total turnover of the BSE stood at Rs.4,88,133 core and of the NSE at Rs.19,73,730 crore as compared to Rs.11,05,027 core and Rs.35,77,410 crore respectively in 2010-11 (See Table Four). In the equity derivative segment, the NSE witnessed a total turnover of Rs.2,37,15,138 crore during 2011-12 as compared to Rs.2,92,48,221 crore during 2010-11. The total turnover in the equity derivative segment of the BSE stood at Rs.58,173 crore in 2011-12 as compared to Rs.154 crore during 2010-11.

Market Movements:

As on 30 December 2011, the markets stood 26 per cent down from the all time high on 05 November 2010 when the Sensex touched 21004.96 and Nifty 6312.45. The indices closed at 15454.92 (-24.62 per cent for the Sensex) and 4624.3 (-24.62 per cent for Nifty) in the calendar year. During the financial year 2011-12 the decline was 20.73 per cent in case of Nifty and 20.52 per cent for the Sensex. Fall in FII inflows led to a decline in Indian markets and contributed to the sharp depreciation of the rupee in the forex market. Moderation in the growth rate of Indian economy has also affected market sentiments. The European debt crisis and downgrade of the US by S&P triggered fears of recession. However, the Indian markets have been less affected as compared to the other major indices in the world.
### Table 9.1 – Resource Mobilization through the Primary Market (in Rs. Crore)

<table>
<thead>
<tr>
<th>Mode</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Debt</td>
<td>1500</td>
<td>2500</td>
<td>9451</td>
<td>4791</td>
</tr>
<tr>
<td>2. Equity</td>
<td>2082</td>
<td>46736</td>
<td>48654</td>
<td>9683</td>
</tr>
<tr>
<td>Of which IPOs</td>
<td>2082</td>
<td>24696</td>
<td>35559</td>
<td>5043</td>
</tr>
<tr>
<td>Number of IPOs</td>
<td>21</td>
<td>39</td>
<td>53</td>
<td>30</td>
</tr>
<tr>
<td>Average Size of the IPO</td>
<td>99</td>
<td>633</td>
<td>671</td>
<td>168</td>
</tr>
<tr>
<td>3. Private Placement</td>
<td>173281</td>
<td>212635</td>
<td>218785</td>
<td>188530</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>176864</td>
<td>261871</td>
<td>276890</td>
<td>2030050</td>
</tr>
</tbody>
</table>

Source: Indian Economic Survey, Table 5.15, p-120.
*as on 31 December 2011.

### Table 9.2 – Trends in Resource Mobilization (net) by Mutual Funds (in Rs. Crore)

<table>
<thead>
<tr>
<th>Sector</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. UTI</td>
<td>10677</td>
<td>-3659</td>
<td>15653</td>
<td>-16636</td>
<td>5323</td>
</tr>
<tr>
<td>2. Public</td>
<td>9820</td>
<td>9380</td>
<td>1249</td>
<td>-13555</td>
<td>3035</td>
</tr>
<tr>
<td>3. Private</td>
<td>133304</td>
<td>-34018</td>
<td>54928</td>
<td>-19215</td>
<td>91980</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>153802</td>
<td>-28296</td>
<td>83080</td>
<td>-49406</td>
<td>100338</td>
</tr>
</tbody>
</table>

Source: Indian Economic Survey, Table 5.16, p-120.
*as on 30 November 2011.
## Table 9.3 – Index Returns, Volatility, Market Capitalization and P/E Ratio

<table>
<thead>
<tr>
<th>Sector</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Nifty</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return(Per cent)</td>
<td>23.9</td>
<td>-36.2</td>
<td>73.8</td>
<td>11.1</td>
<td>-20.7</td>
</tr>
<tr>
<td>Market Cap (Rs. Crore)</td>
<td>1240071</td>
<td>771483</td>
<td>1525162</td>
<td>1755468</td>
<td>1405066</td>
</tr>
<tr>
<td>Daily volatility</td>
<td>2.0</td>
<td>2.6</td>
<td>1.9</td>
<td>1.1</td>
<td>1.3</td>
</tr>
<tr>
<td>P/E Ratio</td>
<td>20.6</td>
<td>14.3</td>
<td>22.3</td>
<td>22.1</td>
<td>16.8</td>
</tr>
<tr>
<td><strong>2. Nifty Junior</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return(Per cent)</td>
<td>16.0</td>
<td>-45.6</td>
<td>148.4</td>
<td>4.7</td>
<td>-26.1</td>
</tr>
<tr>
<td>Market Cap (Rs. Crore)</td>
<td>202809</td>
<td>113523</td>
<td>292316</td>
<td>316529</td>
<td>247531</td>
</tr>
<tr>
<td>Daily volatility</td>
<td>2.4</td>
<td>2.8</td>
<td>2.0</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>P/E Ratio</td>
<td>16.7</td>
<td>8.7</td>
<td>15.8</td>
<td>17.6</td>
<td>13.5</td>
</tr>
<tr>
<td><strong>3. BSE Sensex</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return(Per cent)</td>
<td>19.7</td>
<td>-37.9</td>
<td>80.5</td>
<td>9.9</td>
<td>-20.4</td>
</tr>
<tr>
<td>Market Cap (Rs. Crore)</td>
<td>1071940</td>
<td>695152</td>
<td>1328862</td>
<td>1555322</td>
<td>1266639</td>
</tr>
<tr>
<td>Daily volatility</td>
<td>1.9</td>
<td>2.8</td>
<td>1.9</td>
<td>1.1</td>
<td>1.3</td>
</tr>
<tr>
<td>P/E Ratio</td>
<td>20.1</td>
<td>13.7</td>
<td>21.3</td>
<td>21.2</td>
<td>16.4</td>
</tr>
<tr>
<td><strong>4. BSE 500</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return(Per cent)</td>
<td>24.3</td>
<td>-42.8</td>
<td>96.4</td>
<td>6.5</td>
<td>-22.6</td>
</tr>
<tr>
<td>Market Cap (Rs. Crore)</td>
<td>1996839</td>
<td>1168850</td>
<td>2444151</td>
<td>2776847</td>
<td>2166947</td>
</tr>
<tr>
<td>Daily volatility</td>
<td>2.0</td>
<td>2.6</td>
<td>1.8</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>P/E Ratio</td>
<td>20.0</td>
<td>13.7</td>
<td>20.4</td>
<td>19.2</td>
<td>16.2</td>
</tr>
</tbody>
</table>
9.4 CAPITAL MARKET REFORMS IN INDIA

The capital market was suffering from many problems such as lack of transparency in procedures, price rigging and insider trading. In order to remove these problems, the Government of India set up the SEBI in 1988. In January, 1992, SEBI was made a statutory body and was authorized to regulate all merchant banks on issue activity, lay guidelines and supervise and regulate the working of mutual funds and oversee the working of stock exchanges in India. SEBI has taken a number of steps to improve the functioning of the capital market in India. The Narasimham Committee recommended the abolition of CCI and proposed SEBI to protect the investors and take over the regulatory function of CCI. The Government of India repealed the CCI Act, 1947 and gave SEBI the power to control and regulate the stock exchanges in India. The following measures were undertaken by the Government to reform the capital market in India:
1) **Measures to Strengthen the Government Securities Market.**

The following measures have been taken to strengthen the government securities market:

a) The auction system for the sale of Government of India medium and long term securities was introduced from June 1992. New instruments such as conversion of auction treasury bills into term securities, zero coupon and capital indexed bonds, tap stocks and partly paid stocks were introduced.

b) 364 day treasury bills auction was introduced in April 1992 and 91 day treasury bills auction from January 1993, 14 day treasury bills was introduced in June 1997. 182 day treasury bills were introduced once again in May 1999. The auction of 14 day and 182 day treasury bills was discontinued from 14th May 2001.

c) The Securities Trading Corporation of India was established in 1994 to develop institutional structure for an active secondary market in government securities.

d) A system of primary dealers was established in March 1995 and the guidelines for Satellite Dealers were issued in December 1996.

e) From 01st April, 1997 a new scheme of ways and means advances was commenced and the practice of automatic monetization of central government budget deficit through ad hoc treasury bills was abandoned.

f) The RBI initiated steps for the introduction of a Delivery versus Payment system for transactions in government securities in Mumbai. This system ensures settlement by synchronizing the transfer of securities with cash payment. This has reduced settlement risk in securities transactions and has also prevented diversion of funds.

g) The RBI started providing liquidity support to mutual funds dedicated to investments in government securities.

h) Foreign institutional investors with 100 per cent debt funds were permitted to invest in government securities and treasury bills. Other foreign institutional investors were also allowed to invest
in debt market including government securities subject to the ceiling of 30 per cent.

i) The interest income on government securities was exempted from the provision of tax deduction at source.

j) Retail trading in government securities at select stock exchanges commenced in January 2003.

2) Establishment of the Securities & Exchange Board of India. The SEBI was set up in 1988. It was given statutory recognition in 1992. The SEBI has been created to develop an environment which would facilitate mobilization of adequate resources through the securities market and its efficient allocation.

3) Establishment of the National Stock Exchange of India. The NSE was set up in November 1992 and it started its operations in 1994. Four important innovations were made in the way in which trading takes place at the NSE. These innovations are:

a) Replacement of the physical floor by computerized order matching with strict price time priority.

b) Use of satellite communications by setting up 2000 satellite terminals all over the country. On a given day, about 3500 traders log into the trading computer over this network.

c) NSE is a limited liability company and brokers are franchisees. Hence NSE staff is free from pressures from brokers and is able to perform its regulatory and enforcement functions more effectively.

d) Traditional practices of unreliable fortnightly settlement cycle with the escape clause of badla were replaced by a strict weekly settlement cycle without badla.

These innovations brought the advantages of transparency, anonymity, efficiency and competition in the brokerage industry and also gave equal access to the trading floor from all locations in India.
4. **Establishment of the National Securities Clearing Corporation.** The National Securities Clearing Corporation was set up in 1996 to tackle the problem of counter party risks. The NSCC started guaranteeing all trades on NSE. Thus every trade that takes place is from the risk of counter party defaulting.

5. **Introduction of Dematerialization.** Share certificates were printed on paper resulting in operational cost and risk. Theft and counterfeiting of share certificates gave rise to criminal activities. In order to solve this problem, the National Securities Depository Services (India) Limited was set up in November 1996. The depository maintains a computer record of ownership of securities and dispenses with physical share certificates. This form of trading is known as “Demat”.

6. **Derivatives Trading.** Derivatives are contracts whose value is derived from the underlying asset. The underlying asset can be equity/foreign exchange/any other financial asset. Derivatives help in transferring the price risks either partially or fully by locking-in asset prices. By doing so, derivatives minimize the impact of asset price fluctuations on profitability and cash fallow status of investors who are averse to risk. Derivative trading in equities began in India in June 2000. There are four equity derivative products in India. They are stock options, stock futures, index options and index futures. Derivatives trading take place only in the National Stock Exchange and the Bombay Stock Exchange.

7. **Trading in Central Government Securities.** Trading in government securities was introduced in January, 2003. It can be carried out through a nationwide, anonymous, order-driver, screen-based trading system of stock exchanges. Retail investors are allowed to buy and sell government securities in stock exchanges. Individuals, firms, companies, corporate bodies, institutions, trusts and other entities approved by the RBI are allowed to participate in the retail market.
8. **Rolling Settlement.** Rolling settlement improves the efficiency and integrity of the securities market. Under rolling settlement, all trades executed on a trading day (T) are settled after certain days (N). This is called T + N rolling settlement. Since 01<sup>st</sup> April, 2002 trades are settled under T + 3 rolling settlement. The NSE has introduced T + 2 rolling settlement from 01<sup>st</sup> April, 2003. Under it, each order has a unique settlement date specified at the time of order entry. It is mandatory for trades to be settled on the predetermined settlement date.

9. **Mandatory PAN Requirement.** In order to maintain a good audit trail of the transactions in the securities market and to strengthen the ‘know your client’ concept, Permanent Account Number (PAN) has been made compulsory w.e.f. 01<sup>st</sup> January, 2007.

10. **Stock Exchanges permitted to set Trading Hours.** In 2009-10, the stock exchanges were permitted to set their trading hours in the cash and derivative segments subject to the condition that the trading hours are between 9 a.m. and 5 p.m. and the stock exchange has a risk management system and infrastructure commensurate with the trading hours.

11. **Investor Protection Measures.** The SEBI has introduced an autonomous complaints handling system to deal with investor complaints. It has given recognition to many investor associations. It issues advertisement to guide and enlighten investors on various issues related to the securities market. In October, 2001, the Central Government established the Investor Education and Protection Fund for protecting the rights of the investors.

### 9.5 ROLE OF SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

The capital market was regulated by the Capital Issue (Contract) Act, 1947. The abolition of the Controller of Capital Issues was abolished in the year 1991 and SEBI was given the
responsibility of a market regulator. With the abolition of CCI, prior permission of the government is not required by the companies to access the capital markets. Companies are free to approach the capital markets without prior government permission subject to getting offer documents cleared by SEBI. Controls over price and premium fixation have also been removed and most issuing companies are free to fix the price of their securities for public as well as rights issues.

**Steps taken by SEBI to Improve Capital Market in India.**

The important steps taken by SEBI to improve the functioning of capital market in India are as follows:

1) Periodic inspection of stock exchanges.

2) An advertisement code has been laid down to ensure that the advertisements are fair and do not contain misleading statements.

3) Appointment of SEBI representative to supervise the allotment process in the event of oversubscription.

4) Stock brokers and sub-brokers are required to register under the SEBI Act.

5) Merchant banking has been brought under the supervisory role of SEBI and hence pricing and premium fixation is regulated by SEBI.

6) ‘Insider trading’ has been prohibited in November 1992.

7) Free pricing is permitted subject to consistent track record for three years and credit rating is compulsory for debentures and bonds of more than 18 months.

8) The SEBI (Mutual Fund) Regulations 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 scheme 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.
9) Brokers are mandatorily required to maintain separate accounts for their clients and for themselves. They must disclose the transaction prices and brokerages separately in the contract notes issued to their clients and file their audited reports with SEBI. Brokers are required to issue contract notes to the clients within 24 hours of the execution of the contract. In order to ensure execution of the deals and to give protection to the investors, capital adequacy norms for brokers have been introduced.

10) Infrastructure firms have been exempted from requirements such as making a minimum public offer of 25 per cent of equity, five shareholders per Rs. One lakh of offer and minimum subscription of 90 per cent while floating a public issue.

11) A company can finance buy back out of its free reserves, the securities premium account or proceeds of an earlier issue other than fresh issue of shrews made specifically for buyback purposes.

12) Companies have been given the freedom to fix the par value of shares issued by them. Companies who have issued shares at Rs.10 and Rs.100 can fix the par value of their shares either by consolidating or by splitting their existing shares.

13) Floating of public issues through the Book Building mechanism.

14) Collective Investment Schemes needs to be registered with SEBI. In case of failure of registration, the scheme will have to be wound up.

15) In January, 2000, compulsory rolling settlement in ten select scrips was introduced and since then more scrips have come under the system. In June, 2000, SEBI introduced derivatives trading.

16) An ordinance promulgated on October 28, 2002 gave SEBI the power to search an entity's premises land seize documents, impound cash proceeds and securities connected to any transaction it is investigating and freeze bank accounts. In case of market manipulation or insider trading violations, SEBI can impose a fine of Rs.25 crore or three times the profits made by the entity concerned whichever is higher and for other violations like non-disclosures, Rs. One crore fine can be imposed.
17) In November 2002, SEBI approved the establishment of a Central Listing Authority.

18) In May 2006, listed companies were permitted to raise funds in the form of Qualified Institutional Placement.

19) Permanent Account Number (PAN) was made the sole identification number for all participants in the securities market from July 2007.

20) From January 2008, entry load by mutual funds was waived for investors making applications for investment in mutual fund schemes directly.

SEBI has introduced numerous measures to improve the efficiency of the capital market in India. By improving market efficiency, increasing transparency, preventing unfair trade practices, SEBI has succeeded in raising the standard of Indian capital market to the international level.

9.6 GROWTH OF INSURANCE BUSINESS IN INDIA

The insurance sector in India is a part of the Union List and hence entirely comes under the central government. After 1991, the insurance sector was liberalized and foreign equity participation was allowed up to 26%. As a result, a number of private sector insurance companies along with foreign insurance companies were set up in India. The Life Insurance Corporation of India and the General Insurance Corporation of India are the Government owned behemoths in the insurance sector claiming an overwhelming share of the insurance market, both life and general.

The roots of the Insurance industry in India can be traced back to 1818 when the Oriental Life Insurance Company was set up Calcutta (Kolkata). In 1870, the first domestic insurance company known by the name Bombay Mutual Life Assurance Society was established. In 1912, the Life Insurance Companies Act and the Provident Fund Act were passed to regulate the insurance business. The Life Insurance Companies Act, 1912 made it necessary that the premium-rate tables and periodical
valuations of companies should be certified by an actuary. The oldest surviving insurance company in India is the National Insurance Company Ltd which was set up in 1906. In 1928, the Indian Insurance Companies Act was passed to enable the government to collect statistical information about life and non-life insurance business. In 1938, the 1928 Act was amended by the Insurance Act with a view to protect the interests of the insured.

The Government of India issued an Ordinance on 19 January 1956 nationalizing the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The Life Insurance Corporation (LIC) was the result of a merger of 245 Indian and foreign insurance companies consisting of 154 Indian, 16 non-Indian insurers and 75 provident societies. In 1972 the General Insurance Business (Nationalization) Act was passed, and the general insurance business was nationalized with effect from 01 January 1973. As a result, 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commence business on January 1, 1973.

The LIC had monopoly till the late 90s when the Insurance sector was thrown open to the private sector. Before that, the industry consisted of only two state insurers: Life Insurers (Life Insurance Corporation of India, LIC) and General Insurers (General Insurance Corporation of India, GIC). GIC had four subsidiary companies.

With effect from December 2000, these subsidiaries have been de-linked from the parent company and were set up as independent insurance companies: Oriental Insurance Company Limited, New India Assurance Company Limited, National Insurance Company Limited and United India Insurance Company Limited. Currently the insurance industry in India is worth US$41 billion.

Until 1999, there were no private insurance companies in India. The government then introduced the Insurance Regulatory and Development Authority Act in 1999, thereby de-regulating the insurance sector and allowing private companies. Furthermore, foreign investment was also allowed and capped at 26% holding in the Indian insurance companies. In 2006, the Actuaries Act was passed to give the profession statutory status on par with Chartered Accountants, Notaries, Cost & Works Accountants, Advocates, Architects and Company Secretaries. A minimum capital of US$80 million (Rs.400 Crore) is required by legislation to set up an
insurance business in India. According to estimates, about 35 to 40 million persons from a population of 1.2 billion people are insured. The insurance market has therefore huge potential.

The insurance industry in India provides death benefit, cash value, dividends and policy loans, tax deduction benefit. The major insurance companies other than the State owned LIC and GIC are Birla Sun Life Insurance Company, HDFC Standard, ICICI Prudential Life Insurance, OM Kotak Mahindra Old Mutual, Royal Sundaram, Max Life (earlier Max New York Life), AMP SANMAR, Aviva Life Insurance India, InG Vysya Life Insurance, Met Life India, Allianz Bajaj Life Insurance Company, SBI Life Insurance Company Ltd, the Tata AIG Group, Sahara India Life Insurance Company Ltd, Shriram Life Insurance Company Ltd. The insurance products sold by insurance companies are whole life policies, endowment policies, money back policies, children’s policies and annuities/pension schemes.

9.6.1 The insurance regulatory authority of India:

The Insurance Regulatory and Development Authority (IRDA) is an autonomous apex statutory body which regulates and develops the insurance industry in India. It was constituted under an Act by the Parliament of India called Insurance Regulatory and Development Authority Act, 1999. The agency operates its headquarters at Hyderabad, Andhra Pradesh where it shifted from Delhi in 2001.

The IRDA Act, 1999 was passed as per the major recommendation of the Malhotra Committee report (1994) which recommended establishment of an independent regulatory authority for insurance sector in India. The IRDA was incorporated as a statutory body in April, 2000. The IRDA Act, 1999 also allows private players to enter the insurance sector in India. Foreign equity participation of 26 per cent is also allowed under the Act. It serves as an Authority to protect the interests of holders of insurance policies, to regulate, promote and ensure orderly growth of the insurance industry in India.

The duties, powers and functions of IRDA are laid down in section 14 of IRDA Act, 1999 are as follows:

1. Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.

2. Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include:
a) Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;

b) Protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;

c) Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents

d) Specifying the code of conduct for surveyors and loss assessors.

e) Promoting efficiency in the conduct of insurance business.

f) Promoting and regulating professional organizations connected with the insurance and re-insurance business.

g) Levying fees and other charges for carrying out the purposes of this Act.

h) Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business.

i) Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);

j) Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;

k) Regulating investment of funds by insurance companies;

l) Regulating maintenance of margin of solvency;

m) Adjudication of disputes between insurers and intermediaries or insurance intermediaries;

n) Supervising the functioning of the Tariff Advisory Committee;

o) Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations referred to in clause (2.6).

p) Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and

q) Exercising such other powers as may be prescribed.
9.7 QUESTIONS

1) What is Capital Market? Describe the growth of capital market in India since 1980.
2) Write a note on capital market reforms.
3) Write a note on SEBI.
4) Explain the growth of insurance business in India.
5) Write a note on IRDA.
MODULE 5
FINANCES OF THE GOVERNMENT OF INDIA

Unit Structure :

10.1 Objectives
10.2 The Union Budget
10.3 Study of various Union Budgets
10.4 Trends in the revenue and expenditure of the Government of India in the pre and post reforms period.
10.5 Changes in Tax Policy since 1991
10.6 Tax proposals in the Union Budget 2012-13
10.7 Questions

10.1 OBJECTIVES

- To know the Union Budget and the sources of revenue of the Government of India
- To understand the trends in revenue and expenditure in the pre and post reforms period.
- To know the tax revenue of the GOI, Tax Reforms and changes in tax policy since 1991.

10.2 THE UNION BUDGET

The government budget is a financial statement which describes its revenues and expenditures. The government budget consists of the following data:

1. The actual figures for the year before and the current year.
2. The budget estimates and the revised estimates of the current year.
3. The budget estimates of receipts and expenditure for the year ahead.
The estimates for the year ahead are given in two parts. In the first part, it is assumed that the current year’s taxes and their rates would continue and accordingly the estimates are made. In the second part, estimates of revenue and expenditures are given on the basis of proposed changes in the budget. The government budget therefore becomes a financial statement describing its financial plans and fiscal policy.

The government budget is generally classified into two, namely: the revenue account and the capital account.

A) The Revenue Account:

The revenue account shows revenue receipts and revenue expenditure. The revenue receipts are classified into tax and non-tax revenue. The tax revenue consists of revenue receipts from direct taxes such as personal income tax and corporation tax and revenue receipts from indirect taxes, such as excise and customs duties. Non-tax revenue includes interest receipts and surpluses from public enterprises. Revenue expenditure is divided into developmental and non-developmental expenditure. For instance, the important heads of revenue expenditure of Government of India are defense expenditure, interest payments and subsidies.

B) The Capital Account:

The capital account shows capital receipts and capital expenditure. Capital receipts consist of market borrowings, small savings, special deposits, recoveries of loans, provident funds, external loans disinvestment receipts etc. Capital expenditure consists of debt repayment and expenses incurred on construction of capital assets.

The Government Budget shows deficit or surplus incurred in these accounts. Deficit incurred in one account is made good by showing a surplus on the other account. For instance, since 1997-98 the government of India has been showing a zero budget deficit. A zero budget deficit is shown by a surplus on the capital account which is equivalent to a deficit on the revenue account. Thus by reducing capital expenditure, the government has been making good the deficit on the revenue account. The budget deficit is the difference between receipts and expenditure of the government.
The Budget Statement.

In India, the financial statement of the government is called the Budget Statement. The Central Government places its financial statement before the Parliament and the State governments place their financial statements before their respective State legislatures. The government accounts are kept in three parts, namely: the consolidated fund, the contingency fund and the public account.

The Consolidated Fund.

The government receipts are kept in the consolidated fund. The receipts going to the consolidated fund and the expenses incurred from it become a part of the budget statement. Expenditure from the consolidated fund requires prior sanction of the Parliament. All revenues going to the Consolidated Fund and expenditures to be incurred from this fund are a part of the Budget Statement.

The Contingency Fund.

The contingency fund is maintained for incurring non-postponable expenses. The operations of the contingency fund are also described in the budget statement. In order to incur expenditure from this fund, prior sanction is not required from the Parliament or the State legislature, as the case may be.

The Public Account.

Non-government funds go to the public account. Provident funds, small savings, deposits and advances go to the Public account. Here again, no sanction is required from the Parliament or the State legislatures for incurring expenditure from this account.

In India, the receipts and payments under all the three Accounts are shown separately in the Budget Statements of both the Central and State Governments.

10.3 STUDY OF VARIOUS UNION BUDGETS

The Union Budget of India can be studied with reference to basic fiscal concepts such as the budget deficit, revenue deficit, fiscal deficit, primary deficit and monetized deficit are explained based on the budget data of the Central Government of India for various years in Table 4.1.
Budget Deficit. Budget deficit is the differences between total expenditure and total receipts of the central government. Both receipts and expenditures are divided into categories i.e., revenue receipts and capital receipts and correspondingly we have revenue expenditure and capital expenditure. The budget deficit in the year 1990-91 was Rs. 11,347 crore. From 1997-98 onwards, the government began to show nil budget deficit. This was done by cleaning up the revenue deficit entirely with a matching surplus on the capital account. The difference between capital receipts and capital expenditure (4-5) has been equal to the revenue deficit from 1997-98 onwards. The government has discontinued showing budgetary deficit in their income and expenditure accounts and hence budgetary deficit does not appear in the aforesaid table.

Revenue Deficit. Revenue deficit is the difference between revenue receipts and revenue expenditure of the government. It indicates the excess of revenue expenditure over revenue receipts or dis-saving by the government. It shows an increase in the liabilities of the Central Government without corresponding increase in its assets. In 1990-91, the revenue deficit was Rs. 18,562 crore. In 2001-02, the revenue deficit rose to Rs. 100,162 crore. According to budget estimates for the year 2011-12, the revenue deficit is estimated to be Rs. 3,07,270 crore. The government has been using capital account receipts to clean up the revenue deficit i.e. capital receipts are being used by the government to finance revenue expenditure. The revenue deficit as a percentage of GDP had declined from 3.3 per cent in 1990-91 to 1.0 per cent in 2008-09. However, 2009-10, the revenue deficit went up to 5.2 per cent of the GDP. This was on account of the fiscal stimulus package that was announced in the wake of the Global Financial Crisis of 2008-09. According to the provisional estimates for the year 2010-11, the revenue deficit is 4.2 % and for the year 2011-12, the budget estimate of revenue deficit is 3.2 %. The revenue expenditure as a percentage of GDP also had increased from 12.7 per cent in 1990-91 to 13.5 per cent in 2010-11. However, capital expenditure as a percentage of GDP had declined from 4.4 percent to 2.1 per cent during the same period against receipts of 5.6 per cent and 5.3 per cent. According to the golden rule of public finance, all borrowings by the government must be used for public investment. Unfortunately, in India’s case, a great part of the capital receipts have been used to finance revenue or current expenditure. The burden of fiscal correction has fallen on capital account whereas it should have fallen on the revenue account.
**Fiscal Deficit.** The fiscal deficit is obtained by subtracting total receipts (excluding government borrowings) from the total expenditure. The fiscal deficit was Rs.37,606 crore in 1990-91. In the year 2001-02, the fiscal deficit rose to Rs.140,955 crore and since then there has not been much of an absolute growth in the fiscal deficit. The fiscal deficit as a percentage of GDP had declined from 6.6 per cent in 1990-91 to 2.6 % in 2007-08 and it increased to 7.8 per cent (revised estimates) in 2008-09. However, the decline in fiscal deficit has been achieved by increasingly drawing upon the capital account which is an indicator of poor fiscal management. In 2010-11, the fiscal deficit came down to 4.8% of GDP (provisional estimates). The budget estimates of fiscal deficit for the year 2011-12 is 4.2% of GDP.

**Primary Deficit.** The primary deficit is obtained by deducting interest payments from the fiscal deficit. It is therefore also known as non-interest deficit. Primary deficit is also calculated by deducting net interest payments (interest payments – interest receipts) from the fiscal deficit. The net primary deficit is considered as a relevant measure to determine the stability of debt to GDP ratio. The net fiscal deficit is obtained by excluding governments net lending (loans and advances of government less recoveries of loans) from the fiscal deficit. The primary deficit in the year 1990-91 was Rs.16,108 crore and for 2009-10 it is estimated to be Rs.1,75,485 crore. It only indicates that interest payments have increased over the years. As a percentage of GDP, primary deficit declined from 2.8% in 1990-91 to 2.6 % in 2008-09. However, in 2009-10, it went up once again to 3.2%. The provisional estimate of primary deficit for 2010-11 is 1.8 % and the budgetary estimate for the year 2011-12 is 1.6 per cent of GDP.

**Monetized Deficit.** Monetized deficit is the increase in net RBI credit to the Central government. It constitutes the net increase in the holdings of treasury bills of the RBI and its contribution to the market borrowings of the government. It indicates the amount of fiscal deficit that is monetized or release of additional money supply into the economy. However, the practice of monetization of government’s deficits was discontinued from 01st April, 1997 and was replaced by a new scheme called Ways and Means Advances (WMA). The WMA is a mechanism to fill the temporary gap between the government’s receipts and expenditure. The government of India is obliged to clear the WMA by the end of every financial year. According to the agreement between the RBI
and the Central government on 26\textsuperscript{th} March, 1997, the limit or the ceiling on WMA was kept at Rs.12,000 crore for the first half (April to September) and Rs.8,000 crore for the second half (October to March) of the year 1997-98. The government has also been given an overdraft facility for the first two financial years 1997-98 and 1998-99. However, the overdraft was to be vacated or cleared within a year. But after March 1997, no overdraft facility was to be permitted for more than 10 consecutive working days. The WMA and overdraft facility comes at an interest rate less than 3 percentage points of the market rate and two percentage points above the WMA rate respectively. However, RBI is expected to support the government market borrowing programs by subscribing to the government securities. For the year 1997-98, a provision of Rs.16, 000 crore was made. The immediate effect of this provision will be similar to the monetization of the government deficit. However, the RBI can neutralize the monetization effect by selling these securities through open market operations. The agreement also envisaged fixing up of yearly monetized deficits. As a result of WMA, the RBI will be more effective in pursuing its monetary policy and will have a greater control on money supply.

Table 10.1
Receipts and Expenditures of the Central Government of India.

\begin{tabular}{|c|c|c|c|c|c|}
\hline
\hline
1. Revenue Receipts of which: & & & & & \\
\hline
a) Tax revenue (Net of States share) & 54,954 & 5,40,259 & 5,72,811 & 7,94,277 & 7,89,892 \\
b) Non-tax revenue & 42,978 & 443,319 & 456,536 & 572,790 & 664,457 \\
\hline
11,976 & 96,940 & 1,16,275 & 2,21,487 & 1,25,435 \\
\hline
2. Revenue expenditure Of which: & & & & & \\
\hline
a) Interest & 73,516 & 7,93,798 & 9,11,809 & 10,39,130 & 10,97,162 \\
\hline
\end{tabular}
## Payments

<table>
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<tr>
<th>Payments</th>
<th>21,498</th>
<th>1,92,204</th>
<th>2,13,093</th>
<th>2,34,738</th>
<th>2,67,986</th>
</tr>
</thead>
<tbody>
<tr>
<td>b) Major subsidies.</td>
<td>9,581</td>
<td>1,23,581</td>
<td>1,35,508</td>
<td>1,31,212</td>
<td>1,34,411</td>
</tr>
<tr>
<td>c) Defense Expenditure.</td>
<td>10,874</td>
<td>73,305</td>
<td>90,669</td>
<td>92,386</td>
<td>95,216</td>
</tr>
</tbody>
</table>

### 3. Revenue Deficit (2 – 1)

| Revenue Deficit | 18,562 | 2,53,539 | 3,38,998 | 2,44,853 | 3,07,270 |

### 4. Capital Receipts (a + b + c)

<table>
<thead>
<tr>
<th>Capital Receipts (a + b + c)</th>
<th>31,971</th>
<th>3,43,697</th>
<th>4,51,676</th>
<th>4,06,642</th>
<th>4,67,837</th>
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</thead>
<tbody>
<tr>
<td>a) Recovery of loans.</td>
<td>5,712</td>
<td>6,139</td>
<td>8,613</td>
<td>12,752</td>
<td>15,020</td>
</tr>
<tr>
<td>b) Other receipts (mainly from PSU disinvestment)</td>
<td>0</td>
<td>566</td>
<td>24,581</td>
<td>22,847</td>
<td>40,000</td>
</tr>
<tr>
<td>c) Borrowings and other liabilities.</td>
<td>26,259</td>
<td>3,36,992</td>
<td>4,18,482</td>
<td>3,69,043</td>
<td>4,12,817</td>
</tr>
</tbody>
</table>

### 5. Capital expenditure

| Capital expenditure | 24,756 | 90,158 | 1,12,678 | 1,59,789 | 1,60,567 |

### 6. Total expenditure [2+5 = 6(a) + 6(b)]

<table>
<thead>
<tr>
<th>Total expenditure</th>
<th>98,272</th>
<th>8,83,956</th>
<th>10,24,487</th>
<th>11,98,919</th>
<th>12,57,729</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Plan expenditure.</td>
<td>28,365</td>
<td>2,75,235</td>
<td>3,03,391</td>
<td>3,77,350</td>
<td>4,41,547</td>
</tr>
<tr>
<td>b) Non-plan Expendt.</td>
<td>69,907</td>
<td>6,08,721</td>
<td>7,21,096</td>
<td>8,21,569</td>
<td>8,16,182</td>
</tr>
</tbody>
</table>

### 7. Fiscal Deficit [6 – 1 – 4(a) – 4(b)]

| Fiscal Deficit | 37,606 | 3,36,992 | 4,18,482 | 3,69,043 | 4,12,817 |

### 8. Primary deficit [7 – 2(a)]

| Primary deficit | 16,108 | 1,44,788 | 2,05,389 | 1,34,305 | 1,44,831 |
Table 10.1 (Contd…)

Receipts and Expenditures of the Central Government of India.

(As per cent of GDP)

<table>
<thead>
<tr>
<th></th>
<th>1990-91</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11 (P)</th>
<th>2011-12 (BE)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Revenue Receipts</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b) Tax revenue (Net of States share)</td>
<td>9.7</td>
<td>9.6</td>
<td>8.9</td>
<td>10.4</td>
<td>8.9</td>
</tr>
<tr>
<td></td>
<td>7.6</td>
<td>7.9</td>
<td>7.1</td>
<td>7.5</td>
<td>7.5</td>
</tr>
<tr>
<td></td>
<td>2.1</td>
<td>1.7</td>
<td>1.8</td>
<td>2.9</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>2. Revenue expenditure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d) Interest Payments.</td>
<td>12.9</td>
<td>14.1</td>
<td>14.1</td>
<td>13.5</td>
<td>12.3</td>
</tr>
<tr>
<td></td>
<td>3.8</td>
<td>3.4</td>
<td>3.3</td>
<td>3.1</td>
<td>3.0</td>
</tr>
<tr>
<td>e) Major subsidies.</td>
<td>1.7</td>
<td>2.2</td>
<td>2.1</td>
<td>1.7</td>
<td>1.5</td>
</tr>
<tr>
<td>f) Defense Expendt.</td>
<td>1.9</td>
<td>1.3</td>
<td>1.4</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td><strong>3. RevenueDeficit(2−1)</strong></td>
<td>3.3</td>
<td>4.5</td>
<td>5.2</td>
<td>3.2</td>
<td>3.4</td>
</tr>
<tr>
<td><strong>4. Capital Receipts</strong></td>
<td>5.6</td>
<td>6.1</td>
<td>7.0</td>
<td>5.3</td>
<td>5.2</td>
</tr>
<tr>
<td>(a + b + c)</td>
<td>1.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>d) Recovery of loans.</td>
<td>0.0</td>
<td>0.0</td>
<td>0.4</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>e) Other receipts (mainly from PSU disinvestments)</td>
<td>4.6</td>
<td>6.0</td>
<td>6.5</td>
<td>4.8</td>
<td>4.6</td>
</tr>
<tr>
<td>f) Borrowings and other liabilities.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>5. Capital expenditure</strong></td>
<td>4.4</td>
<td>1.6</td>
<td>1.7</td>
<td>2.1</td>
<td>1.8</td>
</tr>
<tr>
<td><strong>6. Total expenditure</strong></td>
<td>17.3</td>
<td>15.7</td>
<td>15.9</td>
<td>15.6</td>
<td>14.1</td>
</tr>
</tbody>
</table>
[ 2 + 5 = 6(a) + 6 (b)]
c) Plan expenditure. 5.0 4.9 4.7 4.9 5.0
d) Non-plan Expendt. 12.3 10.8 11.2 10.7 9.2

7. Fiscal Deficit [6 – 1 – 4(a) – 4(b)] 6.6 6.0 6.5 4.8 4.6

8. Primary deficit (7 – 2a) 2.8 2.6 3.2 1.8 1.6

Memorandum Items
a) Interest receipts. 8,730 20,717 21,756 22,064 19,578
b) Non-plan revenue expenditure 60,896 5,59,024 6,57,925 7,26,767 7,33,558

Source: Compiled and computed from Indian Economic Survey 2011-12.

10.4 TRENDS IN TAX AND NON-TAX REVENUE IN INDIA (Pre and Post Reforms Period)

The revenue receipts of both the Central and State governments have increased consistently over the years with some exceptions. Here, we discuss the changing trends in tax and non-tax revenue of the Central government. Table 4.2 contains the details of the revenue receipts of the Central Government for the period 1970-71 to 2011-12.

1. Revenue Receipts of the Central Government. The total revenue of the Central government has increased during the period 1970-71 to 2009-10 from Rs.3,293 crores to Rs.6,14,497 crores. During this period, the share of the tax revenue in the total revenue roughly remained at about 75 per cent with variations in the range of ± 8%. In 1970-71, the share of the tax revenue i.e. direct and indirect taxes, was 74.4% in the total tax revenue and it rose marginally to 75.6% in 1980-81 and thereafter to 78.2% in 1990-91. In 2001-02, it came down sharply to 70.9 % and continued to fall to 66.3 % in 2001-02. From 2002-03, the share of the tax revenue once again started increasing and the increasing trend continued until the year 2008-09 when it reached an all time high of 82 %. In 2010-11, the share of the tax revenue further fell down to 71.92% and in 2011-12, it went up again to all time high of 84.2%.
The fluctuation in the share of tax revenue in the total revenue of the Central government can be explained in terms of tax reduction measures initiated by the Central government to boost aggregate demand in the economy. For instance, the fall in the tax revenue in the year 2009-10 was on account of substantial tax reductions made in the indirect taxes to shore up the economy from recession that gripped the Indian economy consequent to the global financial melt-down of 2008-09.

Table 10.2 – Revenue Receipts of the Central Government.

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax Revenue (Net)</th>
<th>Of Which</th>
<th></th>
<th></th>
<th>Of which Interest Receipts</th>
<th>Total Revenue</th>
<th>(2) as a % of (7)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
<td>(7)</td>
<td>(8)</td>
</tr>
<tr>
<td>1970-71</td>
<td>2,451</td>
<td>511</td>
<td>1940</td>
<td>842</td>
<td>589</td>
<td>3,293</td>
<td>74.4</td>
</tr>
<tr>
<td>1980-81</td>
<td>9,358</td>
<td>1,893</td>
<td>7465</td>
<td>3,015</td>
<td>1,795</td>
<td>12,373</td>
<td>75.6</td>
</tr>
<tr>
<td>1990-91</td>
<td>42,978</td>
<td>6,903</td>
<td>36,075</td>
<td>11,976</td>
<td>8,730</td>
<td>54,954</td>
<td>78.2</td>
</tr>
<tr>
<td>2000-01</td>
<td>1,36,658</td>
<td>49,651</td>
<td>87,007</td>
<td>55,947</td>
<td>32,811</td>
<td>1,92,605</td>
<td>70.9</td>
</tr>
<tr>
<td>2001-02</td>
<td>1,33,532</td>
<td>47,703</td>
<td>85,828</td>
<td>67,774</td>
<td>35,538</td>
<td>2,01,306</td>
<td>66.3</td>
</tr>
<tr>
<td>2002-03</td>
<td>1,58,544</td>
<td>61,612</td>
<td>96,932</td>
<td>72,290</td>
<td>37,622</td>
<td>2,30,834</td>
<td>68.7</td>
</tr>
<tr>
<td>2003-04</td>
<td>1,86,982</td>
<td>76,590</td>
<td>1,10,392</td>
<td>76,831</td>
<td>38,538</td>
<td>2,63,813</td>
<td>70.9</td>
</tr>
<tr>
<td>2004-05</td>
<td>2,24,798</td>
<td>95,944</td>
<td>1,28,854</td>
<td>81,193</td>
<td>32,387</td>
<td>3,05,991</td>
<td>73.5</td>
</tr>
<tr>
<td>2005-06</td>
<td>2,70,264</td>
<td>1,20,692</td>
<td>1,49,572</td>
<td>76,813</td>
<td>22,032</td>
<td>3,47,071</td>
<td>77.9</td>
</tr>
<tr>
<td>2006-07</td>
<td>3,51,182</td>
<td>1,69,738</td>
<td>1,81,444</td>
<td>83,205</td>
<td>22,524</td>
<td>4,34,387</td>
<td>80.8</td>
</tr>
<tr>
<td>2007-08</td>
<td>4,39,547</td>
<td>2,31,509</td>
<td>2,09,615</td>
<td>1,02,317</td>
<td>21,060</td>
<td>5,51,864</td>
<td>81.1</td>
</tr>
<tr>
<td>2008-09</td>
<td>4,43,319</td>
<td>2,48,152</td>
<td>1,96,969</td>
<td>96,940</td>
<td>20,717</td>
<td>5,40,259</td>
<td>82.0</td>
</tr>
<tr>
<td>2009-10</td>
<td>4,65,103</td>
<td>2,81,087</td>
<td>1,87,176</td>
<td>1,12,191</td>
<td>19,212</td>
<td>5,77,294</td>
<td>80.5</td>
</tr>
<tr>
<td>2010-11</td>
<td>5,63,685</td>
<td>3,14,606</td>
<td>2,49,080</td>
<td>2,20,148</td>
<td>19,728</td>
<td>7,83,833</td>
<td>71.92</td>
</tr>
<tr>
<td>2011-12</td>
<td>6,64,457</td>
<td>3,73,413</td>
<td>2,91,045</td>
<td>1,25,435</td>
<td>19,578</td>
<td>7,89,892</td>
<td>84.20</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India, Handbook of Statistics on the Indian Economy, 2011-12, Table 101, p.190
2. **Share of Direct Taxes in the Total Tax Revenue.** The share of the direct taxes in the total tax revenue has consistently increased as seen from Table 4.3. The share of direct taxes has consistently increased from 20.8% in 1970-71 to 57.1 per cent in 2009-10, except 1990-91 when the share came down to 16.1 %.

In 2011-12, the share of direct taxes in the total tax revenue went up to 56.2 %. Until the 1990s, the tax structure in India was criticized for want of equity. With progressive increase in the share of direct taxes in the total tax revenue, one can now safely say that the tax structure in India is fairly equitable.

**Table 10.3 – Share of Direct Taxes in the Total Tax Revenue**

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax Revenue (Net)</th>
<th>Of Which</th>
<th>Share of Direct Taxes in the total tax revenue (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>1970-71</td>
<td>2,451</td>
<td>511</td>
<td>1940</td>
</tr>
<tr>
<td>1980-81</td>
<td>9,358</td>
<td>1893</td>
<td>7465</td>
</tr>
<tr>
<td>1990-91</td>
<td>42,978</td>
<td>6,903</td>
<td>36,075</td>
</tr>
<tr>
<td>2000-01</td>
<td>1,36,658</td>
<td>49,651</td>
<td>87,007</td>
</tr>
<tr>
<td>2001-02</td>
<td>1,33,532</td>
<td>47,703</td>
<td>85,828</td>
</tr>
<tr>
<td>2002-03</td>
<td>1,58,544</td>
<td>61,612</td>
<td>96,932</td>
</tr>
<tr>
<td>2003-04</td>
<td>1,86,982</td>
<td>76,590</td>
<td>1,10,392</td>
</tr>
<tr>
<td>2004-05</td>
<td>2,24,798</td>
<td>95,944</td>
<td>1,28,854</td>
</tr>
<tr>
<td>2005-06</td>
<td>2,70,264</td>
<td>1,20,692</td>
<td>1,49,572</td>
</tr>
<tr>
<td>2006-07</td>
<td>3,51,182</td>
<td>1,69,738</td>
<td>1,81,444</td>
</tr>
<tr>
<td>2007-08</td>
<td>4,39,547</td>
<td>2,31,509</td>
<td>2,09,615</td>
</tr>
<tr>
<td>2008-09</td>
<td>4,43,319</td>
<td>2,48,152</td>
<td>1,96,969</td>
</tr>
<tr>
<td>2009-10</td>
<td>4,65,103</td>
<td>2,81,087</td>
<td>1,87,176</td>
</tr>
<tr>
<td>2010-11</td>
<td>5,63,685</td>
<td>3,14,606</td>
<td>2,49,080</td>
</tr>
<tr>
<td>2011-12</td>
<td>6,64,457</td>
<td>3,73,413</td>
<td>2,91,045</td>
</tr>
</tbody>
</table>

3. Share of Non-tax Revenue in Total Revenue Receipts. The share of non-tax revenue has remained around 20% of the total revenue of the Central Government. From a high of 25.6% in 1970-71, it went up to all time high of 37.7 % in 2001-02 and thereafter came down to 17.1 % in 2008-09 and in 2009-10, it went up marginally to 22.8%. In 2011-12, the share of non-tax revenue in the total revenue of the Central Government was 15.8%.

4. Direct and Indirect Taxes of Central Government. The revenue receipts from the components of direct and indirect taxes are presented in Table 4.4. In 1970-71, the direct tax revenue was Rs.511 crore out of which Rs.114 crore came from personal income tax. Personal income tax had a share of about 22.3 per cent. In 1990-91, the share of PIT fell to 2.9 % and thereafter in 2000-01, it went up to 16.6 %. In 2008-09, it went up to 19.3% and in 2009-10, it reached a low of 16.3 per cent. In 2011-2, it was 18 %. Amongst the direct taxes, corporation tax always had a higher share and in 2011-12, it had a share of 38.1% in the direct tax revenue of the Central government.

### Table 10.4 – Direct and Indirect Taxes of Central Government.

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax Revenue (Net)</th>
<th>Direct Taxes</th>
<th>Of Which</th>
<th>Indirect Taxes</th>
<th>Of Which</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Personal Income Tax</td>
<td>Corporation Tax</td>
<td>Excise Duties (net)</td>
</tr>
<tr>
<td>1970-71</td>
<td>2,451</td>
<td>114</td>
<td>371</td>
<td>511</td>
<td>1940</td>
</tr>
<tr>
<td>1980-81</td>
<td>9,358</td>
<td>438</td>
<td>1,311</td>
<td>524</td>
<td>49,651</td>
</tr>
<tr>
<td>1990-91</td>
<td>42,978</td>
<td>1,250</td>
<td>5,335</td>
<td>6,903</td>
<td>23,766</td>
</tr>
<tr>
<td>2000-01</td>
<td>1,36,658</td>
<td>23,766</td>
<td>25,177</td>
<td>49,651</td>
<td>87,007</td>
</tr>
<tr>
<td>2001-02</td>
<td>1,33,532</td>
<td>22,106</td>
<td>25,133</td>
<td>47,703</td>
<td>85,828</td>
</tr>
<tr>
<td>2002-03</td>
<td>1,58,544</td>
<td>27,779</td>
<td>33,893</td>
<td>61,612</td>
<td>96,932</td>
</tr>
<tr>
<td>2003-04</td>
<td>1,86,982</td>
<td>30,765</td>
<td>45,706</td>
<td>76,590</td>
<td>1,10,392</td>
</tr>
</tbody>
</table>

5. **Share of Indirect Taxes.** Amongst the indirect taxes, excise duty had a share of 70.6% in 1970-71. It fell down to 39.1% in 1990-91 and then in 2000-01, it went up to 57.2% and further to 63.6% in 2003-04. In 2008-09, the share of excise duty fell down to 41.3% and in 2009-10, it stood at 43.3% of the indirect tax revenue. The share of custom duty in the indirect tax revenue was 29.4% in 1970-71. It went up to 60.9% in 1990-91 and then in 2000-01, it fell down to 42.8% and further down to 36.4% in 2003-04. In 2008-09, the share of custom duty increased to 58.7% and in 2009-10, it stood at 52.7%. In 2011-12, the share of custom duties was 16.1%.

6. **Relative Shares of Direct and Indirect Taxes in the total Tax Revenue.** The relative shares of direct and indirect taxes in the total tax revenue are given in Table 4.5.
Table 10.5 – Relative Shares of Direct and Indirect Taxes in Total Tax Revenue.

<table>
<thead>
<tr>
<th>Year</th>
<th>Personal Income Tax (%)</th>
<th>Corporation Tax (%)</th>
<th>Excise Duties (net) (%)</th>
<th>Customs Duties (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>4.6</td>
<td>15.1</td>
<td>55.8</td>
<td>21.4</td>
</tr>
<tr>
<td>1990-91</td>
<td>2.9</td>
<td>12.4</td>
<td>32.8</td>
<td>48.0</td>
</tr>
<tr>
<td>2001-02</td>
<td>16.6</td>
<td>18.8</td>
<td>40.8</td>
<td>21.2</td>
</tr>
<tr>
<td>2008-09</td>
<td>19.3</td>
<td>35.3</td>
<td>18.9</td>
<td>16.7</td>
</tr>
<tr>
<td>2009-10</td>
<td>16.3</td>
<td>40.1</td>
<td>18.1</td>
<td>14.0</td>
</tr>
<tr>
<td>2010-11</td>
<td>16.7</td>
<td>40.0</td>
<td>19.55</td>
<td>15.2</td>
</tr>
<tr>
<td>2011-12</td>
<td>18.0</td>
<td>38.1</td>
<td>19.48</td>
<td>16.1</td>
</tr>
</tbody>
</table>


The relative shares of personal income tax, corporation tax, excise duties and customs duties in total tax revenue in 1970-71 were 4.6%, 15.1%, 55.8% and 21.4% respectively. Considerable changes in the relative contribution of these taxes have taken place over the last forty years. Table 7.4 indicates that corporation tax has emerged as the largest contributor to the tax revenue of the central government. The share of corporation tax had gone up from 15.1% in 1970-71 to 40% in 20010-11 and during the same period, the share of personal income tax had also gone up from 4.6% to 16.7%. The share of excise and custom duties came down from 55.8% and 21.4% in 1970-71 to 19.5 and 15.2% respectively during the same period.
After the adoption of the New Economic Policy in 1991, imports were liberalized and import duties were reduced. As a result, the share of custom duties came down from a high of 48% in 1990-91 to 15.2% in 2010-11. It went up marginally to 16.1% in 2011-2.

10.5 CHANGES IN TAX POLICY SINCE 1991

A tax is a financial charge or other levy imposed on an individual or a legal entity by a state. India has a a three-tier federal tax structure, comprising the Union Government, the State Governments and the Urban/Rural Local Bodies. The power to levy taxes and duties is distributed among the three tiers of Governments, in accordance with the provisions of the Indian Constitution. The main taxes/duties that the Union Government is empowered to levy are Income Tax (except tax on agricultural income, which the State Governments can levy), Customs duties, Central Excise and Sales Tax and Service Tax. The principal taxes levied by the State Governments are Sales Tax (tax on intra-State sale of goods), Stamp Duty (duty on transfer of property), State Excise (duty on manufacture of alcohol), Land Revenue (levy on land used for agricultural/non-agricultural purposes), Duty on Entertainment and Tax on Professions & Callings. The Local Bodies are empowered to levy tax on properties (buildings, etc.), Octroi (tax on entry of goods for use/consumption within areas of the Local Bodies), Tax on Markets and Tax/User Charges for utilities like water supply, drainage, etc.

Since 1991 tax system in India has undergone a radical change, in line with liberal economic policy and WTO commitments of the country. Some of the changes are:

1. Reduction in excise and custom duties. Excise duty on most commodities ranges between 0 to 16%. Only on seven items duty is imposed at 32%, viz., motor cars, tyres, aerated soft drinks, air conditioners, polyesters filament yarn, pan masala and chewing tobacco. Duty is charged at 30% on petrol with additional excise duty at Rs. 7 per litre. The said rates are subject to exemptions and deductions thereon as may be notified from time to time. Central VAT (CENVAT) is applicable to practically all manufactured goods, so as to avoid cascading effect on duty. Peak customs duty reduced from 220% (in 1991) to 30% (in 2002). The general project import duty (for new projects and substantial expansion of existing projects) reduced from 85% to 25%. Import duty under EPCG Scheme is 5%.
Research & Development imports attract 5% of customs duty. Export made with imported inputs get concessions in form of duty drawback, duty entitlement pass book scheme and advance license. Many type of industries such as 100% Export Oriented Units (EOUs) and units in free trade zone get facility of zero import duty. An Authority is made for Advance Ruling for foreign investors.

2. **Lowering Tax Rates.** The Chelliah Committee had recommended that the corporation tax rate should be brought down to 40 per cent. Accordingly, corporate tax was lowered in 1994-95 to 40 per cent. It was further reduced to 35 per cent in 1998-99. For domestic companies, Corporate tax is levied @ 35% plus surcharge of 5%, whereas for a foreign company (including branch/project offices), it is @ 40% plus surcharge of 5%. An Indian registered company, which is a subsidiary of a foreign company, is also considered an Indian company for this purpose. The marginal rate of income tax was lowered to 30 per cent in 1997-98.

3. **Abolition of Estate Duty and Gift Tax.** Estate duty, annual tax on wealth and gift tax are the three taxes which are imposed on wealth. Estate duty was a minor source of income and hence it was abolished in 1985. Gift tax was also abolished in 1998.

4. **Service Tax.** In the Budget for 1994-95, a service tax on three specified services was levied. These services were: telephone, general insurance and stock brokerage. The number of services included in the service tax net has since then grown manifold. The rate of the Central service tax was raised from 5 per cent to 12 per cent in the budget of 2008-09. It was further brought down to 10 per cent in the succeeding budget. The number services taxed in the year 2011-12 were 119 and in the budget for 2012-13, it was decided to tax all services except 17which are put in the negative list of service tax.

### 10.6 TAX PROPOSALS IN THE UNION BUDGET 2012-13

**DIRECT TAXES:**

1. Tax proposals for 2012-13 mark progress in the direction of movement towards DTC and GST.

2. DTC rates proposed to be introduced for personal income tax.

3. Exemption limit for the general category of individual taxpayers proposed to be enhanced from Rs. 1,80,000 to Rs. 2,00,000 giving tax relief of Rs 2,000.
4. Upper limit of 20 per cent tax slab proposed to be raised from Rs. 8 lakh to Rs. 10 lakh.

5. Proposal to allow individual tax payers, a deduction of up to `10,000 for interest from savings bank accounts.

6. Proposal to allow deduction of up to Rs. 5,000 for preventive health check up.

7. Senior citizens not having income from business proposed to be exempted from payment of advance tax.

8. To provide low cost funds to stressed infrastructure sectors, rate of withholding tax on interest payment on ECBs proposed to be reduced from 20 per cent to 5 per cent for 3 years for certain sectors.

9. Restriction on Venture Capital Funds to invest only in 9 specified sectors proposed to be removed.

10. Proposal to continue to allow repatriation of dividends from foreign subsidiaries of Indian companies at a lower tax rate of 15 per cent upto 31.3.2013.

11. Investment link deduction of capital expenditure for certain businesses proposed to be provided at the enhanced rate of 150 per cent.

12. New sectors to be added for the purposes of investment linked deduction.

13. Proposal to extend weighted deduction of 200 per cent for R&D expenditure in an in-house facility for a further period of 5 years beyond March 31, 2012.

14. Proposal to provide weighted deduction of 150 per cent on expenditure incurred for agri-extension services.

15. Proposal to extend the sunset date for setting up power sector undertakings by one year for claiming 100 per cent deduction of profits for 10 years.

16. Turnover limit for compulsory tax audit of account and presumptive taxation of SMEs to be raised from Rs. 60 lakhs to Rs. 1 crore.
18. Exemption from Capital Gains tax on sale of residential property, if sale consideration is used for subscription in equity of a manufacturing SME for purchase of new plant and machinery.

19. Proposal to provide weighted deduction at 150 per cent of expenditure incurred on skill development in manufacturing sector.

20. Reduction in securities transaction tax by 20 per cent on cash delivery transactions.

21. Proposal to extend the levy of Alternate Minimum Tax to all persons, other than companies, claiming profit linked deductions.

22. Proposal to introduce General Anti Avoidance Rule to counter aggressive tax avoidance scheme.

23. Measures proposed to deter the generation and use of unaccounted money.

24. A net revenue loss of `4,500 crore estimated as a result of Direct Tax proposals.

**INDIRECT TAXES :**

**Service Tax**

1. Service tax confronts challenges of its share being below its potential, complexity in tax law, and need to bring it closer to Central Excise Law for eventual transition to GST.

2. Overwhelming response to the new concept of taxing services based on negative list.

3. Proposal to tax all services except those in the negative list comprising of 17 heads.

4. Exemption from service tax is proposed for some sectors.

5. Service tax law to be shorter by nearly 40 per cent.

6. Number of alignment made to harmonize Central Excise and Service Tax. A common simplified registration form and a common return comprising of one page are steps in this direction.
7. Revision Application Authority and Settlement Commission being introduced in Service Tax for dispute resolution.

8. Utilization of input tax credit permitted in number of services to reduce cascading of taxes.

9. Place of Supply Rules for determining the location of service to be put in public domain for stakeholders’ comments.

10. Study team to examine the possibility of common tax code for Central Excise and Service Tax.

11. New scheme announced for simplification of refunds.

12. Rules pertaining to point of taxation are being rationalized.

13. To maintain a healthy fiscal situation proposal to raise service tax rate from 10 per cent to 12 per cent, with corresponding changes in rates for individual services.

14. Proposals from service tax expected to yield additional revenue of `18,660

Other proposals for Indirect Taxes

1. Given the imperative for fiscal correction, standard rate of excise duty to be raised from 10 per cent to 12 per cent, merit rate from 5 per cent to 6 per cent and the lower merit rate from 1 per cent to 2 per cent with few exemptions.

2. Excise duty on large cars also proposed to be enhanced.

3. No change proposed in the peak rate of customs duty of 10 per cent on nonagricultural goods.

4. To stimulate investment relief proposals for specific sectors - especially those under stress.

Agriculture and Related Sectors

1. Basic customs duty reduced for certain agricultural equipment and their parts;
2. Full exemption from basic customs duty for import of equipment for expansion or setting up of fertilizer projects up to March 31, 2015.

Infrastructure

1. Proposal for full exemption from basic customs duty and a confessional CVD of 1 per cent to steam coal till 31st March, 2014.
2. Full exemption from basic duty provided to certain fuels for power generation.

Mining

1. Full exemption from basic customs duty to coal mining project imports.
2. Basic custom duty proposed to be reduced for machinery and instruments needed for surveying and prospecting for minerals.

Railways

Basic custom duty proposed to be reduced for equipments required for installation of train protection and warning system and up-gradation of track structure for high speed trains.

Roads

Full exemption from import duty on certain categories of specified equipment needed for road construction, tunnel boring machines and parts of their assembly.

Civil Aviation

Tax concessions proposed for parts of aircraft and testing equipment for third party maintenance, repair and overhaul of civilian aircraft.

Manufacturing

Relief proposed to be extended to sectors such as steel, textiles, branded readymade garments, low-cost medical devices, labor-intensive sectors producing items of mass consumption and matches produced by semi-mechanized units.
Health and Nutrition

1. Proposal to extend concessional basic customs duty of 5 per cent with full exemption from excise duty/CVD to 6 specified life saving drugs/vaccines.

2. Basic customs duty and excise duty reduced on Soya products to address protein deficiency among women and children.

3. Basic customs duty and excise duty reduced on Iodine.

4. Basic customs duty reduced on probiotics.

Environment

1. Concessions and exemptions proposed for encouraging the consumption of energy-saving devices, plant and equipment needed for solar thermal projects.

2. Concession from basic customs duty and special CVD being extended to certain items imported for manufacture for hybrid or electric vehicle and battery packs for such vehicles.

3. Proposal to increase basic customs duty on imports of gold and other precious metals.

Additional resource mobilization

1. Proposals to increase excise duty on ‘demerit’ goods such as certain cigarettes, hand-rolled bidis, pan masala, gutkha, chewing tobacco, unmanufactured tobacco and zarda scented tobacco.

2. Cess on crude petroleum oil produced in India revised to `4,500 per metric tonne.

3. Basic customs duty proposed to be enhanced for certain categories of completely built units of large cars/MUVs/SUVs.

Rationalization measures

1. Excise duty rationalized for packaged cement, whether manufactured by mini-cement plants or others.

2. Levy of excise duty of 1 per cent on branded precious metal jewellery to be extended to include unbranded jewellery.
Operations simplified and measures taken to minimize impact on small artisans and goldsmiths.

3. Branded Silver jewellery exempted from excise duty.

4. Chassis for building of commercial vehicle bodies to be charged excise duty at an ad valorem rate instead of mixed rate.

5. Import of foreign-going vessels to be exempted from CVD of 5 per cent retrospectively.

6. Duty-free allowances increased for eligible passengers and for children of up to 10 years.

7. Proposals relating to Customs and Central excise to result in net revenue gain of Rs. 27,280 crore.

8. Indirect taxes estimated to result in net revenue gain of Rs. 45,940 crore.

9. Net gain of Rs. 41,440 crore in the Budget due to various taxation proposals.

10.7 QUESTIONS

1. What is budget and explain the component of the Union Budget of India.

2. Explain the changing trends in the revenue receipts of the Central Government in the pre and post reforms period.

3. Explain the changes in the tax policy of the government of India since 1991.

4. Explain the tax proposals made in the Union Budget for 2012-13 of the Government of India.
GOVERNMENT EXPENDITURE, FISCAL DEFICIT & LIABILITIES

Unit Structure:
11.0 Objectives
11.1 Public Expenditure
11.2 Classification and Composition of public expenditure in India
11.3 Trends in the expenditure of the Central Government of India
11.4 Fiscal imbalance in India
11.5 The Fiscal responsibility and budget management bill
11.6 The fiscal responsibility and budget management Act, 2003
11.7 Trends in the liabilities of the Government of India
11.8 Appraisal of union Government’s transfer of Financial Resources to the states
11.10 Major Recommendations of the 13th Finance Commission and the Role of Fiscal Policy
11.11 Questions

11.0 OBJECTIVES

- To know the changes in the composition of expenditure of the Government of India
- To understand the trends in the fiscal deficit of the Central Government in India.
- To know the trends in the liabilities of the Government of India.
- To appraise Union Government’s transfer of financial resources to the States.
- To know the recommendations of the 13th finance commission and the role of fiscal policy.
Public expenditure is the expenditure incurred by the government at various levels. These levels may be the Federal or the Central level, the State level and the Local level. The government receives income from tax and non-tax sources of revenue and spends the revenue received on various heads of expenditure. Today, the main function of the State is to provide public and merit goods. Most of the economic and social infrastructure consisting of roads, bridges, dams, canals, transport and communication, public lighting, public parks, public hospitals, government funded education at all levels are provided by the Government in modern economies. The free market economy fails to produce public goods. Similarly, the free market economy would not produce merit goods in sufficient quantity. Thus there is a problem of under-production of merit goods and over-production of demerit goods. The governments therefore need to either subsidize the production of merit goods or supply them in their entirety. In modern economies, public expenditure is directed to achieve the macro-economic, macro-political and macro-social objectives of the State.

Public expenditure is an instrument of fiscal policy in any modern economy. The size and composition of the public expenditure determines the extent of economic welfare enjoyed by the citizens in any country. The classical economists like Adam Smith, JS Mill and JB Say were minimalist in terms of State activities. Public expenditure as an instrument fiscal policy assumed importance with the emergence of Welfare State Capitalism after the Second Great War. The full impact of public expenditure policies can only be seen in free market economies where the State assumes an interventionist role.

According to JB Say, public spending was usually for useless gratification of the wasteful whims of rulers; also it usually interfered with the process of the private capital formation necessary to the development of trade and industry by draining of funds that otherwise might have been accumulated by thrifty savers (Newman, 1968). Ricardo, too, viewed public spending as wasteful because of its possible effects on private capital formation. Malthus was also of the view that public expenditure could be excessive,
leading to “injudicious taxation” or too large a national debt (Newman, 1968).

John Stuart Mill “the business of life is better performed when those who have an immediate interest in it are left to take their own course, uncontrolled either by the mandate of law or the meddling of any public functioning” (Groves, 1964). Favorable opinion on public expenditure began in 1936 with Lutz who favored public expenditure as it directly adds to the community wealth. He said, “Well run government commercial enterprises, reforestation and reclamation projects, and other forms of state business are the most obvious illustrations. Even the expenditure on ordinary services may result in the accumulation of certain assets, such as public buildings, which are a useful addition to the aggregate of community wealth”.

Keynes (1936) looked at compensatory public spending to fill in the blank between aggregate demand and aggregate supply. Keynes therefore looked at public expenditure as an anti-cyclical tool of fiscal policy. Taylor (1953) said, “Government funds may not only help to fill in the troughs of deficiencies in national income, but under proper circumstances may generate increase in private spending which constitute recovery and prosperity”. R. A. Musgrave advocated public expenditure because it leads to: (i) Redistribution in income, (ii) Re-allocation of scarce resources, (iii) Commercial and stabilizing activities.

The Marxian and Keynesian revolutions contributed to the emergence of the Welfare State in the second half of the 20th century. With the emergence of the Welfare State, mixed economies also came into existence. With extensive and intensive increase in the welfare functions of the State, growth and developmental functions were also added to the list of functions performed by the State. The interventionist role of the State expanded to include maintain price stability and encourage economic growth, reduce inequalities of income and eradicate poverty and most importantly ensure human development in terms of improved life expectancy, literacy and education and reduced mortality rates. Public expenditure as a ratio of national income has been increasing in a sustained manner in all economies. In India, public expenditure as a percentage of GDP has increased from 9.1% in 1950-51 to 13.8 $ in 2011-12 (IES 2011-12, Table 3.8, p-65).
In the developed countries, the role of public expenditure is to prevent cyclical fluctuations, prevent stagnation and improving income distribution. Public expenditure can also be used to lift the level of aggregate demand so that the level of income and employment goes up. In developing countries, public expenditure is directed to promoting economic development, redistribute income, and achieve balanced regional development.

11.2 CLASSIFICATION AND COMPOSITION OF PUBLIC EXPENDITURE IN INDIA

In India, public expenditure is classified into revenue and capital expenditure. Classification of Public Expenditure helps to understand the relationship between the government and the rest of the economy and the amount of money spent on different government programs. Under the Constitution of India, revenue and capital expenditures are to be shown separately in the budget.

The central government expenditure consists of revenue and capital expenditure. Revenue expenditure is expenditure incurred for purposes other than creation of assets of the central government. Any expenditure made by the Government leading to reduction in recurring financial liabilities fall under the category of capital expenditure. Such expenditures pertain to payments on acquisition of assets and loans and advances given. The Central Government adopted a new classification of public expenditure from the budget of 1987-88. Accordingly, public expenditure is classified into Plan Expenditure and Non-plan expenditure.

Plan expenditure is composed of Central plans on agriculture, rural development, irrigation and flood control, energy, industry and minerals, transport, communications, science and technology and environment, social services etc. It includes Central assistance for plans of the States and Union Territories. Non-Plan expenditure is a generic term, which is used to cover all expenditure of Government not included in the Plan. It may either be revenue expenditure or capital expenditure. Part of the expenditure is obligatory in nature e.g. interest payments, pension charges and statutory transfers to State and Union Territory Governments. A part of the expenditure relates to essential functions of the State, e.g. defense, internal security, external affairs and revenue collection.
Both plan and non-plan expenditures are incurred by the Central government on revenue and capital account. Revenue expenditure is financed from revenue receipts. Revenue expenditure consists of the following:

a) Interest payments, defense revenue expenditure, major subsidies (food, fertilizers and export promotion) other subsidies, debt relief to farmers, postal deficit, police, pension, other general services (organs of State, tax collection, external affairs etc),
b) Social services (education, health, broadcasting etc),
c) Economic services (agriculture, industry, power, transport, communications, science and technology etc) and,
d) Grants to States and Union territories and grants to foreign countries.

Non-plan capital expenditure includes defense capital expenditure, loans to public enterprises, loans to States and Union territories and loans to foreign governments. Capital expenditure of the Central Government consists of plan and non-plan expenditure and is financed from capital receipts. It consists of the following:

a) Loans to States & UTs for financing Plan projects and loans to foreign governments.
b) Capital expenditure one economic development.
c) Capital expenditure on social and community development.
d) Capital expenditure on defense and
e) Capital expenditure on general services.

11.3 TRENDS IN THE EXPENDITURE OF THE CENTRAL GOVERNMENT OF INDIA

The trend in the receipts and expenditures of the Central Government of India is given in Table 11.1

Revenue Expenditure:

Beginning with revenue expenditure, it may be noted that the revenue expenditure in 1990-91 was Rs. 73,516 Crore and since then it has gone up to Rs.10,97,162 crore in the year 2011-12. Revenue expenditure as a per cent of GDP has increased marginally over the last two decades from 12.9 % in 1990-91 to 14.1 % in 2008-09 and 2009-10. However, in 2010-11, it was down to 13.5 % and in 2011-12 the budget estimate is only 12.3 per cent which is below the figure for the year 1990-91. Thus there has
been an absolute increase in revenue expenditure but it as a percentage of GDP, it has more or less remained constant. Interest payment as a percentage of GDP also has declined over the period from 3.8 to 3.0 per cent. Revenue expenditure on major subsidies has gone up from 1.7 to 2.2 per cent between 1990-91 and 2008-09. However, since then it has declined to 1.5 per cent of GDP in 2011-12. Similarly, defense expenditure has also declined in percentage terms from 1.9 per cent to 1.1 per cent during the period 1990-91 to 2011-12. It may therefore be concluded that revenue expenditure had marginally declined along with decline in the expenditures on the components of revenue expenditure over the last two decades.

**Capital Expenditure:**

Capital expenditure as a percentage of GDP had declined from 4.4 percent to 1.8 per cent during the period. According to the golden rule of public finance, all borrowings by the government must be used for public investment. Unfortunately, in India's case, a great part of the capital receipts have been used to finance revenue or current expenditure. The burden of fiscal correction has fallen on capital account whereas it should have fallen on the revenue account. The budget deficit in the year 1990-91 was Rs.11,347 crore. From 1997-98 onwards, the government began to show nil budget deficit. This was done by cleaning up the revenue deficit entirely with a matching surplus on the capital account. The difference between capital receipts and capital expenditure (4-5) has been equal to the revenue deficit from 1997-98 onwards. The government has discontinued showing budgetary deficit in their income and expenditure accounts and hence budgetary deficit does not appear in the aforesaid table. Capital expenditure by the Central Government has therefore been sacrificed at the altar of fiscal profligacy.

Plan Expenditure by the Central government has marginally declined and has been restored to five per cent of the GDP in 2011-12. Non-plan expenditure has however declined from 12.3 per cent to 9.2 per cent during the period.
Table 11.1

Receipts and Expenditures of the Central Government of India.

(in Rs. Crore)

<table>
<thead>
<tr>
<th></th>
<th>1990-91</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11 (P)</th>
<th>2011-12 (B.E)</th>
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</thead>
<tbody>
<tr>
<td>1. Revenue Receipts of which:</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c) Tax revenue (Net of States share)</td>
<td>54,954</td>
<td>54,0259</td>
<td>5,72,811</td>
<td>7,94,277</td>
<td>7,89,892</td>
</tr>
<tr>
<td>b) Non-tax revenue</td>
<td>42,978</td>
<td>443319</td>
<td>456536</td>
<td>572790</td>
<td>664457</td>
</tr>
<tr>
<td>2. Revenue expenditure Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>g) Interest Payments.</td>
<td>10,874</td>
<td>96,940</td>
<td>1,16,275</td>
<td>2,21,487</td>
<td>1,25,435</td>
</tr>
<tr>
<td>h) Major subsidies.</td>
<td>21,498</td>
<td>1,92,204</td>
<td>2,13,093</td>
<td>2,34,738</td>
<td>2,67,986</td>
</tr>
<tr>
<td>i) Defense Expenditure.</td>
<td>9,581</td>
<td>1,23,581</td>
<td>1,35,508</td>
<td>1,31,212</td>
<td>1,34,411</td>
</tr>
<tr>
<td>j) Other receipts</td>
<td>18,562</td>
<td>2,53,539</td>
<td>3,38,998</td>
<td>2,44,853</td>
<td>3,07,270</td>
</tr>
<tr>
<td>3. Revenue Deficit (2 – 1)</td>
<td></td>
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<td></td>
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<tr>
<td></td>
<td>31,971</td>
<td>3,43,697</td>
<td>4,51,676</td>
<td>4,06,642</td>
<td>4,67,837</td>
</tr>
<tr>
<td></td>
<td>5,712</td>
<td>6,139</td>
<td>8,613</td>
<td>12,752</td>
<td>15,020</td>
</tr>
<tr>
<td>g) Recovery of loans.</td>
<td>5,712</td>
<td>6,139</td>
<td>8,613</td>
<td>12,752</td>
<td>15,020</td>
</tr>
<tr>
<td>h) Other receipts (mainly from PSU disinvestments)</td>
<td>0</td>
<td>566</td>
<td>24,581</td>
<td>22,847</td>
<td>40,000</td>
</tr>
<tr>
<td>i) Borrowings and other liabilities.</td>
<td>26,259</td>
<td>3,36,992</td>
<td>4,18,482</td>
<td>3,69,043</td>
<td>4,12,817</td>
</tr>
<tr>
<td>4. Capital Receipts(a + b + c)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>g) Recovery of loans.</td>
<td>24,756</td>
<td>90,158</td>
<td>1,12,678</td>
<td>1,59,789</td>
<td>1,60,567</td>
</tr>
<tr>
<td>h) Other receipts (mainly from PSU disinvestments)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i) Borrowings and other liabilities.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Total expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>e) Plan expenditure.</td>
<td>98,272</td>
<td>8,83,956</td>
<td>10,24,487</td>
<td>11,98,919</td>
<td>12,65,729</td>
</tr>
<tr>
<td>f) Non-plan Expendt.</td>
<td>28,365</td>
<td>2,75,235</td>
<td>3,03,391</td>
<td>3,77,350</td>
<td>4,41,547</td>
</tr>
<tr>
<td></td>
<td>69,907</td>
<td>6,08,721</td>
<td>7,21,096</td>
<td>8,21,569</td>
<td>8,16,182</td>
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<tr>
<td>6. Fiscal Deficit [6 – 1 – 4 (a) – 4(b)]</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>37,606</td>
<td>3,36,992</td>
<td>4,18,482</td>
<td>3,69,043</td>
<td>4,12,817</td>
</tr>
<tr>
<td>7. Primary deficit [7 – 2(a)]</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>16,108</td>
<td>1,44,788</td>
<td>2,05,389</td>
<td>1,34,305</td>
<td>1,44,831</td>
</tr>
</tbody>
</table>
Table 11.1 (Contd…)

Receipts and Expenditures of the Central Government of India.

(As per cent of GDP)

<table>
<thead>
<tr>
<th></th>
<th>1990-91</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11 (P)</th>
<th>2011-12 (BE)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Revenue Receipts of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d) Tax revenue (Net of States share)</td>
<td>7.6</td>
<td>7.9</td>
<td>7.1</td>
<td>7.5</td>
<td>7.5</td>
</tr>
<tr>
<td>b) Non-tax revenue</td>
<td>2.1</td>
<td>1.7</td>
<td>1.8</td>
<td>2.9</td>
<td>1.4</td>
</tr>
<tr>
<td>2. Revenue expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>j) Interest Payments.</td>
<td>3.8</td>
<td>3.4</td>
<td>3.3</td>
<td>3.1</td>
<td>3.0</td>
</tr>
<tr>
<td>k) Major subsidies.</td>
<td>1.7</td>
<td>2.2</td>
<td>2.1</td>
<td>1.7</td>
<td>1.5</td>
</tr>
<tr>
<td>l) Defense Expendt.</td>
<td>1.9</td>
<td>1.3</td>
<td>1.4</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>3. Revenue Deficit (2 – 1)</td>
<td>3.3</td>
<td>4.5</td>
<td>5.2</td>
<td>3.2</td>
<td>3.4</td>
</tr>
<tr>
<td>4. Capital Receipts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a + b + c)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>j) Recovery of loans.</td>
<td>5.6</td>
<td>6.1</td>
<td>7.0</td>
<td>5.3</td>
<td>5.2</td>
</tr>
<tr>
<td>k) Other receipts (mainly from PSU disinvestments)</td>
<td>1.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>l) Borrowings and other liabilities.</td>
<td>0.0</td>
<td>0.0</td>
<td>0.4</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>5. Capital expenditure</td>
<td>4.4</td>
<td>1.6</td>
<td>1.7</td>
<td>2.1</td>
<td>1.8</td>
</tr>
<tr>
<td>6. Total expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>[2 + 5 = 6(a) + 6 (b)]</td>
<td>17.3</td>
<td>15.7</td>
<td>15.9</td>
<td>15.6</td>
<td>14.1</td>
</tr>
<tr>
<td>g) Plan expenditure.</td>
<td>5.0</td>
<td>4.9</td>
<td>4.7</td>
<td>4.9</td>
<td>5.0</td>
</tr>
<tr>
<td>h) Non-plan Expendt.</td>
<td>12.3</td>
<td>10.8</td>
<td>11.2</td>
<td>10.7</td>
<td>9.2</td>
</tr>
<tr>
<td>7. Fiscal Deficit [6–1 – 4(a) – 4(b)]</td>
<td>6.6</td>
<td>6.0</td>
<td>6.5</td>
<td>4.8</td>
<td>4.6</td>
</tr>
<tr>
<td>8. Primary deficit (7 – 2a)</td>
<td>2.8</td>
<td>2.6</td>
<td>3.2</td>
<td>1.8</td>
<td>1.6</td>
</tr>
<tr>
<td>Memorandum Items</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b) Interest receipts.</td>
<td>8,730</td>
<td>20,717</td>
<td>21,756</td>
<td>22,064</td>
<td>19,578</td>
</tr>
<tr>
<td>c) Non-plan revenue expenditure</td>
<td>60,896</td>
<td>5,59,024</td>
<td>6,57,925</td>
<td>7,26,767</td>
<td>7,33,558</td>
</tr>
</tbody>
</table>

Source: Compiled and computed from Indian Economic Survey 2011-12.
11.4 FISCAL IMBALANCE IN INDIA

The non-developmental expenditure of the Government of India has continuously increased. The fiscal situation became serious in the year 1991-92. This is evident from the indicators of fiscal imbalance. These indicators are the revenue deficit, the gross fiscal deficit and the primary deficit. The trend in these indicators of fiscal imbalance of the Central government for various years is given in Table 11.2. It is seen that between 1980-81 and 1990-91, the revenue deficit of the Central government had risen tremendously. It rose from 1.5 per cent of GDP in 1980-81 to 3.3 per cent in 1990-91. The gross fiscal deficit also grew from 5.7 per cent of GDP to 6.6 per cent during this period. However, in the intervening years, the gross fiscal deficit was much higher than at the end of the period. For instance, in 1985-86, the fiscal deficit was 8.3 per cent of GDP. The primary deficit was 3.8 per cent in 1980-81 and it went up to 5.5 per cent in 1985-86. The ratio of revenue deficit to fiscal deficit was 26.3 per cent in 1980-81. It progressively went up and reached an all time high of 80 per cent in 2003-04. The fiscal situation was not sustainable and therefore demanded immediate corrections. Interest payments amounted to 28 per cent of the revenue expenditure. In the year 1990-91, this figure went up to 36.6 per cent. The fiscal crisis faced by the Central government has been due to growing non-developmental expenditure. Non-plan expenditure on defense, interest payments and subsidies rose rapidly during the 1980s. The interim budget presented to Parliament in March 1991 aimed at a substantial reduction in the fiscal deficit but it did not contain major policy changes which could have reduced the fiscal deficit.

Fiscal Corrections.

The regular budget for 1991-92 was presented to Parliament on July 24, 1991 which took major steps to correct the fiscal imbalance. The fiscal deficit was sought to be reduced from 6.6 per cent of GDP in 1990-91 to 5 per cent in 1991-92. This required a fiscal correction of about Rs.12, 000 crore. Additional revenues were sought to be raised and a five per cent cut on the expenditure provisions contained in the sanctioned Budget estimates for 1991-92 of all ministries/departments. The government was successful in achieving its targeted reduction and the actual fiscal deficit was 4.7 per cent of GDP in 1991-92. The government was encouraged by this achievement and further decided to reduce the fiscal deficit.
to 4 per cent in 1992-93. However, the actual fiscal deficit for the year 1992-93 was 4.8 per cent. But the government was determined to reduce the fiscal deficit and aimed to reduce fiscal deficit to 3.7 per cent in 1993-94. Inflationary pressures were sought to be controlled by reducing the fiscal deficit. However, the government was not successful and the fiscal deficit turned out of control to be 6.4 per cent of GDP. The fiscal situation improved in 1995-96 and 1996-97 as the fiscal deficit declined to 5 per cent in these years. But once again, the fiscal situation worsened and the fiscal deficit went up to 6.2 per cent in the year 2001-02. In the year 2005-06, the fiscal deficit was 4.1 per cent and budget estimates for the year 2006-07 is only 3.6 per cent of GDP.

Interest payments continue to be high and there seems to be no relief from high level of interest payments. Interest payments rose from 3.8 per cent of GDP in 1990-91 to 4.5 per cent in 1993-94. Interest payments declined to 4.3 per cent in 1997-98 but rose again to 4.8 per cent in 2002-03. In 2005-06, the percentage was 3.7 per cent of GDP and budget estimate for the 2006-07 3.3 per cent. According to Raja Chelliah, fiscal advisor to the government of India, the net interest payments by the government can be reduced by bringing down the gross interest payments or by increasing the income from the government’s investments. While it is not possible to increase the income from investments, the government should find ways to reduce the gross interest payments. Gross interest payments can only reduced by implementing a program of retiring public debt.

According to Raja Chelliah, the fiscal deficit can only be reduced by reducing the non-interest expenditure considerably. The money spent on subsidies, capital assistance to non-viable public enterprises, defense expenditure and government’s consumption expenditure must be reduced. Accordingly the expenditure on subsidies and defense has come down considerably. From 1.9 and 1.7 per cents of GDP, the expenditure on subsidies and defense came down to 1.1 and 1.3 per cent of GDP respectively during the period 1990-91 to 2006-07. The government eliminated export subsidy by 1992 but was finding difficult to reduce food and fertilizer subsidies. The government hopes to reduce food subsidy by targeting the PDS to the weaker sections of the society. The government has reduced budgetary support to the plan investment by public enterprises. Non-viable
public enterprises must be disinvested and the proceeds should be used to retire public debt. Similarly, the consumption expenditure of the Government should be reduced by modernizing the way in which government administration is carried. The government should be become an employment generating agency and hence the existing surplus staff should be reduced by offering attractive retrenchment compensation. Similarly, the government should make honest attempts to establish good neighborly relations so that defense expenditure can be reduced.

11.5 THE FISCAL RESPONSIBILITY AND BUDGET MANAGEMENT BILL

The Committee on Fiscal Responsibility and Budget Management was set up by the Government of India on 17th January, 2000 to recommend draft legislation on Fiscal Responsibility to the Government. In the same year, the Government introduced the Fiscal Responsibility and Budget Management (FRBM) Bill in Lok Sabha in December 2000. In the Budget of 2000-01, the Central Government announced that it would create a strong institutional mechanism in the form of Fiscal Responsibility Act to establish fiscal discipline at the Central government level. The FRBM Bill aimed at the following to establish fiscal discipline:

1. Revenue Deficit. Revenue deficit will be reduced by 0.5 percent or more of the GDP every year beginning from 01st April, 2001. The revenue deficit will be neutralized within a period of five years i.e. by 31st March, 2006. Thereafter, the Central government will generate surplus revenue to reduce liabilities in excess of assets.

2. Fiscal Deficit. The Gross Fiscal Deficit will be reduced by 0.5 or more of the GDP every year beginning from 01st April, 2001 and within a period of five years i.e., by 31st March, 2006, the fiscal deficit will be reduced to less than 2 per cent of the GDP.

3. Public Debt. Within a period of 10 years beginning from 01st April, 2001 and ending with 31st March, 2011, the total liabilities of the Central government will not exceed 50 per cent of the GDP.

4. Borrowing from the RBI. The Central government will not normally borrow from the RBI. However, it may borrow by way
of advances to meet temporary deficits in accordance with the agreement which may be entered into by the government with the RBI.

11.6 THE FISCAL RESPONSIBILITY AND BUDGET MANAGEMENT ACT, 2003

The FRBM Act, 2003 came into effect on 05th July, 2003. Accordingly, the Central Government is required to eliminate revenue deficit by March 2009 and to reduce fiscal deficit to 3 per cent of the GDP by March 2008. The FRBM rules were to be framed under the Act to determine annual target for fiscal correction. The Government notified the rules under the FRBM Act on 02nd July, 2004 which came into force on 05th July, 2004.

The following FRBM rules were notified by the Central government. These rules were made effective from 05th July, 2004.

1. Reduction of revenue deficit by 0.5 per cent or more of the GDP every year beginning from 2004-05.

2. Reduction of fiscal deficit by 0.3 per cent or more of the GDP every year beginning from 2004-05.

3. The Central government liabilities will not exceed 9 per cent of the GDP from the financial year 2004-05 and this will be progressively reduced by one percentage point every year.

4. No guarantees in excess of 0.5 per cent of GDP in any financial year beginning from 2004-05.

5. Four fiscal indicators to be projected in the medium term fiscal policy statement.

6. In order to ensure greater transparency in the budgetary process, the Central government is required to disclose changes, if any, in accounting standards, policies and practices that have a bearing on the fiscal indicators. The government is also required to submit statements of receivables and guarantees and a Statement of Assets at the time of presenting the annual financial statement latest by Budget 2006-07.

7. The rules prescribe the form for the quarterly review of the trends of receipts and expenditures. The rules mandate the Central government to take appropriate corrective actions in
case of revenue and fiscal deficit exceeding 45 per cent of the
Budget estimates or total non-debt receipts falling short of 40
per cent of the budget estimates at end of first half of the
financial year.

The Central government appointed a Task Force under the
chairmanship of Mr. Vijay Kelkar. According to the
recommendations of the Task Force, the tax-GDP ratio of the
Central government was to be raised from 9.2 per cent in 2003-04
to 13.2 per cent of GDP in 2008-09. The total expenditure of the
Central government is expected to decline from 15.4 per cent in
2003-04 to 14.3 per cent of GDP by 2008-09. A revenue surplus of
0.2 per cent of GDP is estimated to emerge in 2008-09 and the
fiscal deficit is estimated to fall from 4.8 per cent of GDP to 2.8 per
cent of GDP during this period.

The FRBM Act is a commitment by the Central Government
to ensure fiscal discipline. The government was able to achieve the
FRBM targets intermittently. However, in the wake of the global
financial crisis of 2008-09, the government was not able to keep the
deficits both revenue and fiscal under the FRBM limits. The impact
of the Act on fiscal discipline can be seen in the initial period
followed by slippages in the subsequent period (See Table 3.2).
Both the revenue and fiscal deficit figures have been brought down
to 2.1 per cent and 3.8 per cent of the GDP in the year 2006-07
from 2.5 and 4 per cent respectively in the year 2004-05. This
shows a marked improvement in fiscal consolidation as compared
to the pre-FRBM period. However, the revenue and fiscal deficit
began to climb once again from the year 2008-09. The revenue
deficit was up to a high of 5.2 per cent in 2009-10 and thereafter
down to 3.4 % in 2011-12. The aim of eliminating revenue deficit
by 2009 remains stranded. The fiscal deficit figure came to a low of
2.6 % in 2007-08 but thereafter climbed to an all time high of 6.5 %
in 2009-10 in the wake of the global financial crisis of 2008-09. The
fiscal deficit for the year 2011-12 is 4.6 per cent. The government
has failed to achieve a sustainable fiscal deficit of 3 per cent as
required under FRBM
### Table 11.2: Trends in Deficits of Central Government.

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue Deficit (As per cent of GDP)</th>
<th>Primary Deficit</th>
<th>Fiscal Deficit</th>
<th>Revenue Deficit As per cent of Fiscal Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>3.3</td>
<td>2.8</td>
<td>6.6</td>
<td>49.4</td>
</tr>
<tr>
<td>1991-92</td>
<td>2.5</td>
<td>0.7</td>
<td>4.7</td>
<td>52.7</td>
</tr>
<tr>
<td>1992-93</td>
<td>2.5</td>
<td>0.6</td>
<td>4.8</td>
<td>51.7</td>
</tr>
<tr>
<td>1993-94</td>
<td>3.8</td>
<td>2.2</td>
<td>6.4</td>
<td>59.2</td>
</tr>
<tr>
<td>1994-95</td>
<td>3.1</td>
<td>0.4</td>
<td>4.7</td>
<td>64.6</td>
</tr>
<tr>
<td>1995-96</td>
<td>2.5</td>
<td>0.0</td>
<td>4.2</td>
<td>59.2</td>
</tr>
<tr>
<td>1996-97</td>
<td>2.4</td>
<td>-0.2</td>
<td>4.1</td>
<td>58.2</td>
</tr>
<tr>
<td>1997-98</td>
<td>3.1</td>
<td>0.5</td>
<td>4.8</td>
<td>63.5</td>
</tr>
<tr>
<td>1998-99</td>
<td>3.8</td>
<td>0.7</td>
<td>5.1</td>
<td>74.8</td>
</tr>
<tr>
<td>1999-2000</td>
<td>3.5</td>
<td>0.7</td>
<td>5.4</td>
<td>64.6</td>
</tr>
<tr>
<td>2000-01</td>
<td>4.1</td>
<td>0.9</td>
<td>5.7</td>
<td>71.7</td>
</tr>
<tr>
<td>2001-02</td>
<td>4.4</td>
<td>1.5</td>
<td>6.2</td>
<td>71.1</td>
</tr>
<tr>
<td>2002-03</td>
<td>4.4</td>
<td>1.1</td>
<td>5.9</td>
<td>74.4</td>
</tr>
</tbody>
</table>

**Enactment of FRBM Act**

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue Deficit</th>
<th>Primary Deficit</th>
<th>Fiscal Deficit</th>
<th>Revenue Deficit As per cent of Fiscal Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>3.6</td>
<td>0.0</td>
<td>4.5</td>
<td>79.7</td>
</tr>
<tr>
<td>2004-05</td>
<td>2.5</td>
<td>-0.1</td>
<td>4.0</td>
<td>62.6</td>
</tr>
<tr>
<td>2005-06</td>
<td>2.7</td>
<td>0.4</td>
<td>4.1</td>
<td>64.7</td>
</tr>
<tr>
<td>2006-07</td>
<td>1.9</td>
<td>-0.2</td>
<td>3.3</td>
<td>57.6</td>
</tr>
<tr>
<td>2007-08</td>
<td>1.1</td>
<td>-0.9</td>
<td>2.6</td>
<td>42.3</td>
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<tr>
<td>2008-09</td>
<td>4.5</td>
<td>2.6</td>
<td>6.0</td>
<td>12.8</td>
</tr>
<tr>
<td>2009-10</td>
<td>5.2</td>
<td>3.2</td>
<td>6.5</td>
<td>66.6</td>
</tr>
<tr>
<td>2010-11</td>
<td>3.2</td>
<td>1.8</td>
<td>4.8</td>
<td>66.6</td>
</tr>
</tbody>
</table>

The fiscal consolidation effort of the Central and State governments are criticized on the following grounds:

1. Creating capital surpluses year after year by compromising on development expenditure on social and economic infrastructure would reduce equity and economic growth.

2. The FRBM Act is based on the following assumptions which are essentially wrong:
   
i. Lower fiscal deficits lead to higher and more sustained growth.
   
ii. Larger fiscal deficits lead to higher inflation.
   
iii. Larger fiscal deficits increase external vulnerability of the economy.

CP Chandrashekhar and Jayati Ghosh reject these assumptions. Firstly, if the fiscal deficits are used to finance productive capital expenditure, it will not only lead to higher economic growth but also stimulate private investment. Secondly, inflation is caused by an excess of aggregate demand over supply and such excess may originate from both the public and private sectors. Hence fiscal deficit alone cannot be blamed for inflation. In India, the inflation rate had fallen in the late 1990s in spite of a fiscal deficit of more than 5 per cent of the GDP. Thirdly, external vulnerability depends more on capital and trade account convertibility and the perception of international finance. Therefore capital flight may take place even when the fiscal deficit is low. Huge foreign exchange reserves have been accumulated in spite of large fiscal deficits.

11.7 TRENDS IN THE LIABILITIES OF THE GOVERNMENT OF INDIA

The trend in the outstanding liabilities of Government of India (Central Government) for the period 2006-07 to 2011-12 is presented in Table 11.3. The public debt of the Government of India is composed of internal and external debt. Internal debt consists of market borrowings, compensation bonds, prize bonds
and 15 year annuity certificates. It also includes borrowing of temporary nature such as treasury bills issued to the RBI, commercial banks etc and non-negotiable non-interest bearing securities issued to international financial institutions like the IMF, World Bank and Asian Development Bank. External debt consists of borrowings by the Central Government from external sources and is based on historical as well as year-end rates of exchange. In the early years of independence, the Government of India borrowed mainly for developmental purposes. In contrast, since 1997, the Government has been borrowing even to meet its revenue expenditure i.e. the Government has been making good revenue deficits by surpluses on the capital account and thereby showing zero budget deficit. In fact, the Union Budget of India has discontinued showing budgetary deficit. External debt has increased over the years to more than three per cent of the GDP. In addition to the internal and external liabilities, the Government of India has other liabilities consisting of funds raised through small saving schemes, provident fund, deposits under the compulsory deposit scheme, income tax annuity deposit scheme, reserve funds of the railways and posts and telegraphs etc. Between 2006-07 and 2011-12, the total liabilities of Government of India have increased from Rs. 25, 38, 296 to Rs. 43, 52, 389 crores. As per cent of GDP, the total liabilities have however declined from 59.1 to 48.8 per cent.

Internal liabilities have been increasing over the years and interest burden has also increased. For instance, interest payment in the year 2011-12 was of the order of Rs.267986 crore and in the year 2006-07 it was Rs.150272 crore. However, as a per cent of GDP interest payments have come down from 3.5 to three per cent during this period.

<table>
<thead>
<tr>
<th>Table 11.3 – Outstanding Liabilities of the Central Government (in Rs. Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Internal liabilities#</td>
</tr>
<tr>
<td>a) Internal Debt</td>
</tr>
<tr>
<td>i) Market Borrowings</td>
</tr>
<tr>
<td>ii) Others</td>
</tr>
<tr>
<td>b) Other internal liabilities</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td>2.</td>
</tr>
<tr>
<td>3.</td>
</tr>
<tr>
<td>4.</td>
</tr>
</tbody>
</table>

(As per cent of GDP)

<table>
<thead>
<tr>
<th></th>
<th>Internal liabilities#</th>
<th>56.7</th>
<th>54.6</th>
<th>53.9</th>
<th>52.4</th>
<th>49.2</th>
<th>46.9</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>a) Internal Debt</td>
<td>36.0</td>
<td>36.3</td>
<td>36.0</td>
<td>36.4</td>
<td>35.2</td>
<td>34.9</td>
</tr>
<tr>
<td></td>
<td>i) Market Borrowings</td>
<td>22.7</td>
<td>21.9</td>
<td>23.6</td>
<td>27.0</td>
<td>27.1</td>
<td>27.2</td>
</tr>
<tr>
<td></td>
<td>ii) Others</td>
<td>13.3</td>
<td>14.4</td>
<td>12.5</td>
<td>9.3</td>
<td>8.1</td>
<td>7.7</td>
</tr>
<tr>
<td></td>
<td>b) Other internal liabilities</td>
<td>20.7</td>
<td>18.4</td>
<td>17.9</td>
<td>16.0</td>
<td>14.0</td>
<td>12.0</td>
</tr>
<tr>
<td>2.</td>
<td>External Debt (Outstanding)*</td>
<td>2.4</td>
<td>2.2</td>
<td>2.2</td>
<td>2.1</td>
<td>2.0</td>
<td>1.9</td>
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<tr>
<td>3.</td>
<td>Total outstanding liabilities (1+2)</td>
<td>59.1</td>
<td>56.9</td>
<td>56.1</td>
<td>54.5</td>
<td>51.2</td>
<td>48.8</td>
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</tbody>
</table>

Memorandum Items (in Rs. Crore & as % of GDP)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>201204</th>
<th>210083</th>
<th>264076</th>
<th>249311</th>
<th>278885</th>
<th>304146</th>
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</thead>
<tbody>
<tr>
<td>a)</td>
<td>External debt @</td>
<td>4.7</td>
<td>4.2</td>
<td>4.7</td>
<td>3.9</td>
<td>3.6</td>
<td>3.4</td>
</tr>
<tr>
<td>b)</td>
<td>Total outstanding liabilities</td>
<td>2637084</td>
<td>2935477</td>
<td>3300208</td>
<td>3633072</td>
<td>4053643</td>
<td>4485988</td>
</tr>
<tr>
<td>61.4</td>
<td>58.9</td>
<td>58.6</td>
<td>56.3</td>
<td>52.8</td>
<td>50.3</td>
<td>52.8</td>
<td></td>
</tr>
<tr>
<td>c)</td>
<td>Internal liabilities (non-RBI)##</td>
<td>2217671</td>
<td>2471396</td>
<td>2687037</td>
<td>3054435</td>
<td>3435432</td>
<td>3827516</td>
</tr>
<tr>
<td>51.6</td>
<td>49.6</td>
<td>47.7</td>
<td>47.3</td>
<td>44.8</td>
<td>42.9</td>
<td>44.8</td>
<td></td>
</tr>
<tr>
<td>d)</td>
<td>Outstanding liabilities (non-RBI)##</td>
<td>2418875</td>
<td>2681479</td>
<td>2951113</td>
<td>3303746</td>
<td>3714317</td>
<td>4131662</td>
</tr>
<tr>
<td>56.3</td>
<td>53.8</td>
<td>52.4</td>
<td>51.2</td>
<td>48.4</td>
<td>46.4</td>
<td>48.4</td>
<td></td>
</tr>
<tr>
<td>e)</td>
<td>Contingent liabilities of Central Government</td>
<td>109826</td>
<td>104872</td>
<td>113335</td>
<td>137205</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>2.6</td>
<td>2.1</td>
<td>2.0</td>
<td>2.1</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
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<td>1569043</td>
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<td>22.2</td>
<td>22.2</td>
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11.8 APPRAISAL OF UNION GOVERNMENT’S TRANSFER OF FINANCIAL RESOURCES TO THE STATES

In the context of Federal Finance in India, the following issues needs to be considered:

1. **State Autonomy.** The Indian Constitution is federal in character and unitary in spirit. The Constitution of India therefore ascribes greater strength to the Central Government than to the State governments. The political history of free India also contributed to the strengthening of the Center vis-à-vis the States. The Constitution of India has vested all residuary powers in the Center and kept forty seven items in the concurrent list. This has made the Central Government all powerful and States being dependent on the largesse provided by the Center. On account of one party rule at the Center for the greater part of the political history of India in the post-independence period have made the States dependent on the Center. Many State governments in India have asked for financial autonomy. The demand for financial autonomy of the States needs to be looked at for bringing about balanced regional development in India.

2. **Mis-match Between Requirements and Resources of State Governments.** The Constitution of India makes provision for division of financial powers between the Center and the States. However, the capacity to raise revenue depends upon the nature of revenue sources assigned to the States. Land
revenue is a limited source in any country and India is therefore not an exception. Agricultural income is tax free. Excise duties on liquor, motor vehicles, entertainment etc are relatively less elastic than the taxes assigned to the Center. The tax base of Central taxes has widened considerably over the last six decades and hence the revenue receipts of the Central Government have increased manifold. The demand on the States’ resources is increasing rapidly on account of the increasing focus on development. However, the revenue receipts of the States have not increased in tandem with the increased expenditure requirements on development. As a result, vertical imbalances have increased and the dependence of the State Governments on the Center has also increased.

3. Primacy of the Planning Commission over the Finance Commission. Transfers through the finance commission contribute only about one third of total transfers from the Center to the States i.e. about two-thirds of the transfers are made through the Planning Commission or the Central Government. The Center provides a large amount of resources in the form of discretionary grants to the States. As a result, the Central Government is able to influence the decision making process of the State Governments. Hence, there is not only less financial autonomy but also less political autonomy for the State governments.

4. The Problem of Regional Imbalance. The process of resource transfers through the Planning Commission and the Finance Commission has failed in correcting the horizontal imbalance among the State Governments and inequalities in their per capita incomes. Seventy percent of the Plan assistance is provided in the form of loans and the balance 30 percent is given in the form of grants. The ratio is fixed and does not discriminate between forward and backward States. As a result, regional imbalance has only worsened with the passage of time.

11.9 THE 13TH FINANCE COMMISSION (2010-2015)

The Finance Commission of India was set up in 1951. It was established under Article 280 of the Indian Constitution by the President of India. The Commission was formed to define the financial relations between the Centre and the States. According to the Constitution, the commission is appointed every five years and consists of a chairman and four other members. Over the last six decades and more, the Indian economy has undergone massive
The economy has moved away from the socialistic pattern set up by Prime Minister Nehru to a free market open economy under Prime Minister Narasimha Rao and his successors. This has led to major changes in the Finance Commission’s recommendations over the years. Thus far, Thirteen Finance Commissions have submitted their reports.

The Indian State, like all other federations, is also ridden by the problems of Vertical and Horizontal Imbalances. Vertical Imbalances result because States are assigned responsibilities and in the process of fulfilling those, they incur expenditures disproportionate to their sources of revenue. This is because the States are able to assess the needs and concerns of their people more effectively, and hence, are more efficient in addressing them. Factors like historical backgrounds, differences in resource endowments etc. lead to widening Horizontal Imbalances. The Constitution of India, in recognition of these two problems, has made several provisions to bridge the gap of finances between the Centre and the States. These include various articles in the constitution like Article 268, which facilitates levy of duties by the Centre but equips the States to collect and retain the same. Similarly, there are Articles 269, 270, 275, 282 and 293 all of which specify ways and means of sharing resources between Union and States. Apart from the above-mentioned provisions, The Indian Constitution provides an institutional framework to facilitate Centre-State Transfers. This body is the Finance Commission, which came into existence in 1951, under Article 280 of the Indian Constitution, which states:

1. The President will constitute a Finance Commission within two years from the commencement of the Constitution and thereafter and at the end of every fifth year or earlier, as the deemed necessary by him/her, which shall include a Chairman and four other members.

2. Parliament may by law determine the requisite qualifications for appointment as members of the Commission and the procedure of selection.

3. The Commission is constituted to make recommendations to the President about the distribution of the net proceeds of taxes between the Union and States and also the allocation of the same amongst the States themselves. It is also under the ambit
of the Finance Commission to define the financial relations between the Union and the States. They also deal with devolution of non-plan revenue resources.

Functions of the Finance Commission are as follows:

1. Distribution of net proceeds of taxes between Centre and the States, to be divided as per their respective contributions to the taxes.

2. Determine factors governing Grants-in Aid to the states and the magnitude of the same.

3. Work with the State Finance Commissions and suggest measures to augment the Consolidated Fund of the States so as to provide additional resources to Panchayats and Municipalities in the state.

11.10 MAJOR RECOMMENDATIONS OF THE 13TH FINANCE COMMISSION AND THE ROLE OF FISCAL POLICY

1. The share of states in the net proceeds of the shareable Central taxes should be 32%. This is 1.5% higher than the recommendation of 12th Finance Commission.

2. Revenue deficit of the Center to be progressively reduced and eliminated, followed by revenue surplus by 2013-14.

3. Fiscal deficit to be reduced to 3% of the GDP by 2014-15.

4. A target of 68% of GDP for the combined debt of centre and states to be achieved by 2014-15. The fiscal consolidation path embodies steady reduction in the augmented debt stock of the Center to 45 per cent of GDP and that of the States to less than 25 per cent of the GDP by 2014-15.

5. The Medium Term Fiscal Plan (MTFP) should be reformed and made the statement of commitment rather than a statement of intent. Tighter integration is required between the multi-year framework provided by MTFP and the annual budget exercise.

6. Transfer of disinvestment receipts to the public account to be discontinued and all disinvestment receipts should be maintained in the consolidated fund.
7. Government should list all public sector enterprises that yield a lower rate of return on assets than a norm to be decided by an expert committee.

8. FRBM Act need to be amended to mention the nature of shocks which shall require targets relaxation.

9. In case of macroeconomic shocks, instead of relaxing the States’ borrowing limits and letting them borrow more, the Center should borrow and devolve the resources using the Finance Commission tax devolution formula for inter se distribution between States.

10. Structural shocks such as arrears arising out of Pay Commission awards should be avoided by, in the case of arrears, making the pay award commence from the date on which it is accepted.

11. An independent review mechanism should be set up by the Center to evaluate its fiscal reform process. The independent review mechanism should evolve into a fiscal council with legislative backing over time.

12. Given the exceptional circumstances of 2008-09 and 2009-10, the fiscal consolidation process of the States was disrupted. It is expected that States would be able to get back to their fiscal correction path by 2011-12, allowing for a year of adjustment in 2010-11.

13. States should amend or enact FRBM Acts to build in the fiscal reform path worked out. State specific grants recommended for a State should be released upon compliance.

14. Independent review/monitoring mechanism under the FRBM Acts should be set up by States.

15. Loans from Government of India to States and administered by ministries/department other than Ministry of Finance, outstanding as at the end of 2009-10 to be written off, subject to conditions prescribed.

16. Both Centre and States should conclude 'Grand Bargain' to implement the model Goods and Services Act (GST). To incentivize the States, the commission recommended a sanction of the grant of Rs 50,000 crore.
17. Initiatives to reduce the number of Central Sponsored Schemes (CSS) and to restore the predominance of formula based plan grants.

18. States need to address the problem of losses in the power sector in time bound manner.

The 13th Finance Commission has recommended fiscal consolidation through the elimination of revenue deficit and reduction of fiscal deficit to three per cent of GDP by 2013-14 with a limitation on the combined Debt-GDP ratio of 68 percent. Fiscal policy of both the Center and the States will have to gear up to meet the recommendations of the 13th Finance Commission. It means, fiscal consolidation or reduced non-developmental expenditure in the years to come.

### 11.11 QUESTIONS

a. Explain the composition of public expenditure in India.
b. Explain the trends in the composition of public expenditure in India.
c. Explain trends in the deficit of the Central government of India.
d. Critically examine the FRBM Act of 2003 and efforts made by the Central Government to fulfill the provisions of the FRBM Act.
e. Explain the trends in the liabilities of the Government of India.
f. Write a note on the appraisal of Union Government’s transfer of financial resources to the States.
g. Explain the recommendations of the 13th Finance Commission and the role of fiscal policy.
Module 6
INTERNATIONAL TRADE AND PAYMENTS

Unit Structure:

12.0 Objectives
12.1 Foreign trade of India before 1991
12.2 Growth of External Trade since 1991
12.3 Composition of Exports
12.4 Composition of Imports
12.5 Direction of India's Foreign Trade since 1991
12.6 Direction of Trade
12.7 Questions

12.0 OBJECTIVES

- To know the foreign trade of Government of India before 1991.
- To understand the trends in value, composition and direction of trade since 1991.
- To know the tax revenue of the GOI, Tax Reforms and changes in tax policy since 1991.

12.1 FOREIGN TRADE OF INDIA BEFORE 1991

Foreign trade of India after independence may be studied in the context of planned economic growth and development. It would therefore be right to trace the growth of foreign trade in the pre-reforms period from the first five year plan.
The First Five Year Plan (1951-52 to 1955-56).

The annual average value of imports during the First Plan was Rs.730 crores and that of exports Rs.622 crores. The average annual trade deficit was Rs.108 crores. With the first five year plan, India embarked upon a program of industrial development and capital goods imports were essential to establish a modern industrial sector in the Indian economy. While India imported capital goods, it could largely export only primary goods and hence the trade deficit in India's balance of payments account during the first five year plan.

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

The program of industrialization was only enlarged during the second five year plan. Basic and capital goods industries were set up and the Government of India embarked upon the road to develop a socialistic pattern of society wherein the commanding heights of the economy will be controlled by the public sector. India adopted the heavy industry model of growth and capital goods imports fueled the requirements of industrialization. During the second five year plan, the annual average value of exports was Rs.613 crores and that of imports was Rs.1080 crores thereby posting a trade deficit of Rs.467 crores. The trade deficit therefore expanded during the second five year plan by more than four times.

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

During the third five year plan, the average annual exports was worth Rs.747 crores against annual average imports of Rs.1,224 crores. In addition to the requirements of rapid industrialization, the Indo-China war of 1962 led to escalation of defense imports. In the year 1965-66, agriculture failed in India and the government had to resort to massive food imports. All these factors contributed to expansion in the trade deficit of India. The trade deficit during the third five year plan was Rs.477 crores.


In June 1966, the Rupee was devalued by 36.5 per cent to reduce the volume of imports, to increase exports and to clear the trade deficit in India’s balance of payments. However, agriculture once again failed in the year 1967 and the policy of liberal imports in the case of 59 industries contributed to the increase in trade deficit. In 1966-67, imports amounted to Rs.1992 crores and the
trade deficit went up to Rs.906 crores. In the subsequent two years, the trade deficit declined to Rs.788 and Rs.373 crores respectively. This was on account of good agriculture in 1968-69 and decline in food imports. Devaluation also helped the exports to increase.

**The fourth Five Year Plan (1969-70 to 1973-74).**

The annual average trade deficit during the fourth plan period declined to Rs.162 crores. In fact in 1971-72, the country posted a trade surplus of Rs.104 crores. The policy of import restriction, reduced food imports and export promotion helped to improve India’s trade performance during this period.

**The Fifth Five Year Plan (1974-75 to 78-79).**

The Oil shock of 1973 affected the performance of India’s foreign trade. In 1973-74 i.e. in the final year of the fourth plan, India posted a trade deficit of Rs.432 crores whereas in the previous year, the balance of trade account showed a trade surplus of Rs.104 crores. Clearly, the oil shock of 1973 affected the trade balance and it continued to affect in the succeeding years. However, during the fifth plan period, India’s export performance improved progressively and in the year 1976-77, once again India was able to achieve a small trade surplus of Rs.69 crores. During the fifth five year plan, the average trade deficit was Rs.810 crores. Average annual exports amounted to Rs.5538 crores and imports Rs.4728 crores.

**The Sixth Five Year Plan (1980-81 to 1984-85).**

Due to rising prices of petroleum products, the value of imports rose from Rs.6811 crores in 1978-79 to Rs.12,549 crores in 1980-81 whereas the value of exports rose only marginally from Rs.5726 crores in 1978-79 to Rs.6711 crores. There was a big increase in the trade deficit from Rs.1085 crores to Rs.5838 crores during the two year period. During the entire sixth five year plan, the average trade deficit was Rs.5716 crores. Due to the huge trade deficit, Government of India had to approach the IMF in November 1981 for a loan.
The Seventh Five Year Plan (1985-86 to 1989-90).

Liberal imports during the seventh five year plan period contributed to further widening of the trade deficit. The trade deficit during the final year of the seventh plan was Rs.7670 crores. Exports were worth Rs.27658 crores and imports Rs.35328 crores. The average trade deficit during the plan period was Rs.7730 crores. The Government of India once again had to take a loan of USD 6.7 billion.

12.2 GROWTH OF EXTERNAL TRADE SINCE 1991

The year 1991 has special significance in the economic history of India because the country embarked on a program of economic reforms that changed her economic ideology and approach to economic life of the nation. Economic reforms initiated with the new economic policy of July 1991 were directed at both the domestic as well as the external sector. External sector reforms and structural adjustment in the domestic sector brought about radical changes in the Indian economy. Both imports and exports performed well during the period 1993-94 and 1995-96 with about 20 per cent annual growth. However, between 1996-97 and 2001-02, the rate of growth of external trade fell down due to a number of internal and external reasons. Since 2002-03, once again the growth of external trade picked up.

The performance of exports and imports since 1991 can be studied in three different distinct periods. These periods are:

1. **The First Period (1992-93 to 1995-96).** India’s exports and imports increased by 15.7 and 17.5 per cent respectively on an average during this period. This was much higher than the rate of growth recorded during the 1980s. In the 1980s, exports grew at the rate of 8.2 per cent whereas imports grew at the rate of 7.8 per cent.

2. **The Second Period (1996-97 to 2001-02).** External trade performed miserably during this period. The average growth of exports fell down to 5.8 per cent and that of imports fell down to 5.9 per cent. The Economic Survey 1999-2000 observed that structural constraints were responsible for the fall in exports during this period. Economic recession in most of our trading countries affected Indian exports. The recession particularly in the East Asian countries led to a sharp fall in import demand. Asia accounted for about 20 per cent of India’s exports and
hence the recession adversely affected Indian exports. The developed countries imposed non-tariff barriers on Indian exports during the slow-down of world trade in 1997-98. However, towards the end of this period, world demand began to pick up and Indian exports grew by 10.8 per cent in 1999-2000 and 21.0 per cent in 2000-01. But in the subsequent year, there was a marginal fall in exports by 1.6 per cent in comparison of the previous year. In 1999-2000, imports grew by 17.2 per cent due to a sharp rise in oil prices. The trade deficit went up to $12,849 million in 1999-2000. In the year 2000-01, while exports grew by 21 per cent, imports grew only by 1.7 per cent and as a result, the trade deficit was brought down to $5,976 million. Imports fell down sharply due to the industrial slowdown in India. The slow down continued into 2001-02, however, exports also fell during this year and the trade deficit rose to $7,586 million.

3. The Third Period (2002-03 to till to date). The current period has experienced a spectacular growth in exports until date. Average growth in exports in the ten year period since 2001-02 has been at an all time high of 22.13 % and that of imports at 25.65 per cent. In the year 2010-11, exports increased by 40.5 % and in the year 2007-08 imports increased by 35.5 % which is by far the highest percentage growth experienced in the entire history of Indian economy since 1947. India’s exports and imports increased from USD 44.6 billion and USD 50.5 billion respectively in 2000-01 to USD 251.1 billion and USD 369.8 billion in 2010-11. Thus exports went up by more than five times and imports by more than seven times during the last decade. The compound average growth rate (CAGR) of India’s exports and imports were 8.2 and 8.4 per cent respectively in terms of US dollars in the 1990s, they increased to 19.5 and 25.1 per cent respectively during the period 2000-01 to 2008-09. In the year 2009-10, both exports and imports came down by 3.5 and 5 per cent on account of the Global Financial Crisis of 2008-09. However, in the subsequent year, trade performance rebounded by posting a growth rate of 40.5 per cent in exports and 28.2 per cent in imports. India’s share in world exports and imports increased from 0.7 per cent and 0.8 per cent respectively in 2000 to 1.5 and 2.2 per cent in 2010.

During the first half of 2011-12, India’s exports went up by 40.6 per cent. However, since October 2011 exports fell due to the Euro zone crisis. Total exports were at USD 242.8 billion during 2011-12 (April-January) thus registering a 23.5 per cent growth rate. The net terms of trade which measures the unit value index of exports as a proportion of unit value index of
imports declined to – 14.3 per cent due to the positive growth in unit value index of imports and negative growth in unit value index of exports for the first time in the decade. Income terms of trade reflecting the capacity to import grew by 22.7 per cent in 2010-11 which is the highest in the decade.

India's merchandise imports which fell to USD 288.4 billion with a negative growth of -5.0 per cent in 2009-10 due to the global recession recovered to USD 369.8 billion in 2010-11 with a growth rate of 28.2 per cent. Trade deficit increased by 8.2 per cent to USD 118.6 billion in 2010-11 from USD 109.6 billion in 2009-10. Trade deficit for 2011-12 (April-January) at USD 148.7 billion was 40.4 per cent higher than the USD 105.9 billion in 2010-11 (April-January). Low export growth and moderate import growth have led to the high trade deficit in 2011-12. The high growth of 53.8 per cent in gold and silver imports in 2011-12 also contributed to the high growth in trade deficit.

Table 12.1: Value of India’s Foreign Trade since 1990-91

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<th>Year</th>
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<th>Imports</th>
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<th>Rate of Change (Per cent)</th>
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<th>Import</th>
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*Provisional (April- December).
12.3 COMPOSITION OF EXPORTS

The composition of Indian exports has undergone a radical change over the years and particularly since 1991 (See Table 6.2). The following observations are made in this regard:

1. After independence, the industrial sector achieved a diversified growth and changed from a producer of primary goods to manufactured goods. By mid 1980s, manufacturing exports had a share of 66 per cent in India’s exports. In 2005-06, the share of manufacturing exports had gone up to 72 per cent. The share of primary products had fallen to 10 per cent. In 2010-11, these shares were 68 per cent and 9.9 per cent respectively.

2. In 1991-92, gems and jewellery had a share of 15.3 per cent in Indian exports and in 2005-06 the share fell down marginally to 15.1 per cent. The gems and jewellery industry is import intensive and large amount of pearls and precious stones are imported. In 2010-11, the share of gems and jewellery was marginally down to 14.7 per cent.

3. The exports of engineering goods increased from $ 2,234 million in 1991-92 to $ 21,315 million in 2005-06. Engineering goods had share of 20.7 per cent in Indian exports in 2005-06. In 2010-11, the share of engineering goods in exports was further up to 23.8 per cent. Engineering exports were worth USD 68783 million in 2010-11.

4. Readymade garments had a share of 12.3 in Indian export income in 1991-92 and in 2005-06, the share of readymade garments fell down to 8.3 per cent. This was further down to 4.5 per cent in 2010-11.

5. Exports of chemicals and allied products rose from $1,583 million in 1991-92 to $ 11,935 million in 2005-06. The share in exports was 11.5 per cent in 2010-11 and in terms of USD it was 28,984 million.

6. Exports of cotton yarn, fabrics etc rose from $ 1,300 million in 1991-92 to $ 5,506 million in 2010-11. The share fell down from 7.3 per cent to 3.8 per cent during the period under consideration.

7. The export income from leather and leather manufactures was $ 1,269 million in 1991-92 and in 2010-11 the figure was $ 3768
million. The share came down from 7.1 per cent to 2.2 per cent in 2010-11.

8. The income from fish and fish preparations rose from $ 585 million in 1991-92 to $ 2531 million in 2010-11. The share, however, fell from 3.3 per cent to one per cent in 2010-11.

The following reasons are attributed to the improved performance of India’s exports since 1991:

1. Value added exports have been on the rise during the 1990s. The export of raw material has been increasingly replaced by processed goods.
2. The composition of Indian exports has undergone a change for the better.
3. Exports of manufactured goods increased during this period.

12.4 COMPOSITION OF IMPORTS

The composition of Indian imports, particularly since 1991 had undergone a significant change (See Table 6.3). The following observations are made on the composition of Indian imports:

1. Petroleum, oil and lubricants (POL) imports rose from $ 5,364 million to $ 105964 million during the period 1991-92 to 2010-11. The share of POL imports rose from 27.6 per cent in 1991-92 to 28.6 per cent in 2010-11. An important reason for this rise was increasing international oil prices.

2. Capital goods import accounted for $ 3,610 million in 1991-92 which was 18.6 per cent and in 2010-11, the share fell down to 13.1 per cent. However, in absolute terms capital goods import accounted for $48649 million.

3. In 1991-92, the imports of pearls and precious stones accounted for $ 1,957 million which was 10.1 per cent of total imports. In 2010-11, the imports of pearls and precious stones went up to $ 34620 million. However, the share fell down from 10 per cent to 9.4 per cent during this period.

4. Import of cereals and cereal preparations, sugar, milk and cream has fallen down to 0.5 per cent. However, import of edible oils has been considerable in certain years. For instance, in 2010-11, edible oil imports accounted for $ 6551 million which is 1.8 per cent in total imports. The figure for 1990-91 was $ 182 million.
5. Fertilizer imports stood at $954 million in 1991-92 and it accounted for 4.9 per cent of total imports. In 2010-11, the share fell down to 1.9 and the amount spent was $6885 million.

6. Gold and silver accounted for 11.5 per cent share in total imports and the amount spent in the year 2010-11 was USD 42523.43 million.

12.5 DIRECTION OF INDIA’S FOREIGN TRADE SINCE 1991

Direction of trade refers to the countries to which exports are made to and imports are obtained from. It reveals the major trading partners of a country in terms of both export and import destinations. India’s trading partners are divided into five major groups. They are as follows:

I. Europe.

a) EU (27)-European Union.
   Germany, Belgium, France, UK, Italy, Sweden, Netherland, Finland, Spain, Denmark, Austria, Romania, Czech Republic, Ireland, Poland, Greece, Slovak Republic, Hungary, Portugal, Lithuania, Cyprus, Bulgaria, Slovenia, Luxembourg, Malta, Latvia, Estonia.

b) Other WE (5)– Western European Countries.
   Switzerland, Norway, Turkey, Iceland, Liechtenstein.

c) EE (5)-East Europe
   Croatia, Macedonia, Union of Serbia and Montenegro, Bosnia-Hrzegovin, Albania.

II. Africa

a) Southern Africa (9).
   South Africa, Mozambique, Zambia, Zimbabwe, Swaziland, Namibia, Angola, Botswana, Lesotho.

b) West Africa (22)
   Senegal, Cote D’Ivoire, Li, Liberia, Guinea Bissau, Togo, Ghana, Benin, Nigeria, Congo Peoples Republic, Gabon, Guinea, Gambia, Cameroon, Siera Leone, Burkina Faso,
Mali, Mauritania, Niger, St. Helena, Equatorial Guinea, Sao Tome Cape Verde Island.

c) Central Africa (7)

Congo Democratic Republic, Uganda, Malawi, Central African Republic, Chad, Rwanda, Burundi.

d) East Africa (10)

Tanzania Republic, Kenya, Madagascar, Somalia, Ethiopia, Mauritius, Comoros, Djibouti, Reunion, Seychelles.

III. America

a) North America (2) - USA, Canada.

b) Latin America (43)

Brazil, Argentina, Chile, Panama, Mexico, St Vincent, Costa Rica, Peru, Guyana, Ecuador, Venezuela, Colombia, Suriname, Nicaragua, Dominican Republic, Paraguay, Uruguay, Cuba, Jamaica, El Salvador, Guatemala, Trinidad, Bolivia, Federal Republic of Guiana, Virgin Island US, Honduras, Haiti, Guadeloupe, Bahamas, British Virgin Island, Dominica, Grenada, Antigua, Montserrat, Netherland Antill, Bermuda, Martinique, Barbados, Belize, Cayman Island, St. Kitt NA, St Lucia, Falkland Island.

IV. Asia and ASEAN

a) East Asia (11)


b) ASEAN(10)-Association of South East Asian Nations.

Singapore, Indonesia, Malaysia, Thailand, Myanmar, Philippines, Vietnam Socialist Republic, Brunei, Cambodia and Lao Peoples Democratic Republic.

c) WANA (19)-West Asia and Arabia

United Arab Emirates, Saudi Arabia, Israel, Qatar, Iran, Kuwait, Morocco, Jordan, Oman, Egypt A Republic,
Baharain Island, Tunisia, Sudan, Lebanon, Algeria, Libya, Yemen Republic, Syria, Iraq.

d) NE Asia (8)-North East Asia.

China Peoples Republic, Korea Republic, Japan, Hong Kong, Taiwan, Korea DP Republic, Mongolia, Macao.

e) South Asia (7)

Sri Lanka DSR, Nepal, Pakistan Islamic Republic, Bangladesh Peoples Republic, Bhutan, Afghanistan TIS, Maldives.

V. CIS & Baltics -Commonwealth of Independent Soviets.

a) CARs Countries (5)
Kazakhstan, Uzbekistan, Turkmenistan, Tajikistan, Kyrgyzstan.

b) Other CIS Countries (7)
Russia, Ukraine, Belarus, Georgia, Azerbaijan, Armenia, Moldova.

12.6 DIRECTION OF TRADE

Both the export and import markets of India are well diversified. The share of Asia and ASEAN in total trade increased from 33.3 per cent in 2000-01 to 56.2 in 2010-11. The share of Europe and America fell from 42.5 to 35 per cent during the same period. As a result, India was insulated from the financial crisis of Europe and America to a great extent. There are only five advanced western countries among the top 15 trading partners of India today. In 2000-01, the figure was seven. The top 15 countries however hold 60 per cent share in 2010-11 albeit with some internal changes in terms of countries. The major changes are the entry of Indonesia, Korea, Iran and Nigeria in the new list of 15 in place of Italy, Malaysia, France and Australia. USA has assumed third position in terms of direction of trade from being first in 2007-08. Today, UAE is the largest trading partner followed by China.
The share of Asia and ASEAN in exports increased from 38.7 per cent in 2000-01 to 56.2 per cent in 2010-11 while the share of Europe and USA fell from 46.9 to 30.8 per cent during the same period. The UAE has assumed number one status in terms of direction of exports followed by the USA and China.

Asia and ASEAN are the major source of India’s imports. The share of Asia and ASEAN increased from 28.6 per cent to 61.5 per cent and that of Europe and USA fell down from 27.5 and 5.7 per cent to 18.6 and 4.7 percent respectively. China has the largest share with 11.7 per cent in India’s imports followed by the UAE (7.6 %) and USA (4.7%) in 2011-12 (Apr-Sept). Among the top 15 trading partners, India’s imports from Nigeria, Switzerland and Indonesia experienced a growth of more than 60 % in 2011-12 (Apr-Sept) due to imports of crude oil, gold silver and edible oils. However, India’s imports from Iran, USA and UAE and Belgium registered low growths.
Table 12.2: Composition of Indian Exports (Years 1990-91 & 2010-11).

<table>
<thead>
<tr>
<th>Commodity</th>
<th>1990-91 USD Million</th>
<th>% of Total</th>
<th>2010-11 USD Million</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and Allied Products of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a Tea and mate</td>
<td>3521</td>
<td>19.41</td>
<td>24827</td>
<td>9.9</td>
</tr>
<tr>
<td>b Cashew and Kernels</td>
<td>596</td>
<td>3.23</td>
<td>713</td>
<td>0.28</td>
</tr>
<tr>
<td>c Rice</td>
<td>249</td>
<td>1.38</td>
<td>577</td>
<td>0.23</td>
</tr>
<tr>
<td>d Fish and Fish Preparations</td>
<td>257</td>
<td>1.42</td>
<td>2371</td>
<td>0.95</td>
</tr>
<tr>
<td>2 Ores &amp; Minerals (excluding coal) of which</td>
<td>834</td>
<td>4.6</td>
<td>10130</td>
<td>4.03</td>
</tr>
<tr>
<td>Iron ore</td>
<td>585</td>
<td>3.23</td>
<td>4701</td>
<td>1.87</td>
</tr>
<tr>
<td>3 Manufactured Goods</td>
<td>13229</td>
<td>72.92</td>
<td>170634</td>
<td>68.0</td>
</tr>
<tr>
<td>a Cotton yarn, fabrics, made ups etc.</td>
<td>1170</td>
<td>6.45</td>
<td>5506</td>
<td>2.2</td>
</tr>
<tr>
<td>b Readymade garments.</td>
<td>2236</td>
<td>12.32</td>
<td>11196</td>
<td>4.5</td>
</tr>
<tr>
<td>c Jute Manufactures</td>
<td>166</td>
<td>0.91</td>
<td>458</td>
<td>0.18</td>
</tr>
<tr>
<td>d Leather and leather manufactures</td>
<td>1449</td>
<td>7.9</td>
<td>3768</td>
<td>0.9</td>
</tr>
<tr>
<td>e Gems and Jewellery</td>
<td>2924</td>
<td>16.12</td>
<td>36840</td>
<td>14.7</td>
</tr>
<tr>
<td>f Chemicals and allied products</td>
<td>1176</td>
<td>6.48</td>
<td>28984</td>
<td>11.54</td>
</tr>
<tr>
<td>g Machinery, transport &amp; metals</td>
<td>2158</td>
<td>11.9</td>
<td>68783</td>
<td>27.38</td>
</tr>
<tr>
<td>4 Mineral fuels &amp; lubricants (incl. coal)</td>
<td>528</td>
<td>2.9</td>
<td>42203</td>
<td>16.80</td>
</tr>
<tr>
<td>Total</td>
<td>18143</td>
<td>100.0</td>
<td>251136</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Table 12.3: Composition of Indian Imports (Years 1990-91 & 2010-11).

<table>
<thead>
<tr>
<th>Commodity</th>
<th>1990-91</th>
<th>2010-11</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ Million</td>
<td>% of Total</td>
</tr>
<tr>
<td>1 Food and live animals for food of which</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>a Cereal and cereal preparations</td>
<td>102</td>
<td>0.42</td>
</tr>
<tr>
<td>2 Raw materials and intermediate manufactures of which</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>a Edible oils</td>
<td>182</td>
<td>0.76</td>
</tr>
<tr>
<td>b Petroleum oil and lubricants</td>
<td>6028</td>
<td>25.04</td>
</tr>
<tr>
<td>c Fertilizers</td>
<td>984</td>
<td>4.08</td>
</tr>
<tr>
<td>d Iron and Steel</td>
<td>1178</td>
<td>4.9</td>
</tr>
<tr>
<td>e Chemical elements and compounds</td>
<td>1276</td>
<td>5.3</td>
</tr>
<tr>
<td>f Pearls and precious stones</td>
<td>2083</td>
<td>8.65</td>
</tr>
<tr>
<td>3 Capital goods of which</td>
<td>5833</td>
<td>24.23</td>
</tr>
<tr>
<td>a Non-electrical machinery.</td>
<td>2363</td>
<td>9.81</td>
</tr>
<tr>
<td>b Electrical machinery</td>
<td>949</td>
<td>3.95</td>
</tr>
<tr>
<td>c Transport equipment</td>
<td>931</td>
<td>3.86</td>
</tr>
<tr>
<td>4 Others (Unclassified)</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Total</td>
<td>24075</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Table 12.4
Direction of India’s Imports.

<table>
<thead>
<tr>
<th>Countries / Regions</th>
<th>20010-11</th>
<th>USD Millions</th>
<th>Percentage Share</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I Europe</td>
<td></td>
<td>71181</td>
<td>19.3</td>
</tr>
<tr>
<td>(a) EU Countries (27)</td>
<td></td>
<td>44540</td>
<td>12.0</td>
</tr>
<tr>
<td>(b) Other WE Countries (5)</td>
<td></td>
<td>26589</td>
<td>7.2</td>
</tr>
<tr>
<td>(c) East Europe (5)</td>
<td></td>
<td>51</td>
<td></td>
</tr>
<tr>
<td>II Africa</td>
<td></td>
<td>26062</td>
<td>7.0</td>
</tr>
<tr>
<td>(a) Southern Africa (9)</td>
<td></td>
<td>12574</td>
<td>3.4</td>
</tr>
<tr>
<td>(b) West Africa (22)</td>
<td></td>
<td>12863</td>
<td>3.5</td>
</tr>
<tr>
<td>(c) Central Africa (7)</td>
<td></td>
<td>46</td>
<td></td>
</tr>
<tr>
<td>(d) East Africa (10)</td>
<td></td>
<td>580</td>
<td>0.2</td>
</tr>
<tr>
<td>III America</td>
<td></td>
<td>36287</td>
<td>9.8</td>
</tr>
<tr>
<td>(a) North America (2)</td>
<td></td>
<td>22081</td>
<td>6.0</td>
</tr>
<tr>
<td>(b) Latin America (43)</td>
<td></td>
<td>14206</td>
<td>3.8</td>
</tr>
<tr>
<td>IV Asia and ASEAN</td>
<td></td>
<td>226147</td>
<td>61.2</td>
</tr>
<tr>
<td>(a) East Asia (11)</td>
<td></td>
<td>11639</td>
<td>3.1</td>
</tr>
<tr>
<td>(b) ASEAN</td>
<td></td>
<td>30608</td>
<td>8.3</td>
</tr>
<tr>
<td>(c) WANA (19)</td>
<td></td>
<td>105616</td>
<td>28.6</td>
</tr>
<tr>
<td>(d) NE Asia</td>
<td></td>
<td>76110</td>
<td>20.6</td>
</tr>
<tr>
<td>(e) South Asia (7)</td>
<td></td>
<td>2173</td>
<td>0.6</td>
</tr>
<tr>
<td>V CIS and Baltics</td>
<td></td>
<td>5664</td>
<td>1.5</td>
</tr>
<tr>
<td>(a) CARs Countries (5)</td>
<td></td>
<td>193</td>
<td>0.1</td>
</tr>
<tr>
<td>(b) Other CIS countries (7)</td>
<td></td>
<td>5471</td>
<td>1.5</td>
</tr>
<tr>
<td>VI Other Regions</td>
<td></td>
<td>4429</td>
<td>1.2</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>369769</td>
<td>100.0</td>
</tr>
</tbody>
</table>
Table 12.5 Direction of India's Exports.

<table>
<thead>
<tr>
<th>Countries / Regions</th>
<th>20010-11</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>USD Millions</td>
<td>% Share</td>
</tr>
<tr>
<td>I Europe</td>
<td>50697</td>
<td>20.2</td>
</tr>
<tr>
<td>(a) EU Countries (27)</td>
<td>46857</td>
<td>18.7</td>
</tr>
<tr>
<td>(b) Other WE Countries (5)</td>
<td>3698</td>
<td>1.5</td>
</tr>
<tr>
<td>(c) East Europe (5)</td>
<td>143</td>
<td>0.1</td>
</tr>
<tr>
<td>II Africa</td>
<td>16281</td>
<td>1.5</td>
</tr>
<tr>
<td>(a) Southern Africa (9)</td>
<td>5701</td>
<td>2.3</td>
</tr>
<tr>
<td>(b) West Africa (22)</td>
<td>4546</td>
<td>1.8</td>
</tr>
<tr>
<td>(c) Central Africa (7)</td>
<td>471</td>
<td>0.2</td>
</tr>
<tr>
<td>(d) East Africa(10)</td>
<td>5564</td>
<td>2.2</td>
</tr>
<tr>
<td>III America</td>
<td>37149</td>
<td>14.8</td>
</tr>
<tr>
<td>(a) North America (2)</td>
<td>26913</td>
<td>10.7</td>
</tr>
<tr>
<td>(b) Latin America (43)</td>
<td>10235</td>
<td>4.1</td>
</tr>
<tr>
<td>IV Asia and ASEAN</td>
<td>141023</td>
<td>56.2</td>
</tr>
<tr>
<td>(a) East Asia (11)</td>
<td>1966</td>
<td>0.8</td>
</tr>
<tr>
<td>(b) ASEAN</td>
<td>27278</td>
<td>10.9</td>
</tr>
<tr>
<td>(c) WANA (19)</td>
<td>56758</td>
<td>22.6</td>
</tr>
<tr>
<td>(d) NE Asia</td>
<td>42142</td>
<td>16.8</td>
</tr>
<tr>
<td>(e) South Asia (7)</td>
<td>12879</td>
<td>5.1</td>
</tr>
<tr>
<td>V CIS and Baltics</td>
<td>2864</td>
<td>1.1</td>
</tr>
<tr>
<td>(a) CARs Countries (5)</td>
<td>294</td>
<td>0.1</td>
</tr>
<tr>
<td>(b) Other CIS countries (7)</td>
<td>2570</td>
<td>1.0</td>
</tr>
<tr>
<td>VI Other Regions</td>
<td>3122</td>
<td>1.2</td>
</tr>
<tr>
<td>Total</td>
<td>251136</td>
<td>100.0</td>
</tr>
</tbody>
</table>

12.7 QUESTIONS

1. Examine the trends in India’s foreign trade before 1991.
2. Examine the trends in India’s foreign trade since 1991.
3. Explain the structural changes in the composition foreign trade since 1991.
4. Explain the changes in the direction of India’s foreign trade since 2000-01.
INDIA’S BALANCE OF PAYMENTS SINCE 1991 AND EXCHANGE RATE POLICY

Unit Structure :

13.0 Objectives
13.1 India’s Balance of payments since 1991
13.2 Impact of Economic reforms on balance of payments
13.3 Meaning of Foreign Exchange Market
13.4 Exchange Rate Policy of India
13.5 Meaning of Currency Convertibility
13.6 Convertibility of the Indian Rupee
13.7 Capital Flows
13.8 Foreign Investment in India
13.9 Questions

13.0 OBJECTIVES

• To know the trends in India’s Balance of Payments since 1991.
• To understand the meaning of exchange rate.
• To understand the exchange rate policy of India.
• To appreciate the concept of rupee convertibility.
• To appreciate the trends in capital flows since 2001.

13.1 INDIA’S BALANCE OF PAYMENTS SINCE 1991

The year 1991 is known as the year of Economic Crisis in the post independent economic history of India. The economic crisis of 1991 was an external sector crisis. The International Monetary Fund bailed India out of the crisis but with a condition to initiate structural reforms in the Indian economy. In the same year, India...
initiated the New Economic Policy and went through a program of structural adjustment. Liberalization, Privatization and Globalization were the three corner stones of this new economic policy. The current account deficit in the year 1990-91 was 3.1 per cent of GDP. The Gulf War of 1991 was a major contributor to the crisis suffered by India. Prices of crude oil and petroleum products went up heavily and remittances from the Gulf by Indian expatriates dried up. The Indian Rupee was overvalued and this affected Indian exports. The policy of import substitution pursued by India was not conducive to exports. With poor exports and high imports, India continued to have current account deficits. During the period 1985-90, the trade deficit average 3 per cent of GDP and the current account deficit averaged 2.2 per cent of GDP. These deficits were financed by external borrowings such as external assistance, commercial borrowing and NRI deposits. The government also had to take recourse to run down the foreign exchange reserves. The debt service ratio went up to 35 per cent in 1990-91. It was only after a decade of economic reforms that India for the first time had a current account surplus of 0.7 per cent of GDP in the year 2001-02. In the subsequent year, the current surplus went up to 1.2 per cent of GDP (See Table 7.1). The structural reforms and stabilization measures undertaken by the Government of India after July 1991 were as follows:

**Devaluation of the Rupee.**

In order to restrict imports and encourage exports, the rupee was devalued on 01st July, 1991 and on 03rd July 1991 by 22.8 per cent. The cash compensatory subsidy to exporters was withdrawn after the devaluation. In order to check cost-push inflation as a result of devaluation, appropriate monetary and fiscal measures were undertaken.

**Reduction in Custom Duties.**

Custom duties were reduced to increase the competitiveness of Indian exports and also to control cost push inflation. Reduced custom duties also reduced the cost of Indian exports with high import content. Further, it increased the level of competition to Indian industries. Increased competition encouraged productivity improvements in Indian industry.
Assistance of IMF and World Bank.

The Government of India took assistance from the IMF and the World Bank to overcome the foreign exchange crisis. The Bretton Wood twins agreed to bail out India only if India was to implement structural reforms. India accepted the conditions of assistance and initiated economic reforms through the New Economic Policy of July 1991.

Reduction in Fiscal Deficit.

High fiscal deficit was an important cause of inflation and poor balance of payment situation. The fiscal deficit was reduced from 7.3 per cent of GDP in 1989-90 to 4.7 per cent in 1991-92. By reducing fiscal deficit, aggregate demand was reduced. Lower aggregate demand put a downward pressure on price rise. Lower inflation encouraged exports and reduced imports, thereby helping the balance of payment situation to improve.

Market Determined Exchange Rate.

India adopted the floating exchange rate system in 1993 and the exchange rate was determined by market forces. Correction in the balance of payment to some extent was to be made automatically through market mechanism. After floating the Indian currency, the rupee depreciated against the dollar from 24.47 in 1993 to 35.50 in 1996-97. Depreciation of the rupee boosted Indian exports and increased NRI remittances.

Abandoning the Policy of Import Substitution.

The protectionist policy was given up by the Government and peak import duties were reduced from 150 per cent in 1992-93 to 15 per cent in 2006-07. Import substitution was proving to be highly inefficient and due to the poor quality of manufactured goods in India, the demand for Indian exports was not increasing. The policy of free trade adopted by the Government increased the competitiveness of Indian industry and also led to increasing exports. India’s share in world exports went up from 0.5 per cent to one percent since the implementation of economic reforms.
13.2 IMPACT OF ECONOMIC REFORMS ON BALANCE OF PAYMENTS

The program of economic reforms both internal and external was initiated in 1991. Since then, the balance of payment situation has improved considerably. From a current account deficit of 3.1 per cent in 1990-91 to a surplus of 2.3 per cent in 2003-04 and thereafter small deficits of less than one per cent of GDP, the balance of payment situation has become comfortable as India continues to have overall surplus on the balance of payments. The Balance of Payments summary for the period 1990-91 to 2009-10 is given in Table 7.1. Also see table 7.2 on Selected External sector indicators.

The balance of payment situation of India grew from strength to strength since the beginning of economic reforms in 1990-91. The current account deficit increased from US $2.5 billion in 2004-05 to US $38.38 billion in 2009-10. In percentage terms, it went up from 1.2 per cent of GDP to 2.8 per cent of GDP. The doubling of the CAD can be attributed to the impact of the Global Financial Crisis of 2008-09 on the external sector of the Indian economy. Until 2007-08, the CAD had remained in the range of 1.1 to 1.3 per cent of the deficit. Due to rising oil prices, there was a reversal from current account surpluses seen between 2001-02 and 2003-04 to current deficit from 2004-05 onwards. The capital account after having financed the current account deficit had a surplus of US$ 13.44 billion in 2009-10 which went into the foreign exchange reserves. In 2008-09 i.e. the year immediately after the GFC, the portfolio investments were negative to the extent of US$ 14.03 billion and hence the balance of payment account showed an overall negative balance of US$ 20.08 billion. The foreign exchange reserves were therefore down by US$ 20.08 billion. Due to a quick recovery of the Indian economy from the negative impact of the GFC, in the subsequent year i.e. in 2009-10, the balance of payment account showed on overall positive balance of US$ 13.44 billion. This was on account of a positive portfolio flow of US$ 32.39 billion.
Table 13.1: Balance of Payments (Summary)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Exports</td>
<td>18477</td>
<td>37542</td>
<td>45452</td>
<td>44703</td>
<td>53774</td>
<td>66285</td>
<td>85206</td>
</tr>
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### Table 13.1 (Continued): Balance of Payments (Summary)

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Source: Collated from various issues of IES. PR: Partially revised.

- a – includes among others delayed export receipts and rupee debt service. 
- b – Overall balance includes total current account balance, capital account balance and errors and omissions.

Table 13.2: Selected Indicators of External Sector.

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Source: Collated from various issues of IES.

**TC:** Total Capital Flows (net), ECBs: External Commercial Borrowings, FER: Foreign Exchange Reserves, GDPmp: Gross Domestic Product at current market prices.

**13.2.1 Current Account:**

The exports as a percentage of GDP grew from 5.8 per cent in 1990-91 to 13.2 per cent in 2009-10. The corresponding rise in imports was from 8.8 per cent to 21.7 per cent of GDP during this period. Trade deficit as a proportion of GDP which had declined from 3 per cent in 1990-91 to 2.1 per cent in 2002-03 increased to 8.6 per cent in 2009-10. This was due to large increases in the prices of petrol, oil and lubricants (POL) and the decline in exports from 15.4 per cent in 2008-09 to 13.2 per cent in 2009-10. According to IMF and International Energy Agency estimate, an oil price increase of US $ 10 per barrel results in a deterioration of the trade balance of oil importing developing countries by 1.2 per cent of GDP. Trade deficit in India increased from 2.3 per cent in 2003-04 when oil prices began to rise to 4.9 per cent in 2004-05 and further to 6.2 per cent in 2005-06. Thereafter the trade deficit has consistently gone up to 6.5 in 2006-07, 7.4 % in 2007-08, 9.8 per cent in 2008-09 and 8.6% in 2009-10. Increase in the trade deficit
in the years 2007-08, 2008-09 and 2009-10 can be attributed to the impact of global financial crisis on the external sector of the Indian economy. In 2010-11, the trade deficit increased by 10.5 per cent to US$ 130.6 billion as compared to US$ 118.2 billion in 2009-10. This was due to higher increase in imports relative to exports. In terms of GDP, the trade deficit came down from 8.6 per cent in 2009-10 to 7.8 per cent in 2010-11 due to relatively higher increase in GDP at market prices.

The net invisibles have steadily increased from a negative 0.1 in 1990-91 to 2.1 per cent in 2000-01 and further to 5.8 per cent in 2009-10. Software services and workers’ remittances were mainly responsible for higher invisible surplus. The invisibles account reflects the combined effects of transactions relating to international trade in services, income associated with non-resident assets and liabilities, labor and property and cross border transfers (mainly workers’ remittances). India’s net invisibles increased by 17.3 per cent in 2008-09, led mainly by receipts under private transfers and software services. The net invisibles surplus increased from US$ 75.7 billion (6.1 per cent of GDP) in 2007-08 to US$ 38.9 billion (7.4 per cent of GDP) during 2008-09. In 2009-10, the net invisibles surplus, however, decreased by 9.6 %. In 2010-11, the net invisible balance was at 5 per cent of GDP and was able to finance 64.8 per cent of trade deficit.

Invisible payments increased by 36.2 per cent from US$ 83.4 billion in 2009-10 to US$ 113.6 billion in 2010-11. The growth of 36.2 per cent in invisible payments outstripped the 21.3 per cent growth recorded in 2010-11. Increase in invisible payments was mainly attributed to business services, financial services, travel and investment income. Even though the surplus on account of service sector exports was higher in 2010-11, growth in net receipts on account of transfers was moderate and net outflow of investment income increased during the same period.

Private transfers are mainly in the form of (i) inward remittances from Indian workers abroad for family maintenance, (ii) local withdrawal from NRI rupee deposits, (iii) gold and silver brought through passenger baggage and (iv) personal gifts/donations to charitable/religious institutions. Private transfers increased by 3.7 per cent to US$ 55.6 billion in 2010-11 from US$ 53.6 billion in the previous year. Private transfer receipts constituted 12.4 per cent of the current receipts. A modest increase was observed in other categories of receipts.
NRI deposits when withdrawn domestically form part of private transfers because once withdrawn for local use these become unilateral transfers and do not have any quid pro quo. Such local withdrawals/redemptions from NRI deposits cease to exist as liability in the capital account of the BoP and assume the form of private transfers which are included in the current account of the BoP. Under NRI deposits, both inflows and outflows remained steady. A major part of outflows from NRI deposits is in the form of local withdrawals. These withdrawals, however, are not actually repatriated but are utilized domestically.

The Goods and Services deficit decreased marginally to US$ 81.8 billion (4.9 per cent of GDP) during 2010-11 as compared to US$ 82.2 billion (6.0 per cent of GDP) in 2009-10.

Current Account Balance.

The current account deficit increased to US$ 45.9 billion in 2010-11 from US$ 38.2 billion in 2009-10 despite improvement in net invisibles, mainly on account of higher trade deficit. However, as a proportion of GDP, CAD marginally improved to 2.7 per cent in 2010-11 as compared to 2.8 per cent in 2009-10.

13.2.2 Capital Account:

In 2010-11, both gross inflows of US$ 499.4 billion and outflows of US$ 437.4 billion under the capital account were higher than gross inflows of US$ 345.8 billion and outflows of US$ 294.1 billion in the previous year. In net terms, capital inflows increased by 20.2 per cent to US$ 62.0 billion (3.7 per cent of GDP) in 2010-11 as against US$ 51.6 billion (3.8 per cent of GDP) in 2009-10 mainly on account of trade credit and loans (ECBs and banking capital).

The non-debt flows or foreign investment consisting of FDI and portfolio investment (ADRs/GDRs and FII) on net basis decreased by 21.4 per cent from US$ 50.4 billion in 2009-10 to US$ 39.7 billion in 2010-11. Decline in foreign investment was offset by the debt flows component of loans and banking capital which increased by 130.3 per cent from US$ 14.5 billion in 2009-10 to US$ 33.4 billion in 2010-11.
Inward FDI showed a declining trend while outward FDI showed an increasing trend in 2010-11. Inward FDI declined from US$ 33.1 billion in 2009-10 to US$ 25.9 billion in 2010-11. Sector-wise deceleration during 2010-11 was mainly on account of lower FDI inflows under manufacturing, financial services, electricity and construction. Country-wise investment routed through Mauritius remained the largest component of FDI inflows to India in 2010-11 followed by Singapore and the Netherlands. Outward FDI increased from US$ 15.1 billion in 2009-10 to US$ 16.5 billion in 2010-11. With lower inward FDI and higher outward FDI, net FDI to Indi stood considerably lower at US$ 9.4 billion during 2010-11 (US$ 18 billion in the previous year).

Net portfolio investment declined to US$ 30.3 billion during 2010-11 as against US$ 32.4 billion in 2009-10. This was due to decline in ADRs/GDRs to US$ 2.0 billion in 2010-11 from US$ 3.3 billion in 2009-10 even though FII inflows showed marginal increase to US$ 29.4 billion in 2010-11 from US$ 29.0 billion in 2009-10. Other categories of capital flows, namely debt flows of ECBs, banking capital and short term credit recorded a significant increase in 2010-11. Net ECB inflow increased to US$ 12.5 billion in 2010-11 as against US$ 2.0 billion in 2009-10. Similarly, short term trade credit increased from US$ 7.6 billion in 2009-10 to US$ 11 billion in 2010-11 indicating strong domestic economic performance. External assistance increased from US$ 2.9 billion in 2009-10 to US$ 4.9 billion in 2010-11. Net accretion to serves in 2010-11 at US$ 13.1 billion remained at more or less the same level as in 2009-10 (US$ 13.4 billion).

13.2.3 Challenges and Outlook:

A trade deficit of more than 8 per cent of GDP and CAD of more than 3 per cent is a sign of growing imbalance in the country’s balance of payments. There is scope therefore to discourage unproductive imports like gold and consumer goods to restore balance. In this respect, some weakening of the rupee is a positive development, as it improves trade balance in the long run by increasing export competitiveness and lowering imports.

High trade and current account deficits, together with high share of volatile FII flows are making India’s BoP vulnerable to external shocks. Greater attention therefore has to be given to improving the composition of capital flows towards FDI.
The rupee has experienced high volatility in the last few years. Such volatility impairs investor confidence and has implications for corporate balance sheets and profitability in case of high exposure to ECBs when currency is depreciating. A more aggressive stance to check rupee volatility is therefore necessary.

The size of foreign exchange reserves could be a constraining factor in checking depreciation of local currency in the event of external shock and reversal of capital. It is therefore imperative that during times of surge in capital flows, when currency is under pressure to appreciate, measures are taken to build up reserve levels.

13.3 MEANING OF FOREIGN EXCHANGE MARKET

The foreign exchange market is the international market in which foreign currencies are bought and sold. It is an arrangement for buying and selling of foreign currencies in which exporters sell the foreign currencies and importers buy them. The players in the foreign exchange market are exports and importers, travelers land investors, traders, speculators and brokers and commercial banks and central banks of different countries of the world. The US Dollar was exchanged for 47.05 Indian rupees on 02\textsuperscript{nd} June 2006. The rupee – dollar exchange rate was therefore Rs.47.05 for one US Dollar or One Indian rupee would fetch 0.02 US Dollars. The Rupee – Pound Sterling exchange rate on 02\textsuperscript{nd} June 2006 was Rs.87.90 which means the Pound Sterling – Rupee exchange rate would be UK Pound Sterling 0.01 for one Indian rupee. One Euro was exchanged for Rs.60.25 on the same day. In the foreign exchange market, there are two different rates for buying and selling of foreign currencies. This difference arises due to transaction cost in dealing with foreign currencies.

Broadly there are two systems of exchange rate determination. They are known as fixed and flexible or floating exchange rate systems. Under the fixed exchange rate system, the foreign exchange rate is fixed by the government. The fixed exchange rate was established in the year 1944 under an agreement reached at Bretton Woods in New Hampshire, USA. Under this system, at the fixed exchange rate, if there is disequilibrium in the balance of payments giving rise to either excess demand or supply of foreign exchange, the Central Bank of the country has to buy and sell the required quantities of foreign exchange to eliminate the excess demand or supply. The system
of exchange rate in which the exchange value of a currency is determined by the market forces of demand and supply of foreign exchange is known as flexible or floating exchange rate system.

The **flexible exchange rate** system came into existence after the fall of the fixed exchange rate system in 1977. The changes in the exchange value of a currency in the foreign exchange market are known by the terms appreciation and depreciation. For instance, if the rupee – dollar exchange rate becomes Rs.48.05 in a few days hence, the rupee would be said to have depreciated against the dollar. Conversely, if the rupee – dollar exchange rate becomes Rs.46.05 then the rupee would be said to have appreciated against the dollar. The changes in the exchange rate are determined by the market forces in a flexible exchange rate system. In the case of fixed exchange rate system, the central bank has to buy or sell foreign exchange so that the exchange rate is maintained at the pegged or fixed level. However, the fixed exchange rate could be changed through devaluation or revaluation only with permission from the IMF in case of fundamental disequilibrium in the balance of payments. Thus, if a country was running large and persistent deficit in her balance of payments, it was allowed to devalue its currency in order to improve the balance of payment position. Conversely, if a country was running large and persistent surpluses in the balance of payments, it was allowed to revalue its currency so that correction is made.

The **IMF** maintains funds which are contributed by member countries and gives loans to member countries from its reserves when they face temporary deficit in the balance of payments. If a member country has a persistent deficit in the balance of payment, the IMF would permit such a country to devalue its currency in order to correct the deficit so that a relatively stable or fixed exchange rate system was maintained for the promotion of world trade. In order to maintain the exchange rate at a given level, the central banks of different countries were required to maintain reserves of foreign currencies. The international reserve currencies are the **US dollar, UK Pound Sterling, German Deutsche marks and the Japanese Yen.**
13.4 EXCHANGE RATE POLICY OF INDIA

India followed a fixed exchange rate system until the adoption of new economic policy in 1991. However, after the adoption of floating exchange rate policy in 1991, the exchange rate of rupee versus the dollar became volatile. The foreign exchange rate of Indian rupee began to fluctuate greatly with changing market conditions. In order to prevent both depreciation and appreciation on a large scale, the Reserve Bank of India has to take appropriate monetary measures to maintain stability in the foreign exchange rate of rupee. The exchange rate of Indian rupee is freely determined by the market forces of demand for and supply of US dollars. The disequilibrium in the foreign exchange market causes changes in the exchange rate. For example, in August 2000, the rupee depreciated against the US dollar because of higher demand for US dollars. Higher demand for US dollars was caused by factors such as higher import demand by Indian corporates, capital outflow to the US by FIIs on account of rising interest rates in the US and increase in demand for US dollars by Indian banks. Since export income and capital inflows were not good enough to match rising demand for dollars, the rupee depreciated against the US dollar. In order to stop the downfall of the rupee, the Reserve Bank of India raised the bank rate from 7 per cent to 8 per cent thereby forcing the commercial banks to increase their lending rates. The Cash Reserve Ratio was raised from 7 to 7.5 per cent so that liquidity in the banking system was reduced. The Reserve Bank was able to increase the cost of credit and reduce the availability of credit simultaneously so that domestic demand for US dollars is reduced. The higher interest rates in India would also discourage FIIs and Indian corporate sector to invest abroad. This will help to reduce the demand for dollars and prevent the fall of the Indian rupee. The Reserve Bank of India can also take recourse to releasing foreign exchange reserves to prevent the depreciation of the rupee. The release of more dollars by RBI will increase the supply of US dollars in the foreign exchange market and will correct the disequilibrium thereby stabilizing the exchange rate of rupee.

However, if the rupee appreciates, it will raise the prices of Indian exports and make them uncompetitive. As a result exports will be discouraged. This was the situation in 2003-04 when due to the huge inflow of foreign exchange into India, supply of US dollars increased tremendously. As a result, the value of US dollars fell.
and the Indian rupee appreciated. The exchange rate of US $ which had gone down to about Rs.48 rose to Rs.43.50 in early 2004. In order to prevent the appreciation of the Indian rupee, the RBI intervened and started buying US dollars from the market. As a result, demand for US $ in the market increased bringing about rise in the value of US dollar in terms of rupees. Thus with the intervention of the RBI the value of the Rupee was stabilized.

13.5 MEANING OF CURRENCY CONVERTIBILITY

Currency convertibility refers to free conversion of national currency into the currency of other countries of the world at market determined exchange rates. The people in a country with convertible currency will be able to freely exchange their national currencies with currencies of other countries at market exchange rates. Thus, international currencies such as the US Dollars, UK Pound Sterling, German Deutschemarks, Japanese Yen, French Francs and the Euro Dollar will be freely convertible to Indian Rupees and vice versa if India were to make her currency fully convertible.

When the currency of a country is convertible on only one of the accounts of the Balance of Payments, for instance Current Account, the currency is known to be convertible on current account only. When the national currency of a country is convertible both on current as well as capital account, it is known as a fully convertible currency. For instance, the Indian Rupee is convertible only on the current account and hence full convertibility of the Indian Rupee is yet to be undertaken. Current account convertibility refers to the facility available to both exporters and importers of goods and services to convert their currencies into foreign currencies for the purpose of importing and exporting goods and services. Capital account convertibility refers to free movement of capital across the borders in the form of foreign direct investment and foreign portfolio investment. Investors can therefore convert their domestic currency into foreign currency at market determined exchange rates and invest money in foreign countries both in the financial and real sectors of the economy.
Convertibility of the Indian Rupee means that the rupee can be freely converted into USD, UK pound sterling, yen, Deutschemark etc and vice versa at the market determined exchange rates. In 1991, as part of the new economic reforms initiated by the Government of India, the Indian rupee was made partially convertible from March 1992 under the “Liberalized Exchange Rate Management” scheme in which sixty per cent of all receipts on current account could be converted freely into rupees at market determined exchange rate quoted by authorized dealers and forty per cent of the receipts were to be surrendered to the Reserve Bank of India at the officially fixed exchange rate. The forty per cent exchange receipts on current account were retained by the Reserve Bank of India to finance the imports of essential commodities. With partial convertibility of the rupee on the current account thus introduced a dual exchange rate system. Due to large deficits in India’s balance of payments, full convertibility on the current account was considered risky by the Government. However, when the Balance of Payment situation improved, the Government of India introduced full convertibility of the rupee on the current account in 1993-94. In March 1994, current account convertibility was extended to the invisible account of the Balance of Trade Account. A currency becomes fully convertible only when capital account convertibility is introduced. However, the macroeconomic situation in India is not yet ripe for capital account convertibility and hence Indian currency is yet to be made fully convertible on the external account.

The report of the Committee on Capital Account Convertibility (CAC) constituted by the Reserve Bank of India under the chairmanship of Mr. SS Tarapore, defines CAC “as the freedom to convert local financial assets into foreign financial assets and vice versa at market determined rates of exchange.” Capital account convertibility helps to increase the inflow of foreign capital. However, capital which has flown in can also flow out under unfavorable conditions. Hence capital account convertibility is introduced only after experimenting current account convertibility for a certain period of time. According to the Tarapore Committee, the advantages of capital account convertibility would be as follows:
1. Availability of larger capital stock to supplement domestic resources, reduced cost of capital and better access to international financial markets.

2. There will be gains from trade in international financial assets as CAC will help residents to hold an internationally diversified portfolio which reduces the vulnerability of income streams and wealth to domestic shocks. Diversified portfolio also enables lower funding costs for borrowers and allows savers to earn better returns on investment.

3. Due to competition, financial intermediation becomes more efficient. The quality of financial assets improves as a result of greater liquidity and deeper markets. Free capital flows enable the realization of efficiency gains created by specialization in financial services. Allocative efficiency also improves leading to financial innovation and better productivity.

4. Integration of domestic financial prices with international prices will take place and as a result domestic tax structures may also integrate with international tax structures. This may eliminate the inducement to avoid taxation and capital flight.

5. It increases the effectiveness of fiscal policy by reducing real interest rates applicable to public sector borrowing, brings about an optimal combination of taxes through a reduction of inflation tax and other taxes to international level with beneficial effects on tax revenue and reduces crowding out effects.

A wise fiscal policy can channelize capital flows into productive investments. In contrast, a fiscal policy gone wrong can reduce credibility and create conditions for capital flight.

13.7 CAPITAL FLOWS

Rapid economic growth of developing countries depends upon rapid industrialization. Rapid economic growth in the modern times in the context of developing countries and particularly in the context of emerging market economies of Asia, Latin America and Central Europe would mean huge investments. Huge investments require large savings. However, the savings generated by the developing countries are not sufficient to match the investment requirements and hence there is a need for foreign capital. Even
when the saving investment gap is zero as in the case of India, the need for foreign capital continues because even if you have the money to buy technology, it is not always available at a price. For instance, the Gross Domestic Savings during the 10th Five Year Plan period (2002-2007) was 31.4 per cent, which is a reasonably high rate of savings. The GDS was only 21.5 per cent in the year 1991-92 which is the year in which economic reforms were initiated. In 2010-11, the GDS was 32.3 per cent.

Foreign capital flows have been taking place since the dawn of economic reforms because of the external sector liberalization of the Indian economy. Due to the influx of foreign capital, the industrial structure of India has widened and deepened i.e. both the variety and quantity of industrial products has increased since then. The multinational firms who develop technology would like to benefit from it through commercial exploitation and not sell it at a price. However, through the foreign capital channels such as **Foreign Direct Investment**, technology comes along with foreign investment. FDI constitutes long term investment and transforms the domestic production process by bridging the technological gap. FDI is a non-debt form of foreign capital in contrast to foreign aid and external commercial borrowings. FDI inflow into India is largely of the equity variety. It is broad based and spread into a range of economic activities like financial services, manufacturing, banking services, information technology services and construction. The other component of foreign capital flows is **Foreign Portfolio Investment**. Portfolio investments are short term investments and are made in the financial sector of the economy as against FDI which goes into the real sector of the economy. The need for foreign capital in the context of developing countries is explained more precisely in the following paragraphs.

1. **Sustaining a High Level of Investment.** Foreign capital becomes important particularly for those under-developed countries whose domestic savings and investments are not large enough to derive high economic growth rates. Countries with a negative saving investment gap definitely needs foreign capital to close the gap and achieve the desired rate of economic expansion. Further, foreign capital assumes importance even in the case of those countries like India whose saving investment gap is zero. Targeting high rates of economic growth i.e. in the range of seven to nine per cent per annum will not be possible even when the savings rate is reasonably high. The capital output ratio is high in developing countries due to the poor nature of technology. Foreign capital not only increases the level of investment but also helps in
reducing the capital output ratio to bring about a higher economic growth rate. It further widens and deepens the secondary and tertiary sectors of the economy. The primary sector remains unaffected because foreign capital is not allowed in this sector in countries like India.

2. Sustaining a High Level of Entrepreneurship. Developing countries have a smaller pool of entrepreneurs. The height and width of the entrepreneurial class is smaller in developing countries. This is proved by the fact that in the list of Fortune 500 companies for the year 2011, there were only eight Indian companies. Out of the eight, Reliance Industries, Tata Motors and Tata Steel were the only three private sector companies with the rest being public sector companies. Indian Oil, ONGC, Bharat Petroleum, Hindustan Petroleum and State Bank of India were the five public sector firms. The number of US companies in the list was 133 with the top three companies, namely: Wal-Mart Stores, Exxon Mobil and Chevron together posting an annual turnover equivalent to the national income of India in 2010-11. Opening the door to foreign investment means opening the door to the sea of entrepreneurial class to your country so that it is no more a pool, it becomes a sea.

3. Sustaining the Development of Basic Economic Infrastructure. The development of transport and communication and power generation is fundamental to rapid economic growth. Poor transport and communication and inadequate power generation means lower capacity utilization and high costs. Further investment in infrastructure projects is lumpy and has long gestation periods. Very few domestic entrepreneurs would have the ability to make huge investments and the patience to wait for a long period to make profits. Private domestic capital would therefore be relatively shy towards infrastructure investments. Foreign capital is not only large but also aggressive to make forays into infrastructure projects like building of expressways, metro-rails, mono-rails, power generation, basic and mobile telephony etc. In countries like India, the state of economic infrastructure is far from satisfactory and poor economic infrastructure fails to actualize the potential growth capacity of the economy. Foreign capital helps to bridge the gap between potential and actual growth rates.

4. Sustaining a Favorable External Balance. Developing countries being dependent on high value imports and low value exports, generally face a negative balance on the trade account.
If the deficit on the trade account is small, it may be wiped out by small surpluses on the invisible account, thereby having either a balance or a surplus on the current account. It is also possible that a country may run deficits on all the accounts in the balance of payments and face a balance of payment crisis. With the overall balance of payment position going negative, a country has the only recourse to seek aid from the international financial institutions like the International Monetary Fund and the International Bank for Reconstruction and Development. With foreign investment, a country may run current account deficits and yet have an overall surplus on the balance of payment account because of a large surplus on the capital account. Further, sustained overall surpluses on the capital account leads to accretion of foreign exchange reserves. For instance, the foreign exchange reserves of India in the year 1990-91 was only USD 5.8 billion whereas in the year 2010-11, the reserves went up to USD 304.8 billion. The great accretion in the foreign exchange reserves of India was due to open door policy to foreign investment adopted by the Government of India in the wake of economic crisis of 1991.

13.8 FOREIGN INVESTMENT IN INDIA

FDI has been the most attractive type of capital flows for emerging market economies because of its lasting nature and also because it is considered as a medium for transforming the domestic production process by bridging the technological gap between the recipient and investing countries. US$ 27.02 billion was the FDI in 2010-11. FDI inflows were dominated by equity capital and they were broad-based i.e., they spread across a range of economic activities like financial services, manufacturing, banking services, information technology services and construction.

FDI Inflows into India (1991-92 to 2010-11).

Open door policy towards foreign investment adopted by the Government of India through its new economic policy has attracted more investments in to the country. Indian Industries have gone global and at the same time, the inflow of FDI in to the country has increased overtime. FDI until the year 2010-11 was of the order of USD 194.3 billion or 62.8 % of the total foreign capital flows in India. The Inflow of FDI into India over the period 2000-01 to 2010-11 is given in the table 7.3.
FDI Inflows to India (2000-01 to 2010-11).

<table>
<thead>
<tr>
<th>Year</th>
<th>(In USD Millions)</th>
<th>Total Inflows</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FDI Inflows</td>
<td>FPI Inflows</td>
</tr>
<tr>
<td>2000-01</td>
<td>4029</td>
<td>2760</td>
</tr>
<tr>
<td>2001-02</td>
<td>6130</td>
<td>2021</td>
</tr>
<tr>
<td>2002-03</td>
<td>5035</td>
<td>979</td>
</tr>
<tr>
<td>2003-04</td>
<td>4322</td>
<td>11377</td>
</tr>
<tr>
<td>2004-05</td>
<td>6051</td>
<td>9315</td>
</tr>
<tr>
<td>2005-06</td>
<td>8961</td>
<td>12492</td>
</tr>
<tr>
<td>2006-07</td>
<td>22826</td>
<td>7003</td>
</tr>
<tr>
<td>2007-08</td>
<td>34335</td>
<td>27271</td>
</tr>
<tr>
<td>2008-09</td>
<td>37838</td>
<td>-13855</td>
</tr>
<tr>
<td>2009-10</td>
<td>37763</td>
<td>32376</td>
</tr>
<tr>
<td>2010-11</td>
<td>27024</td>
<td>31471</td>
</tr>
<tr>
<td>Total</td>
<td>194314(61.20)</td>
<td>123210 (38.80)</td>
</tr>
</tbody>
</table>

**Source:** Indian Economy, 64th Edition Datt & Sundaram.

The services sector in India has the largest share in the Gross Domestic Product and the performance in terms of attracting FDI has been as good as its status in the economy. The top ten sectors of the Indian Economy which have succeeded in attracting more FDI during the period 2000-2011 and the sector-wise FDI Inflows is given in table 13.4.
### Table 13.4

Sector-wise FDI Inflows to India for the period April 2000 to March 2011.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Sector</th>
<th>Cumulative FDI inflows (in USD Millions)</th>
<th>% age of total inflows</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Services Sector</td>
<td>27007</td>
<td>21</td>
</tr>
<tr>
<td>2</td>
<td>Computer Software and Hardware</td>
<td>10723</td>
<td>08</td>
</tr>
<tr>
<td>3</td>
<td>Telecommunications</td>
<td>10589</td>
<td>08</td>
</tr>
<tr>
<td>4</td>
<td>Housing and Real Estate</td>
<td>9632</td>
<td>07</td>
</tr>
<tr>
<td>5</td>
<td>Construction Industry</td>
<td>9178</td>
<td>07</td>
</tr>
<tr>
<td>6</td>
<td>Automobile Industry</td>
<td>5927</td>
<td>05</td>
</tr>
<tr>
<td>7</td>
<td>Power</td>
<td>5900</td>
<td>05</td>
</tr>
<tr>
<td>8</td>
<td>Metallurgical Industries</td>
<td>4235</td>
<td>03</td>
</tr>
<tr>
<td>9</td>
<td>Petroleum and Natural Gas</td>
<td>3153</td>
<td>03</td>
</tr>
<tr>
<td>10</td>
<td>Chemicals</td>
<td>2892</td>
<td>02</td>
</tr>
</tbody>
</table>

Source: Indian Economy, 64th Edition Datt & Sundaram.

The country wise FDI (Foreign Direct Investment) Inflow from April 2000 to March 2011 for the top 10 countries is given in Table 13.5.

### Table 13.5


<table>
<thead>
<tr>
<th>Ranks</th>
<th>Sector</th>
<th>FDI inflows (In USD Millions.)</th>
<th>Percentage of Total Inflows</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Mauritius</td>
<td>54227</td>
<td>42</td>
</tr>
<tr>
<td>2</td>
<td>Singapore</td>
<td>11895</td>
<td>9</td>
</tr>
<tr>
<td>3</td>
<td>U.S.A.</td>
<td>42542</td>
<td>7</td>
</tr>
<tr>
<td>4</td>
<td>UK</td>
<td>6639</td>
<td>5</td>
</tr>
<tr>
<td>5</td>
<td>Netherlands</td>
<td>5700</td>
<td>4</td>
</tr>
<tr>
<td>6</td>
<td>Japan</td>
<td>5276</td>
<td>4</td>
</tr>
<tr>
<td>7</td>
<td>Cyprus</td>
<td>4812</td>
<td>4</td>
</tr>
<tr>
<td>8</td>
<td>Germany</td>
<td>2999</td>
<td>2</td>
</tr>
<tr>
<td>9</td>
<td>France</td>
<td>2264</td>
<td>2</td>
</tr>
<tr>
<td>10</td>
<td>U.A.E.</td>
<td>1893</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>129716</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Indian Economy, 64th Edition Datt & Sundaram.
Mauritius has been the leading country in terms of FDI in India. Out of the total FDI, 42% was contributed by Mauritius, followed by Singapore, USA and UK. Netherlands, Japan and Cyprus contributed four per cent each, Germany and Japan contributed two per cent each with United Arab Emirates contributing one per cent. The balance 20% was contributed by rest of the world with each country having less than one per cent share in FDI.

FOREIGN PORTFOLIO INVESTMENT.

FPI flows were of the order of USD 123.21 billion (38.8 %) of the total foreign capital flows by the year 2010-11. With greater openness in the emerging market economies and developing countries, portfolio investment flows became net outflows in one out of the last four years ending 2011. The year 2008-09 witnessed a great reversal in the wake of the Global Financial Crisis with a massive net outflow of US$ 13.85 billion.

13.9 QUESTIONS

a. Write a note on India’s Balance of Payment position since 1991.

b. What do you understand by exchange rate and explain the exchange rate policy of India?

c. Write a note on convertibility of Indian Rupee.

d. Explain the trends in Foreign Capital Flows in India during the period 2000-01 and 2010-11.