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ECONOMIC DEVELOPMENT AND POLICY IN INDIA

Section B : Sectoral Aspects of the Indian Economy

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Graduate Course

Economic Development and Policy in India

Section B: Sectoral Aspects of The Indian Economy

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LESSON 1 **UNIT I**

'AGRICULTURE- ROLE, GROWTH, PRODUCTION AND PRODUCTIVITY'

- Dr. Anupama Rajput

Studying this chapter should enable you to understand:

- Role and importance of agriculture in India.
- Major trends in agriculture growth.
- Patterns of agriculture production and productivity.
- Reasons of low agriculture productivity.
- Measures to improve agriculture productivity in India.

Introduction

Agriculture is the backbone of Indian economy because of its high share in employment and livelihood creation. The share of agriculture in the gross domestic product has registered a steady decline yet this sector provides direct employment to more than fifty percent of total workforce in the country and a large proportion of the population depends upon agro-based industries and trade of agriculture products. It is also an important source of raw material and demand for many industrial products, particularly fertilizers pesticides, agricultural implements and a variety of consumer goods contribute significantly to the exports. However, the growth of agriculture over a period of time remained lower than the growth in non-agriculture sectors.

Role and Significance of Agriculture in India

Agriculture has a key position in India's economy in view employment and contribution to the national income and international trade.

1. Agriculture is the largest provider of Employment

Agriculture continues to be largest source of employment and livelihood. In the year 2006-07 around 52 percent of the country's workforce is directly engaged in agriculture and allied activity which is down from 70 percent in early 90's and 57 percent in 2001. Besides direct employment this sector provides employment in ago-based industries like edible oils, cotton, sugarcane etc. Further, large employment opportunities are also generated in activities that handle agriculture products like storage, transportation, rural banking and agriculture export.

2. Agriculture Contribution to the National Income

In the early 1950s, half of India's GDP came from the agricultural sector. By 1995, that contribution was halved to about 25 per cent. The significant contribution of agriculture sector to the GDP of the country in the initial period of planning period reflects the inadequate development of non-agriculture sector. Table1 below gives an overview of share of agriculture output in India's GDP:

Table1: Share of Agriculture Output in India's GDP

Year	1950-51	1965	1976	1985	1991	1997	2007
% Share	52.2	43.6	37.4	32.8	28.3	24.4	18.5

Source: various issues of economic survey

As expected of virtually all countries in the process of development, as a result of development in non-agro sector in the recent years, the share of agriculture in total GDP has registered a steady decline from 52.2% in 1950-51 to 18.5% in 2006-07 in India.

3. Agriculture supplies raw material for Large Section of Industry

Agriculture provides raw material to various industries such as cotton textile, jute, sugar etc. The food processing, village and cottage, handloom industries are also dependent upon agriculture for inputs.

4. Agriculture provide food-Surplus to the Expanding Population

The agriculture in India meets almost the entire food needs of the growing population. The proportion of food-imports in the total import has always been quite low and declining. The growth in the agriculture sector, though lower than in the non-agriculture, nonetheless remained higher than the growth of population. Between 1950-51 and 2006-07, production of food grains increased at an average annual rate of 2.5 percent compared to the growth of population which averaged 2.1 percent during this period. As a result, India almost became self-sufficient in food grains and there were hardly any imports during 1976-77 to 2005-06, except occasionally. In 2006-07, food grains constitute only around 2.1 percent of total imports of the country.

5. Agriculture provides Market for Industrial Goods

The majority of population in rural India is dependent upon agriculture. The demand of industrial goods in rural India is largely dependent upon agriculture development. Agriculture thus has significant forward and backward linkage with industries.

6. Agriculture holds significant position in international Trade of Indian Economy:

Though the share of agriculture in total exports is falling, agricultural products and agro-based commodities accounted for about 10.35 percent of total exports in 2006-07. This reflects the increasing dynamism of the economic profile of the country. Further, agriculture accounts for 4 percent to 6 percent of total value of imports. Thus agriculture sector occupies an important position in the country's international trade of Indian economy. In fact a major portion of international trade is in the agricultural products.

7. Agriculture sustains a Larger Economic Infrastructure

Agriculture sector provides support to the economic infrastructure in terms of warehousing, marketing and processing of agro products. Further this sector utilizes a large part of nation's transportation system and rural banking services.

Self-Check Questions

- Explain the contribution of agriculture sector to the GDP and employment generation?
- Explain the linkages of agriculture growth with industrial sector?
- What is the position of agriculture sector in the international trade of the country?

Trends in Agriculture Growth in India

Agriculture contributes significantly to the growth in GDP of the country but has remained the slowest moving sector of Indian economy. During the pre-green revolution period, i.e. from independence to 1964-1965, the agricultural sector grew at an annual average of 2.7 per cent. This period saw a major policy thrust towards land reforms and the development of irrigation infrastructure. In the post green revolution period from the mid -1960s to 1991**,** the agricultural sector grew at average of 3.0 percent with 3.5 percent during 1980-1981 to 1990-1991. The green revolution period involved the adoption of modern technology to the agriculture sector (Table 2).

The agricultural sector**'**s growth decreased to 2.9 per cent during 1992-93 which was further reduced to 2.5 percent during 1997-1998 to 2006-07. The important reasons for the slowdown are: no major breakthrough in developing new high-yielding varieties during the 1990s, reduction in the public expenditure in agriculture sector and a decline in the environmental quality of land which reduced the marginal productivity of the modern inputs.

Table 2: Average GDP growth rates of agriculture sector at 1999-2000 prices (Percent)

Period	Years	Total Economy	Agriculture & Allied	Non-Agriculture
Pre-Green Revolution	1951-52 to 1967-68	3.7	2.5	4.9
Green Revolution	1968-69 to 1980-81	3.5	2.4	4.4
Technology dissemination	1981-82-1990-91	5.4	3.5	6.4
Early Reforms	1991-92 to 1996-97	5.7	3.7	6.6
Ninth and Tenth Plan	1997-98 to 2006-07 2005-06 to 2006-07	6.6 9.5	2.5 4.8	7.9 10.7

Source: Economic Survey 2007-2008

Agriculture Production and Productivity in India

The agriculture production refers to the total production or output produced of two kinds of crops viz. food crops and non-food crops. Food crops consist of cereals such as rice, wheat, jowar etc and pulses such gram, moong etc. The non-food crops consist of oilseeds, sugarcane, cotton, jute etc. In India food-crops are grown over nearly three-fourths of gross sown area. Table 3 gives the trends in agriculture production.

Trends in Agriculture Production

In the earlier years of economic planning, food availability was the serious problem in India. The total food grain production was hardly 51 million tones in 1950-51, which

increased to 217 million tones in 2006-07and is expected to grow to 219.3 million tones in 2007-08 (Economic Survey 2007-08).

The trends in growth rate of total production clearly indicate that the total food grain production witnessed a tremendous spurt in the post green revolution period (mid 60's to 1990). During the period (1964-65 to 1980-81), the growth rate remained subdued. It may be noted however, that the area expansion having slowed down considerably, the output growth during this period was achieved through tremendous improvement in the yield growth (Table3). During this period, Acharya (1998) explains that the policy package for this period was substantial and consisted of: a) introduction of high-yielding varieties of wheat and rice by strengthening agricultural research and extension services, b) measures to increase the supply of agricultural inputs such as chemical fertilizers and pesticides, c) expansion of major and minor irrigation facilities, d) announcement of minimum support prices for major crops, government procurement of cereals for building buffer stocks and to meet public distribution needs, and e) the provision of agricultural credit on a priority basis. The physical and institutional infrastructure relating to marketing of agriculture output was also created. Further, the growth in net area cultivation also contributed to the agriculture growth.

The period since the early 1990s (the economic reforms were initiated in 1991) is much worse compared to any other period since independence and this comparison is quite stark when compared to the preceding decade, i.e. 1980s. In the eighties, the rate of growth of agricultural output (all crops) was 3.19 per cent; this figure was halved to 1.58 per cent, in the subsequent period. The rate of growth of food grains production, decelerated to 1.2 per cent during the reform period (1991-2007), lower than annual rate of growth of population, averaging 1.9 per cent (Table 3 & 4). Since 1991, Government initiated the process of economic reforms, which involved deregulation, reduced government participation in economic activities, and liberalization. Though much of the reforms were not initiated to directly affect agriculture sector, this sector was affected indirectly by devaluation of exchange rate, liberalization of external trade and disprotection to industry. The new international trade accord and WTO, requiring opening up of domestic market were expected to provide productivity gain through increased exports growth. However, the trade liberalization resulted into real threat for several commodities produced in the country due to cheap imports with very slow export growth. Export growth from India has not shown a large increase due to the still-existing restrictions on exports in the major importing international markets (Table 3& 4).

Table 3: All India Growth Rates of Area (A), Production (P) & Yield(Y) of Crops

Crop	1949-50 to 1964-65			1967-68 to 1980-81			1980-81 to 1989-90			1990-91 to 1999-2000			2000-01 to 2006-07		
	A	P	Y	A	P	Y	A	P	Y	A	P	Y	A	P	Y
Food grain	1.35	2.82	1.36	0.38	2.15	1.33	-0.23	2.85	2.74	-0.07	2.02	1..52	0.38	1.19	1.74
Non Food	2.44	3.74	0.89	0.94	2.26	1.19	1.12	3.77	2.31	1.18	2.69	1.09	2.26	4.62	3.66
All Crops	1.58	3.15	1.21	0.51	2.19	1.28	0.10	3.19	2.56	0.27	2.29	1.33	0.93	2.61	3.07

Source: Agricultural Statistics at Glance, Ministry of Agriculture, Government of India, 2007

Table 4: Production of Principal Crops (Million tonnes)

Crops	1960-61	1970-71	1980-81	1990-91	2000-01	2003-04	2004-05	2005-06	2006-07
Rice	34.58	42.22	53.63	74.29	84.98	88.53	83.13	91.79	92.76
Wheat	11.00	23.83	36.31	55.14	69.68	72.15	68.64	69.35	74.89
Coarse cereals	23.74	30.55	29.02	32.70	31.08	37.60	33.46	34.06	34.25
Pulses	12.70	11.82	10.63	14.26	11.07	14.91	13.13	13.39	14.23
Total food grains	**82.02**	**108.4**	**129.59**	**176.39**	**196.81**	**213.19**	**198.36**	**208.59**	**216.13**
Oilseeds	**6.98**	**9.63**	**9.37**	**18.61**	**18.44**	**25.19**	**24.35**	**27.98**	**23.88**
Cotton (Lint)@	5.60	4.76	7.01	9.84	9.52	13.73	16.43	18.50	22.70
Jute & Mesta*	5.26	6.19	8.16	9.23	10.56	11.17	10.27	10.84	11.26

@ Production in million bales of 170 kg. each. * Production in million bales of 180 kg. each.

Source: Ministry of Agriculture, Government of India, 2007

Trends in Agriculture Productivity

Productivity shows the production or output per unit of input. Agricultural productivity is generally studied form two perspectives:

(i) Productivity of Land

(ii) Productivity of Labor

(i) Productivity of Land: It is given as output per hectare of land. In the early period of independence the yield per hectare of land was extremely low in case of all crops. The two major food-crops viz. Wheat and rice have shown substantial increase in productivity during early 70's. The productivity in coarse cereals like maize improved largely after 1980-81.This is mainly due to widespread use of high yielding varieties of seeds**,** development of irrigation facilities and use of fertilizers. In case of other crops like pulses and oilseeds**,** productivity gains have been negligible. But for other food crops the increase in productivity has been very slow. In the case of non-food crops the significant increase in productivity occurs in cotton. The productivity growth in oilseeds has not been very encouraging (Table 5).

Table 5: Productivity Trends in Major Crops (Yield: Kg per Hectare)

Crops	1960-61	1970-71	1980-81	1990-91	2000-01	2003-04	2004-05	2005-06	2006-07
Rice	1013	1123	1336	1740	1901	2077	1984	2102	2084
Wheat	851	1307	1630	2281	2708	2713	2602	2619	2617
Coarse cereals	528	665	695	900	1027	1221	1153	1172	1158
Pulses	539	524	473	578	544	635	577	598	594
Total food grains	**710**	**872**	**1023**	**1380**	**1626**	**1727**	**1652**	**1715**	**1707**
Oilseeds	507	579	532	771	810	1064	885	1004	895
Cotton (Lint)@	125	106	152	225	190	307	318	362	392
Jute & Mesta*	1049	1032	1130	1634	1867	2008	2019	2173	2154

@ Production in million bales of 170 kg. each. * Production in million bales of 180 kg. each.

Source: Ministry of Agriculture, Government of India, 2007

(ii) Productivity of Labor Engaged in Agriculture: It is given as output per person working in agriculture. The per capita output of Indian cultivator is very poor as compared to cultivators in the developed countries. This can be seen from the fact that 52 percent of workforce engaged in agriculture contributes only 18.5 percent of national income in 2006-07. Thus remaining 48 percent (engaged in non-agro sector) contributes more than 80 percent of national income. In

developed nations like USA, U.K. the contribution of agriculture accounts for about 5 percent to 7percent of national income with only 5 percent to 25 percent of workforce engaged in agriculture. This clearly indicates the low level of productivity of workforce engaged in the agriculture.

International Comparisons of India's Agricultural Productivity

Despite the substantial improvements in the productivity in case of major crops the productivity trends in India is far below those obtained in many developed nations. Table 6 gives the productivity of some crops in India and other countries. It is clear from this table that the yield per hectare of rice was less than 40 percent of the yield in the USA and Japan and about one-third of Egypt. In case of other crops also India stands extremely poor in comparison to other countries.

Table 6: International Comparisons of Yield of Some Selected Commodities-2003

Yield (Kg./Hectare)

Rice		**Wheat**	
Country	**Yield**	**Country**	**Yield**
Egypt	9430.89	U.K.	7777.899
U.S.A.	7447.65	France	6234.862
Japan	5849.85	China	3906.534
Myanmar	3705.263	**India**	**2617.094**
Bangladesh	3428.829	Pakistan	2380.716
India	**3000.295**	Bangladesh	1992.288
Pakistan	3054.751	Iran	1984.615
World	**3837.404**	**World**	**2664.966**
Maize		**Groundnut**	
Italy	7744	China	2623.805
France	7137.373	U.S.A	3540.49
Egypt	7710.843	Argentina	2025.641
China	4854.379	Brazil	2082.353
Philippines	1802.012	**India**	**937.5**
Pakistan	1457.143	Uganda	710.9005
India	**2114.286**	Sudan	631.5789
World	**4471.689**	**World**	**1347.466**

Source: Compiled from Economic Survey, 2003.

Causes of Low Productivity

There is no single reason for low productivity in agriculture in India. The causes of low productivity are as follows:

1. General Causes

(i) Excessive Pressure of Population on Land

The heavy pressure of population on land is caused by the limited growth of employment opportunities in the non-agricultural sector for rural people and rapid growth of rural population. In 2001, about three-quarters of the rural working population were employed in the agriculture sector. The increasing population is largely responsible for subdivision, fragmentation of land holdings that results into low productivity of land.

(ii) Social Environment

The social environment in terms of illiteracy, superstitious attitude and unresponsive behavior towards the new technology is also a major limiting factor to the improvement in the agricultural productivity. Further, the human factor engaged in the agriculture sector is most unsatisfactory due to poor health and hygiene conditions.

(iii) Land Degradation

The natural resource degradation in rural areas has occurred due to two major problems one is the increasing population pressure that has resulted into decline in forest cover and second is the erosion and loss of top-soil which is very difficult to reverse. The increased land degradation is mainly due to the increased use of chemical fertilizers, and low quality of canal water. This has resulted into loss of nutrients in the land and fall in the productivity levels.

(iv) Lack of General Infrastructural Facilities

The economic rural infrastructural facilities are inadequate in terms of availability of road, transportation facilities, electricity and power. The Government's expenditure on total rural development has declined tremendously. There is a marked slowdown in capital formation in the agriculture sector.

(v) Inadequate Agricultural Capital Formation:

Agriculture sector cannot make substantial contribution to the economic development of the country. The capital formation in the agriculture sector particularly the public capital formation in the agriculture sector is declining. The investment in agriculture as a proportion of GDP has fallen from 1.92 per cent in 1990 to1.31 per cent in 2003. The depressed capital formation has resulted into low agriculture productivity.

2) Institutional Causes

(i) Defective Land Tenure System

The exploitative character of land tenure system in the form of Zamindari system has reduced the capacity, incentive and motivation of the cultivators to improve productivity. The exploitative practices in terms of excessive rent, insecurity of land tenure and no land ownership rights causes cultivators to share large portion of output with land owners. This has resulted in lack of resources and interest of farmers to introduce technological improvements and thus increase productivity.

(ii) Uneconomic Land Holdings

The average land-holding in India is not only small in size but split into pieces and scattered due to sub-division and fragmentation of land. The average land-holding is just 2.30hectares according to the latest agriculture census in India. This has resulted into the uneconomic land holding making investments in improved technology and inputs unviable .This has caused reduction in land productivity.

(iii) Inadequate Credit and Marketing Facilities

There has been a drastic reduction of institutional credit for agriculture. It is evident from the fact that the percentage share of agricultural credit, in the total credit of all scheduled commercial banks since the early 1990s has fallen compared to the levels, reached in the 1980s. Banks and financial institution are reluctant to provide financial assistance at fair rate of interest to farmers. Since 2003**,** however, there is an increase in absolute amount of credit to agriculture sector of all banks. However, the most disturbing trend of institutional financing in the recent years is the increase in the share of indirect financing by these institutions. The share of direct financing of farmers has declined tremendously. Thus, a large section of farmers has to depend upon non-institutional credit system (like moneylenders, and traders) that charge exorbitant rate of interest. The investment for improved seeds, irrigation facilities and other improved technological requirements to increase land productivity is adversely affected due to paucity of funds.

3) Technical Causes

Technological Backwardness

Most of farmers use traditional agriculture methods mainly due to paucity of finance. The use of high-yield variety seeds and fertilizers is very limited. Since the early 1990s there has been the weakening of scientific research and extension services by the government. By all accounts, the agricultural universities, which had played a critical role in the development and dissemination of better quality seeds, other inputs and improvement in agricultural practices, have been starved of funds with adverse consequences. Government has withdrawn from provisioning of HYV seeds developed in laboratory to the farms. Farmers have to pay exorbitant prices to the private suppliers for the low quality seed variety which has adverse consequences on the agricultural productivity.

Increasing Input Cost

The increase in the input cost due to reduction in subsidies for fertilizers and better seeds and increase in cost of power are responsible for the deceleration in the agriculture growth in the recent years.

Inadequate Irrigation Facilities

The vast proportion of cultivable land in India is rain-fed. Further, the infrastructure for irrigation is highly underdeveloped due to defective management as revealed by the fact that only 52.4 percent of the land was irrigated in the year 2003. A good monsoon results in a robust growth for the economy as a whole, while a poor monsoon leads to a sluggish growth. As rainfall is often insufficient, uncertain and irregular, it leads to low productivity. Further, the Government's expenditure on irrigation coverage and flood control has witnessed a declining

trend during the reform period. The constant and regular supply of water is required to use chemical fertilizers and other technological resources to boost up production.

Self-Check Questions

- Give the international comparison of agriculture productivity in India?
- Explain the trends of Indian agriculture production and productivity?
- What are the institutional causes of low agricultural productivity in India?
- "Technological backwardness is not sole factor that explain retarding agriculture growth in India". Comment on this statement.

Measures to Improve Productivity

Government has initiated various measures to overcome the problem of low agriculture productivity but the following measures are required to strengthen the agriculture development**:**

(1) Effective Implementation of Land Reforms

The land reforms in terms of Zamindari abolition, ceiling and redistribution of land tenurial relations, consolidation of small and scattered holdings, minimum wages of landless labor etc needs to be effectively implemented. This will help to provide incentives and motivation to farmers to improve productivity and investment in agriculture sector. It will also have social implication by providing due share in the output. The strong political will and better administrative skills are required to operationalize these reforms at the grass root level.

(2) Greater Usage of Modern Technology

The components of modern technology in terms of improved seeds, fertilizers and pesticides have to be made available easily to the farmers at fair prices. Farmers are required to be given training about the usage of these components especially fertilizers and chemical pesticides. The services of constant expertise, guidance and counseling about seeds sowing, time of sowing etc needs to be developed. In fact a second green revolution is required to distribute these technological inputs including improved variety of seeds to the cultivators.

(3) Better Credit Facilities

The timely and sufficient financial assistance is the precondition to improve usage of better technology. Government had launched various schemes and institutions to improve agricultural credit such as establishment of cooperative banks, rural branches of nationalized banks, grameen banks etc. However, there is a lack of coordination under the multi-agency credit system. Further, there is an absence of appropriate motivation and knowledge especially amongst commercial banks to provide agriculture credit in the rural areas. In fact, the rural credit system should be developed as comprehensive financial cum service constancy organization that provides financial and farm-related help to the farmers.

(4) Restructuring Cropping Pattern

The scientific research has mainly focused upon two major crops viz, wheat and rice. The breakthrough in terms of improved varieties of seeds has to be explored for other crops.

(5) Development of Irrigation Facilities

The main obstacle in the exploitation and use of modern technology is the water shortage. The inter-linking of river projects needs to be implemented speedily to reduce the ill-effects of floods and droughts. The greater use of dry and commercial cropping that requires lesser use of water should be encouraged. The surface-irrigation and water-pumping arrangements should be increased.

(6) Development of Research Institutes

The research labs and agricultural universities have to be established, upgraded and sustained. The problems such as lack of resources, equipments and experts in these institutes need to be addressed immediately. The weakening of link between laboratory research and application on farm has to be minimized

(7) Betterment of Warehousing and Distribution Services

The warehousing facilities are so under-developed that it renders the stored goods unsuitable for consumption. It is paradoxical that the country suffers from deficient food supplies in many regions and the food grains are rotten in warehouses. The modern warehousing facilities, transportation system and marketing methods needs to be developed to increase the availability of food to the masses. This would provide incentives to marketable surplus among farmers and go a long way to improve productivity. The public- private alliance may be encouraged to increase investment in warehousing services.

(8) Population Control

The continuous growth in the population especially in the rural areas is the major cause of uneconomic land-holding which limits the usage of modern technology. Thus the family planning and population control remain national priority.

(9) Introduction of Co-Operative Farming and Marketing

The co-operatives in India are suffering due to strict Government controls and legislations. The co-operative should be given greater operational freedom and allowed to enlarge their activities including banking and marketing of agro products.

Agriculture Policy, 2000

The Government on 28th July 2000 made public a National Agriculture Policy aimed at catapulting agricultural growth to over 4 per cent per annum by 2005. This growth is to be achieved through a combination of measures including structural, institutional, agronomics and tax reforms discussed as follows**:**

- Price protection to farmers in the post- WTO regime when all the quantitative restrictions are removed.
- Private sector participation would be promoted through contract farming and land leasing arrangements to allow accelerated technology transfer, capital inflow, assured markets for crop production, especially of oilseeds, cotton and horticultural crops.

- Private sector investment in agriculture would be encouraged, particularly in areas like agricultural research, human resource development, post harvest management and marketing.
- Government would enlarge coverage of futures markets to minimise the wide fluctuations in commodity prices as also for hedging their risks. The policy hoped to achieve sustainable development of agriculture, create gainful employment and raise standards of living.
- The Policy envisages evolving a "National Livestock Breeding Strategy" to meet the requirement of milk, meat, egg and livestock products and to enhance the role of draught animals as a source of energy for farming operations.
- Plant varieties would be protected through a legislation to encourage research and breeding of new varieties. Development of animal husbandry, poultry, dairy and aquaculture would receive top priority.
- The restrictions on the movement of agricultural commodities throughout the country would be progressively dismantled. The structure of taxes on foodgrains and other commercial crops would be reviewed.
- The excise duty on materials such as farm machinery and implements and fertilisers used as inputs in agricultural production, post harvest storage and processing would be reviewed.
- Appropriate measures would be adopted to ensure that agriculturists, by and large, remained outside the regulatory and tax collection system.
- Rural electrification would be given high prioity as a prime mover for agricultural development.
- The use of new and renewable sources of energy for irrigation and other agricultural purposes would be encouraged.
- Progressive institutionalisation of rural and farm credit would be continued for providing timely and adequate credit to farmers.
- Endeavour would be made to provide a package insurance policy for the farmers, right from sowing of crops to post-harvest operations, including market fluctuations in the prices of agricultural produce.

The agriculture policy, 2000 emphasized on the organizational and institutional changes to improve agriculture growth.

National Policy for Farmers, 2007

Government of India has approved the National Policy for Farmers, 2007 taking into account the recommendations of the National Commission on Farmers and after consulting the State Governments. The National Policy for Farmers, among other things, has provided for a holistic approach to development of the farm sector. The focus will be on the *economic well being of the farmers* in addition to improved production and productivity. The broad areas of its coverage include:

(i) ***Asset reforms:*** To ensure that a farmer household in villages either possesses or has access to a productive asset or marketable skill.

(ii) ***Water use efficiency:*** *the* stress on awareness and efficiency of water use will be given.

(iii) ***New technologies*** like biotechnology, information and communication technology (ICT), renewable energy technology, space applications and nano-technology would be encouraged for improving productivity per unit of land and water on a sustainable basis.

(iv) ***National Agricultural Bio-security System*** would be established to organize a coordinated agricultural biosecurity programme.

(v) ***Seeds and Soil Health:*** Quality seeds, disease free planting material and soil health enhancement hold the key to raising small farm productivity. Every farmer is to be issued with a soil health passbook containing integrated information on farm soils with corresponding advisories.

(vi) ***Support services for women:*** Appropriate support services like crèches, child care centres and adequate nutrition needed by women working in fields would be funded.

(vii) ***Credit & Insurance:*** The financial services would be galvanized for timely, adequate and easy reach to the farmers at reasonable interest rates.

(viii) ***Gyan Chaupals*** *will* promote learning of farmers thereby strengthening extension services.

(ix) Necessary steps would be taken to put in place an appropriate *social security scheme* for farmers.

(x) ***Minimum Support Price (MSP)*** mechanism to be implemented effectively across the country so as to ensure remunerative prices for agricultural produce.

(xi) ***Food Security basket*** **is to be enlarged** to include nutritious millets such as bajra, jowar, ragi and millets, mostly grown in dry land farming areas.

LESSON 2

LAND REFORMS

- Dr. Anupama Rajput

Studying this chapter should enable you to understand:

- Meaning and Rationale of Land Reforms in India
- Components of Land Reforms
- Appraisal and Progress of Land Reforms in India
- Government Measures

Introduction

Land is the crucial factor in the agricultural operations. The size, distribution and ownership pattern of land holding referred to as land tenurial determines the social-economic status of cultivators. These factors are important components of institutional framework of agriculture. The institutional framework also affects the agricultural productivity. In India the ownership and control of land was highly concentrated in a few landlords whose main intention was to extract maximum rent, either in cash or kind, from tenants. As a result, agricultural productivity suffered and oppression of tenants resulted in a progressive deterioration of their plight. Land reforms were initiated to change land relations favorable to actual tillers of land.

Land Reforms: Meaning and Rationale

In India, the average holding is small in size and is highly scattered which makes it uneconomic for production. Further, the land tenurial system (i.e. size, distribution and ownership pattern of land holding) in India has been characterized by wide disparity in the land ownership whereby land is owned in bulk by few. It is evident from the fact that according to the most recent agriculture census more than half of rural population dependent upon agriculture (nearly 63 percent) own smallholdings of less than 1 hectare, with large parcels of 10 hectares of land or more in the hands of less than 2 percent. The absolute landless and the nearly landless (those owning up to 0.2 hectares of land) account for as much as 43 percent of total peasant households. Further, the existence of exploitative intermediaries in the form of zamindari system, allow the land owners to collect large share of production as rent from the actual cultivators. The actual tillers thus possessed no ownership rights over land and worked as tenants on land who can be evicted form the land at will by zamindars. Apart form adding misery to the life of tiling peasants, the system provides no incentives to improve productivity. The land reforms were initiated to ensure incentives and fair reward to cultivators. Thus the important **rationale** of land reforms is:

1. The farm structure based on owner-operated units is more efficient than one based on wage labor. There is little economic motivation for tenant farmer or wage labor to develop farmland for increased production. Since a cultivator who did not have security of tenure, and was required to pay a high proportion of output in rents, was less likely to invest in land

improvements, or use high yielding varieties or other expensive inputs likely to yield higher returns. As a result, agricultural productivity suffered. The land distribution in favor of actual cultivators thus helps to increase agriculture productivity as it offers direct economic benefits to the actual tillers.

2. Land being the most important productive asset in the rural areas. The ownership and the tenacity of land determine the social and economic status. The redistribution of land in favor of rural poor would help to improve their economic well-being, nutritional intake and access to credit. This would reduce income inequalities and rural poverty.

3. Apart from its economic role, land reforms have profound social impact. If the patterns of ownership are fair and just it enhances faith in justice and equity. A skewed land distribution pattern, alienation, or poverty is bound to lead to social discontentment, widespread unrest, and violent venting of frustration and anger. This could further increase volatility in a multi-ethnic and multi-religious country like India.

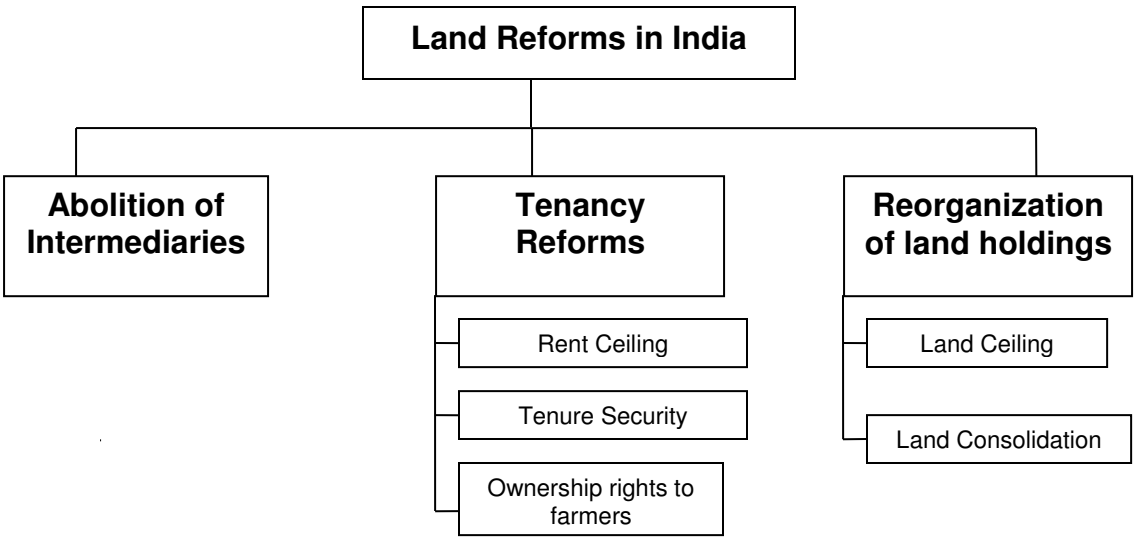
4. The small and marginal land-holding results in under-utilization of land since the uneconomic land area is generally put to non-agriculture use mainly for housing or sale of land.

5. The inequality of land holding cause land degradation and has adverse ecological impact. In an effort to increase production on the limited land it is rigorously exploited by applying overdose of artificial fertilizers and chemical. This reduces the natural fertility of soils and increases its vulnerability to erosion**.** The excessive ground water irrigation causes salinization and problems like water logging.

Definition of Land Reforms

Land reforms may be defined as institutional changes that aim at changing the land relations favorable to the actual tillers of land and increasing the average farm-size of the cultivators. Land reforms consist of **two changes** or **reforms one** is to reform the land relations between the owners and actual tillers of land and **second** is to change the average size of land holding so as to make it an economically viable unit. The objective of land reform is to provide social justice to the cultivators in order to assure equal opportunity to the larger section of rural population and to promote agriculture growth. The land reforms consist of the **following measures:**

- Abolition of Intermediaries
- Tenancy Reforms
- Reorganization of land holdings



1. Abolition of Intermediaries

Broadly speaking the intermediary pattern of land tenure system can be grouped into three distinct categories viz ryotwari, mahalwari and zamindari. Under ryotwari system the registered holder of land is recognized as its proprietor and pays revenue directly to the government. The holder is at the liberty to sublet the property or transfer it. The system led to increase in the number of tenant peasants and landless labor.

In the Mahalwari system, the community of peasant own land and are co-sharer of the land. The co-sharers were jointly and severally liable for land revenue. The system developed community based agriculture and attain economies of large scale production. In this system, the village head colleted revenue for which the commission is paid.

Under Zamindari system one or few household owned one or more villages and were responsible for the payment of land revenue to the Government. The basic problem of the system was that it gave rise to a widespread absentee landlordism whereby the landowner or Zamindar own land but don't actually cultivate it. These landlord adopted exploitative practices in terms of charging high rents from tenant peasants who worked on land. These landlords symbolized oppression and tyranny on tillers. It provides no incentive to the cultivators to improve productivity.

The abolition of intermediaries in all forms that covered around more than 40 percent of total land area started in 1948 with the enactment of legislation in Madras. Later on, other states followed the suit. The abolition brought large section farmers into direct relationship with Government i.e. the tillers were made the owners of land they cultivated and were responsible to pay land revenue to the Government. The landless agricultural laborers were also given land from the cultivable waste-land and forest land. The intermediaries were compensated by the Government.

Critical Appraisal

(i) Long delay in Passing Legislations and its Implementation

The delay occurred in passing the bill for zamindar abolition which gave zamindar and other elite class enough time to circumvent the legal requirements of handing over land to peasants. The implementation also suffered as zamindar adopted delay tactics in handing over documents that declare their land-holdings.

(ii) Existence of Loopholes

The big land owners misuse certain provision in enactment to their favor. For instance the land could be evicted and taken back by zamindar for "personal cultivation". The term personal cultivation is defined very loosely. In this manner, zamindars were able to hold large piece of land in their family where cultivation was done by hired agriculture labor. In fact, this led to the new rural capitalist class in the rural economy and brought back the absentee land-lordism

(iii) Manipulations by Zamindar

The large scale manipulations in the form of repurchase of land by fair or foul means from the peasants were very common. The abolition of intermediaries thus suffered from various snags and gave rise to absentee landlordism on the large scale and exploitation of landless laborers persisted in the rural India.

2. Tenancy Reforms

Tenancy cultivation is quite common in rural India whereby the land is cultivated by small farmers and share crop with owners as payment of rent for using land. There are **two types of tenants** prevalent**: i) occupancy or permanent tenants' ii) tenants-at-will or temporary tenants**. Occupancy tenants enjoy permanent right of cultivation which is heritable i.e. transferred to the next generation. Tenants- at-will can be ejected from the land at any time at will of landlords. These peasants are subject to insecurity and exploitation in terms of huge rent. The legislative and administrative measures were taken by the Government to provide security tenants and regulated the rent payable by them. Tenancy reforms included the following measures:

(i) Rent Ceiling: The maximum rent payable by the tenant has been fixed. It cannot exceed one fourth to one fifth in most states.

(ii) Tenure Security: The security of tilling of land is provided whereby the tenants now cannot be ejected at will except for self-cultivation provided the rent is paid.

(iii) Conferring Ownership Rights to Peasants: The legislative changes have been made to provide for conferment of ownership rights on all the cultivating farmers on the payment of specified amount to the landlords.

Critical Appraisal

Tenancy reforms progressed in a large number of states though with varied degree of success with quite a number of peasants and landless laborers were given ownership rights. However, the reform process suffered from ineffective implementations of enormous legislations due to the following reasons:

(i) Misuse of Exemptions and Escape Clauses: In the legislation escape clauses were provided that were misused by big land-owners. For example land-owners resorted to ejection of tenants on the pretext of self-cultivation. In fact, tenancy-at-will with no formal contract was increased. The term self-cultivation was defined very loosely. In this manner the owners were able to resume a substantial part of the land. These owners don't cultivate land but informally lease it out on the basis of sharing of crop. The cultivators under these informal leases are under constant threat of ejection.

(ii) Fictitious surrender of land by tenants to landowners': Land-owners on paper showed that the tenants have been voluntarily given up right on the land in favor of landowners.

(iii) Lack of Information and Economic Support among Poor Tenants: The policy required the payment of specified amount to the owners to obtain ownership rights but the cultivators lack resources to acquire land from owners.

(iv) Non-Availability of Updated records of Land-Ownership: also created problems in proper implementation of land reforms.

(v) Lack of Political will to rigorously implement Tenancy Reforms: As large politicians were big land owners so the slow progress of reforms was in their self-interest.

(vi) Higher Rent: The efforts were made to fix rent rather than to reduce rents. In many places rents were fixed at a level already prevailing or fixed traditionally.

Thus the implementation of tenancy reforms left much to be desired. The land favored well-off land lords and created greater insecurity of tenure in the form of informal leasing of land. The resource constraint of the tenants also prevented the large transfers of land in their favor.

3. Reorganization of Land Holdings

Reorganization of land-holding involves changing the land-size of cultivators so as to make it a viable economic unit. This will help to adopt modern technology and improved agricultural practices. The reorganization of land is undertaken through the following measures:

(i) Ceiling on Land Holdings: The legislative enactments were adopted that fixed the maximum size of the land a person or a family can own. The land over and above the ceiling is declared surplus which is redistributed to the small, marginal and landless farmers. The wide differences exist in the legislative enactments from state to state in terms of ceiling limit, exemptions and distributive policies. Since the inception of ceiling laws Government fixes targets for possession and distribution of surplus land. However, the actual possession and distribution fail to meet

these targets. The implementation of the ceiling laws has been very tardy. In the recent years some state Governments have given relaxation in the ceiling laws to the industry and big farmers.

(ii) Consolidation of Land-Holdings: Small and scattered land-holding were consolidated into compact economic holdings. The small-sized fragmented and scattered with a person/family land at different places were identified and equivalent of consolidated land were given at one place. The programmed was initially started on voluntary basis but later on made compulsory. The important **factors** that cause **sub-division** and fragmentation of land-holdings are:

(a) Pressure of population: The acute growth in the population in the rural causes increasing pressure on the land. Every individual desires a share in the land thus the land gets sub-divided.

(b) Law of inheritance: The Indian inheritance law especially Hindu and Muslim law of succession give equal right of share to all children in the inheritance which led to sub-division and fragmentation of land.

(c) Rural indebt ness: Farmers in rural India are largely dependent upon local money lenders who charges huge interest and very often the land is mortgaged to raise loan. In the event of non-payment of loans the part of land has to be sold off. This led to sub-division of land-holdings.

Consequences of Sub-Division

(a) Wastage of Capacity: The small and fragmented holdings sometimes make it impossible to use for cultivation and so the land capacity is wasted due to uneconomic size.

(b) Higher Cost: The cost of production per unit of land on small-size farm increases. Further, the old techniques are used on such farms that further aggravate the cost of production.

(c) Lack of Modernization or land Improvement Techniques: The mechanized method of cultivation like electric pumps thrashers tractors etc or modern irrigation system cannot be adopted due to limited scale.

(d) Loss of Acreage: The large quality of cultivable land is lost due to boundaries and fencing. The litigation due to disputes on these issues further results into wastage of land.

Critical Appraisal

The reorganization of land aims at bringing reduction in the inequalities of land-ownership in rural areas. The data on the land-holding however suggest that the position is far from satisfactory and the concentration of land-holding in the hands of few is a general phenomenon in villages. The factors behind slow progress in the reorganization process are as follows:

(i) Social Causes: Farmers are found to be attached emotionally to their land and so are unwilling to participate in the consolidation process.

(ii) Impractical: Land quality differs at different places and so it is difficult practically to allot equivalent land to farmers at one place for scattered land.

(iii) Lack of Updated Records and Incompetent Administrative Staff: The consolidation process requires the complete knowledge of land and its quality but due to lack of record it becomes difficult to implement it.

(iv) Corruption: The dishonest administrators helped the big land owners to make fake transfers and evade ceiling laws. Further, the waste, barren or low-quality land was declared as surplus land that could not be cultivated.

(v) Long Delays and Litigation: The time-gap between the announcement of the policy and enactment of laws also enable to make fictitious transfers and sales of land to evade ceiling laws. The legal cases were filed in the courts in this regard. Thus the big chunk of potential surplus land was lost as the legal battles dragged for years.

(vi) Lack of Political Will: The ceiling laws lack proper political backing due to excessive big farmer's pressure on the political parties.

Suggested Measures

1. Strengthening of Legal Framework: The loopholes in the existing laws should be plugged. There should not be any scope of conflicting interpretations. The provisions should be made for speedy settlements of disputes. The laws should provide for easy registration of all the transactions connected with land, including tenancy agreement.

2. Computerization of Land Records: Lack of proper land records is an important cause of slow progress of land reforms in India. The administrative set-up must ensure updated and timely compilation of land records. Computerization can help to improve efficiency and preservation of data on land. This information is useful to determine surpluses of land, distribution of the surplus of land, profile of land ownership, resolving of land disputes.

3. Greater Awareness and support: The beneficiaries of land reforms namely, small farmers, being illiterate and resource-poor lack the awareness of the schemes and procedures on land reforms. The awareness programme at the grass-root level has to be initiated. The financial support should be provided to landless cultivators so as to acquire ownership rights on land.

4. Motivated Administrative Personnel: The efficient and devoted personnel are the prerequisite for an effective implementation of legislations. The time-bound targets on computerization, distribution of land can be started to improve accountability of personnel.

5. People's Participation: It is important that the people interested in land reforms are associated with their implementation. It helps to improves administration's accountability. NGO's may take up the grievance of the farmers and pursue the court cases on behalf of farmers.

6. Strong Political Will: The political leaders should commit to the speedy land reforms across all states. The mass awakening among cultivators for these reforms can be initiated by them.

7. Prevent Re-emergence of Informal Tenancy: Quick surveys for recording of tenants should be conducted to prevent the coercive transfer of land by cultivators.

Conclusion

A degree of success has been achieved in certain regions and states, especially with regard to issues such as the abolition of intermediaries, protection to tenants, rationalization of tenure systems, and the imposition of ceilings on landholdings. However, a number of problems remain far from resolved. The studies indicate that inequalities have increased, rather than decreased. The number of landless laborers has risen, while the wealthiest 10 percent of the population monopolizes more land now than in 1951. Vested interests of the elite landowners and their powerful connection with the political-bureaucratic system have blocked meaningful land reforms and their implementation. Loopholes in land tenure legislation have facilitated the evasion of some of the provisions in land ceiling reforms by large landholders.

Concept-Check Questions

- What is the pattern of Land-Holding in India?
- Give rationale of Land reforms of India.
- What are the important methods of tenancy reforms in India?
- Explain the need and methods of consolidation of Land holding in Indian agriculture sector?
- What are reasons of failure of Land reforms in India? Give suggestions for successful implementation of land reforms in India?

LESSON 3

GREEN REVOLUTION

- Dr. Anupama Rajput

Studying this chapter should enable you to understand:

- Meaning and Components of Green Revolution
- Economic Impact of Green- Revolution on Indian agriculture
- Problems associated with Green-Revolution

Introduction

The dramatic transformation in agriculture practices that involves the use of new methods of cultivation and inputs refers to as Green Revolution in India. The green revolution consists of technological improvements which were mainly adopted to increase agriculture productivity. The green revolution occurs as a result of adoption of new agriculture strategy during mid 60's by Government of India to achieve self-sufficiency in the foodgrains production. These changes bring about a substantial increase in agriculture production in a short span of time.

Components of Green Revolution
The core components of new agriculture strategy are :

(i) Use of High-Yeilding Variety(HYV) seeds that matures in short span of time.

(ii) Application of fertilizers, manures and chemicals in the agriculture production.

(iii) Multiple Cropping Patterns that allows farmers to grow two or more crops on the same land as HYV seeds matures quickly. This helped the increase of total production.

(iv) Mechanization of farming with the use of machines like tractors, harvesters pump sets etc in the agriculture occur in a big way.

(v) Better Infrastructure facilities in terms of better transportation, irrigation, warehousing, marketing facilities, rural electrification were developed during the period of green revolution.

(vi) Price Incentives involving provision of the minimum support prices for various crops so as to allow reasonable price to farmers for their produce. This offers inventive to the farmers to adopt new practices.

(vii) Better financial assistance through spread of credit facilities with the development of wide network of commercial banks, cooperative banks and establishment of National Bank for Agriculture and Rural Development (NABARD) as an apex bank to coordinate the rural finance in India.

Impact of Green Revolution

The green revolution resulted quantitative and qualitative development in the agriculture in India. The quantitative improvement occurs as a result of steep increase in the production of agriculture output. The qualitative improvement resulted into adoption of modernized technology in the agriculture. The impact of green revolution can be discussed as follows:

1. Spectacular increase in agriculture production

The dependence on food imports is eliminated with the increase in agriculture production. The country becomes self-sufficient in foodgrains. In fact India was the second largest importer in 1966 and it imported no foodgrain in subsequent decades except during late 80's and early 90's mainly due to failure of monsoons or untimely rains or floods in different regions. However, it may be noted that in recent years annual growth in the food grain production is losing its momentum.

2. Improvement in productivity

The tremendous increase in agriculture production occurred as a result of improvements in productivity. The productivity was quite low in the pre-green revolution period. The substantial increase in the productivity occurred in wheat and rice in the earlier periods but later on it spread to other crops also.

3. Increase in Employment

Green revolution generated employment opportunities into diverse activities which were created as a result of multiple cropping and mechanization of farming. It helped to stimulate non-farm economy that generated newer employment in various services such as milling, marketing, warehousing etc.

4. Food grain Price Stability

The adoption of new agricultural technology has led to the increased production and marketable surplus of crops especially food grains that have resulted into price stability of food items.

5. Strengthening of forward and backward linkages with industry

The increase in agriculture production has strengthened the forward linkage of agriculture sector with industry in the sense of supplying inputs to the industry. The backward linkage with the industry has also received a boost as agricultural modernization created larger demand for inputs produced by industry.

Concept-Check Questions

- **What are the important components of Green Revolution in India?**
- **Explain the meaning of HYV seeds?**
- **What are basic requirements of application of modern techniques in agriculture?**

Problems with Green Revolution

The new agriculture strategy has resulted into increased productivity and returns for farmers. This has resulted in decline in rural poverty to an extent. However, the revolution resulted into increased income, wide interpersonal and regional inequality and inequitable asset distribution. The major problems associated with green revolution are as follows:

(1) Increase in personal inequalities in rural areas

The income inequality between rich and poor increases **due** to:

(i) The owners of large farms were the main adopters' of new technology because of their better access to irrigation water, fertilizers, seeds and credit. In other words, given the need for complex agricultural techniques and inputs, the green revolution benefits the large farmers. The small farmers lagged behind the larger farmer as small farmers had to depend upon traditional production method. Since the rich farmers were already better equipped, the green revolution accentuate the income inequalities between rich and poor.

(ii) Green revolution resulted into lower product price and higher input prices which also encouraged landlords to increase rents or force tenants to evict the land.

(iii) The mechanization pushed down the wages of and employment opportunities for unskilled labor in the rural areas thereby further widening the income disparities.

(2) Increased Regional disparities

Green revolution spread only in irrigated and high-potential rain fed areas. The villages or regions without the access of sufficient water were left out that widened the regional disparities between adopters and non-adopters. Since, the HYV seeds technically can be applied only in land with assured water supply and availability of other inputs like chemicals, fertilizers etc. The application of the new technology in the dry-land areas is simply ruled out.

The states like Punjab, Haryana, Western UP etc. having good irrigation and other infrastructure facilities were able to derive the benefits of green revolution and achieve faster economic development while other states have recorded slow growth in agriculture production.

(3) Environmental Damage

Excessive and inappropriate use of fertilizers and pesticides has polluted waterway, killed beneficial insects and wild life. It has caused over-use of soil and rapidly depleted its nutrients. The rampant irrigation practices have led to eventually soil degradation. Groundwater practices have fallen dramatically. Further, heavy dependence on few major crops has led to loss of biodiversity of farmers. These problems were aggravated due to absence of training to use modern technology and vast illiteracy leading to excessive use of chemicals.

(4) Restrictive Crop Coverage

The new agriculture strategy involving use of HYV seeds was initially limited to wheat, maize and bajra. The other major crop i.e. rice responded much later. The progress of developing and application of HYV seeds in other crops especially commercial crops like oilseeds, jute etc

has been very slow. In fact, in certain period a decline in the output of commercial crops is witnessed because of diversion of area under commercial crop to food crop production. The basic factor for non-spread of green revolution to many crops was that in the early 1960's the severe shortage in food grains existed and imports were resorted to overcame the shortage. Government initiated green revolution to increase food grain productivity and non-food grain crops were not covered. The substantial rise in one or two food grain crop cannot make big difference in the total agricultural production. Thus new technology contributed insignificantly in raising the overall agricultural production due to limited crop coverage. So it is important that the revolutionary efforts should be made in all major crops.

It can be concluded that green revolution is a major achievement for India which has given it a food-security. It has involved the adaptation of scientific practices in the agriculture to improve its production and productivity. It has provided benefits to poor in the form of lower food prices, increased migration opportunities and greater employment in the rural non-farm economy. However, the inequalities between region and individuals that adopted green revolution and those who failed to adopt has worsened. Further, green revolution has led to many negative environmental impacts. The policy makers and scientists are urged to develop and encourage the new technologies that are environmentally and socially sustainable.

Role of Technology in Indian Agriculture

The important reason of low agricultural productivity in India is the unsatisfactory spread of new technological practices, including cultivation of HYV seeds. The adoption of new technology mainly the cultivation of HYV seeds requires intensive use of fertilizers and pesticides under adequate and often assured water supply. The use of HYV seeds involves higher yield risk as compared to the traditional seeds in the absence of proper irrigation facilities. The inadequate irrigation facilities in most part of the country explain the limited regional spread of modern technology. Nearly 64 percent of total cultivated area is rainfed. Further, the irrigated area is generally used for growing rice and wheat while other crops are grown mostly in the rainfed and unirrigated area. In this scenario the technological development in terms of adoption of HYV seeds with chemical and fertilizers is only limited to few regions having irrigation coverage and that too for wheat and rice. Thus the adoption of new technology requires **the development of irrigation facilities** at first place so as to increase its regional and crop spread.

Another, factor that inhibits the dissemination of modern technology is the small and marginal land holdings and **slow progress of tenancy reforms**. The lack of ownership rights on land provide no incentive to adopt improved technology as the production is shared with the land owners and cost of adoption of new technology will be borne by the tenant cultivators. Thus institutional reforms in terms of land reforms have to be strengthened to improve adoption of modern technology.

The use of new technology improves the agriculture productivity. However, it also adds to the instability in the output growth. The application of new technology raises the response of output to water. Thus if applied under the rainfed conditions then the instability in output will be greater. However, the increase in output would be stable if applied under assured irrigated conditions. This requires effective public distribution system to stabilize prices during uncertain conditions.

Thus both institutional and technological changes have played important role in agriculture growth in India. The technological changes by themselves could not bring revolutionary productivity growth in the agriculture without the institutional and infrastructural changes. The new technology cannot be used if the agrarian system suffers from gross inequalities of land ownership and cultivation is in the hands of landless cultivators. Thus land reforms are required to abolish intermediaries and to undertake the reorganization of land holding. Further, modern technique also requires higher amount of investments. Thus organizational reform in terms of better availability of **agri-credit** is also important. In nutshell, it can be concluded that though technical reforms provide modern inputs to increase agriculture production but organizational and institutional reforms would provide suitable conditions to apply these modern inputs.

Self-Check Questions

- Examine the trends in the agricultural production and productivity during the Green Revolution period?
- "Green Revolution has increased he production level substantially. At the same time it has led to substantial increase in the inter-regional and inter-personal inequalities". Discuss.
- "Technological progress is a necessary but not sufficient condition for agriculture growth in India." Comment on the statement.

LESSON 4

AGRICULTURE MARKETING AND PRICING POLICY IN INDIA

- Dr. Anupama Rajput

Studying this chapter should enable you to understand:

- **Structure of Agriculture marketing in India**
- **Agriculture cooperatives**
- **Future trading**
- **Critical Appraisal of Agriculture Marketing**
- **Major Objectives and Instruments of Agriculture Price Policy**
- **Buffer Stock**
- **Appraisal of Agriculture Pricing Policy**

Introduction

Agricultural marketing, essentially being a sub-set of the overall marketing system, refers to all the activities, agencies and policies involved in the procurement of farm inputs by the farmers and the movement of agricultural produce from the farms to the consumers/manufacturers/ exporters. An efficient marketing system minimizes costs and maximizes benefits to all the sections of the society. It ought to provide remunerative prices to the farmer, food of the required quality at reasonable prices to the consumers and adequate margins to the middlemen.

Structure of Agricultural Marketing in India

At present, the structure of Indian agricultural marketing system consists of**:** Agricultural Co-operative Marketing Societies; Regulated Markets; Public Trading and Futures Trading. Besides, there is private trading, which takes place out of these segments. These are discussed as follows:

(i) Agricultural Co-operative Marketing Societies

Under the cooperative marketing society the members of the society agree to sell their surplus produce to the society. As soon as the members supply the produce to the society, an advance is provided to carry on with their agricultural operations. The society collects the produce of all the members and also of the non-members of the village, often processes the produce and then disposes it. The society decides the timing of sale depending upon market conditions of the commodity. If it is felt that the present price is unfavorable and in future the price would rise then society may decide to stock the output and sell it in the future. Generally, the society covers number of villages and thus tends to be effective and successful. Co-operatives have diversified their activities into other areas such as constructing warehouses, providing credit facilities, processing of agro-products, *etc*. The agricultural cooperative marketing is generally featured by a four-tiered structure: viz Primary marketing societies at the base level, District/regional federations at the district level, State marketing federations at the

State level and National Federation at the apex level. The National Agricultural Co-operative Marketing Federation (NAFED) is the apex co-operative marketing organization in India.

Benefits of Co-operative Marketing Societies

The important advantages of cooperative marketing societies are as follows:

(i) The marketing society allows collective bargaining. The individual small farmers have weak bargaining power and so could not fetch better price for their products.

(ii) Marketing cooperative advances loans to the farmers and enables them to wait for better prices. It lends them to meet their demands.

(iii) Cooperative provides storage and warehousing facilities. The large scale storage allows it to obtain insurance benefits. The loss due to damages of agriculture products can be minimized.

(iv) It encourages the farmers to produce standardized products and discourage them from adulterating their produce.

(v) It helps to eliminate the middlemen and so allow better price to the cultivators.

Progress in Co-operative Marketing

The produce marketed through agricultural co-operative marketing societies accounts for about 8 to 10 per cent of the marketed surplus. The important commodities marketed by these societies are foodgrains, sugarcane, cotton, oilseeds, fruits, vegetables and plantation crops. The progress of co-operative marketing societies has varied from State to State and within each State from commodity to commodity. Maharashtra, Uttar Pradesh, Gujarat, Punjab, Haryana, Karnataka and Tamil Nadu together account for more than 80 per cent of the total agricultural produce marketed through co-operatives in the country. In Punjab, Maharashtra, Uttar Pradesh, Andhra Pradesh and Tamil Nadu, 75 per cent of the foodgrains are marketed by co-operative societies. In Maharashtra and Uttar Pradesh, 75 per cent of sugarcane, in Maharashtra and Gujarat, 75 per cent of cotton, and in Karnataka 84 per cent of plantation crops are marketed through the co-operative societies (Rangarajan, 1997).

The net work of cooperative marketing structure now comprises over 6,000 primary marketing societies, at the district level there are 160 central marketing societies covering nearly all the important mandis in the country; at the state level there are 29 general purpose state level co-operative marketing federations and the national level there are National cooperative development corporation(NCDC), the National Agricultural Co-operative Marketing Federation(NAFED), National Cooperative Tobacco Growers Federation, and the Tribal Cooperative Marketing Development Federation of India.

The progress of co-operative marketing societies has been far from satisfactory in most of the States in the country because farmer members do not patronize these societies for the sale of their produce. Instead farmers use the services of commission agents in the regulated markets for various reasons such as easy access to commission agents, facility of advance loan, hassle free transactions and personalized services rendered by commission agents. State intervention

through its nominated officials (secretaries) and politicization of these societies had also been responsible for their failure.

(ii) Regulated Markets

The regulated markets have been organized in most of the States to facilitate trading in an orderly manner in specified commodities at specified places at the least margin. For this purpose, comprehensive rules have been framed and market committees have been set up to enforce discipline among the participants under the respective State Agricultural Produce Marketing Regulations Acts.

Though the establishment of regulated markets was started during 1930s, the programme got momentum only after independence. The number of regulated markets has risen from 236 in April 1951 to 7,161 in March 2001. Nearly 98 per cent of the wholesale markets are now functioning under this scheme. The country also has 27,294 rural periodical markets as on March 2001, about 15 per cent of which function under the ambit of regulated markets (GOI, 2001a). The progress of regulated markets is not uniform in all the States. There are also variations across States in the development of infrastructural facilities as well as market fees charged in the regulated markets. The number of regulated markets and the infrastructural facilities therein are by and large inadequate to meet the current marketing requirements. While regulated markets have helped in mitigating the market handicaps of the producers/sellers at the wholesale level, the rural periodic markets in general and the tribal markets in particular remained out of its developmental ambit.

(iii)Public Trading

The objective of Public or State trading is stabilization of prices at levels that are regarded as remunerative to producers and reasonable to consumers. Under the present practice of public trading , the Government purchases specified commodities at notified procurement prices directly from producers and distributes the purchased items among consumers through a network of fair price shops at notified issue prices.

The price stabilization policy of the Government can be described as a well-conceived package, if we take the objectives, the instruments and terms of reference of the price recommending expert body, *i.e.,* Commission for Agricultural Costs and Prices *(*CACP) into consideration. The price components bear upon production (at minimum support price), securing surpluses (at procurement prices) and distribution or meeting the needs of consumers (at issue prices). The procurement agencies, the fair price shops, buffer stock operations and imports, when necessary, back the implementation of the price stabilisation policy. Thus seen as a whole, these seem to be a well-set design of the price stabilisation policy. However, as for the achievement in terms of price stabilisation is concerned, the success has not been as expected. The short-term prices have been fluctuating because of random impact on supply. Generally, these are at the lowest at the time of harvest and the highest before the next crop is harvested. Quite a substantial part of the crop production consists of distress sale. In certain crops like wheat and rice fluctuations are moderated, partly because the producers being rich have holding power and access to credit/ storage facilities and partly because of the operations of the procurement agencies (Rangarajan, 1997). The increases in the minimum support price of wheat and rice have been pronounced, which led to increasing cultivation of wheat and rice and in turn contributed to the rise in the procurement of foodgrains. The increasing procurement, coupled

with declining off-take, had raised the level of food stocks as against the buffer stock norms in the recent past years. The cost of operations of the procurement agencies has therefore gone up substantially and the open-ended procurement by these agencies has become unsustainable.

(iv) Futures Trading

Future trading has also been allowed to protect the market participants from the risk arising out of adverse price fluctuations. There is a three-tier regulatory structure for conduct of futures trading. At the base level, there are recognized/ registered commodity associations/ exchanges. At the middle level, there is Forward Markets Commission (FMC), which regulates the functioning of commodity exchanges and approves their constitution and byelaws. The Department of Consumer Affairs, Ministry of Consumer Affairs, Food and Public Distribution, Government of India is at the top level, which oversees the overall functioning of the forward and futures markets.

Till 1991, futures trading was permitted in only 6 commodities. The process of reform was set in motion with the setting up of Kabra Committee, which submitted its report in 1994. Since then, several measures have been initiated in a phased manner to promote futures markets in the country. But the pace of reforms has so far been slow and cautious. At present, future trading is permitted in 81 commodities under 25 commodity exchanges. Government however has suspended 6 commodities (including wheat and rice) for future trading to curb inflation.

The response of the future market has been quite remarkable as seen by the enthusiasm shown in the commodity segments. In some areas farmers are gradually getting aware of futures prices which are disseminated through exchanges. In general, the commodity exchanges are deficient in several aspects such as infrastructure, logistic, organizational structure, management, linkages with spot markets and financial markets, reliability and an efficient market information system. Of late, the number of active members and the volume of trade in most of the commodity exchanges had been shrinking. Setting up of screen-based online trading, warehouse receipt system, guarantee fund, electronic clearinghouse and settlement system, *etc.* have not found favour with most of the commodity exchanges so far. The resource crunch has, no doubt, been the major constraint facing most of the exchanges in undertaking these reforms.The Budget 2008-09 apart from an incidence of 12 per cent service tax and 2 per cent education cess, slapped Rs. 17 per lakh for commodities trading and 6 per cent as exchange levy. Budget has failed to meet the expectations of participants in the commodity future markets. This is likely to hinder the growth of commodity market in India. In a nutshell, the commodity futures markets in India continue to be underdeveloped .There is an urgent need to educate farming communities on how to use the exchange to hedge their price risks. Moreover to opt for the modern mechanisms, consolidation has to happen in Indian agriculture. Banks, FIIs and other institutions should be permitted to trade in commodity markets to improve trading volumes.

Problems facing Agriculture Marketing in India

The economic reforms are currently underway in India that encompasses the agricultural marketing system as well. The essence of these measures is to improve the efficiency and productivity of all institutions whose working is far from satisfactory. Against this background, it is necessary to see the lacunae that have arisen in the agricultural marketing that are discussed as follows:

1. Poor Warehousing Facilities: The Indian farmers lack proper warehousing facilities for storing the agriculture produce. The facilities are so poor that the crops are spoiled in the warehouses. Cultivators fail to get good price for its product.

2. Poor Transportation Facilities: The roads are unusable in many villages. The connectivity of the village roads with the main roads is still missing in many parts of the country. Thus it is difficult to take output to the markets.

3. Problem of Distress Selling: The poverty and indebt ness reduce the capacity to wait for better prices of crops. The cultivators are forced to sell the output to the moneylenders at the cheap price to clear off the debts.

4. Infrastructure Bottlenecks and Corruption in Mandis: The farmers may have to wait before selling its produce in the mandis. In some states mandis are very far from the villages. The warehousing facilities are not well-developed in these mandis. The intermediaries charge their own commission from the farmers. The unnecessary deductions are made on the pretext of low quality of produce.

5. Lack of awareness of future market: The volume in the commodity market forms a very small percentage of total agriculture trading in India. There is an urgent need to educate farming communities to use commodity markets.

6. Lack of agro-Processing at large scale: Processing of agricultural products especially perishable commodities forms only a small percentage of the total production. The major part of the total production is sold in raw form so farmers get lower prices for their products.

Government Measures to improve Agricultural Marketing in India:

1. Grading and Standardization: The grading stations have been established to grade and standardize many agricultural goods. The graded goods are stamped with the seal of the Agricultural Marketing Department-'AGMARK'. The goods bearing the 'AGMARK' command better prices in the market.

2. Provision of Warehousing Facilities: The warehousing facilities have been provided in the villages to prevent distress sale by the farmers. Apart from Central and State Government, Food Corporation of India has constructed its godowns and warehouses.

3. Marketing Surveys: The market survey of agriculture products are conducted and published to benefit farmers. The surveys also discuss the problems and measures to tackle the problems associated with the marketing of agro-products. The prices of agriculture products in major markets are published widely. Further, for dissemination of information all sorts of media like radio, television, display board etc are used.

4. Cooperative Movement in Agriculture Marketing: Government has helped to establish multi-purpose cooperative societies with emphasis on credit and marketing. NAFED has been

established as an apex cooperative marketing society at national level. Funds and credit facilities are provided to these cooperatives. The training facilities are provided for cooperative personnel.

5. Encouragement of Exports of Agricultural Products: The export of agricultural products has shown an increasing trend in the recent years. The trade policy of the Government has evolved various schemes to improve agro exports. The Agro Export Zones are established to encourage agriculture exports.

6. Setting up of Special Boards: The Government has set up number of special commodities boards like rice, pulses, jute etc to specifically formulate policies for these commodities. The exports councils have been established to suggest measures to improve exports of agricultural commodities.

7. Setting up of Regulated Markets: The government has set up markets for agriculture products which are regulated under the Agricultural Produce Market Act. The management of these markets rest with the committees on which different interests are represented so that cultivators get fair price for their produce.

Suggested Measures

(i) Integration of Domestic Markets with International Markets: The barriers in free marketing across different states especially for foodgrains should be dismantled. This calls for dismantling of restrictions on pricing, trading, distribution and movement of agricultural products within the country. Further, India, being a signatory to the World Trade Organisation (WTO) Agreement, should do away with physical barriers, both for imports and exports, on various agricultural commodities. Simultaneously, it should reduce tariff barriers within a time frame. These steps could facilitate the integration of domestic markets with international markets in due course.

(ii)Strengthening Co-operative Marketing Societies: The progress made by co-operative marketing societies so far, though noteworthy, is not wholly satisfactory. Co-operatives have yet to cover a substantial part of the total agricultural produce. It is, therefore, essential that these co-operatives develop at a faster speed and along right lines. Marketing societies need to be more closely intertwined with other societies dealing with farming inputs, credit, *etc.* The best way to do so is to establish multipurpose societies to look after all the aspects of agricultural marketing. These societies, apart from organizing the sale of agricultural produce, should undertake construction of their own storage capacity, provide for their own transport, arrange for the processing of produce, grade their goods, organize exports, *etc.* This will reduce their dependence on other sources and provide a total view of marketing services to the members.

(iii)Strengthening of Regulated Market Structure: The management of regulated markets is entrusted to agricultural produce marketing committees (APMC) on which different interests are represented. There is an urgent need to make these market committees viable and managerially competent in keeping with liberalized trade atmosphere. The market committees should be headed by marketing professionals. Further, the present number of regulated markets is not enough to meet the growing requirements of the country. There is also an urgent need to develop

rural periodic markets in a phased manner with necessary infrastructural amenities to have a strong grass-root level link in the marketing chain.

(iv) Re-framing Price Stabilization Policy: With a view to provide remunerative price to the farmer, food at affordable price to the consumer and sustained growth of marketable surplus, all undesirable restrictions on agricultural trade has to be removed. Public procurement, storage and distribution of foodgrains need to be managed efficiently on commercial lines.

(v) Developing Efficient Commodity Futures Markets: In order to strengthen the future market Government should set up more commodity exchanges, improve the regulatory and supervisory systems, modernize clearinghouse operations, upgrade training facilities and establish an enabling legal framework to develop vibrant commodity futures market in India.

(vi) Promoting Direct Marketing: Promotion of direct marketing as one of the alternative marketing structures is beneficial for the farmers as well as the buyers as it enables the former to meet the specific requirements of the latter. Direct marketing enables farmers and buyers to economize on transportation costs, handling charges, market fees, *etc.*, to improve price realization considerably. In direct marketing, the market will operate outside the purview of Agricultural Produce Marketing Act and will be owned by professional agencies, such as wholesalers, trade associations, NGOs or self-help groups (SHGs).

(vii)Improving Transport Infrastructure: The traditional rural transport system should be improved. The public investments in the road, railway and waterways should be developed.

(viii)Improving Storage Facility: The private sector needs to be encouraged to enter the warehousing and storage in a big way by extending proper incentives to it. Experiment of the creation of decentralised rural godowns also needs to be pursued more vigorously. Village Panchayats, co-operatives, SHGs, farmers organisations, NGOs, *etc.,* should also be encouraged to undertake warehousing activity under the scheme. In case of perishable commodities like fruits, vegetables and flowers, the complete cold chain comprising pre-cooling, grading, packaging, cold storage and refrigerated vans should be developed.

(ix) Providing Processing, Packaging and Grading Facilities: Proper cleaning, grading and packaging of primary products will need greater attention not only in the physical markets, but also in the villages from where produce is brought to the market for sale. Besides, there is a need to educate the farmers for proper grading and packaging before they bring the produce to the market. In the changed context, new technologies of packing like tetra packs, ascetic packing, pouches, *etc.* need to be introduced.

(x) Making Available Credit for Marketing: Provision of credit by the organized financial system to support agricultural marketing has to grow further. Considerable amount of institutional financing for agricultural marketing is directed towards public organizations. The credit facility available to private traders is quite limited.

(xi)Promoting Agricultural Marketing Research: The agricultural marketing research in the areas of agri-business management, post-harvest management, grading, standardization, quality

assurance, export promotion and information technology should be promoted. The agriculture research institutes and universities should be further strengthened to undertake applied and operational research in agricultural marketing, impart training to market functionaries and provide consultancy services to the public as well as private organizations engaged in agricultural marketing. Further, conferences, seminars, and workshops should be conducted from time to time on current and relevant issues to facilitate exchange of views among various market functionaries.

Conclusion

The agricultural marketing system stands today at a critical stage of its evolution. It needs to meet the growing requirements of farmers, consumers, industry and exports as also of agriculture, which is becoming input-intensive and getting diversified. At the same time, the requirements of the small farmers and poorer sections have also to be met. Efficient marketing can ensure better income for the producers and improved satisfaction to the consumers. This requires the increased public investments to improve infrastructural facilities and proper maintenance and up gradation of the existing facilities through repair, replacements and technological modernization.

Concept-check Questions

- **What are the important components of agriculture marketing structure in India?**
- **What are problems facing agriculture cooperatives in India?**
- **Write a note on future trading in agriculture commodities.**

Agricultural Price Policy

Agriculture price has significant impact on producers and buyers of agriculture products. The agriculture price offers incentives to improve production and marketable surplus to the cultivators and affect the allocation of resources.

Nature of Agriculture Price in India

Agriculture prices depict large fluctuations and except for few years in the beginning of planning since 1951 there has been an almost continuous uptrend in the agriculture prices. The causes of such fluctuations are as follows:

(i)Dependence on Rainfall: The production of agricultural goods is more dependent upon vagaries of nature. A good rainfall results into higher production and scarce or excessive rains/floods have an adverse impact on agricultural output. The erratic natural conditions thus give rise to the sharp variations in the agricultural output supply. These variations in the output gives rise to the large price variations.

(ii) Low price Inelasticity of demand of Agricultural Goods: The demand for agriculture goods particularly food crops don't change with the change in its price. The overproduction in agriculture leads to price crash as demand doesn't increase and under production causes prices to rise as demand doesn't fall.

Objective of Agriculture Price Policy

The stability of agriculture price is essential since the higher agriculture prices affect purchasing power of consumers and greater input cost to the industrial users. The reduction in the purchasing power of the consumer has implication on demand for industrial goods. The **broad objectives** of agriculture price policy in India are:

- To set remunerative prices with a view to encourage higher investment and production in the agriculture.
- To set the prices at levels so that the consumers are not adversely affected.
- Agriculture prices should be such that the terms of trade between agriculture and non-agriculture sector is not adversely affected.
- To set price in such a manner so that optimal crop mix can be achieved.

Thus, theoretically, Agriculture Price Policy (APP) accounts for various economic factors such as the rate and quality of economic growth, in identifying and promoting the optimal crop mix. This consequently ensured appropriate allocation of resources, capital formation in the agriculture sector and fair inter-sectoral terms of trade.

Major Instruments of Agriculture Price Policy (APP) in India

APP includes the following instruments:

(i) Minimum Support Price (MSP) & Procurement prices
(ii) Buffer Stocks

(i) MSP and Procurement Prices: The price support policy was initiated by the Government to provide protection to agricultural producers against any sharp drop in farm prices. If there is a good harvest and market prices tend to dip, the government guarantees an MSP or floor price to farmers, which covers not only the cost of production, but also ensures a reasonable profit margin for the producers. MSP is announced each year and is fixed after taking into account the recommendations of the CACP (Commission for Agricultural Costs and Prices). CACP is an agency which advises the Government on a continuing basis about the level of MSP. Procurement prices are the prices of Kharif and Rabi cereals at which the grain is to be domestically procured by public agencies (for example, FCI [Food Corporation of India]) for release through public distribution services (PDS). Normally, the procurement price is lower than the open market price and higher than MSP. In the present system only one set of prices is announced for crops.

While recommending the prices the CACP takes comprehensive overview of the entire structure of the economy of a particular commodity and the likely effect of the price policy on the rest of economy particularly, on the cost of living, level of wages, industrial cost structure etc. An important consideration underlying the price policy is that it should compensate the farmers for the increasing input cost and provide incentive to increase investment in the agriculture. The MSPs are normally announced upfront before the commencement of sowing operations of the particular crop and have usually been remunerative and significantly higher than the cost. The MSP and procurement prices have been raised over the years. Table 1 reflects the changes in MSP since 1980.

Table1: Minimum Support Price/Procurement Price for Wheat and Paddy (Rs. per quintal)

Crop Year	Wheat	Paddy (Common Variety)
1980-81	117	105
1990-91	225	205
1995-96	380	360
1999-00	580	490
2000-01	610	510
2001-02	620	530
2002-03	620	530
2003-04	630	550
2004-05	640	590
2005-06	650	600
2006-07	750	610

Source: Economic Surveys

(ii) Buffer stocks and Public Distribution System: Buffer stock operations are an integral component of agriculture price in India. It is used as an instrument to minimize the fluctuations in the prices of agriculture products. Buffer stocks have a price stabilizing impact on the economy. Under the buffer stock policy, government builds up stock of agricultural commodities either through purchases from domestic market or through imports and release these stocks in the domestic market when the prices are rising. The government supply thus moderates the sharp increase in the price of agricultural products. In the event of bumper crop, the market price is substantially reduced. In this situation government make procurements at MSP or procurement price and prevent fall in price. This helps to prevent distress sales among farmers.

The public distribution system (PDS) is used to supply the buffer stock to the weaker sections. At present PDS consists of a network of 350 000 fair-price shops that are monitored by state governments. Supplying basic food commodities through PDS not only serves the purpose of reaching the needy, it also acts as a control for general consumer prices. FCI is the sole repository of food grains reserved for PDS. The Corporation has functioned effectively in providing price support to farmers through its procurement scheme and in keeping a check on large price increases by providing food grains through PDS.

The sufficient buffer stock is required to be maintained to meet emergencies like droughts, crop failures floods and crop damages or other such calamities to prevent sharp rise in market prices. Government has well defined norms of stock to be kept in the central pool. In the past years especially in the year 2002 and 2003 the procurement of food grains has been substantially (three times) higher than the prescribed norms. This has resulted in the huge rise of stock pile up with FCI because on one hand there was a rise in the procurement of food grains by FCI and on the other hand there was fall in the off take from PDS. Since October 2003 the size of buffer stock is falling and it has been lower than the buffer norm in the year 2005 and 2006.

Appraisal of Price Policy

The policy has been instrumental in creating a fairly stable price environment for the farmers to induce them to adopt new production technology and thereby increase the output of food grains. The subsidized distribution of food grains has helped in improving economic access to food. Owing to the decline in the real prices (prices vis-à-vis the income) of basic staple food, the organized sector and the industry could keep their wage bills low. The benefits of price policy and input/food subsidies, have, thus been shared by all the sections of society. However, the present price policy has certain shortcomings discussed as follows:

(i) The price policy has to evolve a qualitatively superior crops mix i.e. to provide incentive for growth of crops which are nutritionally superior or the crops where the country has comparative advantage. In India this aspect of agricultural price policy has remained largely neglected.

(ii) During the last few years, lack of prudence in fixing the level of support prices of rice and wheat led to not only accumulation of excessive stocks but also raising the public cost of food grain policy. During these years, the government fixed MSPs of rice and wheat at much higher levels than that recommended by CACP. Currently however the stocks are below or almost close to the minimum prescribed levels.

(iii) The farmers in the new emerging states could not get the minimum support prices for their produce. This happened mainly because the nodal agency (FCI) and state agencies in the new emerging surplus states are not geared to undertake price support operations. The FCI remains occupied with large volumes of purchases traditional surplus producing states (like Punjab, Haryana, and western U.P)

Conclusion

The agricultural price policy has relied too heavily on price incentives in the form of assured crop prices for achieving increase in production. The non-price factors such as efficient technology, financial inputs, land reforms and improved human resources are all very significant in expanding the volume of aggregate output and productivity. The scarce state's economic resources should be used in improving social and economic infrastructure in the rural area rather than providing subsidized agriculture output to the public at large. The price policy cannot produce desirable effects of improving agricultural productivity if the agricultural infrastructure is weak. It is desirable that the agricultural prices are announced for few commodities as it is commercially unsustainable for government to procure foodgrains at higher price and allow offtake at subsidized price.Further, an adequate attention is given to the infrastructure development.

Concept-check Questions

- **What is the rationale of agriculture pricing in India?**
- **Distinguish between MSP and procurement price.**
- **What are important instruments of agriculture price policy (APP) in India?**
- **Give critical appraisal of APP in India.**

LESSON 5

AGRICULTURE CREDIT IN INDIA

- Dr. Anupama Rajput

Studying this chapter should enable you to understand:

- Sources and pattern of agriculture credit in India
- Institutional framework of Indian agriculture credit
- Trends and Appraisal of Institutional agriculture credit
- Suggested measures to improve agriculture credit
- Recent Government's Initiatives.

Introduction

Agriculture credit is an important prerequisite for agricultural growth. Agricultural policies have been reviewed from time to time to provide adequate and timely availability of finance to this sector. Rural credit system assumes importance because for most of the Indian rural families, savings are inadequate to finance farming and other economic activities. This coupled with the lack of simultaneity between income realization and expenditure and lumpiness of agricultural capital investments. The institutional credit system is critical for agricultural development and its role has further increased in the liberalized economic environment. In India a multi-agency approach comprising co-operative banks, scheduled commercial banks and regional rural banks (RRBs) has been followed to allow credit to agricultural sector.

Types of Agriculture Credit:

The agriculture credit can be classified on the basis of:

(1) According to Tenure of Agricultural Credit i.e. the credit requirement based on the time-period of loans. It can of three types:

(a) Short-Term: It refers to the loans required for meeting the short-term requirements of the cultivators. These loans are generally for a period not exceeding and repaid after the harvest. For example loans required for the purchase of fertilizers, HYV seed, for meeting expense on religious or social ceremonies etc.

(b) Medium-Term: These loans are for a period up to 5 years. These are the financial requirements to make improvements on land, buying cattle or agricultural equipments, digging up of canals etc.

(c) Long-Term: These loans are for a period of more than 5 years and are generally required to buy additional land or tractor or making permanent improvements on land.

(2) According to Purpose of Agriculture Credit: The agriculture credit on the basis of purpose for which the credit is used can be of two types:

a) **Productive:** Productive loans are the loans that are related to agricultural production and economically justified. For example purchase of tractor, land, seeds etc.

b) **Unproductive:** Unproductive credit are used for personal consumption and unrelated to productive activity for example loans for expenditure on marriages, religious ceremonies etc.

Source of Agricultural Credit in India:
There are two broad sources of agricultural credit (Chart1) in India:

(1) Non-Institutional Sources
(2) Institutional Sources

(1) Non-Institutional Sources: The non-institutional finance forms an important source of rural credit in India, constituting around 40 percent of total credit in India. The interest charged by the non-institutional lenders is usually very high. The land or other assets are kept as collateral. The important **sources of non-institutional credit** are as follows:

(i) Money-Lenders: Money-lending has been the widely prevalent profession in the rural areas. The money-lenders charge huge rate of interest and mortgage the property of the cultivators and in some cases even the peasants and members of his family are kept as collateral.

(ii) Other Private Sources:

(a) Traders, landlords and commission agents: The agents give credit on the hypothecation of crops which when harvested is used to repay loans.

(b) Credit from relatives: These credits are generally used for meeting personal expenditure.

(2) Institutional Sources: The general policy on agricultural credit has been one of progressive institutionalization aimed at providing timely and adequate credit to farmers for increasing agricultural production and productivity. Providing better access to institutional credit for the small and marginal farmers and other weaker sections to enable them to adopt modern technology and improved agricultural practices has been a major thrust of the policy. National Bank for Agriculture and Rural Development (NABARD) is an apex institution established in 1982 for rural credit in India. It doesn't directly finance farmers and other rural people. It grants assistance to them through the institutions described as follows:

1. Rural Co-Operative Credit Institutions:

Rural Credit cooperatives are the oldest and most extensive form of rural institutional financing in India. The major thrust of these cooperatives in the area of agricultural credit is the prevention of exploitation of the peasants by moneylenders. The rural credit cooperatives may be further divided into **short-term credit cooperatives** and **long-term credit cooperatives.**

The **short-term credit cooperatives** provide short-term rural credit and are based on a three-tier structure as follows:

(a) Primary Agricultural Credit Societies (PACs): These are organized at the village level. These societies generally advance loans only for productive purposes. The main objective of a PACS is to raise capital for the purpose of giving loans and supporting the essential activities of the members such as supply of agricultural inputs at cheap price, improving irrigation on land owned by members, encourage various income-augmenting activities such as horticulture, animal husbandry, poultry etc. In India, around 99.5 percent of villages are covered by PACs.

(b) District Central Cooperative Banks: These cooperatives are organized at the district level. The PACS are affiliated to the District Central Co-operative Banks (DCCBs). DCCBs coordinate the activities of district central financing agencies, organize credit for PACs and carry out banking business.

(c) State Co-Operative Banks: The DCCBs are affiliated to State Co-operative Banks (SCBs), which coordinate the activities of DCCBs, organize provision of finance for credit worthy farmers, carry out banking business and act as leader of the Co-operatives in the States.

Long-term credit Cooperatives: These cooperatives meet long-term credit of the farmers and are organized at two levels:

(i) Primary Co-Operative Agriculture and Rural Development Banks: These banks operate at the village level as an independent unit.

(ii) State Co-Operative Agriculture and Rural Development Banks: These banks operate at state level through their branches in different villages.

2. Commercial Banks:

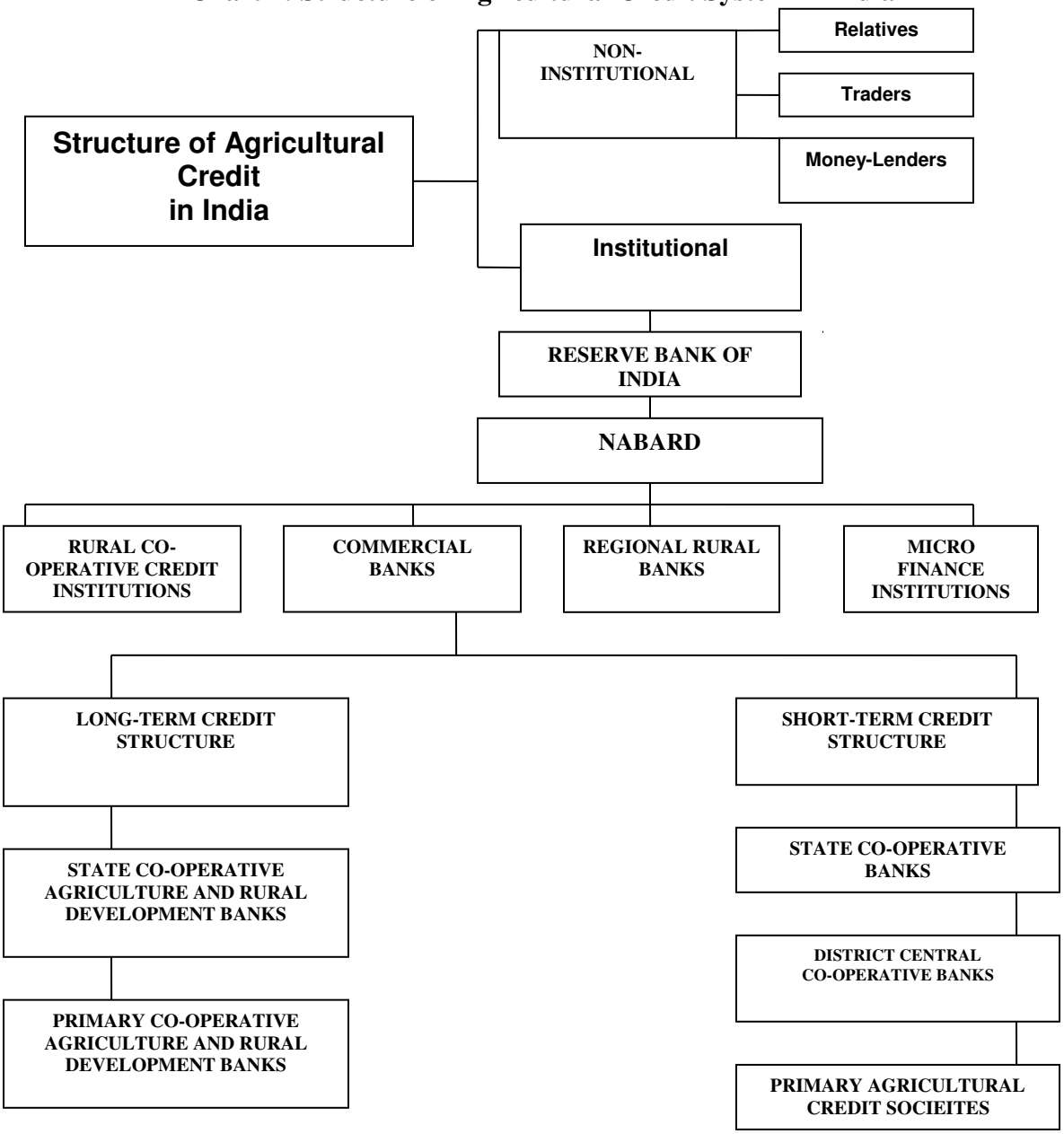
Commercial Banks(CBs) provide rural credit by establishing their branches in the rural areas. The share of commercial banks in rural credit was very meager till 1969. The All India Rural Credit Review Committee (1969) recommended multi agency approach to the rural and especially agricultural credit. It suggested the increasing role of the CBs in providing agricultural credit. Further, under the Social Control Policy introduced in 1967 and subsequently the nationalization of 14 major CBs in 1969 (followed by another six banks in 1980), CBs have been given a special responsibility to set up their advances for agricultural and allied activities in the country. The major expansion of rural branches took place and CBs introduced Lead Bank scheme and district credit plans for rural areas. Banks were asked to lend 18 percent of their total advances to agriculture within the quota of 40 percent of priority sector lending. This expansion of rural credit remained till the late 1980s. However, during late 80's, CBs suffered huge losses due to waiving of agricultural loans by the government. The financial liberalization process with the adoption of Narasimham Committee report in 1993 has necessitated the banks to focus on profitability and adopt prudential norms. The proportion of bank credit to rural areas especially small borrowers has come down steadily.

3. Regional Rural Banks (RRBs):

RRBs are the specialised banks established under RRB Act, 1976 to cater to the needs of the rural poor. RRBs are set-up as rural-oriented commercial banks with the low cost profile of cooperatives but with the professional discipline and modern outlook of commercial banks. Between 1975 and 1987, 196 RRBs were established with over 14,000 branches. As a result of the amalgamation, the number of RRBs was reduced from 196 to 133 as on 31 March, 2006 and to 96 as on 30 April 2007. RRBs covered 525 out of 605 districts as on 31 March 2006. After

amalgamation, RRBs have become quite large covering most parts of the State. Increased coverage of districts by RRBs makes them an important segment of the Rural Financial Institutions (RFI). The branch network of RRBs in the rural area form around 43 per cent of the total rural branches of commercial banks. A large number of branches of RRBs were opened in the un-banked or under-banked areas providing services to the interior and far-flung areas of the country. RRBs primarily cover small and marginal farmers, landless laborers, rural artisans, small traders and other weaker sections of the rural community. However, even after so many years, the market share of RRBs in rural credit remained low and have suffered huge losses. In recent years Government has initiated reform process to improve the functioning of RRBs.

Chart 1: Structure of Agricultural Credit System in India



Efforts are made to increase the capital base and investible fund of these banks. The financial support is provided to improve training, technology development including computerization in these banks. The structural consolidation process has been initiated by amalgamating these banks. This has resulted into pooling of resources including experienced work force, common marketing efforts and thus better customer services. Further, RRBs have been able to derive the benefits of increased area of operations and enhanced credit exposure. These measures have provided remarkable improvements in the financial performance of RRBs. The number of RRBs incurring losses and the levels of non- performing assets has reduced dramatically.

4. Micro Finance Institutions (MFIs):

Banks offer concessional interest rates for the rural credit. However; small farmers are unable to access them because of borrower-unfriendly products and procedures, inflexibility and delay, and high transaction costs, both legitimate and illegal. Thus, Non-Government Organisations (NGOs) are providing alternative means to enhance access to credit by the poor since mid-70's. After pioneering efforts by organizations like SEWA, MYRADA, PRADAN and CDF, in 1992 the RBI and NABARD encouraged commercial banks to link up with NGOs to establish and finance self-help groups (SHGs) of the poor. The RBI has included financing of SHGs under priority sector lending. At present, there are three groups of SHGs viz. SHGs formed and financed by the banks (20 percent); SHGs formed by other formal agencies but financed by banks; SHGs financed by banks using NGOs and other agencies (8 percent).These institutions provide small loans to the poor at low interest rates without collateral.

The experience of micro-finance scheme in India suggests that i) It is the cost effective way of financing the rural poor; ii) The repayment rate of SHGs is more than 95 percent due to peer pressure; iii) It reduces transaction costs of borrowers as well as lenders; iv) It inculcates the habit of thrift among members and provide timely credit.

Concept-Check Questions

- Explain the reasons that necessitate agriculture credit?
- What are the various kinds of agriculture credit?
- Give the distinction between institutional and non-institutional source of agriculture finance.
- What are the major sources of institutional agriculture credit in India?

Trends in Agricultural Credit

Over time, spectacular progress has been achieved in terms of the scale and outreach of institutional framework for agricultural credit. Some of the major discernible trends are as follows:

1. Increasing Dependence on Institutional Credit

One of the major achievements in the post-independent India has been the widening of the spread of institutional machinery for credit and decline in the role of non-institutional sources. The share of institutional credit, which was little over 7 per cent in 1951, increased

manifold to over 66 per cent in 1991, reflecting a remarkable decline in the share of non institutional credit from around 93 per cent to about 31 per cent during the same period. However, the latest NSSO Survey reveals that the share of non-institutional credit has taken a reverse swing which is a cause of concern (Table 1).

Table 1: Relative Share of Borrowing of Cultivator Households from Different Sources

(Figures are in Per cent)

Sources Credit	**1951**	**1961**	**1971**	**1981**	**1991**	**2002**
Non-Institutional	**92.7**	**81.3**	**68.3**	**36.8**	**30.6**	**38.9**
of which Money Lenders	69.7	49.2	36.1	16.1	17.5	26.8
Institutional	**7.3**	**18.7**	**31.7**	**63.2**	**66.3**	**61.1**
of which Cooperatives Societies / Banks	3.3	2.6	22.0	29.8	23.6	30.2
Commercial Banks	0.9	0.6	2.4	28.8	35.2	26.3
Unspecified	–	–	–	–	**3.1**	–
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source : All India Debt and Investment Survey and NSSO.

2. Trends of Overall Institutional Credit Flow

Over time, the flow of credit to agriculture and rural sector has expanded impressively (Table 2). The ground level credit flow had registered an increase from Rs. 1675 crore in 1975-96 to Rs.86891 crore in 2003-04 and further to Rs.203297 crore in 2005-06. This rate of growth was even higher than the growth rate of Gross Domestic Product (GDP) originating in agriculture.

Despite this growth, the credit needs of agriculture have not been met fully and overwhelming numbers of farm households have not been able to borrow from institutional sources. While short-term credit has remained the dominant component of total credit, its relative importance declined from 70.3 per cent in 1975-76 to 58.1 per cent in 2006-07.

Table2: Institutional credit flow to agriculture sector (Rs. crore)

Agency	1975-76	1983-84	1993-94	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08*
Cooperatives	1186	2938	10117	23524	23636	26,875	31231	39404	42480	33070
Regional Rural Banks	2	263	977	4854	6070	7581	12404	15223	20435	15925
Scheduled Commercial Banks	405	1885	5400	33587	39774	52441	81481	125477	140382	88765
Other Agencies	82	185	0	80	80	84	193	382	NA	NA
Total Credit	**1675**	**5244**	**16494**	**62045**	**69560**	**86981**	**125309**	**180486**	**203297**	**137760**

*** Up to November 2007. Source:** All India Debt and Investment Survey and NSSO.

3. Agency-wise Credit Flow

The analysis of agency wise credit flow indicates that the cooperative banks were the major source of agriculture credit in 1975-76 constituting around 71 percent of the total ground level credit flow followed by commercial banks at 24.2 percent and regional rural banks at 4.9 percent . Though cooperative banks had dominated agriculture credit supply till the early reform period, commercial banks and RRBs recorded impressive growth rates. As a result, in 2006-07, the share of cooperative banks in the total institutional credit flow receded to 20.1 percent and that of commercial banks advanced to 69.1 percent. Although the quantum of disbursement from cooperative banks increased, it could not keep pace with commercial banks in enhancing credit flow due to several reasons including its poor financial health, dual control, lack of internal controls and corporate governance norms and excessive dependence on other financial institutions.

Although the share of cooperative credit is now much lower than that of commercial banks, the reach of cooperative credit societies is much wider. Cooperative credit societies have more than twice the number of rural outlets and four times more accounts than those of scheduled commercial banks and RRBs put together. Low recovery rates and mounting overdues have clogged the process of recycling of credit by cooperatives, impaired their ability to avail of refinance facilities from (NABARD), increased transaction costs and more importantly, have deprived potential borrowers of the opportunity to avail of credit facilities from the cooperatives. As a result, cooperatives have been losing their capacity to meet the growing credit needs of agriculture.

4. Size-wise Credit Flow

Despite impressive growth in direct credit to farmers from the scheduled commercial banks between 1991-92 and 2003-04, contrary to expectation, credit disbursement to small and marginal farmers has not been encouraging. Though the number of accounts increased for small farmers yet the credit flow favoured the richer farmers.

5. Region-wise Credit Flow

While analyzing the pattern of credit flow, it is observed that the proportions of bank deposits and credit shares have moved in favour of the South, West and North regions. While the share of loans in the total disbursement of credit for agriculture and allied activities were the maximum for the South region, it was the minimum for North-east region.

Recent Initiatives

Government of India & Reserve Bank of India: In order to increase credit flow to the agriculture sector, the policy of doubling of agricultural credit in three years was introduced in 2004-05. In order to expand the outreach of the banking services, banks made available basic banking 'no-frills' account with low or nil minimum balances as well as low or no charges in 2005. The regional rural banks were also specifically advised to allow limited overdraft facilities in 'no-frills' accounts without any collateral or linkage to any purpose.

National Agricultural Insurance Scheme (NAIS): NAIS is implemented since Rabi 1999-2000 season with the objectives to provide insurance coverage and financial support to the farmers in the event of failure of any of the notified crops as a result of natural calamities, pests and diseases and to encourage the farmers to adopt progressive farming practices, high value in-puts and higher technology in agriculture and to help stabilize farm incomes particularly in disaster years.

Government of India & NABARD

i. Rural Infrastructure Development Fund: RIDF was established in 1995-96 with a corpus of Rs. 2,000crores with the major objective of providing funds to state governments and state owned corporations to develop rural infrastructure such as rural roads, rural bridges, irrigation works, soil conservation, flood protection, drinking water, infrastructure for rural education etc. The total corpus of RIDF till 2007-08 (RIDF-I to RIDF-XIII) amounted to Rs.72, 000 crores with 2008-09 budget further adding the amount of RIDF XIV of Rs. 14,000 crores to this corpus. The total sanctions and disbursements as on 30 June 2007 aggregated Rs. 61312.27 crores and Rs.38581.82 crores respectively.

ii. Micro Finance Innovations: The credit accessibility for the poor from conventional banking is limited due to lack of collaterals and information. Micro finance has emerged as an alternative financial vehicle that provides micro credit or small loans granted to the poor without any collateral. These loans are provided through micro finance institutions (MFIs). NABARD plays a key role in developing the MFIs by providing them refinance facility at low interest rates.

iii. Kisan Credit Card Schemes: The kisan credit cards (KCC) scheme was introduced in 1998-99 to facilitate short-term credit to farmers. Each farmer is given with a kisan credit card and a pass book for providing revolving cash credit facilities. NABARD provide refinance facility to commercial banks and cooperatives to provide credit under this scheme.

iv. Refinance under Swarnajayanti Gram Swarozgar Yojna (SGSY): NABARD provides refinance facility to institutions that support SGSY.

v. Co-operative Development Fund: NABARD has set up the cooperative development fund in 1993 with objective of strengthening the co-operative credit institutions in the areas of resource mobilization, recovery position etc. the assistance is provided to cooperatives by way of soft loans or grants.

Weaknesses in Rural Credit Structure

1. Overemphasis of Monetary Credit: The rural credit institutions have given overemphasis on the financial assistance to the cultivators. While the finance is very important factor but it should be complemented with the extension of services in form of guidance, expertise and counseling on agricultural issues.

2. Multiplicity of Institutions: The rural credit structure is based on multi agency credit system whereby there exist numerous organizations providing similar kind of financial services. There is a lack of coordination in the system and the commercial viability is adversely affected in this scenario.

3. Lack of Motivation: In order to fill the gap that occurred due to the failure of rural cooperative societies Government gave increasing role to the commercial banks. However, commercial banks lack the desired skills and expertise in the agro-credit. The banks have enough financial resources but the service consultancy is not available. Thus, there is a failure to provide complete package of assistance to the farmers. Further, financial sector reforms have put pressure on banks to improve their financial position and so these banks are now concentrating on selected clientele of large borrowers

4. Financial Exclusion: Despite of a large network of the institutional credit system, it has not been able to adequately penetrate the informal rural financial markets and the non-institutional sources continue to play a dominant role in purveying the credit needs of the people residing in rural areas. The results of the All-India Debt and Investment Survey (AIDIS, 2002) also indicate that the share of the non-institutional sources, in the total credit of the cultivator households, had increased from 30.6 percent in 1991 to 38.9 percent in 2002.

5. High Interest Rates: The rate of interest charged by rural financial institutions (RFIs) from farmers continues to be considerably higher than those charged by financial institutions from urban consumers. The owners of small or marginal farms, which are non-viable or viable at the margin, and self-employed in the informal sector, cannot afford to bear the level of interest charged by RFIs.

6. Procedural Delays: There is a problem of considerable delays in processing of loan applications and collaterals. Thus farmers shy away from institutional financing and increase their dependency upon non-institutional sources.

7. Poor Recoveries: Banks are shying away from rural financing mainly because of poor recoveries which is inflicting the system. It is ironical that the recoveries position is adverse amongst rich farmers than amongst the small farmers. The political decisions of waiving off loans are further putting pressures on the financial system**.**

Suggestions for Improving Institutional Rural Credit System:

1. Financial Discipline to Improve Recovery: A national consensus among political parties should be evolved for not politicizing the RFIs and resist from announcement of loan or interest waiver schemes and giving calls for not repaying the institutional loans. However, given the risk involved in the agriculture credit the recovery system should be flexible and humane.

2. Revamping the Cooperative Credit Structure: The Cooperative Credit Structure should be strengthened to make use of its wider reach. These have to be recapitalised so as to provide funds for improving their financial positions. There is a need of capacity building, human resource development, institutional restructuring to ensure democratic functioning, and improving the regulatory regime to empower the Reserve Bank of India (RBI) to enforce prudent financial management.

3. Better Physical, Social and Economic Infrastructure: The long term policy framework needs to be designed to improve infrastructure facilities so as to boost rural economic growth. This requires **increased public expenditure** on social infrastructure (like education, availability of drinking water, health facilities), physical infrastructure (like roads, power) and economic infrastructure like (irrigation, modern agricultural techniques). These measures would help to improve the debt paying capacity of rural poor and provide greater opportunities to RFIs.

4. Financial cum Consultancy Approach: RFIs needs to provide extension services like consultancy about seeds, availability and use of modern inputs, marketing strategies etc to the cultivators so that a holistic package of assistance can be provided to them.

5. Group Approach to Lending: The lending to homogenous farmer's groups needs to be organized to improve credit delivery. This would help to improve recovery because of peer pressure. Further, group lending tends to be cost-effective. Involving NGOs or rural educated youths in organizing farmers or rural families in groups, scrutinizing applications, disbursement of loan and effecting recoveries would help RFIs in reducing lending costs.

6. Autonomy to RRBs: RRBs should be given more autonomy and flexibility in planning and lending policies, so that their comparative advantage in rural lending is restored.

7. Greater involvement of Micro Finance Organizations: The banks need to involve micro-finance agencies like SHGs, NGOs etc. and other grass root level financial intermediaries who have better understanding of the credit needs and recovery situations.

8. Technological Up Gradation: Technological improvements like computerization can be critical in building up a reliable credit information system and database on customers, reducing transaction costs and facilitating better pricing of risk, improving the efficiency of the financial system, and thereby increasing the access of un-banked rural people in an efficient manner.

9. Information Dissemination to Rural Poor: Credit counseling, awareness and financial education regarding the benefits of institutional financing are important for effective expansion of financial services in rural areas. To do this, banks may utilize the services of non-governmental organisations, village youth clubs, village panchayats, farmer clubs and self-help groups into confidence.

Note on National Bank for Agriculture and Rural Development (NABARD)

NABARD was established in July 1992 as an apex institution to coordinate the activities of organizations engaged in the area of rural credit. It took over from RBI all the functions that the latter performed in the field of rural credit. It is designed specifically to provide undivided attention and focus to the credit problems of rural sector. As an apex bank it is involved in refinancing credit needs of major financial institutions in the country engaged in offering financial assistance to agriculture and rural development operations and programmes. The **functions of NABARD** can be divided into three categories:

(1) Credit Functions:

NABARD's credit functions cover planning, dispensation and monitoring of credit. This activity involves framing policy and guidelines for rural financial institutions, providing credit facilities to issuing organizations such as commercial banks, cooperatives etc. and monitoring the flow of ground level rural credit. As stated earlier, NABARD doesn't directly deal with farmers and other rural people. It provides refinance facilities in terms of short-term loans for crops, marketing and other working capital requirements, medium-term and long-term credit to cooperatives for investment purposes including rural infrastructure. The loans are also provided to the state government for investment in cooperatives.

(2) Developmental and Promotional Measures:

In order make credit more productive, NABARD has been undertaking a number of developmental and promotional activities such as to provide help to cooperative banks and Regional Rural Banks to prepare development actions plans for themselves, enter into MoU with state governments, cooperative banks and RRBs to improve the affairs of banks, provide financial assistance to cooperatives and Regional Rural Banks for establishment of technical, monitoring and evaluations cells

(3) Supervisory Functions:

NABARD has been sharing with the Reserve Bank of India certain supervisory functions in respect of cooperative banks and Regional Rural Banks (RRBs). NABARD has been entrusted with the statutory responsibility of conducting inspections of State Cooperative Banks (SCBs), District Central Cooperative Banks (DCCBs) and Regional Rural Banks (RRBs) under the provision of the Banking Regulation Act, 1949. In addition, NABARD has also been conducting periodic inspections of state level cooperative institutions such as State Cooperative Agriculture and Rural Development Banks (SCARDBs), Apex Weavers Societies, Marketing Federations, etc. on a voluntary basis. The objectives of periodic inspections is to protect the interest of the depositors, to ensure banks work according to the rules and regulation issued by Government and to examine the financial soundness of the banks.

Conclusion

The rural credit systems have under gone several changes during the last decade. There has been an increasing trend towards institutional rural financing. The financial institutions are under stress, particularly since the financial sector reforms of 1992-93. The credit policy should continue to emphasize small borrowers. The commercial banks have started feeling shy of lending to agricultural sector and rural poor. The provisions of mandatory lending for priority sector and the agricultural activities should continue. The banks should take the help of NGOs and local formal institutions in their lending programmes to reduce the transaction costs and improve recoveries. The financial cum consultancy approach needs to be followed. For meeting the credit needs of the poor, the programmes like linking of self-help groups (SHGs) with lending agencies are to be further strengthened.

Concept-Check Questions

- **"**There is an increasing trend towards institutionalization of agriculture credit in India". Do you agree with the statement?
- Which institutional source accounts for major proportion of agriculture credit in India?
- What are the credit and supervisory functions of NABARD?
- What do you mean by financial cum consultancy approach agriculture credit?
- What do you understand by Micro-financial institutions?
- Which one dominate the agriculture credit – Short-term or Long-term?

LESSON 6

AGRICULTURE LABOR IN INDIA

- Dr. Anupama Rajput

Studying this chapter should enable you to understand:

- Meaning and important features of Agriculture labor in India.
- Magnitude and reasons of growth of Agriculture laborer in India.
- Government measures to improve the agriculture labor

Introduction

The distinguishing feature of rural economy of India has been the growth of agriculture labor in the crop production. The phenomena of under-employment, under-development and surplus population are visible amongst agricultural labourers. Agricultural labors constitute the most neglected class in Indian rural sector and are highly unorganized. The income level of these workers is quite low and employment is quite irregular. Further, these workers lack alternative employment due to lack of training and skills.

Definition of Agriculture Labor

Agriculture labor may be defined as labor who works in agriculture or allied activities for the whole or pat of the year in return for (in cash or kind or both) for full-time or part time work. The agriculture laborer has no risk in the cultivation, and no right of lease or contract on land but merely works on another person's land for wages. The definition includes workers who are engaged in other agri-based occupation such as dairy farming, horticulture, poultry etc. It also includes the people who don't work throughout the year but only for part of the year. Agriculture labor Enquiry Committee defined agriculture labor household as the household whose main source of income is derived as wages for working on farms of others.

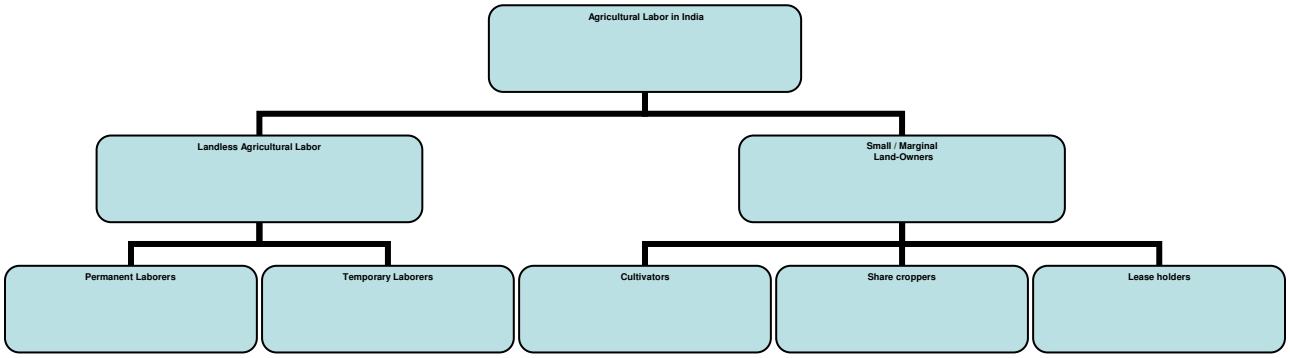
Agriculture laborers (chart 1) can be classified into two broad categories:

1. Landless Agricultural Laborer: The laborers don't posses land and can be further sub-divided into:

(i) Permanent Laborers attached to cultivating households: Permanent or attached laborers generally work on some sort of contract. The wages are
determined by custom or tradition.

(ii) Temporary or Casual Laborers: Casual labourers are engaged only during peak period for work. The employment is temporary and labourers are paid at the market rate. These labourers are not attached to any landlords.

Chart 1: AGRICULTURE LABOR IN INDIA



2. Small and Marginal Land-Owners: These are very small cultivators whose main source of earnings due to their small and marginal holdings is wage employment. These laborers can again be divided into **three subgroups**:

- **(i)** **Cultivators:** Cultivators are small farmers, who possess very little land and therefore, have to devote most of their time working on the lands of others as labourers.
- **(ii)** **Share croppers:** Share croppers are those who, while sharing the produce of the land for their work, also work as labourers.
- **(iii)** **Lease holders:** Lease holders are the tenants who not only work on the leased land but also work as labourers.

Features of Agricultural Laborers: The main features, characterizing Indian agricultural labor are as follows :

1. Agricultural Labourers are Scattered: Agricultural labour in India is being widely scattered over large number of villages in the country and so cannot be effectively organized.

2. Unskilled and Lack Training: Agricultural labourers, especially in smaller villages are generally unskilled workers carrying on agricultural operation at a very low wages. Majority of them are generally conservative and tradition bound. There is hardly any motivation for change or improvement. Since there is no alternative employment, the agricultural labourer has to do all types of work- both farm and domestic for landlord.

3. Unorganised: Agricultural laborers are not organized like industrial laborers. These laborers are illiterate and ignorant. They live in villages scattered all over the country. Hence they could not be organized in unions. Accordingly, it is difficult for them to bargain with the land owners and secure good wages.

4. Low Social Status: Most agricultural workers belong to the depressed classes, which have been neglected for ages. In some parts of India, agricultural laborers are migratory, moving in search of jobs at the time of harvesting with a lot of dislocation of family life, dislocation of education of children and numerous other handicaps.

5. Abudance of Labour: The agricultural labourers are abundant in supply in relation to their demand. It is only during the sowing and harvesting seasons that there appears to be nearful employment. But, once these seasons are over, majority of agricultural workers are jobless

especially in areas, where there is single cropping pattern. The problem is further aggravated due to the fact that these labors are generally unskilled and so couldn't find alternative employment.

6. Low Bargaining Power: Due to all the above mentioned factors, the bargaining power and position of agricultural laborers in India is very weak. In fact, quite a large number of them are in the grip of village money lenders, landlords and commission agents, often the same person functioning in all the three capacities. The agricultural labor is the most exploited class of people of India. Thus partly because of factors beyond their control and partly because of their inherent bargaining weakness, the farm laborers have been getting very low wages and have therefore to live in a miserable sub-human life.

Magnitude of Agricultural Laborers:

According to 1981 census, the agricultural workers constitute 22.7 percent of the total labour force which is increased to 26.1 percent in 1991. Further, of the total workforce engaged in the agriculture sector has increased dramatically. (Table1). In 1951, the numbers of agriculture laborer were 27.3 millions which rose to 106.8 millions in 2001.

Table 1: Population and Agricultural Workers (In Millions)

Year	Cultivators	Agricultural Labourers	Total
1951	69.9 (71.9)	27.3 (28.1)	97.2 (100.0)
1961	99.6 (76.0)	31.5 (24.0)	131.1 (100.0)
1971	78.2 (62.2)	47.5 (37.8)	125.7 (100.0)
1981	92.5 (62.5)	55.5 (37.5)	148.0 (100.0)
1991	110.7 (59.7)	74.6 (40.3)	185.3 (100.0)
2001	127.3 (54.4)	106.8 (45.6)	234.1 (100.0)

Source: Registrar General of India, New Delhi.

Figures within parentheses are percentages to Total Agricultural Work force.

Causes for the Growth of Agricultural Laborers:

There are a number of factors responsible for the continuous and enormous increase in the number of agricultural laborers in India. The more important among them are:

1. Increase in Rural Population: The increase in population is the major cause of sub-division and uneconomic land holding in the rural area as the same piece of land gets distributed among large number of persons in the family which becomes inadequate for their own basic requirements. Thus the rural families have to search for the employment to fulfill their economic needs.

2. Decline of Cottage Industries and Handicrafts: The rural industries are on the decline due to increased competition from modern industries. In the absence of the alternative employment opportunities for workers engaged in these village industries there is an increase of agriculture labor in India.

3. Eviction of Small Farmers and Tenants from the Land: The large scale ejectment took place through the device of fictitious surrenders to escape the clauses of laws relating to land reforms has caused an increase in the agriculture labor.

4. Uneconomic Land Holdings: The vast inequality in the distribution of land-holding has resulted in the need to search for the rural employment.

5. Increase in Indebtedness: A very large proportion of rural population is in the grip of non-institutional source of credit especially money-lenders that charge huge interest. In order to pay these debts, poor farmers have to sell their land and look for the employment on other's farms.

6. Break-up of Joint Family System: The economic support system has been reduced with the break-up of the joint family system. This has increased the need to work outside the family's land-holding.

Government Measures:

The Government has shown awareness of the problems of agricultural workers and suggested ways and means to improve the conditions of agricultural laborers. These are discussed as follows:

1. Legislative Measures: The central government has fixed minimum wages for workers on farm under the Minimum Wages Act, 1948. Subsequently, the Plantation Labour Act, 1951 was enacted to provide certain basic facilities to plantation workers. Many other existing labour laws are applicable or have direct bearing on agricultural labour.

2. Abolition of Bonded Laborers: Since 1975 the concept of bonded labor has been abolished. Under the Bonded labour system (Abolition) Act, every bonded laborer is free and is discharged from any obligation to render bonded labour. The rehabilitation programmes have been initiated to improve the conditions of erstwhile bonded laborer.

3. Providing Land to Landless Laborers: Land reforms in terms of land ceilings and redistribution of land to small and landless laborers have been initiated. The government's fallow and wasteland has been given to agricultural laborers. The state government gives priority to landless laborer especially to those belonging to scheduled castes and tribes in the allotment of government land and surplus land.

4. Special Employment Schemes: The special employment progarmmes have been initiated to promote social justice among the poor such as i) Crash Scheme for Rural Employment(CSRE) ii) Pilot Intensive Rural Employment Project (PIREP) iii) Food for works programme (FWP) iv) National Rural Employment Programme (NREP) v) Rural Landless Employment programme (RLEP) vi) Drought Prone Area Programme (It was known as Rural Works Programme). These progammes help in providing supplementary employment to agricultural labourer.

5. Welfare Measures: The welfare measures to help the agricultural laborer include provision of house-sites to homeless, primary education for rural poor, rural health services, supply of safe drinking water, educating and organizing rural workers.

Suggestions for the Improvement of Agricultural Laborers:

The following suggestions can be made for the improvement of the socio-economic position of the agricultural laborers:

1. **Better Implementation of Legislative Measures:** The poor laborers are not in a position to bargain for reasonable rewards for their hard work due to lack of organized efforts to implement the legislations.

2. **Improvement the Bargaining Position:** The agricultural laborers may be organized so that they can effectively bargain for better working conditions and enable better enforcement of legislations.

3. **Resettlement of Agricultural Workers:** The schemes of land redistribution to small and landless laborers needs to strengthened so as raise their income level and social status.

4. **Creating Alternative Employment:** The training and skill improvement programmes are required to be developed to allow alternative employment opportunities for rural workers. The public works schemes should be for longer period in the year so as to provide useful employment throughout the year. Non-agricultural industries should be developed so as to absorb surplus labor. The Development of medicinal plants and energy Plantation which have high growth and employment potential should be encouraged. Horticulture, farm management programmes, agri-clinics and seed production are other potential areas for employment generation.

5. **Improvements in Agricultural Sector:** The rural infrastructure development like better irrigation facilities, warehousing, easy access to agricultural inputs etc, effective implementation of land reforms and spread of farm mechanization can help to improve economic well-being of agricultural laborers.

6. **Better Credit Availability:** The financial assistance at cheaper rates of interest and on easy terms of payment for undertaking subsidiary occupation should be provided.

7. **Cooperative Farming:** The cooperative farming by pooling of land by small and marginal farmers may be developed. This measure would provide better incentive to improve productivity of farm as these farmers will continue to be owners of their land and share the fruits of their efforts. Government should facilitate the smooth working of these cooperatives by providing cheap credit, marketing and inputs.

8. **Increase in Public Investment:** There is a need to step up public investment in agriculture especially in creating affordable rural social infrastructure like cheap education, health facilities, drinking water etc. This would help in improving the growth potential of rural poor. The subsidies are required to be better targeted towards rural poor. The public expenditure may be directed towards re-generation of degraded forests, watershed development, wasteland development and other highly labor intensive activities.

Concept Check Questions

- What are the various kinds of agriculture labor in India?
- Give the nature and magnitude of Indian agriculture labor.
- Write a note on agriculture in India.

5 6

LESSON 1 **UNIT II**

INDUSTRIAL POLICY

- Dr. Bhawna Rajput

Studying this chapter should enable you to understand:

- Approach and features of Industrial Policies in the pre-1991 period
- Industrial Policy in the post-1991 period. Distinction between pre and post 1991 industrial policy framework

Introduction

The industrial policy means the procedures, principles, policies rules and regulations which control the industrial undertaking of the country and pattern of industrialization. It explains the approach of Government in context to the development of industrial sector. In India the key objective of the economic policy is to achieve self-reliance in all sectors of the economy and to develop socialistic pattern of society. The industrial policy in the pre-reform period i.e. before1991 put greater emphasis on the state intervention in the field of industrial development. These policies no doubt have resulted into the creation of diversified industrial structure but caused a number of inefficiencies, distortions and rigidities in the system. Thus during late 70's and 80's, Government initiated liberalization measures in the industrial policy framework. The drastic liberalization measures were however, carried out in 1991.

Industrial Policies Prior to 1991

Industrial Policy Resolution, 1948

The first important industrial policy statement was made in the Industrial policy Resolution (IPR), 1948. The main thrust of IPR, 1948 was to lay down the foundation of mixed economy whereby the private and public sector was accepted as important components in the development of industrial economy of India. The policy divided the industries into four broad categories:

(i) Industries with Exclusive State Monopoly: It included industries engaged in the activity of atomic energy, railways and arms and ammunition.

(ii) Industries with Government Control: It included the industries of national importance and so needs to be registered. 18 such industries were put under this category eg. fertilizers, heavy chemical, heavy machinery etc.

(iii) Industries in the Mixed Sector: It included the industries where private and public sector were allowed to operate. Government was allowed to review the situation to acquire any existing private undertaking.

(iv)Industries under Private Sector: Industries not covered by above categories fell in this category.

IPR, 1948 gave public sector vast area to operate. Government took the role of catalytic agent of industrial development. The resolution assigned complementary role to small-scale and cottage industries. The foreign capital which was seen with suspect in the pre-independent era was recognized as an important tool to speedup up industrial development.

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

IDRA, 1951 is the key legislation in the industrial regulatory framework. IDRA, 1951 gave powers to the government to regulate industry in a number of ways. The main instruments were the regulation of capacity (and hence output) and power to control prices. It specified a schedule of industries that were subject to licensing. Even the expansion of these industries required prior permission of the government which means the output capacity was highly regulated. The Government was also empowered to control the distribution and prices of output produced by industries listed in the schedule. The IDR Act gave very wide powers to the Government. This resulted in more or less complete control by the bureaucracy on the industrial development of the country.

The main provisions of the IDRA, 1951 were

a) All existing undertakings at the commencement of the Act, except those owned by the Central Government were compulsorily required to register with the designated authority.

b) No one except the central Government would be permitted to set up any new industrial undertaking "except under and in accordance with a licence issued in that behalf by the Central Government."

c) Such a license or permission prescribed a variety of conditions, such as, location, minimum standards in respect of size and techniques to be used, which the Central Government may approve.

d) Such licenses and clearances were also required in cases of 'substantial expansion' of an existing industrial undertaking.

Industrial Policy Resolution, 1956

IPR, 1956 is the next important policy statement. The important provisions are as follows:

(1) New classification of Industries: IPR, 1956 divided the industries into the following three categories:

(a) Schedule A industries: The industries that were the monopoly of state or Government. It included 17 industries. The private sector was allowed to operate in these industries if national interest so required.

(b) Schedule B industries: In this category of industries state was allowed to establish new units but the private sector was not denied to set up or expand existing units e.g. chemical industries, fertilizer, synthetic, rubber, aluminum etc.

(c) Schedule C industries: The industries not mentioned in the above category formed pat of Schedule C. Thus the IPR, 1956 emphasized the mutual existence of public and private sector industries.

(2) Encouragement to Small-scale and Cottage Industries: In order to strengthen the small-scale sector supportive measures were suggested in terms of cheap credit, subsidies, reservation etc.

(3) Emphasized on Reduction of Regional Disparities: Fiscal concessions were granted to open industries in backward regions. Public sector enterprises were given greater role to develop these areas.

The basic rationale of IPR, 1956 was that the state had to be given primary role for industrial development as capital was scarce and entrepreneurship was not strong. The public sector was enlarged dramatically so as to allow it to hold commanding heights of the economy.

Monopolies Commission

In April 1964, the Government of India appointed a Monopolies Inquiry Commission "to inquire into the existence and effect of concentration of economic power in private hands." The Commission looked at concentration of economic power in the area of industry. On the basis of recommendation of the commission, Monopolistic and Restrictive Trade Practices Act (MRTP Act), 1969 was enacted. The act sought to control the establishment and expansion of all industrial units that have asset size over a particular limit.

Industrial Policy Statement, 1973

The Policy Statement of 1973 drew up a list of industries to be started by large business houses so that the competitive effort of small industries was not affected. The entry of competent small and medium entrepreneurs was encouraged in all industries. Large industries were permitted to start operations in rural and backward areas with a view to developing those areas and enabling the growth of small industries around.

Industrial Policy Statement, 1977: The main elements of the new policy were:

1. Development of Small-Scale Sector: The main thrust of the new industrial policy was an effective promotion of cottage and small industries. Government initiated wide-spread promotional and supportive measures to encourage small sector. The small sector was classified into 3 categories viz. Cottage and household industries which provide self-employment; tiny sector and small-scale industries. The purpose of the classification was to specifically design policy measures for each category. The policy statement considerably expanded the list of reserved items for exclusive manufacture in the small-scale sector.

2. Restrictive Approach towards Large Business Houses: The large scale sector was allowed in basic, capital goods and high-tech industries. The policy emphasized that the funds from financial institutions should be made available largely for the development of small sector. The large sector should generate internal finance for financing new projects or expansion of existing business.

3. Expanding Role of Public sector: The industrial policy stated that the public sector would be used not only in the strategic areas but also as a stabilizing force for maintaining essential supplier for the consumer.

Further, the policy statement reiterated restrictive policy towards foreign capital whereby the majority interest in ownership and effective control should rest in Indian hands.

Industrial Policy, 1980

The industrial policy 1980 emphasized that the public sector is the pillar of economic infrastructure for reasons of its greater reliability, for the large investments required and the longer gestation periods of the projects crucial for economic development. The IPR1956 forms the basis of this statement. The important features of the policy were:

1. Effective Management of Public Sector:

The policy emphasized the revival of efficiency of public sector undertaking.

2. Liberalization of Industrial licensing:

The policy statement provided liberalized measures in the licensing in terms of automatic approval to increase capacity of existing units under MRTP and FERA. The asset limit under MRTP was increased. The relaxation from licensing was provided for large number of industries. The broad-banding concept was introduced so that flexibility is granted to the industries to decide the product mix without applying for a new license.

3. Redifining Small-Scale Industries:

The investment limit to define SSI was increased to boost the development of this sector. In case of tiny sector the investment limit was raised to Rs.1 lakh; for small scale unit the investment limit was raised from Rs.10 lakh to Rs.20 lakh and for ancillaries from Rs.15 lakh to Rs. 25 lakh.

Industrial policy, 1980 focused attention on the need for promoting competition in the domestic market, technological up gradation and modernization. The policy laid the foundation for an increasingly competitive export based industries and for encouraging foreign investment in high-technology areas.

Era of Liberalization after 80's:

After 1980, an era of liberalization started, and the trend was gradually to dilute the strict licensing system and allow more freedom to the entrepreneurs. The steps that were taken in accordance with the policy included:

(i) Re-endorsement of licenses: The capacity indicated in the licenses could be re-endorsed, provided it was 25 percent more than the licensed capacity (1984).

(ii) Liberalization of 1990: The measures were as follows:

a) Exemption from licensing for specific new units.
b) Investment of foreign equity up to 40 percent was freely allowed.
c) Location restrictions were removed.

Major Features of Pre-1991 Industrial Policy:

1. Protection to Indian Industries: Local industries were given shelter from international competition by introducing partial physical ban on the imports of products and high imports tariffs. Protection from imports encouraged Indian industry to undertake the manufacture of a variety of products. There was a ready market for all these products.

2. Import-Substitution Policy: Government used its import policy for the healthy development of local industries. Barring the first few years after Independence, the country was facing a shortage of foreign exchange, and so save scarce foreign exchange imports-substitution policy was initiated i.e. Government encouraged the production of imported goods indigenously.

3. Financial Infrastructure: In order to provide the financial infrastructure necessary for industry, the Government set up a number of development banks. The principal function of a development bank is to provide medium and long-term investments. They have to also play a major role in promoting the growth of enterprise. With this objective, Government established the Industrial Finance Corporation of India (IFCI) (1948), Industrial Credit and Investment Corporation of India (ICICI) (1955), Industrial Development Bank of India (IDBI) (1964), Industrial Reconstruction Corporation of India (1971), Unit Trust of India (UTI) (1963), and the Life Insurance Corporation of India (LIC).

4. Control over Indian Industries: Indian industries were highly regulated through legislations such as Industrial licensing, MRTP Act, 1969 etc. These legislations restricted the production, expansion and pricing of output of almost all kinds of industries in the country.

5. Regulations on Foreign Capital under the Foreign Exchange and Regulation Act (FERA): FERA restricted foreign investment in a company to 40percent. This ensured that the control in companies with foreign collaboration remained in the hands of Indians. The restrictions were also imposed on technical collaborations and repatriations of foreign exchange by foreign investors.

6. Encouragement to Small Industries: Government encouraged small-scale industries (SSIs) by providing a number of support measures for its growth. Policy measures addressed the basic requirements of the SSI like credit, marketing, technology,entrepreneurship development, and fiscal, financial and infrastructural support.

7. Emphasis on Public Sector: The Government made huge investments in providing infrastructure and basic facilities to industries. This was achieved by establishing public sector enterprises in the key sectors such as power generation, capital goods, heavy machineries, banking, tele- communication, etc.

Review of Pre-1991 Industrial Policy

The pre1991 industrial policies created a climate for rapid industrial growth in the country. It has helped to create a broad-base infrastructure and basic industries. A diverse industrial structure with self-reliance on a large number of items had been achieved. At the time of independence the consumer goods industry accounted for almost half of the industrial production. In 1991 such industries accounted for only about 20 percent. In contrast capital goods production was less than 4 percent of the total industrial production. In 1991 it had gone up to 24 percent. Industrial investment took place in a large variety of new industries. Modern management techniques were introduced. An entirely new class of entrepreneurs has come up with the support system from the Government, and a large number of new industrial centers have developed in almost all parts of the country. Over the years, the Government has built the infrastructure required by the industry and made massive investments to provide the much-needed facilities of power, communications, roads etc. A good number of institutions were promoted to help entrepreneurship development, provide finance for industry and to facilitate development of a variety of skills required by the industry.

However, the implementation of industrial policy suffered from shortcomings. It is argued that the industrial licensing system has promoted inefficiency and resulted in the high-cost economy. Licensing was supposed to ensure creation of capacities according to plan priorities and targets. However, due to considerable discretionary powers vested in the licensing authorities the system tended to promote corruption and rent-seeking. It resulted into pre-emption of entry of new enterprises and adversely affected the competition. The system opposite to its rationale favored large enterprises and discriminate against backward regions. Government announced a number of liberalization measures in the industrial policy of 1970, 1973 and 1980. However, the dramatic liberalization efforts were made in the industrial policy, 1991.

Concept-Check Questions

- Give features of the act that requires the specified industries to obtain industrial licensing.
- What is the rationale of MRTP Act, 1969?
- What are the important regulations that control industries in the pre-1991 era?
- "Public Sector attained commanding heights in the economy". Comment on the statement.

New Industrial Policy, 1991

India's New Industrial Policy announced in July 1991 (hereafter NIP) was radical compared to its earlier industrial policies in terms of objectives and major features. It emphasized on the need to promote further industrial development based on consolidating the gains already made and correct the distortion or weaknesses that might have crept in, and attain international competitiveness. (Ministry of Industry, 1991). **The liberalized Industrial Policy aims at rapid and substantial economic growth, and integration with the global economy in a harmonized manner. The Industrial Policy reforms have reduced the industrial licensing requirements, removed restrictions on investment and expansion, and facilitated easy access to foreign technology and foreign direct investment.**

Pre vs. Post 1991 Policy

1. Distinctive Objectives of New Industrial Policy (NIP), 1991: NIP had two distinctive objectives compared to the earlier industrial policies:

i) Redefinition of Concept of Self-Reliance: NIP redefined the concept of economic self-reliance. Since 1956 till 1991, India had always emphasized on Import Substitution Industrialization (ISI) strategy to achieve economic-self reliance. Economic self-reliance meant indigenous development of production capabilities and producing indigenously all industrial goods, which the country would demand rather than importing from outside. The goal of economic self-reliance necessitated the promotion of ISI strategy. It helped to built up the vast base of capital goods, intermediate goods and basic goods industries over a period of time. NIP redefined economic self-reliance to mean the ability to pay for imports through foreign exchange earnings through exports and not necessarily depending upon the domestic industries.

ii) International Competitiveness: NIP emphasized the need to develop indigenous capabilities in technology and manufacturing to world standards. None of the earlier industrial policies, either explicitly or implicitly, had made reference to international technology and manufacturing capabilities in the context of domestic industrial development (Ministry of Commerce and Industry, 2001). For the first time, NIP explicitly underlined the need for domestic industry to achieve international competitiveness.

To achieve these objectives, among others, NIP initiated changes in India's industrial policy environment, which gained momentum gradually over the decade. The **important elements of NIP** can be classified as follows:

1. Public sector de-reservation and privatization of public sector through dis-investment;
2. Industrial Delicensing;
3. Amendments of Monopolies and Restrictive Trade Practices (MRTP) Act, 1969;
4. Liberalised Foreign Investment Policy;
5. Foreign Technology Agreements (FTA);
6. Dilution of protection to SSI and emphasis on competitiveness enhancement.

1. Public Sector De-Reservation and Privatization through Dis-Investment:

Till 1991, Public Sector was assigned a pre-eminent position in Indian Industry to enable it to achieve "commanding heights of the economy" under the Industrial Policy Resolution (IPR), 1956. Accordingly, areas of strategic importance and core sectors were exclusively reserved for public sector enterprises. Public enterprises were accorded preference even in areas where private investments were possible.

Since 1991, **the public sector policy** consists of:

(i) Reduction in the number of industries reserved for public sector: Now only two industries (atomic energy and railway transport) are reserved for the Public Sector. They are known as "Annexure I" industries (Ministry of Commerce and Industry, 2001). The essence of government's Public Sector Undertakings (PSUs) policy since 1991 has been that government should not operate any commercial enterprises. The policy emphasized to bring down government equity in all non-strategic PSUs to 26 percent or lower, restructure or revive potentially viable PSUs, close down PSUs, which cannot be revived and fully protect the interests of workers. Government's withdrawal from non-core sectors is indicated on considerations of long-term efficient use of capital, growing financial un-viability and the compulsions for these PSUs to operate in an increasingly competitive and market oriented environment (Disinvestment Commission, 1997).

(ii) Implementation of Memorandum of Understanding (MOU): As a part of the measures to improve the performance of public enterprises, more and more of public sector units have been brought under the purview of Memorandum of Understanding (MoU) system. A memorandum of understanding is a performance contract, a freely negotiated document between the Government and a specific public enterprise.

(iii) Referral to BIFR: Many sick public sector units have been referred to the Board for Industrial and Financial Reconstruction (BIFR) for rehabilitation or, where necessary, for winding up.

(iv) Manpower Rationalization: In order to make manpower rationalization Voluntary Retirement Scheme (VRS) has been introduced in a number of PSUs to shed the surplus manpower.

(v) Private Equity Participation: PSUs have been allowed to raise equity finance from the capital market. This has provided market pressure on PSUs to improve their performance.

(vi) Disinvestment and Privatization: Disinvestment and privatization of existing PSUs has been adopted to improve corporate efficiency, financial performance and competition amongst PSUs. It involves transfer of Government holding in PSUs to the private shareholders.

2. Industrial Delicensing:

The removal of licensing requirements for industries, domestic as well as foreign, commonly known as "de-licensing of industries" is another important feature of NIP. Till the 1990s, licensing was compulsory for almost every industry, which was not reserved for the public sector. This licensing system was applicable to all industrial enterprises having investment in fixed assets (which include land, buildings, plant & machinery) above a certain limit. With progressive liberalization and deregulation of the economy, industrial license is required in very few cases. Industrial licenses are regulated under the Industries (Development and Regulation) Act 1951. At present, industrial license is required only for the following:

(i) Industries retained under compulsory licensing (five industries are reserved under this category).

(ii) Manufacture of items reserved for small scale sector by larger units: An industrial undertaking is defined as small scale unit if the capital investment does not exceed Rs. 10 million (approximately $ 222,222). The Government has reserved certain items for exclusive manufacture in the small-scale sector. Non small-scale units can manufacture items reserved for the small-scale sector if they undertake an obligation to export 50 percent of the production after obtaining an industrial license.

(iii) When the proposed location attracts locational restriction: Industrial undertakings to be located within 25 kms of the standard urban area limit of 23 cities having a population of 1 million as per 1991 census require an industrial license.

Thus, excluding these, investors are free to set up a new industrial enterprise, expand an industrial enterprise substantially, change the location of an existing industrial enterprise and manufacture a new product through an already established industrial enterprise. The objective of industrial delicencing would be to enable business enterprises to respond to the fast changing external conditions. Entrepreneurs will be free to make investment decisions on the basis of their own commercial judgment. This will facilitate the technological dynamism and international competitiveness. Further industries will have freedom to take advantage of 'economies of scale' as well as 'economies of scope' in the current industrial policy environment.

3. Amendment of Monopolies and Restrictive Trade Practices (MRTP) Act, 1969: An important objective of India's earlier industrial policies was to prevent emergence of private monopolies and concentration of economic power in a few individuals. Accordingly, Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 was enacted

and MRTP Commission was set up as a permanent body to periodically review industrial ownership, advice the government to prevent concentration of economic power, investigate monopolistic trade practices and inquire into restrictive trade practices, which are prejudicial to public interest. An MRTP firm was mainly defined in terms of asset size. An MRTP company had to obtain prior approval of the government for setting up a new enterprise as well as for expansion. However, MRTP Act was applicable only to private sector companies.

Since 1991 MRTP Act has been restructured and pre-entry restrictions have been removed with regard to prior approval of the government for the establishment of a new undertaking, expansion, amalgamation, merger, take over, and appointment of directors of companies. The asset restriction and market share for defining an MRTP firm has been done away with. MRTP Act is now applicable to both private and public sector enterprises and financial institutions. Today only restrictive trade practices of companies are monitored and controlled. The MRTP act has been replaced by the Competition Act, 2002. This law aims at upholding competition in the Indian market. The competition commission has been established in 2003 which mainly control the practice that have an adverse impact on competition.

4. Liberalized Foreign Investment Policy:

India's earlier industrial policies welcomed FDI but emphasized that ownership and control of all enterprises involving foreign equity should be in Indian hands. The Balance of Payments (BoP) difficulties in the mid 1960s forced the country to adopt a more restrictive approach towards FDI through the setting up of a Foreign Investment Board, which classified industries into two groups: **banned** and **favored** for foreign technical collaboration and FDI. The number of industries for foreign investment was steadily narrowed down and by 1973 there were only 19 industries where FDI was permitted (Kucchal, 1983).The enactment of FERA, 1973 marked the beginning of the most restrictive phase of India's foreign investment policy. The NIP radically reformed foreign investment policy to attract foreign investment. The important foreign investment policy measures are as follows:

i) **Repeal of FERA, 1973:** FERA, 1973 has been repealed and Foreign Exchange Management Act (FEMA) has come into force with effect from June 2000 (RBI, 2003). Investment and returns can be freely repatriated except where the approval is subject to specific conditions such as lock-in period on original investment, dividend cap, foreign exchange neutrality, etc. as specified in the sector specific policies. The condition of 'dividend balancing' was withdrawn for dividends declared. A foreign investor can freely enter, invest and operate industrial enterprises in India,

ii) **Dilution of Restrictions on Foreign Direct Investment (FDI):** FDI is allowed in all sectors including the services sector except atomic energy and railway transport. FDI in small scale industries is allowed up to 24 percent equity. Use of brand names/trade marks is allowed. Further, FDI up to 100 percent is allowed under the automatic route in all activities/sectors except the following which require prior approval of the Government:-

- Sectors prohibited for FDI;
- Activities/items that require an industrial license;
- Proposals in which the foreign collaborator has an existing financial/technical collaboration in India in the same field;
- Proposals for acquisitions of shares in an existing Indian company in financial service sector and where Securities and Exchange Board of India (substantial acquisition of shares and takeovers) regulations, 1997 is attracted;
- All proposals falling outside notified sectoral policy/CAPS under sectors in which FDI is not permitted.

Thus most of the sectors fall under the automatic route for FDI.

5. Foreign Technology Agreement

The automatic approvals for technology agreement are allowed to industries within specified parameters. Indian companies are free to negotiate the terms of technology transfer with their foreign counterparts according to their own commercial judgment.

6. **Dilution of Protection to Small Scale Industries (SSI) and Emphasis on Competitiveness:** SSIs enjoyed a unique status in Indian economy due to its diversified presence across the country and thereby utilizing resources and skills, which would have otherwise remained unutilized. Due to their potential to generate large-scale employment, produce consumer goods of mass consumption, alleviate regional disparities, etc., industrial policies protected the sector for its growth. The principal protective measures for SSI comprised: **(i)** Demarcating SSI from the rest of industry through a definition under the IDR Act, 1951, **(ii)** Concessional credit from the banking system, **(iii)** Fiscal concessions, **(iv)** Exemption from industrial licensing and labor legislations**, (v)** Preferential access to scarce raw materials, both domestic and imported, **(vi)** Market support from the government through reservation of products for government purchase and price preferences, and **(vii)** Reservation of products for exclusive manufacturing in SSIs and restrictions on the growth of output and capacity in the large-scale sector for products reserved for SSI manufacturing. These policy measures protected SSIs from both internal and external competition.

However, since 1991 the protective emphasis of SSI policy has undergone dilution. In August 1991, government of India brought out an exclusive policy for SSI. The policy marked: (i) the beginning of an end to protective measures to small industry and (ii) promotion of competitiveness by addressing the basic concerns of the sector namely technology, finance and marketing. Subsequently, the number of items reserved exclusively for small industry manufacturing has been gradually brought down. This policy has lost its relevance to a large extent because though these products could not be manufactured by large enterprises domestically, they can be imported from abroad due to the removal quantitative and non-quantitative restrictions on most imports by April 1, 2001 (Ministry of Finance, 2002). Concession element in lending rates for small industry has been largely withdrawn during the 1990s (RBI, 2003). The number of products reserved exclusively for purchase from small industry by the government has been

reduced to 358 items from 409 items. Measures have been adopted to improve technology and export capabilities of SSIs. Thus the overall promotion orientation of SSI has shifted from protection towards competitiveness.

Impact Of Industrial Policy, 1991

The all-round changes introduced in the industrial policy framework have given a new direction to the future industrialization of the country. There are encouraging trends on diverse fronts. Industrial growth was 1.7 per cent in 1991-92 that has increased to 9.2 percent in 2007-08.The industrial structure is much more balanced. The impact of industrial reforms is reflected in multiple increases in investment envisaged, both domestic and foreign. This is due to encouraging response from the private sector. There has been dramatic increase in FDI since 1991. The foreign investment as a percentage of total GDP has increased from 0.5 percent in 1990-91 to 5.7 percent in 2006.Investments in infrastructure sector such as power generation have surged from players of various sizes in different states. The capital goods have grown at an accelerated pace, over a high base attained in the previous years, which augurs well for the required industrial capacity addition.

Conclusion

The Government policies and procedures in the pre-1991 period aimed at industrial development of the country, but the enactment of the IDR Act, procedures laid down for obtaining industrial licensing and various rules acted as a great deterrent to the growth of industries in the country. The bureaucracy acquired unprecedented powers and authority over all kinds of industrial activities. The NIP announced in July 1991, unshackle the industries from the cobweb of bureaucratic control to allow it to achieve international competitiveness. NIP encouraged foreign investment in the economy and opened it to greater domestic and international competition.

Concept-Check Question

- What are the objectives of NIP, 1991 that distinguish it from pre-1991 policy?
- Give the distinctive features of new public sector policy.
- "The government's SSI policy has shifted from protection towards competitiveness". Comment on this statement and give features of new SSI policy.

LESSON 2

'PUBLIC SECTOR ENTERPRISES IN INDIA'

- Dr. Bhawna Rajput

Studying this chapter should enable you to understand:

- Meaning of Public Sector Enterprises (PSEs).
- Rationale and Contribution of PSEs in Indian Economy.
- Performance of Indian PSEs.
- Problems inflicting PSEs.
- Recent Government Initiatives for improving PSEs.

Introduction

Public Sector Enterprises (PSEs) or State owned and managed units have played a strategic role in the Indian economy. The key factors contributing to stronghold of these enterprises are the need of rapid industrialization with equitable distribution of economic wealth and inadequacies of free market. India witnessed a greater degree of state ownership and increased regulation since second plan that envisaged industrialization as a development strategy. By 1980s the poor performance of state-owned companies was acknowledged and various efforts were made to improve performance. In an era of economic reform process initiated since1991, privatization has become a key component of public sector policy of the government. The survival of PSEs now depends upon performance efficiency and profitability.

Definition Of Public Sector Enterprises

Public Sector Enterprises often referred to as government owned undertakings/enterprises or state-owned enterprises are wholly or partly owned and controlled by the government and produce marketable goods and services i.e. PSEs includes **industrial and commercial enterprises** which are **managed and controlled by government**. Public sector and PSEs are different from each other. The word public sector is wider and includes all kinds of organization commercial (i.e. PSEs) and non-commercial that are owned partly or fully and effectively managed by Government. Thus Government funded universities, colleges, hospitals, schools are part of public sector but are not PSEs because these organizations lack commercial orientation.

Rationale Of Pses In India

The policy rationale for public ownership and government provision of certain goods and services has been based on the presence of some form of market failure, which are addressed through public ownership. In India, PSEs are assigned the responsibility of fulfilling specific social goals like correcting regional and economic imbalances, providing employment and reducing the concentration of monopoly power in the economy. Further, as a pre-requisite for balanced growth, the state controls the key sectors of the economy which is popularly known as the 'commanding heights' rationale of PSEs. The rationale of PSEs in India is discussed as follows:

1. Rapid Economic Development

The prerequisite of faster economic development is the creation of infrastructure and the growth of basic industries like power, steel transportation; communication, banking etc. These industries require huge capital investment and involve long-gestation period and so private sector may not be interested to undertake the development of such industries. Further, the private sector lack financial and technical skills to develop such industries. In other words, reluctance on the part of private entrepreneurs to develop key industries due to high risk and low returns necessitated the establishment of PSEs. Government with its capacity to mobilize huge economic resources can develop the industries that are significant for growth prospects of the country. Thus in the earlier phase of development heavy state spending on investment in basic infrastructural sectors and service facilities(for example financial institutions, telecommunication banking etc.) is essential for providing a congenial atmosphere to the private sector to facilitate the process of accelerated development of the economy.

2. Reduction of Concentration of Economic Powers

PSEs reduce inequalities of income through welfare programmes, favorable pricing policy towards small industries and supply of cheaper goods to the consumer. Private sector may manipulate the price of essential goods and indulge into quick profit-making by controlling the volume and price of such goods. PSEs prevent such concentration of economic power.

3. Balanced Regional Growth

Private sector generally neglects backward regions that lack infrastructure and other basic facilities such as power, roads, telecommunication, skilled labor etc. PSEs set up large projects in these areas and spend huge cost to develop such areas. In this manner PSEs help to achieve balanced regional growth.

4. Employment Generation

The adequate generation of employment opportunities is a major objective of the public sector enterprises. This sector has provided direct employment to more than 80 percent of organized labor.

5. Import-Substitution and Export-Promotion

In the initial period of development foreign exchange constraints exist due to huge imports of capital goods and low exportable surplus. PSEs produce importable goods domestically which tend to save precious foreign exchange and facilitate exports.

6. Resource Mobilization

PSEs mobilize savings through large network of banking and financial institutions. The profits of PSEs are ploughed back into developmental activities of the country. Further, PSEs contribute to the Government's exchequer through payment of tax and divideds.

ROLE AND CONTRIBUTION OF PSE IN INDIA: RECENT EVIDENCES

The role of PSEs in the provision of social and economic infrastructure has been impressive. It has significant contribution to the country's economy by filling the gaps in the industrial sector, generating employment and balanced regional development. The major contributions of PSEs are explained as under:

Contribution towards Industrial Development and GDP Growth

The role of Indian PSEs in the process of industrialization is widely acclaimed. The PSEs has helped to build sound and diversified industrial base. The capacity creation by PSEs in basic industries such as generation and distribution of electricity, telecommunication public transportation stood at around 50 percent. In case of basic metals fuel and fertilizers it stood at 80 percent to 100 percent. These industries are central to economic development process of industrialization. PSEs contribute around 27percent of total industrial production of the economy. On the eve of the First Five Year Plan there were 5 central public sector enterprises (CPSEs) with a total (financial) investment of Rs. 29 crore. Both the number of enterprises and the investment in CPSEs recorded an overwhelming increase over the years, especially so after the Second Five Year Plan. As on 31st March, 2007, there were a total of 247 CPSEs with a total of Rs. 421089 crores. (Table1).The contribution of PSEs in the real gross capital formation as depicted in table2 clearly indicate that PSEs occupy a significant position in the process of country's capital formation and holds commanding heights of the economy.

As far as the share in national production is concerned, central PSEs in the 1950-51, contribute 3 percent of national income which has increased to around 8.23percent in 2006-07.

Table 1: Growth of Public Sector

	1st Plan 1951-1956	2nd Plan 1956-1961	3rd Plan 1961-1966	4th Plan 1969-1974	5th Plan 1974-1979	6th Plan 1980-1985	7th Plan 1985-1990	8th Plan 1992-1997	9th Plan 1997-2002	10th Plan 2002-2007
Total Investment (Rs. in Crs.)	29	81	948	3897	6237	18150	42673	135445	324614*	421089*
Enterprises (Nos.)	5	21	47	84	122	179	215	246	240	244
Average Capital Formation**	36.9	47.2	52.1	44.7	48.5	50.8	45.8	36	29.2	23.6

Source: **Public Enterprises Survey 2006- 2007: Vol. - I**

As in the Balance Sheet, & Data is at the commencement of the each Five Year Plan.

* At the end of Five Year Plan. ** as % of country's total capital formation

Resource Generation Of Pses

An important objective of PSEs in India has been to generate resources for reinvestment as well as for investment in other development projects of the economy. In the post reform period Government has emphasized on the internal resource generation and reduction on the budgetary support (i.e. Government financing from the annual budget outlay). The Government support for PSEs was less than 0.7 percent of total budget allocation in 2006-07.In perusal of this policy, during Xth plan (2002-07), there has been a substantial improvement in the amount of internal resource of CPSEs indicating clear improvement in the overall health of PSEs. Total resource generated by CPSEs on their own that consists of internal resources (like profits) and extra budgetary resources (like money raised by issuing shares, bonds etc) went up dramatically by 2007(Table3). Further, the budgetary support during the plan has reduced from 8.98 percent to 5.43 percent which mean that CPSEs are depending more on their own resources (around 94.5 percent). Thus PSEs are contributing to the development process with less and less assistance from Government.

Table 2: Plan Investment during the Tenth Five Year Plan

(Rs. in crore)

Year	Non- Budgetary Support		Budgetary Support
	Internal Resources	Extra Budgetary Resources	
2002-03	55.51	35.51	8.98
2003-04	49.39	42.65	7.96
2004-05	50.89	41.07	8.04
2005-06	51.31	43.49	5.20
2006-07	60.85	33.71	5.43

Source: Public Enterprises Survey 2006- 2007: Vol. - I

Contribution to the Government Resources

PSEs contribute to the public exchequer by way of dividends, interest, corporate tax, excise duty, etc. The contribution has witnessed phenomenal growth over time particularly during reform period. During seventh plan (1985-90) for example, it was Rs.694.10 billion which was doubled to Rs. 1337.80 billion during the eighth plan (1992-97). In 2005-06, it was Rs.1,2545.6 billion which is risen to Rs. 14763.5 billion. About 42 percent of total tax revenue of the Government has been contributed by PSEs. This contrasts with the very poor tax contribution of private corporate sector.

Contribution Towards Foreign Exchange Earnings

PSEs are an important contributor to the nation's foreign earnings as PSE exports accounts for almost 11 percent of total merchandise export of the country in the year 2007-08. PSEs are moving ahead to avail newer opportunities in the foreign capital market and has witnessed a steady increase in the mobilization of funds from the foreign market. Many PSEs are undertaking joint venture abroad that has further improved the foreign exchange earning of the country.

The growth profile of PSEs thus has been very impressive. The PSEs hold commanding heights in terms of total investment in key sectors like steel, electricity generation and petroleum.

Financial Performance of Pses

The market-oriented reforms since 1980's have brought a commendable change in the performance of PSEs in India. The reduced budgetary allocation accompanied by a greater managerial autonomy and a growing competition has instill a greater amount of cost consciousness amongst PSEs. The changes in the market conditions and corporate governance had ensured greater accountability. But these advantages could not be translated into improved financial performance (Table3). **The financial performance of these enterprises though improving is far from satisfactory.**

Table3: Profitability Profile of Central Public Sector Enterprises

(Rs. in crore)

	Pre-Reform Period		Reforms Began		Reform Period	
Details	**1983-84**	**1988-89**	**1991-92**	**1996-97**	**2001-02**	**2006-07**
No. of operating enterprises	201	226	237	236	231	217
Capital employed	29851	67629	117991	202021	389934	665124
Net Profit:	241	2994	2356	10258	25978	81550
(a) Profit of profit making CPSEs	1778	4917	6079	16120	36432	89773
Profit making CPSEs (No.)	108	117	133	129	120	156
(b)Loss of loss incurring CPSEs	1537	1923	3723	5862	10454	8223
Loss Incurring CPSEs (No.)	92	106	102	104	109	59
(c) CPSEs Making no profit/no loss	1	3	2	3	2	1
% of Net Profit to Capital Employed	0.80	4.4	2.0	5.1	6.66	12.26
Dividend Payout Ratio	55.2	11.79	29.16	30.03	31.06	33.28

Source: Public Enterprises Survey, Various Issues, Department of Public Enterprises, Ministry of Industry, Government of India, New Delhi.

The ratio of net profit to capital employed has been 3.5 percent on average during 80's which fell to 3 percent during early period of reforms. This ratio has witnessed an increasing trend over the last decade. It stood at 12.26 percent in 2006-07.

Another important indicator of improvement in public sector's overall health and performance is the sharp decline in number of loss making PSEs and their losses. The number of loss making units has declined from 92 in 1983-84 to 59 in 2006-07. As indicated in the table over 100 PSEs have been loss making in 2000. It is necessary to mention that of the large number of PSEs making losses in 2000 were originally the private enterprises in textile sector which were nationalized or taken over by PSEs to protect employment in these enterprises.

Further, the profits earned and dividend paid by PSEs is steadily improving. There is an improvement in the amount of capital employed. The trend clearly indicates the expansion of CPSEs and improvements of efficiency in using investible funds.

In order to sustain profitability trends in future, PSEs are required to achieve a higher growth in the resource generation. The reform process especially of loss-making units have to be further strengthen as the number of loss making is still on the higher side as the data relates to CPSEs only. The situation only worsens if state run enterprises are included in the analysis.

Concept -Check Questions

- Differentiate between Public Sector and Public sector enterprise.
- What is the meaning of Budgetary Support for PSEs?
- Explain sources of contribution by PSEs to the public exchequer.
- Explain "Commanding heights" of PSEs.

Problems Facing Pses In India

1. Defective Pricing Policy

The prices of goods and services produced by the PSE in India for long have been determined by Govt. under administered price regimes (APR). In post-91 era with intense market competition Government has dismantled the APR in most cases and PSEs have been given independence to fix their own price competitively. In the recent years various price regulatory commission for regulating prices in best interest of both consumers and producers have been established whose recommendations are applicable both for private and PSEs. Government on its part continues to be sensitive to the needs of the poor and price level in the economy. Any rise in price generally warranted by market conditions is avoided. Pricing of petroleum is an example in this respect. The rise in the international

price of crude oil is hardly passed on to the consumers. The social approach set prices in PSE causes a lower returns and financial losses.

2. Excessive Political Interference

There exists considerable political interference in the operational aspects of PSEs in terms of appointment in the management, pricing of products, location of projects. The decisions are guided by political considerations and not by economic factors.

3. Delays in Decision-Making

The red-tapism and bureaucratic management causes delay in decision-making of these organizations. PSEs thus fail to take advantage of opportunities thrown open by the market.

4. Over-Manning

The public sector enterprises are overstaffed. It increases cost of production and inefficiency in the organization.

5. Lack of Accountability

The appraisal system lack performance-based remuneration system. The system lacks incentives to improve and penalties for delays and failures. The security of service makes them lethargic and reduces creativity. This lack of accountability causes inefficiency and losses in the public enterprises.

6. Under-Utilization of Capacity

The public enterprises operate at less than their full capacity and produce lower than potential output. This increase the cost of production as the fixed cost is distributed over small output.

Public Sector Reforms

The Industrial policy resolution of 1956 has been the guiding factor which gave PSEs a strategic role in the economy. Massive investments have been made over the past five decades to build public sector. These enterprises have successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in various areas. Initially, public sector investments were in the key infrastructure areas, but later on it begun to spread in all areas of he economy including non-infrastructure and non-core areas. Since 1980's, the performance of state owned enterprises has been undergoing a close scrutiny in India. The existence of huge fiscal deficit made it difficult to raise funds at home and abroad. It was felt that the PSEs were absorbing a large chunk of government funds in the form of subsidies, which has resulted in the misallocation of resources brought about by diversion of savings. In order to overcome these problems government allows relaxation in the controls over PSEs and the emphasis was put on efficiency and internal resource generation of these enterprises. The public sector reforms in India since 1991 involves structural changes that aim at increasing efficiency, decentralization, accountability and market orientation of these

enterprises. The important reform measures introduced in the recent years are discussed as follows:

1. Allowing Managerial Autonomy

Government has adopted empowerment of PSEs as a continuous process. The management of PSEs has been given operational autonomy in respect of human resource development decisions like recruitment, promotion and other service related decisions. The profit-making enterprises which don't depend on the budgetary support of the government identified as Navratnas and miniratnas are given enhanced powers to take investment and project -related decisions such as decisions relating to capital expenditure, raising capital from the market, mergers and acquisitions etc. Board of Directors of PSEs exercises the delegated powers subject to the broad guidelines issued by Government. This would help PSEs to mitigate problems relating to delay in decision- making and help to improve the competitive strength of these enterprises.

2. Performance-based Accountability through Memorandum of understanding (MOU) System

MOU is an instrument that specifies mutual responsibilities of two parties who sign it. It is signed between government and management of PSEs. MOU clarifies objectives and targets expected form the management and performance evaluation takes place with reference to these objectives. Thus it allows management by results and objectives rather than management by controls. Further an attempt is made to evaluate performance of PSEs on the basis of financial and operational performance indicators such as sales, growth in sales and return on assets, dividend pay-out ratio and earning per share.

3. Manpower Rationalization

PSEs for long have been suffering from over manning. Voluntary Retirement Scheme (VRS) has been introduced in a number of PSEs to shed the surplus manpower. In order to provide security net to those who opt for VRS, Counseling, Retraining and Redeployment (CRR) scheme has been launched. CRR aims at retraining employees who have opted for VRS so that the employees can adapt to new vocation after their separation from PSEs.

4. Professionalism in Management

In order to improve efficiency, Board of Directors (BOD) of PSEs has been strengthened with the induction of professional managers. The number of Government nominated directors has been reduced. Management personnel are allowed greater operational autonomy in implementing the policies of the board. Efforts are being made to reduce political and bureaucratic interference in the working of public sector enterprises.

5. Dereservation

The portfolio of the public sector investments has been thoroughly reviewed to focus the public sector on strategic, high-tech and essential infrastructure. The new industrial policy 1991 adopted the policy of dereservation that allowed the entry of

private sector in the activities exclusively reserved for public sector. The list of industries reserved solely for the public sector -- which used to cover 18 industries, including iron and steel, heavy plant and machinery, telecommunications etc. has been drastically reduced to two: atomic energy generation, and railway transport. These reform mainly aim at providing competition to the public sector.

6. Transparency in Operations of PSEs

Corporate Governance Code has been formulated to bring greater amount of public accountability and transparency amongst PSEs in an era of competitive environment in 2005. Corporate governance refers to ethical business and transparent conduct of management of organization so as to protect the interest of stakeholders (i.e. shareholders, employees, suppliers etc.).These are the guidelines that management is required to follow in their decision-making process. The code meet the regulatory framework, builds harmonious relations with the stakeholders, provide high degree of accountability to the parliament and the public and ensures transparency in decisions. Further, PSEs are also subject to Right to Infromation Act (RTI).

7. Revival and Restructuring of Sick PSEs

Efforts are made to modernize and restructure PSEs and revive sick industries. The chronically sick industries have been sold off or closed. Companies having potential for revival have been allowed to be turned around by private sector. In 2004, **Board for Reconstruction of PSE (BRPSE)** has been created to take up restructuring and revival of PSEs. BRPSE is an advisory body which provides measures to strengthen, modernize PSEs. It advises government on disinvestment or closure or sale of chronically sick or loss making units that cannot be revived. It also monitors incipient sickness in PSEs so as to detect their problems at the initial stage that can result into sickness at the later stage. As on 15-7-07, 57 PSEs have been referred to BRPSE.

8. Allowing PSEs to Enter Capital Market

In an era of reduced budgetary support PSEs have been allowed to raise equity finance from the capital market. This has provided a market pressure on PSEs to improve their performance. As investors keep on monitoring the shares listed on stock exchange and market price movements reflect the performance of the company so management remain alert of their operational efficiency. Further, the listing of PSEs share in the market has offered new opportunities to the investors that have also improved the trading activity of the stock exchanges in India. In the year 2007, 44 central PSEs were listed on the stock exchange. Some of PSE shares are enlisted on the international stock exchange (for example MTNL share is listed on New York stock exchange).

9. Modernization

The new policy provided for modernization of plants, rationalization of productive capacity and changes in the product mix of PSEs. Further PSEs have been allowed to enter into technology joint ventures and have alliance to obtain technology and know-how. **National Investment Fund** has been established in 2005 to provide funds for revival and capital investment requirements of PSEs. The disinvestment proceeds will be

channelized to this fund. This would help them to develop competitive strategy based on market needs.

10. Disinvestment and Privatization

Disinvestment in India primarily aims at improving corporate efficiency, financial performance and competition amongst PSEs. It involves transfer of Government holding in PSEs to the private shareholders. Disinvestment introduces competition and market discipline on PSEs and depoliticizes the decision-making process.

Concept-Check Question

- Explain the meaning of Navratnas and Miniratnas.
- What is Memorandum of Understanding (MOU)?
- What are the social security measures initiated by government for workers of divested PSEs?
- Give the rationale of BRPSE.

Disinvestment And Privatization

The New Economic Policy initiated in July 1991, clearly indicated that the Public Enterprises have shown negative rate of return on capital employed and in wake of economic reforms the role of PSEs have to be redefined so that it should withdraw from the areas where no public purpose is served by its presence, and The public sector should make investment only in those areas where investment is mainly infrastructural in nature and where private sector participants are not likely to come forth to an adequate extent within a reasonable time perspective. In this direction, Government has decided to adopt disinvestment and privatization policy which is explained as follows**:**

Disinvestment vs. Privatization

Disinvestment refers to the dilution of government's stake in a public enterprise. If the dilution of government's stake involves the transfer of management and control of the enterprise as well then it is referred to as privatization. Thus if the government transfers 51 percent or more shares of public enterprise to the private shareholders then this dilution would transfer the majority of decision making power of the government. If less than 50 percent government's shareholding is transferred then the effective control would remain in the hands of government and the enterprise is not said to be privatized.

Thus privatization involves the dilution of government's shareholding that also leads to the effective change to management and control. Disinvestment is wider in its meaning that extends to dilution of government's shareholding to a level where there is no change in the control to the dilution that results in the transfer of management i.e privatization.

Objectives of Disinvestment

The following are the main objectives of disinvestment:

i) **To provide fiscal support:** The argument for fiscal support emphasizes that the resources raised through disinvestment must be utilized for retiring past debts and there by bringing down the interest burden of the Government.
ii) **To introduce, competition and market discipline;**
iii) **To find growth;**
iv) **To encourage wider share of ownership in the public enterprises;**
v) **To depoliticise essential services and improve efficiency**.

Modalities of Disinvestment: In India three modalities are used for disinvestment:

(a) Offering shares of Public Sector Enterprises at a fixed price through a general prospectus. The offer is made to the general public through the medium of recognized market intermediaries.

(b) Sale of Equity or Strategic Sale through Auction of share amongst pre determined clientele, whose number can be large. The reserve price for the PSE's equity can be determined with the assistance of merchant bankers. In case of strategic sale, government retained a part of the equity with it, though management control is transferred to the strategic partner. The strategic partner is required to purchase an equity stake which is large enough to ensure a workable majority.

(c) Offer for Sale determining the fixed price for sale of a public enterprise, inviting open bidders and accepting highest bidder's quotation for sale.

Until 1999-2000, it was primarily the sale of minority shares of CPSEs in small lots. From 1999-2000 till 2003-04, the emphasis of disinvestment changed in favor of **'Strategic Sale'.** Currently, the emphasis is on listing of unlisted profitable CPSEs (other than the Navratanas) each with a **'networth'** in excess of Rs. 200 crore, through Initial Public Offerings (IPOs). It also involves sale of minority shareholding of the Government in listed, profitable CPSEs either in conjunction with a Public Issue of fresh equity by the CPSE concerned or independently by the Government, subject to the residual equity of the Government being at least 51 percent and the Government retaining management control of the CPSE. Thus the emphasis is on the wider public participation in the disinvestment process.

Concept-Check Question

- Differentiate between Disinvestment and Pprivatization.
- What do you mean by Strategic Sale of PSEs?
- What is the purpose of National Investment Fund?

Progress of Disinvestment

The Government in July 1991 initiated the disinvestment process in India, while launching the New Economic Policy **(NEP)**. The crucial shift in the Government policy for disinvestment of PSE's was mainly attributable to poor performance of these enterprises and burden of financing their requirements through budget allocations. In 1991, there were 236 operating public sector undertakings, of which only 123 was profit making. The top 20 profit making PSE's accounted for 80 percent of the profits, implying that less than 10 percent of the PSE's were responsible for 80 percent of profits. The return on public sector investment for the year 1990-91 was a just over 2 percent.

If we visualize the progress of disinvestment in the Central Government undertakings from 1991-2007 The disinvestment proceeds are encouraging but have been far lower than the target except for few years. Till 2007, cummulative amount Rs.49, 241.64 crore have been collected from disinvestment proceeds.

The reasons for such low proportion of disinvestment proceeds as against the target set were identified and presented below:

(i) The unfavourable market conditions are the main reason responsible for this down ward trend of disinvestment.

(ii) The offers made by the Government for disinvestment of PSEs are not attractive and stringent bureaucratic procedures cause the discouraging of the private sector investors.

(iii) The valuation process, procedures and surplus employees are other factors hindering the disinvestment process.

(iv) The Government is not transparent about its approach towards sequencing the restructuring and the methods of privatisation of PSE's.

Disinvestment Policy in India: Evolution and Recent Initiatives

The disinvestment of the Government's equity in CPSEs started in 1991-92, when minority shareholding of the Central Government in 30 individual CPSEs was sold to selected financial institutions (LIC, GIC, and UTI) in bundles. The shares were sold in bundles to ensure that along with the attractive shares, the not so attractive shares also got sold.The Rangarajan Committee recommended in April, 1993, that the percentage of equity to be disinvested should be generally under 49 per cent in industries reserved for the public sector and over 74 per cent in other industries. The Disinvestment Commission was established in the year 1996-97 to advise Government on disinvestment issues. Government has now emphasized the divestment in the non-strategic PSEs even below 26 percent. Since 2000, the increasing emphasis is placed on strategic sale and the entire proceeds from disinvestment/privatization is decided to be deployed in social sector, restructuring of PSEs and retirement of public debts. At present the emphasis is placed on public offering of shares to the public. The **salient features of recent disinvestment**

policy since 2004 of the Government with respect to Central Public Sector Enterprises (CPSEs) are as follows:

(i) The profit-making companies on principle are generally not privatized. Privatization is considered on a transparent and consultative case-by-case basis. The existing "Navratnas" companies in the public sector are allowed to raise resources from the capital market.

(ii) The efforts are made to modernize and restructure sick public sector companies and revive sick industry. The chronically loss-making companies are sold-off, or closed, after all the workers have got their legitimate dues and compensation. The private industry is inducted to turn around companies that have potential for revival.

(iii) The disinvestment proceeds are used to provide resources for social needs and to meet investment requirements of profitable and revivable units. **National Investment Fund** has been created in 2005 for this purpose that would channelise the disinvestment proceeds.

Self-Check Question

Q. "PSEs hold commanding heights in the economy but financial performance of these enterprises are far from satisfactory". Comment on this statement and explain the role and contribution of PSEs in India.

Q. Critically examine the performance of PSEs in India. Would you recommend disinvestment of public sector units?

LESSON 3

PRIVATE SECTOR IN INDIA

- Dr. Bhawna Rajput

Introduction

Despite the important role played by the public sector in India, the contribution of private sector to overall growth was always higher than public sector because of its significantly higher share in GDP. The importance of private sector can be assessed in terms of its share in domestic saving and gross domestic capital formation. The gross domestic savings and gross domestic capital formation of private sector accounts for around 25 percent and 18 percent respectively of total GDP at market price. The plan wise statistics depicts that private sector dominates the savings and capital formation in the economy. Under the new economic policy the private sector has become more preponderant than public sector.

Profile of Private Sector in India

Considerable Growth

Over the years in the past since independence, the private sector has gown rapidly. There has been an impressive accretions in the number of persons employed, value of output produced and the extent of national income generated. The share of private sector is dominant in agriculture, forestry, fishery and small-scale industries. Though the share of private sector in the heavy industries is not significant but in the recent years an uptrend is witnessed. Further the private sector has grown faster as a result of the FDI liberalization measures, industrial delicensing and external demand boost from devaluation.

Diversified Structure

The private sector in India has a diversified product profile i.e. private sector encompasses a large variety of industries scattered all over the country.

Reasonably Profitable

The private sector has shown profitability greater than its public counterparts. Further the sale, production and investment growth in the private sector exceeds that of public sector.

Shortcomings and Limitations of Private Sector

Private sector though has depicted a spectacular growth profile but it suffers from the limitations discussed as follows:

1) Unhealthy Working: Barring few exceptions, private sector in India often indulge in unfair business practices of generation of black-economy and corrupt business dealings like evasion of tax, charging higher prices for goods, creating artificial scarcity of Goods

etc. A series of capital market scams by big corporate and cooperative banks has brought into sharp focus the need for improvement of regulation of private sector.

2) Lack of Social Orientation: Private sector is motivated towards short-term gain and often fails to maximize production of essential goods. Private sector has been extremely cautious to venture into innovative products and processes.

3) Slow Progress in R&D: The private sector has been hesitant to invest in the research and development of technology. Huge public investments are made in the universities and research institutes by the government. The commercial behavior guide the investment and funding of research projects.

4) Monopoly and Concentration of Power: The restrictive production policies and charging of higher price have resulted in monopoly gains to the private sector. The policy of mergers, acquisition has been used to prevent competition in the industry. The increased foreign investment that targets the small domestic industry to enter the domestic market has further aggravated the problems of concentration of economic wealth in the hands of few.

5) Industrial Unrest: The labor unrest is quite alarming in the private sector especially amongst small scale and medium-sized enterprises. The wages in these enterprises are quite low and there exists adverse working condition. The industrial disputes are quite high as compared to the public sector. This often results into strikes, lockouts, gheraos etc. The harmful consequences are obvious: work stoppage leading to the non-utilization of capital equipment, idle labor, resulting in the wastage of economic resources.

6) Sickness: The large number of total unit in the private sector is either sick or prone to become sick. The sickness is the result of many problems such as bad management, old production methods, outdated technology, inadequate capital and labor unrest.

Suggested Measures

The focus of post-reform policy in India has been to attract private investments in expanding India's infrastructure, which would catalyse the economic growth and poverty reduction. The public sector has been allowed to focus on few strategic areas. However, the results of these reforms measures have been mixed. Existing imperfections system has constrained the projects in the private sector. The following measures are suggested to improve investment climate for the private sector in India**:**

1 Better Public Administration and Governance: Poor governance in the government departments has had adverse impacts on India's private sector. Public bodies such as state electricity boards **(SEBs)**, Municipal bodies and others have a poor governance record manifest in the form of poor record keeping, lack of integrity in accounting, information delayed, employee indiscipline, etc, which severely restricts their ability to contract with the private sector. Thus the private participation in the infrastructure development is inhibited.

2. Competition Policy: Excessive regulation of entry and exit from business relative to most countries is a key factor contributing to less competitive markets in India.this has resulted in lower private foreign investments in the country.

3. Legal and Judicial Reform: Legal delays and uncertainty on property rights, speed of the courts, inadequacy of bankruptcy and foreclosure laws, inflexibility of labour laws significantly increase risk perception and consequent costs to the private sector.

4. Infrastructure Development and Reforms: By most standards, and in all sectors, delivery of infrastructure services has lagged behind demand mainly due to the tremendous increase in population, accelerating urbanization and faster India's industrial growth. The delays, cost overruns, and lack of competitiveness results in the slow growth of basic infrastructure facilities. The infrastructure development would improve the investment climate for the private sector in India.

Though considerable progress has been made in increasing the role of the private sector in the economy, significant investment potential could be unleashed if key reforms are initiated in the energy sector and the financial health of the public utilities that will transact with the private sector is improved.

Public vis-à-vis Private Sector in the Post Liberalized Period

The public sector in India has played a significant role in the overall development of the economy. The reform process has redefined the role of public sector to focus on strategic areas which are considered essential for accelerating economic growth. The public sector will focus on the regulatory aspects so as to allow the smooth operations of competitive markets. Further, government is expected to play a greater role in the development of social and physical infrastructure in the country. The role of private sector has increased tremendously in the areas which have a scope of competitive markets. Strengthening the private sector's capability is also an important need. This could be achieved through enhancing their capital base and widening the range of debt instruments available in the market. Supporting deserving projects through insurance and guarantee products would moderate the risk profile of the projects and improve the private participation in the infrastructure sector.

LESSON 4

SMALL SCALE ENTERPRISES

- Dr. Bhawna Rajput

Studying this chapter should enable you to understand:

- Meaning and Importance of Small Scale Enterprises in India
- Problems of Small Scale Enterprises
- Government Policy on Small Scale Enterprises

Introduction

The industrial policy resolutions have given special role to the small scale sector. The small scale sector plays a pivotal role in the Indian economy in terms of employment, output and exports. The growth in this sector has resulted into wider dispersal of industrial and economic activities and ensures better use of local resources. The small sector covers a wide spectrum of industries and small scale services and business enterprises and thus is referred to as small scale Enterprises (SSEs). SSEs include modern small scale industries (SSIs), tiny enterprises, small scale service enterprises and village and cottage industries.

Definition of Small Scale Enterprises (SSEs)

The definition of SSEs is based on the criterion of value of plant and machinery which has been revised over the years. At present the small industrial unit has been classified as follows:

i) Small Scale Industrial Units (SSI) units having investment in plant and machinery upto Rs.1 crore.

ii) Ancillary Industrial Units having investment in plant and machinery upto Rs.1 crore. Such an undertaking must sell not less than 50 percent of its output to other industrial undertakings.

iii) Export-oriented Units having investment in plant and machinery upto 1 crore. The unit must export at least 30 percent of its output by the end of three years from the date of commencement of production.

iv) Tiny Units having investment in plant and machinery upto Rs.25 lakhs irrespective of location.

The investment limit in plant and machinery in case of specified Hi-tech and export oriented units has been raised to Rs. five crore to ensure suitable technology up gradation and to enable them to attain competitive edge.

Definitions of Micro, Small & Medium Enterprises under Micro, Small & Medium Enterprises Development (MSMED) Act, 2006

In accordance with the provision of **(MSMED) Act, 2006** the Micro, Small and Medium Enterprises (MSME) are classified in two Classes:

(a) Manufacturing Enterprises: The enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the industries (Development and regulation) Act, 1951)**.** The Manufacturing Enterprise are **defined in terms of investment in Plant & Machinery.**

(b) Service Enterprises: The enterprises engaged in providing or rendering of services and are **defined in terms of investment in equipment.**

Thus the new definition have clearly included industrial as well service into Small Scale Enterprises(SSEs).The limit for investment in plant and machinery / equipment for manufacturing / service enterprises are as under:

Manufacturing Sector	
Enterprises	**Investment in plant & machinery**
Micro Enterprises	Does not exceed twenty five lakh rupees
Small Enterprises	More than twenty five lakh rupees but does not exceed five crore rupees
Medium Enterprises	More than five crore rupees but does not exceed ten crore rupees
Service Sector	
Enterprises	**Investment in equipments**
Micro Enterprises	Does not exceed ten lakh rupees
Small Enterprises	More than ten lakh rupees but does not exceed two crore rupees
Medium Enterprises	More than two crore rupees but does not exceed five crore rupees.

Modern vs. Traditional Cottage SSEs

Traditional SSEs are labor-intensive, requires specialized skills and craftsmanship which are often handed down from one generation to another. The cottage industries are generally located in the rural areas, mostly make use of local resources and cater to the local demands. These industries involve the production of conventional goods.

Modern SSEs are capital-intensive and involves high-tech in the production. These are generally concentrated in the urban areas and may procure raw materials from distant places and produce sophisticated goods that are sold both in national and international markets. These industries produce sophisticated goods.

Role of SSEs

SSEs have acquired prominent role in the industrial and economic development. It has contributed significantly to the socio-economic welfare of the country. The SSEs continue to be a vibrant sector of the Indian economy. It contributes significantly to the growth of Gross domestic product (GDP), employment generation, exports and creation of entrepreneurial base. These are discussed as follows:

1) Employment Generation: The small scale sector contributes about four-fifth of manufacturing employment in India. The SSEs are generally labor-intensive and thus create more employment for the given amount of capital. SSEs provide employment to locally available semi-skilled and unskilled workers who would otherwise be unemployed.

Further, SSEs develop self-employment and entrepreneurial base in the country. Given the acute unemployment problem in India, creation of employment opportunities largely depends upon the development of SSEs.

During Xth plan period (2002-07), SSEs register around 4.57 percent growth in employment where as large industries growth was around 0.85 percent. It is the segment which provides employment next to agriculture. The growth in employment in this sector is much above the population growth of India (i.e1.5 percent) The employment intensity of this sector can be judged from the fact that 1 person is employed for every Rs.1.49 lakh rupees invested in fixed assets of SSEs as against 1 person for every Rs. 5.56 lakh in the large organized sector.

2) Equitable distribution of Income and wealth: The equitable distribution of income and wealth occurs as the large numbers of SSEs are dispersed in wide range of regions and is held by large number of people. The number of SSEs account for more than 95 percent of total industrial units in the country. Large scale industries on the other hand are owned by few big owners and so led to concentration of income and wealth in the hands of few. Further, SSEs possess much larger employment potential as compared to large enterprises. Small sector thus enable a vast majority of people to derive the benefits of economic development.

3) Mobilization and utilization of local latent resources: SSE mobilizes the latent i.e. unused or idle resources in terms of surplus labor, idle capital and deploys these resources in the productive activity. The SSEs provide opportunities to develop entrepreneurial skills and encourage the innovations at the grassroots level. It provides large amount of supply links by sourcing inputs from the local areas and so have greater local multiplier effect than large enterprises. This is a definite gain to the society as a whole.

4) Regional Dispersal of Industries: SSEs are dispersed across wide range of areas and regions. The large scale industries are concentrated in big metropolitan cities as these cities provide an easy access to the basic facilities of power, transport, roads, banking etc.

as such it resulted into regional disparities with already well-off states developed faster than other. The small scale industries with localized operations spread in the remote corner of the economy. These industries can be easily set up in different parts of the country and energizes the village industries. This led to reduction of regional economic disparities.

5) Contribution toward GDP and output growth: SSEs contribute around 39 percent of gross manufactured output. The output in Xth plan recorded a growth rate of 8.87 percent p.a.

6) Contributes towards Foreign Exchange: SSEs hold a significant share in exports earnings. The products like handicrafts, gems, jewelry, carpets, carpets, silk which is a forte of SSEs possess huge demand in foreign market. These products require low import-content. Further, the financial constraints and small size of SSEs inhibit the sourcing of raw inputs from abroad and greater use of local resources and save foreign exchange. Thus SSEs contribute to the precious foreign exchange of the country. The direct exports from SSEs accounts for nearly 34 percent of total exports. Besides direct exports SSEs indirectly contribute to the export earnings in terms of production of parts or components for use in exportable goods or export order from large units. Further, the non-traditional products account for more than 95 percent of total SSEs exports. The products groups' where SSEs dominates are sports goods, readymade garment, processed food and leather products.

7) Arrest Rural-Urban Migration: The rapid increase of population and lack of enough job opportunities in the rural areas has caused migration of rural population to urban areas. This excessive migration has resulted into problems like housing shortage, low level of civic facilities , growth of slums and additional social problems like theft etc. The development of SSEs in the rural areas can provide employment opportunities near the homes of rural people and so reduce rural migration.

Progress of SSEs in India

The SSEs in India has made progress over past few decades. It has emerged as a very significant sector of the Indian economy with considerable contribution towards GDP, industrial production, employment generation and exports. It has grown tremendously from mere 8.7 lakh units in 1980 to 128.44 lakh units in 2007(Table1). SSEs has also witnessed significant growth in the total production, employment and export earnings.

Table1: Progress OF SSEs Sector

Year	Units (Lakh nos.)	Production (Rs. crore) At 1993-94 prices	Employment (Lakh nos.)	SSI Exports Rs. crore
1980-81	8.7	72200	71.0	1600
1985-86	13.5	118100	96.0	2800
1990-91	67.9	84728	158.3	9664
1995-96	82.8	121175	197.9	36470
2000-01	101.1	184401	240.9	69797
2005-06	123.4	418884	299.9	150242
2006-07	128.44	473339	312.52	NA

NA: Not Applicable
Source: Office of the Development Commissioner (MSME)

Problems of SSEs in India

Concurrent with an impressive growth SSEs face number of problems which are manifested in such a way that this sector fails to achieve the required amount of dynamism and growth. The problems of SSEs are discussed as follows:

1) Financial Problems: Finance is the most important aspect for any industrial development. The scarcity of finance and credit is the main obstacle in the growth of SSEs. These enterprises are generally organized in sole-proprietary and partnership concerns and so have no access to the capital market. There exists insufficient equity type institutional support. Delays in institutional finance, unhelpful attitude of banks are the common problems of SSEs. The delay in sanctions of loans occur due to lengthy procedural formalities, insistence upon certificate from local authorities such as village office, block development officers etc and over-emphasis on collateral security. Banks generally avoid financing smaller SSEs due to high mortality rate, low overall recovery performance and high cost of servicing SSEs loans. In this scenario SSEs have to depend upon high interest non-institutional finance.

2) Slow Technological Progress: Paucity of funds is the major area for the slow adoption of innovative practices in the business. The unsatisfactory technology delivery mechanism such as arrangement for demonstration of cost and use of new technology also cause low technical progress in SSEs. SSEs especially the cottage and village industries have to depend upon outdated and obsolete production technique. This adversely affects the quality of output and increases manufacturing cost.

3) Marketing –Related Problems: The problem of marketing products of SSEs generally arise due to small scale production causing high product cost, lack of standardization of product, adequate marketing research, competition from big industrial units and insufficient research and holding capacity. Another related problem is the weak bargaining power of tiny and village industries vis-à-vis large buyers which is causing long overdue from these buyers. SSEs thus fail to obtain fair and timely price for their

products. Lack of proper marketing is an important factor causing sickness in SSEs. The inadequate organized marketing support for cottage and village industries also causes low promotion of their products.

4) Lack of Proper Planning: Planning comprises of the outlay of the quantum of output, time framework of implementation, product and marketing strategies. The performance feasibility study are often neglected by SSEs due to time and cost factors. As a consequence, SSEs face large sickness at early stage of their operation.

5) Sickness: There exists large level of sickness amongst SSEs. The incipient sickness (ie. Sickness at an early stage of existence) is largely due to lack of planning, professional management and financial problems. The sickness causes wastage of large amount of finances that remain locked into these units. Further, sickness also leads to various socio-economic problems such as lower production, employment and exports.

6) Shortage of Raw Material: Raw material scarcity caused disruption in the production process. SSEs fail to make bulk purchases and thus have to pay higher price for inputs. The suppliers of scarce raw material give preference to buyers. SSEs have to depend upon low quality localized high price raw material. Further, SSEs fail to make alternative arrangements for critical inputs such as power due to financial constraints. These factors adversely affect product quality and cost of production.

Government Measures

An important place is assigned to SSEs sector in the development policy of the country. Till 90's Government focused more on protectionist policy towards SSEs. The shift in policy paradigm towards this sector occurred since1991 to impart more vitality and growth-impetus to the sector. The sector has been substantially delicensed. The regulations and procedures have been reviewed and modified to instill competition and efficiency in this sector. The policy initiatives adopted to promote this sector are discussed below:

1. Reservation: The policy of reservation was initiated in 1967 primarily as a promotional and protective measure for exclusive production in SSEs. The number of items reserved is continually revised by Government. In 1967, 47 items were reserved for exclusive production by SSEs which expanded to 873 in October 1984. The rationale of reservation policy was to expand employment opportunities through setting up of SSEs and to protect them from competition by large enterprises. In the new global scenario with WTO agreement Government is required to remove quantitative restrictions on imports of items. A large number of items exclusively reserve for SSEs can now be freely imported. Thus the reservation has cost its relevance so **the government has drastically reduced the number of items reserved for exclusive manufacture by micro small and medium enterprises (MSME). As on March 2007, the list of items for exclusive production contains 114 items which was further reduced to 35 in February 2008. Non-MSME units can undertake manufacture of reserved items only if they undertake 50 percent export obligations.**

2. Financial Support: Government has made efforts to ensure adequate and timely availability of financial assistance to SSEs. RBI has issued guidelines to public sector banks to ensure 20 percent growth in credit to SSEs. Small Industries Development Bank of India (SIDBI) which is an apex institution and coordinates the financial assistance availability to SSEs has scaled up and strengthens its credit operations to this sector. The branch network of SIDBI has been increased. In order to improve an access to the capital market, the equity participation by other industrial undertaking not exceeding 24 percent of total shareholding has been allowed. The legislative changes are under way to allow limited liability partnership for SSEs. This would limit the financial liability of some partners who have invested capital. Risk capital fund has been created to provide equity-type long term loans to SSEs. The credit guarantee fund scheme is launched by government in 2000 to allow collateral free credit to SSEs.

3. Fiscal Support: Government has allowed tax concessions in terms of lower excise duty on production, lower sales tax on sales, tax-holiday and extended the time limit for payment of excise duty by SSEs.

4. Marketing Support Measures: In order to provide market support to SSEs, Government has taken following measures:

(i) Preferential Purchases and Price Preferences by Government: The Government organizations are statutorily required to make specified level of purchase from SSEs and the same has to be disclosed in their annual reports. At present the number of items for exclusive purchase from SSEs stood at 358. Government also provides price preference to SSEs in their purchases over large scale units.

(ii) Financial Assistance is allowed for participation in the international trade fair by representatives of SSEs.

(iii) Training Programmes on various aspects of marketing like marketing management, export marketing etc are conducted by Government.

(iv) Institutional Marketing Support is provided by National Small Industries Corporation (NSIC) and Small Industries Development Organization (SIDO).

5. Institutional Support: Government has established various organizations to help SSEs. These institutions assist SSEs in purchase of raw material, marketing of goods, technological and skill improvement and arranging credit. The important organization established are Khadi and Village Industries Commission and commodity specific organizations such Handloom Board, Cottage Industries Board, Coir Board etc. Specialized financial and consultancy institutions such as SIDBI, NABARD (for supporting rural industries), SIDOs, NSIC has been established to provide financial, marketing and managerial assistance to SSEs.

6. Raw Material Assistance: The institutional support is provided to allow availability of raw material (both indigenous and imported) at fair price. The centers have been established to distribute scarce raw material to SSEs. Buffer stocks are maintained for raw materials. This has helped SSEs to focus on production of quality products.

Recent Government's Initiatives

In view of liberalization and globalization and reduced Government intervention in market-driven economy the protectionist policies has been replaced by supportive policies. The recent measures adopted by government are as follows:

i) **Legislative Measures:** Micro, Small and Medium Enterprises Development Act, 2006 has been enacted to facilitate the promotion and development of SSEs. This Act seeks to facilitate promotion and development and enhancing competitiveness of these enterprises. It provides the first-ever legal framework for recognition of the concept of "enterprise" (comprising both manufacturing and services) and integrating the three tiers of these enterprises, namely, micro, small and medium. The basic purpose is to develop the consultative mechanism at the national level that represents stakeholders from three classes of enterprises. The act provides for the establishment of specific funds to support SSEs. The progressive credit policy with targetted growth of credit to SSEs has been incorporated in the Act. The mechanism has been designed to reduce the problems of delayed payment to SSEs.

ii) **Support for Cluster-Based Development:** The holistic approach is adopted to develop cluster of SSEs so as to provide common facilities in these clusters. The existing industrial infrastructure will be upgraded and new facilities will be created in the public-private partnership mode.

iii) **Technology and Quality Up Gradation:** The support is provided by establishing training-cum product development centers.

iv) **Strengthening of Entrepreneurial and Managerial Development Programmes :** Financial assistance is provided to B-schools to conduct tailor-made management courses for SSEs. Entrepreneurial clubs are established in the Colleges or Universities.

v) **Empowerment of Women-Owned Enterprises:** The concessions, marketing and credit facilities on priority basis are provided to enterprises owned and managed by women.

vi) **Strengthening of Data base for SSEs:** It is decided to collect database on SSEs through annual sample surveys and quinquennial (i.e. happening every five years) census so that policy decisions can be framed for SSEs based on systematic data that provides inputs for systematic policy initiatives.

Conclusion

SSEs enjoy inherent advantages over their larger counterparts in terms of generation of employment opportunities, equality of income and wealth and greater export potential. The globalize economy has ushered in greater accessibility to the market, need of greater linkage of SSEs with larger companies and improved manufacturing techniques. The measure adopted by Government have been attempted to alleviate the problems of SSEs. The recent initiatives have changed the outlook of business from protection to liberalization. It has created a sense of competition amongst SSEs.

Self-Check Questions

- Distinguish between Small Scale and Cottage Industries.
- Explain the role and importance of Small-Scale Enterprises in Indian Economy.
- What are the problems facing SSEs in India?
- Discuss Indian Government's measures to improve the development of SSEs.

LESSON 5

FOREIGN CAPITAL

- Dr. Bhawna Rajput

Studying this chapter should enable you to understand:

- Meaning of foreign capital
- Important components of foreign capital flows in India
- Trends in Foreign capital investment
- Government's policy on foreign direct investments.

Introduction

Foreign capital has a key role in the economic development process of the country. It is a source of modernization, income and employment generation in the economy. India's recent liberalization of its foreign investment regulations has generated strong interest by foreign investors, turning India into one of the fastest growing destinations for global investment inflows. Foreign firms are setting up joint ventures and wholly owned enterprises in services such as computer software, telecommunications, financial services, and tourism. The present chapter examines the recent trends and pattern of foreign capital flows in India.

Components of Foreign Capital in India

Foreign capital refers to the capital flows from resident entity of one country to the resident entity of another country. The resident entity may be an individual, corporate firm or a Government. In India, there are three important components of foreign capital flows (See Chart 1):

1) **Foreign Capital Investments**
2) **Foreign Aid**
3) **External Commercial Borrowings**

(1) Foreign Capital Investments:

Foreign capital investments refer to investments made by an entity which is not the resident of the country. In India there are two components of foreign capital Investments:

(i) Foreign Direct Investments (FDI)
(ii) Foreign Portfolio Investments (FPI)

(i) **Foreign Direct Investments (FDI):** FDI refers to the physical investments made by foreign investors in the domestic country. The physical investments refer to the direct investments into building, machinery and equipments. Reserve bank of India (RBI) defines FDI as a process whereby resident of one country (i.e. home country) acquires ownership for the purpose of controlling production, distribution and other activities of a firm in the another country.(i.e. the host country). It reflects the lasting interest by the foreign direct investors in the entity or enterprise of domestic economy. There exists a long-term relationship between the foreign investor and the domestic enterprise. The foreign direct investors generally exert a high degree of influence on the management of the entity. The direct investor can be an individual, public or private enterprises (referred to multinational corporations or MNCs)) or Government. The management influence is exerted if foreign investor holds significant shareholding or voting power in domestic entity. FDI can be equity or debt investment. In India there are three **important element of FDI:**

(a) Equity investments by foreign investors;
(b) Reinvested earnings i.e retained earning of FDI companies;
(c) Debt Investment (particularly the inter-corporate debt between related entities).

The important forms of FDI are investments through:
(i) Financial Collaboration
(ii) Joint Ventures and Technical Collaboration
(iii) Capital Markets
(iv) Private Placements.

(ii) Foreign Portfolio Investments (FPI): FPI refers to the short-term investments by foreign entity in the financial markets. These are indirect investments and include investment in tradable securities, such as shares, bonds, debenture of the companies. Foreign Portfolio investors don't exert management control on the enterprise in which they invest. The important objective of FPI is the appreciation of the capital investment regardless of any long-term relationship with enterprise (IMF, Balance of Payment Manual). These investments are made with short-term speculative gains. There are three kinds of FPI in India:

a) **Foreign Institutional Investment:** These are the investments made by foreign institutions like pension funds, foreign mutual funds etc. in the financial markets.

b) **Funds raised through Global Depository Receipts or American Depository Receipts (GDRs/ADRs):** GDRs and ADRs are instruments which signify the purchase of share of Indian companies by foreign investors or American investors respectively.

c) **Off-shore funds:** The schemes of mutual funds that are launched in the foreign country.

Foreign Direct Investments (FDI) vs. Foreign Portfolio Investment (FPI)

The relative significance of two important components of foreign investments can be summarized as follows:

(a) FDI accelerates growth process mainly due to superior technology transfers and greater competition that generally accompany FDI. Domestic firms improve R&D to sustain competition with foreign firms or multinational firms. FDI also improves export competitiveness of the country. So, **FDI** has a **positive spillover effects** on the economy. FPI enables the country to use huge pooled foreign funds and directly doesn't involve any kind of superior technology or managerial transfers. Thus FPI has limited spillover effects than FDIs.

(b) FDI reflects seriousness and commitment on part of foreign investors since FDI causes high initial set up cost and higher exit costs in terms of difficulty in selling stake in the firm. Thus **foreign direct investor** stay invested for **long-term** in the country and so help to improve growth prospects of the country. **FPI** is guided by **short-term** gains and involves problems to exit the country. **FPI tends to be more volatile than direct investments.** The sudden FPI outflows at the time of domestic crisis may disrupt the development process of the country.

(c) Portfolio investors due to their short-term perspective may indulge into speculative activities in the domestic financial market and may cause problems for the domestic investors.

(d) FDIs are directly managed by foreign owners FPI on the other hand are managed by "outside managers". So FDI results into better asset management.

(e) The increased FDI flows give positive signal about the long-term prospects of domestic economy and greater creditability of the country. A very substantial amount of FPI of short-term nature depicts risk in the domestic economy.

(2) External Aid

External aid refers to the concessional foreign finance with flexible terms and conditions. It may be in the form of long term concessional debt or grants (doesn't involves any repayment obligations). The tenure of the aid is generally very long. The important **sources** of foreign aid in India are:

(i) Official Aid:

It is given by foreign governments or international official bodies such World Bank, International Monetary Fund (IMF), Asian Development Bank (ADB) etc. It can be:

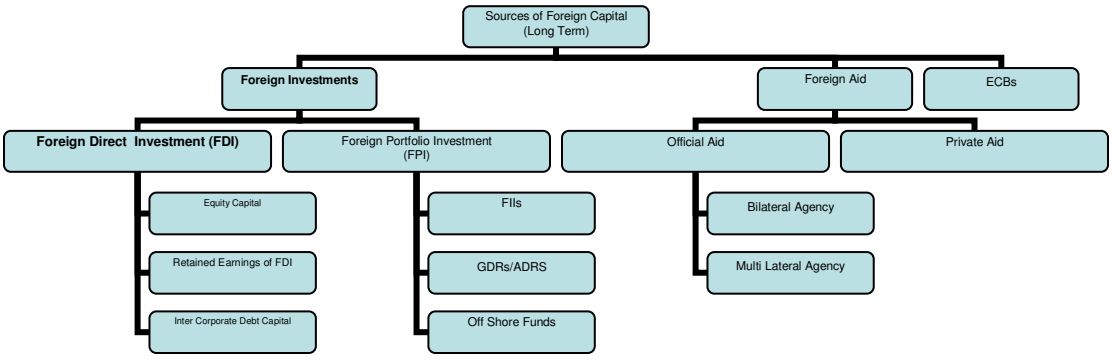
(a)Bilateral Aid: Loans or grants under bilateral (i.e. between two countries) agreement.

(b)Multilateral Aid: loans or grants extended by multilateral (i.e. more than two countries) agencies e.g. Loans from IMF, World Bank etc.

Further, official aid (Bilateral or Multilateral) can be **Government Aid** (i.e. aid that passes through government) or **Non-Government Aid** (i.e. aid received by non-government bodies directly from bilateral or multilateral agencies).

(ii) Private Aid: It is the fund which is received from private individuals, firms or institutions.

Chart 1: Sources of Foreign Capital (long Term)



External aid may also be distinguished as **tied aid or untied aid.** The tied aid is given with conditions in terms of its use e.g for the purchase of goods for specific purpose or to be spent on specific country. The untied aid can be used freely by the recipient country. Foreign aid allows an access to foreign funds without putting pressures of their repayment. In the initial growth process the country having saving-investment gap, fails to attract enough private foreign capital. Foreign aid helps to reduce the financial constraints on the growth of the economy. In the absence of foreign aid country would have to rely on commercial borrowings that involve huge interest burden on the country. Foreign aid can be used to create infrastructure and basic industries and thus helps to contribute towards economic development of the country. There are certain **problems** with the use of foreign aid discussed as follows:

(a) Political Pressures: Heavy dependence on foreign aid may introduce political compulsions on the economy. Donor countries may put certain pressures and lead to decisions not in the interest of the country. Sanctions imposed against for taking nuclear test is a recent example of pressures that developed nations imposed on developing nations.

(b) Uncertainty of Aid: Aid moves at the convenience of the donor countries. The delay or uncertainty in the aid may cause harmful consequences on the projects dependent upon aid.

(c) Restrictive Use: Aid generally involves conditions upon its use and may result in undesirable production and consumption pattern in the economy. For example donor countries may insist upon purchase from specified sellers. The foreign suppliers may charge higher price and cause high cost of the project. Tied aid may not allow the free-use of funds in the sectors important for the development process of the country. The real cost of aid appears to be high due to conditions imposed on its use.

(d) Low Utilization Rate: It is ironical that developing nations having scarcity of capital and resources are not able to utilize the total amount of sanctioned aid. This may be due to the lack of complementary domestic resources or experience to use aid. Further the procedural delay also cause low aid utilization.

(e) Complacent domestic initiatives: Foreign aid brings moral hazards in the recipient country. It results in the complacent behavior on part of government to improve resource generation.

Despite the problems associated with foreign aid, factors, such as lower cost, long-term nature of aid, have encouraged the dependence on foreign aid in comparison to commercial funds. In the recent years however, there is a significant decline in foreign aid as a percentage of GDP.

(3) External Commercial Borrowings (ECBs):

ECBs comprises of borrowings from international capital market on commercial terms. It covers all medium/long term loans e.g. supplier's credit, foreign currency convertible bonds (FCCBs), e.g. India development bonds, resurgent India bond (RIBs) etc. The interest rates on these borrowings are higher than foreign aid. The higher dependence on these borrowings can cause financial burden on the economy.

Concept-check Question

(i) Differentiate between foreign capital and foreign investment.
(ii) How is foreign direct investment different from foreign portfolio investment?
(iii) "Foreign direct investment is superior to foreign portfolio investment". Comment
(iv) What are the various sources of foreign capital flows in India?
(v) What is the difference between official and private aid?

Need of Foreign Capital

(1) Supplement domestic resources

Foreign capital inflows add to the domestic resources of the recipient country. The developing countries suffer from poor saving rate and so cannot raise sufficient investible funds to improve economic growth process. The saving investment gap is filled by foreign capital. This way a nation can increase the level of capital formation than what can be provided by the domestic savings.

(2) Improve Balance of Payment (BOP) Position

At the initial stage of development, nations require the use of imported capital goods and technical know-how as the domestic economy is underdeveloped. Further, exports in such countries suffer from inherent weaknesses like lack of exportable surplus, lack of technological up gradation and infrastructure. Thus there is a persistent deficit in BOP. Foreign capital raised the recipient economy's capacity to import goods and updated technology. Further, foreign investors have better understanding of the foreign market. As a result exports competitiveness of a country and dependency on imports is gradually reduced which prevent BOP crisis of the country.

(3) Technological and Managerial Improvements

Foreign capital allows accessibility of improved technology from developed nations. Foreign investments especially FDI brings updated technology and professional managerial teams along with finance. This technology transfer improves the productive efficiency of the economy. Further foreign capital helps to stimulate research in the country with their R&D activities.

Apart from the direct effects foreign capital has "spillover effects" on the rest of the economy. Spillover effects occur due to forward and backward linkage effects between foreign firms and domestic firms. Backward linkages result in availability of inputs produced by foreign firms at lower cost. Further, Foreign firms allow technological improvements of their suppliers. The suppliers are given training to improve their business practices and supply inputs to firms at lower prices. Forward linkages result in the increased demand by foreign firms for goods produced by domestic firms.

(4) Human Capital Improvements

The foreign firms enhance employee's skills through training and job-learning. It allows its employees better wages and working conditions. Such improvements have additional spillover effects on the economy as employees with improved skills may join other domestic firms or become entrepreneur. Thus other firms benefits from such human enhancements.

(5) Creates Competitive and Efficient Business Environment

Foreign firms increase the competition and force the domestic firms to adopt more efficient business practices. The inefficient local firms are driven out of business and thus

freeing the resources to be used productively. The competition leads to higher productivity, lower prices and more efficient resource allocation.

(6) Augmentation of Employment Opportunities

Foreign investments create new enterprises and activities in the domestic economy and so offer large employment opportunities and help to tackle the problem of unemployment.

(7) Improve Environmental and Social Conditions

Foreign investors by transferring cleaner and greener technology help in environment protection. There is however, a debate that the foreign investors export outdated technology which is not acceptable in their own economy. But this risk can be reduced if the environmental policy of the host country is inadequate. Foreign capital generates employment opportunities, reduce poverty and improve labor standards and thus result into better social climate of the country.

(8) Better Corporate Practices

Foreign investors lead to changes in managerial and business practices. These investors insist on improved internal reporting system, disclosure norms and improved corporate practices in the host country. This leads to improved corporate efficiency.

(9) Helps to neutralize the Income Fluctuations and Smoothen Domestic Consumption

The smooth income and consumption pattern can be achieved by foreign borrowing at the time of scarcity of resources and by foreign lending at the boom time. Foreign markets may offer attractive investment opportunities when the domestic economy is facing recessionary conditions. Further, foreign investment is used to take benefits of portfolio diversification.

(10) Improvement in Financial System:

The portfolio flows help to provide greater liquidity and trading volumes in the stock market. This helps to improve investment avenues for domestic saver and allow corporate to raise capital from the market. Thus investment projects requiring huge capital investments can be implemented.

(11) Contribution to National Exchequer of Host Country

The foreign firms improve government's revenue collection in terms of tax contribution like profit tax, excise duty, sales tax etc.

Limitations of Foreign Capital

(1) Crowds out local Capital and Entrepreneurial Growth:

Foreign capital is generally directed towards buying the existing profitable enterprises of the host country. The small enterprises generally are the easy target. Thus foreign investments destroy the local industry and entrepreneurial growth.

(1) Adverse impact on BOP Position

In the long run foreign investments cause strain on the BOP position of the economy due to repatriations of profits by foreign firms, payment of interest on foreign debt, management fees and royalties on foreign technology agreements. In certain cases the import content of exports is very high due to heavy dependence on foreign inputs.

(3) Distortions of Domestic Investment Patterns

Foreign capital may lead to the development of projects that may lack any domestic relevance and cause misallocation of resources. Foreign firms for example generally insist upon low-tech consumer sector or trade and service sector. However, in the initial phase of development infrastructure growth may be the priority. Further in case of tied foreign aid, the donor country may insist upon certain conditionalities that may adversely affect the sovereignty of the host country.

(4) Competition for local Domestic Resources

Foreign investors raise resources from the domestic market to finance their activities. Thus the notion that foreign investments results into infusion of additional capital is a misnomer. Foreign firms instead of complementing the local resources compete for the resources.

(5) Outdated Technology

There is a risk that technology transfers by foreign investors may be inappropriate. Foreign firms try to dump the outdated technology in the developing nations. It is quite likely that these firms use labor-saving technology which is unsuitable for labor abundant country like India.

Concept-Check question

- "Foreign capital is not a bag of unmixed blessings as far as its impact on BOP is concerned". Comment on this statement.
- How does foreign capital flows improve technological and entrepreneurial environment of a country.
- Explain the implication of foreign capital on the resources of the country.

Trends and Pattern of Foreign Capital Flows in India

Foreign capital flows into India is mainly influenced by the Government's policy environment. In the initial period of planned development the emphasis was on self-reliance and so dependence on foreign capital in the form of foreign aid was at the modest level. The strategy of economy of precious foreign exchange and import-substitution industrialization was followed. In 1980's export-promotion strategy was the core component of government's industrial policy and flow of foreign capital increased. During 80's however, due to low effective aid utilization and significant pressure on BOP as international oil prices increases dramatically in 1979-80 there was a sharp increase on external commercial borrowings (ECBs) in form of IMF loan facilities, NRI deposits. The private corporate sector was also allowed to raise private capital from international capital market. Towards the end of 80's foreign debt to GDP and debt-service ratio deteriorated significantly.

The policy approach to ECB underwent significant changes in early 90's with the introduction of reforms and external sector consolidation process. The focus was placed on low borrowings and restrictions on end-use of borrowings. During this period NRI long-term deposit was made more attractive. NRI deposits thus remained important sources of foreign capital.

Further government clearly emphasized on the need of supplementing debt capital with non-debt capital. The high-powered Committee on BOP recommended the need for achieving this compositional shift. The major shifts occur with liberalization of FDI and FPI norms in India in 1992. By 1993-94 FDI and FPI norms taken together emerged as the most important source of external finance. Since then an increasing trend is witnessed in the foreign investment inflows. The non-debt flow has exceeded net debt flows and foreign investments have remained as the important form of external financing in India. (Table1)

Table 1: India's Capital Flows: Composition

	Annual average		
Indicator\Period	**1990-91 to 1996-97**	**1997-98 to 2002-03**	**2003-04 to 2005-06**
Non-debt Creating Flows	41.9	58.3	78.1
Debt Creating Flows	52.4	34.8	22.1
Other Capital	5.7	6.9	-0.2 *
Total (1 to 3)	**100.0**	**100.0**	**100.0**

(Per cent to total)

* The negative share of 'other capital' during 2005-06 indicates that payments on account India's investment abroad were more than the capital inflows through 'non NRI banking channel' and 'other capital'. **Source: Annual Reports of** Reserve Bank of India.

Trends of Foreign Investment Flows in India

1. Share in World's Investment Flows:

India share of world foreign direct flows **has increased dramatically.** During the recent past India has attracted more than $40 billion of private investments. At a time when the flows of private capital investments has shrunk the FDI flows has strengthened due to the strong domestic fundamentals such as good corporate performance, consistent industrial growth, well-developed stock market and huge potential for economic growth. Further, the liberalization of FDI and FPI policy has led to the surge in capital inflows. The stock market liberalization has attracted a greater FPI in the Indian market. The increased FPI flows in India have been part of the increased flow of FPI to emerging economies.

2. Contribution to India's Gross Capital Formation:

The share of FDI flows in the gross capital formation is showing a consistent increasing trend which means that FDI plays significant role in the overall growth process of the country. The foreign investment as a percentage of total GDP has increased from 0.5 percent in 1990-91 to 5.7 percent in 2006.

TABLE 2: FOREIGN INVESTMENT INFLOWS

(US $ million)

Year	(A) Direct investment	(B) Portfolio investment	Total (A+B)
1990-91	97	6	**103**
1991-92	129	4	**133**
1995-96	2144	2748	**4892**
2000-01	4029	2760	**6789**
2003-04	4322	11377	**15699**
2004-05	6051	9315	**15366**
2005-06	8961	12492	**21,453**
2006-07*	22,079	7003	**29,082**
2007-08	32,435	29,395	**61,830**

Source: Annual Reports of Reserve Bank of India.

Recent trends in FDI flows

Country Sources of FDI

By country, the largest direct investor in India is Mauritius, largely because of the India-Mauritius double-taxation treaty. Firms based in Mauritius invested $16.0 billion in India between 1991 and 2006, equal to 39 percent of total FDI inflows. The second largest investor in India is the United States, with total capital flows of $5.6 billion during the 1991–2006 period, followed by the United Kingdom, the Netherlands, and Japan.

Distribution of FDI within India

FDI inflows are heavily concentrated around two major cities viz. Mumbai and New Delhi with Chennai, Bangalore, Hyderabad attracting significant share. The rural areas have attracted smaller number of high-value projects.

Sectoral Composition of FDI

Till about 1990, the government policy was to channelise FDI inflows mainly in technology intensive manufacturing industry and heavy capital goods sector. The share of petroleum, power and services sectors in FDI was very marginal. With changes in FDI policy since 1991 and opening up of infrastructure sector for FDI, the share of manufacturing sector in FDI declined and that petroleum and power sectors rose significantly.

Causes and Reasons of Low FDI in India

The total FDI inflows in India have improved very significantly over time (Table 2). The comparison of the foreign investment inflows with other developing nation like china reveals that India is unable to attract high amount of foreign direct investments. The **reasons of low FDI inflows** are as follows:

1. Poor Infrastructure Facilities

The poor infrastructure reduces the enthusiasm for FDI in the country. Insufficient power, poor roads facility, overburdened railways make it difficult to operate efficiently. In India there exists a low level of investment in the development of infrastructure. Further, time and cost overrun are common problems with government funding projects. There is a need to enhance private capital in the infrastructure sector.

2. Weaknesses in Education System

Indian education system suffers from many problems such as low degree of literacy rate, lack of skill enhancement necessary for employment. The government expenditure on education is low given the level of population. Further, the education system fails to provide enough and relevant well-trained workforce.

3. Bureaucracy and Corruption

Excessive corruption discourages FDI as it increases cost of doing business and results into mistrust in the system. Though with liberalization procedural bottlenecks have been reduced but delays in approval, complex procedure are common concerns of investors in India.

4. Strict labor regulations

The labor regulations in India are governed by large number of complex legislations. Restrictive labor legislations dampen FDI in the labor-intensive industries.

5. Outdated Judiciary System

The outdated legal system in India seems to be an important setback in the way of FDI. The legal system suffers from the problems such as corruption, inefficient court procedure and long delays.

6. Inefficient Enforcement of Intellectual Property Rights (IPR)

The WTO agreement has made dramatic improvements in the legislation related to trademarks, copyrights and patents protection. But the problems in the implementation of these legislations, lack of trained staff and corruption are important cause of concern in this area.

7. State Obstacles

The government's policies such as Differential sale and excise taxes (States and Centre) on small and large companies, rules regarding land acquisition, land use, power connection etc act as hindrance to the foreign investment inflows.

Government Policy on FDI

There have been significant changes in approaches and policies relating to FDI in India in tune with the developments in the industrial policies and also foreign exchange situations from time to time. There are four distinct phases of Government's policy on FDI in India:

First Phase (1950-1967): Cautious welcome of FDI

During this period, India's development strategy focused on import substitution industrialization. The availability of capital, technology, skills, entrepreneurship etc. was very limited. The attitude towards foreign investments was highly receptive. Foreign investors were assured of non-discriminatory treatment at par with domestic enterprises. It was however, emphasized that the majority interest in ownership and control would always be in Indian hands. The incentives and concessions were offered to attract foreign investments.

Second Phase (1967-1980): Restrictive Policies

During this phase restrictions on FDI flows were imposed. The investible requirements of funds increased due to industrialization and foreign exchange outflows were increasing due to technology and inputs imports. Thus government adopt restrictive attitude towards the FDI to arrest investments which allow higher outflows in terms of royalty payments, dividends, interest etc. Foreign Exchange Regulation Act (FERA) was enacted in 1973 to control FDI inflows.

Third Phase (1980-1990): Gradual Liberalization

The gradual liberalization of FDI policies in the 80's occurred due to the deterioration of foreign exchange position in the wake of oil crisis and low exports growth. Hence a gradual liberalization on foreign investment inflows were allowed in the industrial and trade policies. A degree of flexibility was introduced in the policy concerning foreign ownership. The rules and procedures concerning payments of royalties and lump sum technical fees were relaxed and taxed were reduced.

Fourth Phase (1991 onwards): Liberalized Policy

The industrial policy statement of 1991 has followed an open-door policy on foreign investment and technology transfers. The policy since then has been aimed at encouraging foreign investment particularly in core and infrastructure sectors. The **important aspects of the FDI policy** are:

1. The policy has opened large number of sectors for FDI with higher level of foreign equity participation.

2. The transparency is introduced in the approval procedures viz automatic approval of FDI up to 51 percent (now up to 100 percent in certain cases) in high-priority, capital intensive, high technology industries.

3. Non-Resident Indian (NRIs) are allowed to invest up to 100 percent in the high-priority industries.

4. Foreign technology agreements are also liberalized in terms that transfer based on the commercial judgment are freely allowed.

5. Foreign Investment promotion Board has been set up to look into large foreign investment projects.

Concept-Check question

- "The non-debt foreign investment capital flows are increasing and remained higher than the net-debt foreign capital flows". Do you agree with the statement?
- "The foreign investment flows in India are increasing but still it is not the most favored nation for foreign direct investment". Comment on this statement.

Conclusion

Foreign capital helps to augment domestic resources of the economy and enables it to achieve higher growth rates. It improves productive efficiency and technology up gradation in the host country but it can also lead to inappropriate investment and consumption pattern. However, the economic benefits from foreign capital don't accrue automatically. There is a need to develop a healthy enabling environment to reap the benefits. The recipient country should develop adequate regulatory framework, good general educational and health condition for human resource and an openness to trade and compete. This will equip the country to derive the benefits of foreign capital.

LESSON 1 **UNIT III**

FOREIGN TRADE& BALANCE OF PAYMENT POSITION OF INDIA

- Dr. Anupama Rajput

Studying this chapter should enable you to understand:

- Role of foreign trade in the economic development of a country
- Trends in India's foreign trade
- Definition of Balance of Payments (BOP)
- Components of BOP
- Developments in India's BOP since 1950-51

Foreign Trade: Role and Significance

Foreign trade refers to the exchange of goods and services between two or more countries. Foreign trade is an indispensable means for sustaining the economic growth and development of a nation. A country cannot be completely self sufficient, and trade between countries is therefore essential to ensure supply of a country's needs. Moreover, it enables the people to enjoy those goods and services which the nation cannot produce themselves or which can be produced at a relatively high cost. In other words due to the diversities amongst the countries in terms of availability of labor, capital, technology and entrepreneurial skills a country cannot have the potential to produce all the commodities. Each one of them specializes in the production of only such commodities, which can be produced at comparatively lower cost than the others. Such products are exported to others and in return imports of products are made where there exists comparative cost disadvantage in the domestic production. This is referred to as the theory of comparative advantage. The theory argued that free trade will benefit all due to comparative advantage.

It **contributes to economic development** in a number of ways:

1) It enables the imports of capital goods and intermediate goods that involve advanced technology, which speedenup the development process. The flow of advanced technology improves the factor productivity.

2) The import of capital goods involving advanced technology offers other advantages in terms of improvement in managerial talents, know-how, skills and entrepreneurship.

3) It generates pressure for dynamic changes through (i) competitive pressure from imports and (ii) pressure of competition for export markets.

4) Exports allow increase in production and exploitation of economies of scale and increasing familiarity with absorption of new technologies. These in turn, help to increase the profitability of the domestic business without any corresponding increases in price.

5) Foreign trade increases worker's welfare through:

- Larger exports that results into higher wages;
-Cheaper imports enable better consumption pattern;
-It enables workers to become more productive with the use of better technology and other inputs.

Further, the increased openness to trade has been strongly associated with the reduction of poverty in most developing countries.

Role of Foreign Trade in India

Foreign trade is playing an increasingly large role in the Indian economy. The size of Indian foreign trade and its value both have increased during post independence period. The increase in foreign trade however, cannot be said satisfactory during initial period of planning because Indian share in total world trade has remained remarkably low and it decreased over the years. In 1950's, India's share in world exports was 1.9 percent. This compared favorably with 0.9 percent in China and 1.4 percent in Japan. By 1965, the share had dropped to 1 percent (Bhagwati and Desai, 1970) and it continued to fall progressively to 0.45 percent in 1980 and recovered marginally in 1997 to 0.62 percent which has further increased to 1.04 percent 2007. According to WTO data, India's share in world trade (exports and imports taken together) increased from 1.2 per cent in 2006 to 1.3 per cent in 2007. During 2007, India's imports were 1.5 per cent of world imports. India was the 26th largest exporter and the 18th largest importer in the world in 2007.This is in sharp contrast with other developing nations that lay emphasis on progressive integration of economy with world economies. India, on the other hand, persisted with the inward orientation in its policies till 1991 with a gradual change towards globalization after that. It clearly indicates that India has failed to increase its share in the total world trade in the initial period of development. The pattern of India's foreign trade can be summarized with its salient features. The total value of India's foreign trade has gone up from US$2542 million in 1950-51 to US$398658 million in 2007-08. But much of this increased was concentrated in the last ten years. The value of India's imports has increased because of rapid industrialization, periodic hike in oil prices, policy of import liberalization, and imports to control inflationary pressure within the country. **Table 1** provides the information on the foreign trade of India since 1950-51. India's exports has increased form $US 1269 million in 1950-51 to US$ 159007 million in 2007-08.During the same period imports also increased from US$ 1273 million to US$ 109173 million. Trade balance shows negative figure in almost all around the period. Trade deficit increased from US$ 4 million in 1950-51 to US$ 239651million in 2007-08. If we compare the growth rate in exports and imports, it is evident that sharp increased is observed after 1970-71 and 1990-91 both in exports and imports. During this period

imports have grown faster than exports. The gap between exports and imports i.e. trade balance shows sharp increase after 2001-02. There have two years since 1950-51 when India's balance of trade was favorable indication exports out-performing imports i.e. 1972-73 and 1976-77.This trend clearly reflects increasing exports and imports but exports not matching with the imports.

Table 1: India's Foreign Trade

Year	Exports ($US Million)	Imports ($US Million)	Trade Balance ($US Million)	Exports Growth	Import Growth
1950-51	1269	1273	-4	-	-
1960-61	1346	2353	-1007	**1.10**	**7.91**
1970-71	2031	2162	-131	**4.36**	**-0.52**
1980-81	8486	15869	-7383	**15.63**	**23.73**
1990-91	18413	24075	-5662	**8.28**	**4.51**
1999-00	36822	49671	-12849	**8.61**	**9.63**
2000-01	44560	50536	-5976	**21.01**	**1.74**
2001-02	43827	51413	-7586	**-1.64**	**1.73**
2002-03	52719	61412	-8693	**20.28**	**19.44**
2003-04	63483	78149	-14666	**21.10**	**27.25**
2004-05	83536	111517	-27982	**30.84**	**42.69**
2005-06	103091	149166	-46075	**23.40**	**33.76**
2006-07	126362	185749	-59388	**22.57**	**24.52**
2007-08	159007	239651	-80644	**25.83**	**29.01**

Source: Economic Survey, Government of India, Ministry of Finance

The first twenty years of Indian Planning were marked by "Export Pessimism". During this period the focus of the planners was on import substitution rather than export promotion. It was from early 1970's that India started realizing the importance of an aggressive export policy when it was confronted with the worst balance of payment crisis due to sharp rise in the international price of petroleum products by the OPEC nations. As a result, India adopted export promotion measures. However, the basic framework of industrial and trade policies remained unchanged. It was only from 1991 that exports was seen as an integral part of industrial and development policy. The policy thereafter emphasized technological up gradation, reduction of custom duties, freer imports and domestic and international competition for the entire industrial sector as pre-requisite for export promotion.

The structure of India's foreign trade is typically of a developing economy. India has been an exporter of agricultural raw materials agro based manufactured products. There has been a continuous decline in the share of agricultural raw materials and allied products. One of the reasons for this trend is increased population and local demand for these products. On the other side the exports of non-traditional items is gaining importance. Engineering, handicrafts, iron ad steel, chemical, readymade garments, fish

and fish products etc are gaining importance as exportable products. Two major items viz. electronics and software shows very sharp increase.

There has been marked change in the relative share of trade to various countries signifying the emerging new economic relationship. The OECD group (Organization for Economic Co-operation and Development) countries (viz. European Union, USA, Canada, Australia, Japan etc.) are the largest trading partner, its share is declining in recent years Whereas trade with OPEC(Organization of Petroleum Exporting Countries) countries like Iran, Iraq etc, Eastern Europe and other developing nations is assuming greater importance.

Self-Check Questions

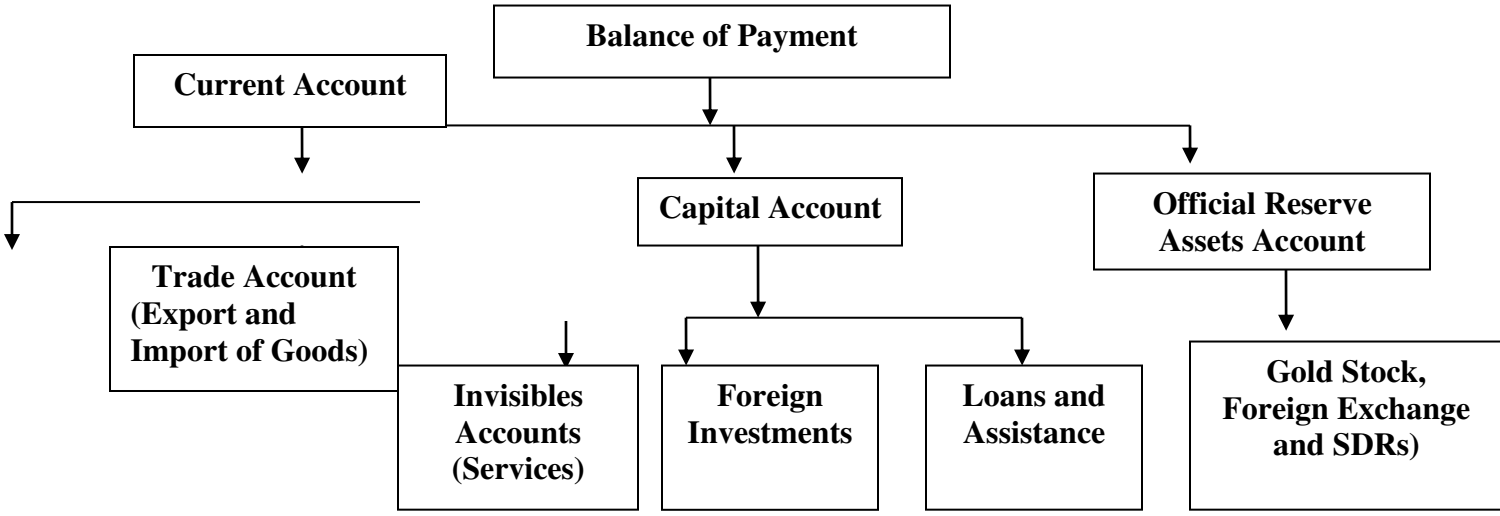
- Enumerate the benefits of foreign trade for a country?
- Discuss the role of foreign trade in India?

Balance of Payment and Balance of Trade

The **Balance of Payments** of a country is a systematic record of all economic transactions between the residents of a country and the rest of the world. It is composed of all receipts on account of goods exported, services rendered and capital received by residents and payments made by them on account of goods imported, services received and capital transferred to non-residents or foreigners.

Balance of Payment (Figure1 below) consists of (i) current account, (ii) capital account and (iii) cash account/official reserve assets account. The current account component records all current transactions that involve the flow of goods and services in the form of exports and imports for a country during a given year. The current account has two sub parts viz. trade account (that records export and import of goods) and invisible account (that records movements of services and other invisibles). The difference between credit (goods exported) and debit (goods imported) side of the trade account is termed as **Balance of Trade (BOT)**. During a given period of time, exports and imports may be exactly equal in which case, the balance of trade is said to be balanced. If the value of exports of a country exceeds the value of imports, the country is said to have an export surplus or a favorable balance of trade, when the value of imports coming to a country is greater than the value of exports, the balance of trade is said to be deficit or unfavorable. The **balance on invisibles or services(BOS) account** depicts exports and imports of services such as financial services like banking, insurance and other services like shipping, travel, investment income, etc. The BOS account is included in BOT to get balance of current account.

Figure1: Components of Balance of Payment



Capital account in the balance of payment account shows the capital receipts and payments between the country and rest of the world. It includes foreign investment flows, external loans, borrowings and other capital items such as donations from individual or multilateral donor agencies etc.

The Government's official reserve assets accounts comprise of gold stock, holdings of convertible foreign currencies, and Special Drawings Rights (SDRs).This account is the balancing item in response to current and capital accounts transactions. The account will see a decline in terms of foreign exchange reserves i.e. a net outflow of foreign exchange, whenever total disbursements on the current and capital accounts exceed total receipts. Thus, the balance on current account plus the balance on capital account must always be offset by the balance on official reserves asset account.

Trends of Balance of Trade and Balance of Payment in India

The trends of India's balance of payment position (Table 2) can be studied as follows:

BOP Position in the 50s

In the early 1950s when India launched its economic planning, the balance of payments position was more or less comfortable. However, in 1951-52, there was a large trade deficit and as a result, despite net surplus invisible transfers and capital account surplus (which was due to long term loans) there was overall deficit on the current and capital accounts which was met by the official reserves account. India witnessed surplus in the current account and surplus in BOP position in the year 1952-53 and 1953-54. As a result India experienced an increase in the official reserves position. During 1954-55 and 1955-56 there was surplus on both current and capital accounts. During the second five year plan, trade deficit was much more than the net surplus on invisible transfers and surplus on capital account. India experienced an outflow from the official reserves account towards meeting the balance of payments requirements. The foreign exchange reserves of the country declined sharply during this period. The basic reason of the significant deficit in the BOP was that the country embarked upon the planned development in the fifties. The rapid industrialization of the country through development of basic and heavy industries guided the industrial and trade policies. The 'Import substitution' was recognized as the appropriate strategy for rapid industrialization. Export pessimism was evident throughout the early decades of Planning. This results into surge in the import demand on account of development of heavy industries and slowdown in the export performance.

BOP Position during 1960

During the decade of 60's the balance on current account was unfavorable mainly because of steep rise in imports of food grains, machinery and equipments and sluggish exports. The balance on invisibles account which had been positive so far turned negative during this decade. India sought external assistance in a big way under capital account and loans from World Bank and withdrawals from IMF. Heavy trade deficits, debt obligations and a sharp fall in foreign exchange reserves led to the devaluation of the rupee in 1966.

BOP Position during 1970's

In the early 70s, though exports grew more significantly, the larger increase in imports led to continued trade deficits and India had deficits even in terms of invisible transfers. In the year 1973-74, however, the country had a substantial current account surplus despite a trade deficit. This was due to large surplus in terms of invisible transfers. Further, there was a huge inflow of foreign aid. This results into comfortable BOP position during this decade. In this year, country faced pressure on the balance of payments as the import bill rose dramatically. As a result, India went for huge external assistance to tide over the balance of payment problems that become a regular feature thereafter. The adjustment to first oil shock of 1973-74 was rendered smooth by buoyant invisible transfers, visible exports, spurt in private transfer receipts and increased inflow of external aid.

Table2: Balance of Payment Position (1960-2008)

Year	Trade Balance	Net Invisibles	Current Account Balance	Increase(-)/ Decrease (+) in Foreign Exchange Reserves
1960-61	–475.2	82.8	–392.4	59.2
1970-71	–421.6	–23.8	–445.4	88.6
1980-81	–5967.2	4310.6	–1656.6	516.0
1990-91	–16934	–435	–17369	2293
2000-01	-27302	45139	-11598	-27528
2001-02	-36182	71381	16426	-56593
2002-03	-42069	82357	30660	-82037
2003-04	-65741	127369	63983	-143993
2004-05	-125725	139591	-12174	-115907
2005-06	-203991	185927	-43737	-65896
2006-07	-268727	240933	-45343	-163634
2007-08	-324678	291739	-70357	-369689

Source: RBI annual reports and Economic Survey, Government of India

BOP Position during 1980's

In the year 1979-80 India faced second oil shock that had a far more severe impact on the economy's balance of payment than that of the first shock. Increase in oil prices substantially increased the import bill while exports failed to cope up with the rising imports. Export performance was depressed by the severe international recession of 1980-83. Exports grew by about 3 percent, in terms of volume. As a result trade deficit widened during the entire decade of 1980 barring three years 1982-85. Net invisible receipts were substantially higher and continued to provide support to the balance of payments. During 1982-85, the balance of payments pressure eased to some extent, due to substantial decline in the oil imports as a result of increase in domestic production of crude oil. However, during the latter half of 1980's trade deficit reached new highs that put strains on BOP. The volume of imports rose sharper than the volume of exports. The fall in international crude oil prices during this period helped to some extent, to contain the oil import bill. On the other hand, non-oil imports increased significantly due to large imports of food grains in 1988-89. Imports of capital goods, defence imports, imports of ships and air crafts, etc. and export-related imports also went up. At the same time, support from invisible receipts fell due to steadily growing interest payments and outgo

on account of profits, dividends, royalty, technical fees and professional fees. During 1981-90, the current account deficit averaged 2.4 percent of GDP. The repayments to the I.M.F during the period put added pressure on the balance of payments. External assistance, commercial borrowings and non-resident deposits increased tremendously that result into increased India's external debt.

BOP crisis — 1990-92

In the year 1991, India experienced the worst ever BOP crisis since independence. The year 1990-91 witnessed three major developments which contributed to this crisis- i) substantial increase in oil price following Gulf war that led to substantial increase in the import's bill of the country. Further the remittances from Indian workers employed in Kuwait also stopped; ii) decline in exports due to disintegration of USSR and iii) problems on the domestic front
(like fiscal imbalance, double digit inflation, political uncertainty etc.). India's credit rating got downgraded and was denied access to external commercial credit markets. The net balance on invisibles account turned negative, trade deficit reached new peak and a net outflow of Non-Resident Indian (NRI) deposits occurred in 1990. All these led to a dwindling of India's foreign exchange reserves from a level of Rs. 5480 crore at the end of August 1990 to Rs. 1666 crore on 16th January 1991. Though emergency borrowings from the I.M.F. provided some temporary relief, the decline in reserves continued. By June 1991, the level of foreign exchange reserves dropped to the extent that they were barely sufficient to finance imports for a fortnight. The Government of India was on the verge of default on payment of external borrowings in June1991.

Table 3: Selected Indicators of India's External Sector (1990-91:2007-08)

S.NO.	Indicators (as a % of GDP)	1990-91	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
(i)	Exports	5.8	9.4	10.6	11	12.1	13	14	13.5
(ii)	Imports	8.8	11.8	12.7	13.3	16.9	19.4	20.9	21.2
(iii)	Trade Balance	-3	-2.4	-2.1	-2.3	-4.8	-6.4	-6.9	-7.7
(iv)	Invisible Balance	-0.1	3.1	3.4	4.6	4.4	5.2	5.8	6.2
(v)	Current A/C Balance	-3.1	0.7	1.2	2.3	-0.4	-1.2	-1.1	-1.5
(vi)	Foreign Investment	-	1.7	1.2	2.6	2.2	2.6	3.2	5.2
(vii)	Import cover of Reserves (in months)	2.5	11.5	14.2	16.9	14.3	11.6	12.5	15

Source: RBI annual reports and Economic Survey, Government of India

BOP Position: 1992-95

During 1991 the economic reforms and macro-economic stabilization measures were introduced to tide over the BOP crisis of 1991.The drastic changes occur in the trade policy that includes devaluation of rupee, convertibility of rupee, tariffs cuts, and import liberalization. In the initial year of reforms the import growth picked up and since the growth in exports was not that significant, trade deficit, increased. The invisibles account also recorded deterioration. On the other hand, there was a rise in the outgo on interest payments, royalties, technical fees and miscellaneous payments. As a result, current account deficit increased.

During 1993-94, the balance of payments position improves significantly due to growth in exports, fall in international prices of crude oil and the slack in the growth of non-oil imports. The trade deficit reduced dramatically. The decline in international interest rates also allowed savings in the invisibles account. The market determined exchange rate led to strong growth in remittances. As a result of all these, the current account deficit declined significantly (Table3). Further the liberalized foreign investment policy led to the increase in the flow of foreign investment.

During 1994-95, both exports and imports grew significantly: exports grew by 18.4 percent, in US dollar terms and imports by 22.9 percent. Invisible payments also rose considerably. As a result, the current account deficit widened. But the total capital flows in 1994-95 were much in excess of financing needs and so the foreign exchange reserves buildup (Table 4).

Table4: India's Foreign Exchange Reserves

Year	Foreign Exchange Reserves (in $ US million)	Import Cover of Reserves (in months)
1950-51	1914	16.8
1960-61	390	2.0
1970-71	584	2.9
1980-81	5850	4.5
1990-91	2236	1.0
1991-92	5631	3.2
2001-02	54106	11.5
2002-03	76100	14.2
2003-04	112959	16.9
2004-05	141514	14.3
2005-06	151622	11.6
2006-07	199179	12.5
2007-08	309723	15.0

Source: RBI annual reports and Economic Survey, Government of India

BOP Position since 1995

In the year 1995-96 the surge in exports and imports continued. However the current account deficit grew tremendously to 1.7 percent of GDP. In fact, 1995-96 was the only year in the post reform period to register a foreign exchange reserve draws down. **The balance of payments (BOP) has been in an overall surplus since 1996-97, with reserves rising (Table2&4).** The negative growth was witnessed in the levels of exports and imports in 1998-99. The current account deficit narrowed down in the year 2000-01 to about 0.5 percent GDP. **India witnessed surplus in the current account for three consecutive years i.e. 2001-02, 2002-03, and 2003-04.** This surplus was accompanied by strong net capital inflows. The current account recorded deficit since 2004-05 that is increasing. The deficit was caused by a burgeoning excess of merchandise imports over exports, which was left uncompensated by the net surplus in invisibles. The increase in imports occurs due to increase in the international price of crude and other major items of imports like gold.

Thus, at present the large merchandise trade deficit coexist with a lower current account deficit because of the surplus on services account. Even in the years when there were surpluses on the current account, India had a relatively larger trade deficit. As a proportion of GDP, on balance of payments (BOP) basis, exports rose from a level of 5.8 per cent in 1990- 91 to reach a level of 13.5 per cent of GDP in 2007-08 (provisional). However, imports have grown even faster from 8.8 percent to 21.2 per cent of GDP during the same period. Thus, trade and current account deficit widened to 7.7 per cent and 1.5 percent of GDP in 2007-08 (Table3). The sustained increase in invisibles surplus during 2007-08 continued to cushion the impact of widening of merchandise trade deficit. The invisible surplus mainly reflects exports of software services and remittances from Indians working abroad. Favorable domestic financial and economic conditions, continued liberalization of capital account, sustained growth momentum of India a surge in capital inflows to India during 2007-08 was witnessed. It is remarkable that India has made these achievements in the face of appreciation of rupee, high interest rates, spiraling oil prices and general economic slowdown in the major trading countries in the world. It is also important to emphasize that the rising trend in capital inflows has been accompanied by a change in its composition. The most welcome feature was the rise in gross foreign direct investment inflows in the recent years. India emerged as the second most favored FDI destination after China in 2005 and 2006 according to the UNCTAD World Investment Prospects Survey 2007-2009. This has led to the overall balance of payments surplus which results in the led to an accretion of foreign exchange reserves and improved import coverage of reserves during 2007-08.

Self-Check Questions

- What is balance of payment? Discuss its components?
- Evaluate the circumstances which led to the BOP crisis in 1991-92. How did India overcome this crisis?
- What lessons can be learnt from the BOP crisis in 1991-92?
- Define the terms: balance of trade, balance of invisible transfers, current account balance, capital account balance and balance of paymentsDiscuss the trend of India's BOP situation since 1991-92.

LESSON 2

WORLD TRADE ORGANIZATION & INDIA

- Dr. Anupama Rajput

Meaning

The World Trade Organization (WTO) is a Multi-lateral organization which facilitates the free flow of goods and services across the world and encourages fair trade among nations. It is a 149-member organization that represents all the trading nations of the world, who import-export goods & services. The basic objective of WTO is to increase the global income as a result of increased trade and the overall enhancement of the prosperity levels of the member nations. WTO came into formal existence on January 1st 1995. As an organization it has vast powers and functions than its predecessor GATT (General Agreement on Tariffs and Trade). GATT came into existence in the year 1948, immediately after the Second World War with 23 countries became the founder members. GATT provided platform for 8 trade negotiations until 1994, the last trade negotiations – the Uruguay Round, resulted in the creation of WTO.

Objectives of WTO

The objective of the World Trade Organization is to help trade flow smoothly, freely, fairly and predictably in order to meet its objective, WTO performs the following functions:

- Administers WTO trade agreements;
- Acts as a forum for trade negotiations;
- Settles and handles trade disputes;
- Monitors and reviews national trade policies;
- Assists the member in trade policies through technical assistance and training programmes;
- Provides technical assistance and training for developing countries;
- Co-operates with other international organization.

Principles

The agreements of WTO cover everything from trade in goods, services and agricultural products. These agreements are based on the principles mentioned as below:

(i) Non-Discrimination:

This principle requires every member country must treat all its trading partners equally without any discrimination. It means that if a country offers any special

concession to one trading partner, such concessions need to be extended to its other trading partners as well in entirety. This principle effectively gets translated into "MFN" or the Most Favored Nation.

(ii) Reciprocity:

This Principle reflects that any concession extended by one country to another need to be reciprocated with an equal concession such that there is not a big difference in the countries payments situation. This was further relaxed for developing countries facing severe Balance of Payments crisis. This principle along with the first principle would actually result in more and more liberalization of the world trade as any country relaxing its trade barriers need to extend it to all other members and this would be reciprocated.

(iii) Transparency:

This principle requires that there is transparency in the domestic trade policies of member countries. The member countries are required to sequentially phase out the tariff barriers and non-tariff barriers through negotiations.

These principles are designed to serve the purpose of freer and fair trade and also to encourage competitive environment in the global market.

Implications of WTO on Members Countries:

The World Trade organization was established with an objective of enhancing the free and fair trade, improve growth rate of world trade by encouraging members to reduce trade barriers and to increase the overall prosperity in the global economies. The implication of WTO can be mentioned as follows:

- Promote Peace in the world trade as the disputes are handled at WTO forum constructively.
- Freer trade reduces the costs of living.
- Wider choice of products and services.
- Promotes Economic Growth as result of increased trade.
- Encourages Efficiency

WTO and India:

India is a founder member of World Trade Organization and also treated as the part of developing countries group for accessing the concessions granted by the organization. As a result, there are several implications for India for the various agreements that are signed under WTO discussed as follows:

(i) Reduction of Tariff and Non-Tariff Barriers: The agreement involves an overall reduction of peak and average tariffs on manufactured products and phasing out the

quantitative restrictions over a period. The important implication is that the firms that have competitive advantage would be able to survive in the long run.

(ii) Trade Related Investment Measures (TRIMS): The agreement prohibits the host country to discriminate the investment from abroad with domestic investment i.e. agreement requires investment to be freely allowed by nations.

(iii)Trade Related Intellectual Property Rights (TRIPS): An intellectual property right seeks to protect and provide legal recognition to the creator of the intangible illegal use of his creation. This agreement includes several categories of property such as Patents, Copyrights, Trademarks, Geographical indications, Designs, Industrial circuits and Trade secrets. Since the law for these intangibles vastly varied between countries, goods and services traded between countries which incorporated these intangibles faced severe risk of infringement. Therefore the agreement stipulated some basic uniformity of law among all trading partners. This required suitable amendment in the domestic International Property Rights (IPR) laws of each country over a period of time. As a result Patents Act, Trade and Merchandise Mark Act and the Copyright Right Act were amended in India. The main impact of this is on industries such as pharma and bio-technology. Further, the technology transfer from abroad is expected to become costly and difficult.

(iv)Agreement on Agriculture (AOA): The agreement on agriculture broadly deals with providing market access, reduction of export subsidies and government subsidies on agriculture products by member countries. The reduction of tariffs and subsidy in export and import items would open up competition and provide a better access to Indian products abroad.

(v) Agreement on Sanitary and psyto-sanitary measures (SPM): This agreement refers to restricting exports of a country that do not comply with the international standards of germs/bacteria etc. Since allowing such products inside the country, there would be spread of disease and pest in the importing country. The implication of these agreements is that there is an urgent need to educate the exporters regarding the changing scenario and standards at the international arena especially in food processing, marine food and other packed food industries.

(vi) Multi-Fiber Agreement (MFA): This agreement is dismantled with effect from 1 January 2005. The result was removal of quantitative restrictions (QRs) on the textile imports in several European countries. As a consequence a huge textile market is opened up for developing countries like India. In order to take advantage of opening up better preparedness is required in terms of modernization, standardization, cost efficiency, and customization to meet challenges of foreign customers.

Besides these major agreements there are several other agreements such as agreement on **Market Access**, which propagates free market access to products and reduction of tariff and non-tariff barriers; agreement to have **Safeguard Measures** if there is an import surge and it is liable to affect the domestic industries in the transition economies. These measures can include imposing Quantitative Restrictions (QRs) for a

certain period and also imposing tariffs on the concerned products, **Agreement on Counter-Veiling Duties (CVD), Anti-Dumping Duty (ADD)** against imported products if the charges of Dumping are proved against the exporting country.

Conclusion:

The Indian economy has experienced a major transformation as a result of the changing multilateral trade discipline within WTO framework. It is expected that the sectors such as textiles, clothing, leather and leather products, and food, beverages, and tobacco etc would experience growth in output and exports. However, there is a serious and urgent need to re-look the strategies followed by individual firms in the changing context of increasing competition and opened markets.

Self-Check Questions

Write a short note on WTO and its impact on Indian economy?

INFLATION AND PRICE POLICY

One of the most intricate challenges of our present times is the problem of rising Inflation. Its effect can be felt by each and every person to at least some degree, whether he is an engineer, doctor, lawyer, govt. servant or anybody. Inflation makes no partiality in choosing its innocent victims. So what exactly is inflation and how is it caused? Whether it originates in our home country or it is imported from abroad? What are our Economists doing to control Inflation? These are the questions that naturally arise in anyone's mind.

Introduction

Inflation is defined as a general rise in prices of all commodities. In the words of Samuelson, "by inflation we mean a time of generally rising prices for goods and factors of production – rising prices of bread, cakes, haircuts, rising wages, rents etc". It is not the rise in the price of my favorite commodity e.g. McDonalds Pizza, but the overall rise in the prices of all the goods and services manufactured and consumed within the territory of a nation. When we say that the monthly rate of Inflation is 12%, what it means is that on an average, the prices of all goods and services have increased by 12% in the period of last one month. The essence of inflation is disequilibrium between aggregate demand and aggregate supply, i.e. excess of demand over supply that keeps the price level rising over time

Measures of Inflation

In India, Inflation is measured using WPI (Wholesale Price Index). It is very tedious to track each and every commodity and calculate its price rise. Instead of that an Index of several goods and services is prepared. India's WPI is a weighted-index of 435 commodities. It means price-rise of all commodities will not be treated equally. The price-rise of rice will have more weight-age than price-rise of a Maruti-car. That is because rice is consumed by a very large number of people compared to a Maruti car. The weight-age of a Mercedez car will be still lower in the WPI. So when this WPI increases from say 100 to 112, we say that the rate of inflation is 12%.

Many other countries like UK, USA, China, etc. use CPI (Consumer Price Index) to measure inflation. This is a more realistic measure because it computes the index based on the increase in actual price paid by the consumer. On the other hand, WPI considers the rise in the price by the Wholesalers of the goods and services.

Trends of Price Movement

Inflation wise, the past half a century can be divided into distinct phases, viz.,

i. **Period of relative price stability (1951-1956).** The average annual rate of price rise or inflation was almost nil during this period. Within this period the price changes varied between negative to positive. The overall price stability, or even negative inflation rate was mainly the result of bumper agricultural production

and tremendous success of the first plan. However pressures of high demand towards the beginning of Second Plan caused the prices to rise.

ii. **Phase of Moderate Inflation (1956-1971).** During the period 1956-1971, average annual inflation rate rose to 6.4 per cent**.** The price position during third five-year plan deteriorated badly. The average increase in prices was around 5.8 per cent. However there was a small decline (-1.1 per cent) during 1968-69 mainly due to the impact of a bumper crop in the year1966-67.

iii. **Period of High Inflation Rate (1971-1981).** During the decade 1971-81, the annual average inflation rate (rate of increase in price level) became still higher to reach 10 percent. The crop failure in 1972 and the oil shock of 1973 were the main factors behind the inflation. The average inflation rate which was higher at 12 per cent during 1971-72 to 1975-76 and slightly lower at 8.5 per cent during 1976-77 and 1980-81. Planwise, the inflation rate which was high at around 9 percent during the fourth plan (1969-74) came down to 6.3 percent during the fifth plan 1974-79.

iv. **Slow down of Inflation (1981-1991)**. During this phase the annual inflation rate slightly came down to 8 per cent. The highest recorded price rise during this decade was 18 per cent in 1980-81 and lowest of 4.4 percent in 1985-86. But during the five- year period (seventh plan 1985-90) it rose to around 8 percent.

v. **Price situation in the Nineties.** The 1991-1996 periods witnessed the revival of strong inflationary pressures**.** But 1996 onwards inflation declined and inflation rate has declined to moderate levels varying between 4 to 6 per cent. Since then, the inflationary situation came under control with a noticeable decline in the prices of primary food articles as well as manufactured food products.

vi. **Recent Rise in Inflation.** The price situation was stable and largely comfortable during the tenth plan (2002-2007) period. With the annual rate of inflation in India having touched 7 per cent on a point-to-point basis during the week-ending March 22, 2008. Indeed, by July 2008, the key Indian Inflation Rate, the Wholesale Price Index, has risen to 11.89%, its highest rate in 13 years. This is more than 6% higher than a year earlier and almost three times the RBI's target of 4.1%.

Causes of Rising Prices

To understand the various causes that have contributed to the continuing price rise or inflation in India, we have to look into factors which have on one side, pulled the demand upwards and on the other side, prevented supply from keeping pace with this rising demand. Inflation is basically a combination of two types of phenomenon. Its causes could be nailed down to Cost-Push inflation and Demand-Pull inflation.

Cost-Push Inflation is caused by rise in the cost of factors of production. In classical economic theory, there used to be only three factors of production - land, labor and capital. However, in today's complex world, infinite factors are required to produce a single product or commodity e.g. house-rent, electricity, admin-expenses, raw-materials, fuel (petroleum), steel, etc. The price rise in any one or more of these factors will increase the cost of production of the final product. The producer of the commodity (the businessman) will naturally shift this cost to his consumers by raising the cost of his final product. This phenomenon is called Cost-Push Inflation.

There are some of factors that have contributed to increase in cost of production are as follows:

- Fluctuation in output and supply.
- Increase in taxes i.e. taxation, as a factor in rising costs and prices.
- Changes in administered prices.
- Hike in oil prices and global inflation.

Let us take a simple example. Suppose a bakery owner produces bread by using several factors like wheat, flour, machines, labor, etc. The cost of production of one piece of bread comes to $8. He adds $2 as his profit-margin and sells it to consumers at $10. This continues for several days. Now suppose the price of wheat increases due to low production or crop failure. Now the owner recalculates his cost of production. It comes to $10. He now adds his margin of $2 and increases the cost of bread to $12. This directly results in 2% rise in the cost of bread, or in the bread component of the WPI.

Demand-Pull Inflation is another type of inflation. In this case, the cost of factors of production remains same. However, due to increase in the demand of the commodity by consumers in the market relative to its supply, the owner will naturally increase the prices. In this case, demand has increased, but supply has remained constant.
There are some factors behind rapid increase in demand and relatively slow growth over the past few decades. This is as follows:

- Increase in money supply.
- Massive increase in government expenditure.
- Rapid increase in population.
- Growth of black money.

Let us take a simple example, suppose the cost of production of one piece of bread remains constant at $8. He adds his margin of $2 and charges $10 to each consumer. Now suppose the preference of his bread increases among the consumers, as it becomes more popular. This results in an increased demand for bread (This is a simplified example, in real world demand and supply is more complex). So sensing more demand for his product, the owner increases the price to $12.

Liquidity: The term Liquidity is usually used to identify hard cash. In fact Liquidity just means money in any form. Liquidity is also referred to the ability and ease with which an asset could be converted to money. For e.g. cash is the most liquid asset. Savings-account deposit could also be called liquid asset. How is Liquidity related to Inflation you may ask? The answer is simple. It's because of Demand-Pull Inflation. The demand for the commodity is directly influenced by the amount of money that people have. The Government or Central Bank can directly influence demand-pull inflation by controlling liquidity.

Consequences or effects of rising price

Inflation had caused serious imbalances in the Indian economy. Price relationships were badly distorted and production pattern had gone out of line with demand.

Adverse effect on production. Inflation had led to economic recession in many sectors of the Indian economy. Due to inflation, prices of certain important articles of consumption such as textiles had increased to very high levels forcing demand for such

goods to decline specially from the poorer sections of the country. With increasing expenditure on essential goods, the expenditure on the other goods had declined. While demand had declined, production too had declined due to shortage of raw materials, transport, power and so on. Production had adversely affected by frequent labour troubles such as strikes and lockouts. Over and above all these, the rise in the price level had eroded the volume of investment in real terms. The decline in real investment worsened the economic recession still further till recently.

Adverse effect on the distribution of income. Under mild inflation or continued slow rise in prices, profit keep on increasing. As wages and salaries remain more or less fixed, income of the industrial and business classes increases relative to the income of working classes. Thus, there is a redistribution of income in favour of the rich capitalist and business people and therefore the gap between the rich and the poor increases. The share of profits in national income increases whereas that of wages and salaries falls and thus income redistribution takes place in favour of the richer section of society.

Objectives of Price Policy

Inflation is unjust and inequitable. It upsets the entire production process, generates speculative tendencies, hits the poor hard and adversely affects economic growth. Thus inflation needs to be controlled. But an undue reduction in price level can set deflationary trend in motion. This would adversely affect business activity through reduced profit expectations, and hamper the growth process. Thus, a suitable price policy is needed which fulfils the following objectives:

i. to maintain price stability of foodgrains and other goods consumed by the poor to insulate them against inflation.
ii. to maintain incentives for stimulating production and economic growth, which can be done through a mild, slow and gradual price increases, and
iii. to maintain inter-sectoral balance in prices of agriculture goods, industrial products and prices of other goods and services.

It is with these objectives in mind that various policy instruments have been used to control inflation and achieve a measure of price stability in India.

Remedial Measures to control Rising Prices

In India, the Ministry of Finance and the RBI (Reserve Bank of India) always strive to control inflation. Efforts should be made to curtail demand and improve supply management to control rising prices. Some of the measures to control inflation are discussed as below.

"The guiding principal in respect to inflation management continues to be that in the medium to long run, the increase in prices is largely sustained by monetary expansion. In short run, however, inflation could be affected by non-monetary, essentially supply side factors."

Monetary Policy

Monetary policy refers to the policy measures that affect the economic variables, viz., output, prices, etc., through changes in money supply. In India, the RBI, being the central bank of the country formulates and implements monetary policy with the objective of stabilizing prices and promoting growth generating forces in output and employment

levels. In general term, RBI uses its monetary policy to achieve a judicious balance between the growth of production and control of the general price level. They control inflation by directly affecting the demand pull inflation by changing the amount of liquidity circulating in the economy. It helps to check speculative activity (in period of inflation). In July 2008, RBI has raised the interest rates and cash reserve ratio to check the volume of liquidity and credit in the country and thereby control the inflationary rise in prices taking place. The RBI (the Central Bank of India) can change the liquidity by its various tools .These tools of controls are broadly two: quantitative and qualitative controls.

Quantitative controls are used to control the volume of credit and indirectly to control inflationary and deflationary pressures caused by expansion and contraction of credit.
Quantitative controls are also known as general credit controls and consist of CRR, Bank-Rate (REPO and Reverse-REPO), SLR, etc.

- **CRR (Cash Reserve Ratio)** is the proportion of amount which each commercial bank has to maintain in the form of hard cash. All commercial banks accept deposits from individuals and lend it to borrowers at a higher interest rate. The difference between the interest rate which they collect from borrowers and which they pay to their depositors is their profit. Naturally, each bank will try to lend all the money they collect from depositors. However, banks can't lend all the money they have. Under law, each bank has to maintain a certain proportion of cash as reserve. This is known as CRR. For e.g. if the CRR is 5% and the bank collects Rs. 100 from its depositors. Then it has to maintain Rs.5 as Reserve. It can lend other Rs.95 to its borrowers. RBI can decrease vast amounts of liquidity circulating in the economy by raising the CRR. When RBI increases the CRR, the bank's lending power decreases. Less lending means less borrowing, this in turn means less money in the economy. In July 2008, the RBI increased the CRR from 8.75% to 9% to control inflation.
- **SLR (Statutory Liquidity Ratio)** is also similar to CRR. But in case of SLR, Government-Securities need to be maintained by the commercial banks instead of cash. All commercial banks have to maintain liquid assets in the form of cash, gold and unencumbered approved securities equal to not less than 25 percent of their total demand and time deposit liabilities. RBI has stepped up the liquidity ratio for two reasons:

a) higher liquidity ratio forces commercial banks to maintain a larger proportion of their resources in liquid form and thus reduces their capacity to grant loans and advances to business and industry- thus it is anti-inflationary
b) higher SLR was used to divert bank funds to finance government expenditure.

It may be mentioned here that stepping up statutory liquidity requirements (SLR) and the cash reserve ratio (CRR) have same effect, viz., they reduce the capacity of commercial banks to expand credit to business and industry and thus are anti-inflationary.

- **Bank-Rate** is basically the interest rate at which the Central Bank borrows from the other scheduled commercial banks. This rate is directly linked to the interest rates charged in turn by all the commercial banks to its customers. All these other interest rates on Home-loans, Personal-loans, etc. also increase with the increase in bank-rate. Thus, by raising the Bank-Rate and in turn all other Interest Rates,

the RBI makes borrowing money from banks a very costly affair. People are thus discouraged to borrow more money and total amount of liquidity decreases in the economy. In July end, the RBI increased the Bank Rate from 8.5% to 9.5%. This was an increase of 50 basis-points (0.5%) to control inflation.

Although the rise in interest rates initially makes life difficult for people who have taken loans on floating interest rates, it is a required step to bring down inflation which is a larger evil. It might also be noted that RBI, by making the policy changes can control only one type of inflation i.e. demand-pull inflation. It cannot affect the other type of inflation i.e. cost-push inflation which is caused by rise in prices of raw-materials and other factors of production. That is why the rate of inflation is increasing continuously since last six months although the RBI is trying to control it.

Open market operation: During inflation, the central bank sells government securities and price bonds in the open market in order to contract the supply of money. This is done to influence the volume of cash reserves with commercial banks and thus influence the volume of loans and advances they can make to the industrial and commercial sectors. RBI had not used this tool for many years. Such a policy of buying government securities will be adopted to reverse economic recession in the country. It appears that RBI will actively use open market operations as an instrument of monetary policy and not simply to support the market for government bonds.

Fiscal Policy

Fiscal policy is budgetary policy in relation to taxation, public borrowing, and public expenditure. Changes in the total expenditure can be effected by fiscal measures Price policy designed to promote economic growth includes measures for controlling the volume of public expenditures in general and fiscal deficit in particular. The aim is to reduce any undue pressure on the limited supply of consumption goods. Besides, the consumer should be available at prices regarded reasonable from the point of view of low-income groups.

To combat inflation, fiscal measures would involve increase in taxation and decrease in government spending. During inflation the government is supposed to counteract an increase in private spending. A decline in public expenditure alone is not sufficient. Government must simultaneously increase taxes to affect a cut in private expenditure - in order to minimize inflationary pressures. Some of terms are explained below:

- **Taxes:** As we know, when more taxes are imposed, the size of the disposable income and the magnitude of the inflationary gap diminish, given the available supply of goods and services. Inflationary pressure is significantly weakened by the simultaneous curtailment of government expenditure and an increase in taxation due to a decline in disposable income with people. It has been argued that a tax policy can be directed towards restricting demand without restricting production. For instance, excise duties or sales tax on various commodities take away the buying power from the consumer goods market without discouraging the expansion of production capacity. Therefore excise duties should be rationalized to minimize their cost push effect. But, during inflation, a progressive direct tax is considered best; it is also justified in the interest of social equity.

- **Government expenditure**: The expenditure of the central and the state governments which have grown enormously must be controlled. Government must reduce its administrative expenditure by cutting down the size of the bloated government machinery. Non-essential and non-productive expenditure in the public sector must be reduced and if possible eliminated. In this connection, particular emphasis should be laid on reduction of non-plan expenditure of the government. Ultimately without government cutting down its expenditure it is not possible to control inflation**.**
- **Subsidies:** The massive amount of money that is used for subsidies on food, fertilizers, etc., must be rationalized. Only those subsidies which really help the poor and actually reach them and those which are crucial for country's development should be continued and all others must be abolished. Thus subsidies need to be reduced substantially while protecting the interest of the really poor people. The government should also avoid popular measures and pre-election doles to retain political power.

Briefly, then, a reduction in public expenditure, and an increase in taxes produces a cash surplus in the budget. Keynes, however, suggested a programme of compulsory savings, such as "deferred pay" or "forced savings" as an anti- inflationary measure. Private savings have a strong disinflation effect on the economy and an increase in these is an important measure for controlling inflation. Government policy should, therefore, include devices for increasing savings. A strong savings drive reduces the spendable income of the people, without any harmful effect of the kind associated with higher taxation. Moreover, the effects of a large deficit budget, which is mainly responsible for inflation, can be reduced by covering the deficit through public borrowings.. Further, public debt may be managed in such a way that the supply of money in the country may be controlled. The government should avoid paying back any of its past loans during inflation in order to prevent an increase in the circulation of money. Anti-inflationary debt management also includes cancellation of public debt held by the central bank out of a budgetary surplus

Redesigning public distribution

It is necessary to so recast the distribution system that it serves better the interest of the poor. To enable people to purchase wheat, rice, kerosene etc at reasonable prices, the government had opened around 4.74 lakh fair price shops. People below the poverty line would get the foodgrains at half the price charged from those above e the poverty line. To make the system effectively serve the weaker sections, the income tax players have been excluded from the PDS.

Conclusion

From the above discussion it is conclude that, Fiscal policy alone may not be very effective. An effective programme for combating inflation should combine fiscal and monetary tools in a manner complementary to one another.