M.A. Economics IVth Semester

ECON 241 (DSC)

INDIAN ECONOMY

Lessons : 1 to 21

CENTRE FOR DISTANCE AND ONLINE EDUCATION

(CDOE)

HIMACHAL PRADESH UNIVERSITY,

SUMMER HILL, SHIMLA - 171005

Indian Economy **Course X**

Contents

SYLLABUS

M.A. (ECONOMICS) COURSE-ECON-241 (DSC)

INDIAN ECONOMY

Maximum Marks: 100

Unit-I

Growth and Structure of Indian Economy Since 1950:- Growth of Indian economy since 1950. Measures for raising economic growth. Trends in the nature and magnitude of poverty, inequality and unemployment. Changes in-occupational patten. Demographic trends and economic development. Rate and trend in saving; investment and growth rate.

Unit-II

Growth of Agricultural and Industrial Sectors: Trends in agricultural production and productivity. Food policy and public distribution system (PDS). Impact of liberalization on agricultural sector. Industrial Growth performance and problems. Industrial concentration: its nature and extent Cottage and small scale Industries. Impact of liberalization and privatization on the industrial sector.

Unit-III

Money Supply, Inflation and Public Policies: factors determining interest rates. Money supply and inflation in India. Financial sector reforms during 1990's. Recent tax reforms. Growth and structure of subsidies in India. Macro-economic policies - fiscal policy income policy and stabilization policy. Parallel economy and its implications.

Unit-IV

International Trade Policies: Composition and directions of India's foreign trade. Factors determining the balance of payment. Disequilibrium in the balance of payment. Causes, consequences and policy measures. India's policies towards foreign capitals collaboration, export promotion and import substitution. Exchange rate policy and the convertibility of Rupee.

Unit-V

Development Policies: India's planned development; Successes and failures. Policies for social Justice (with special reference to the alleviation of poverty, inequality and unemployment). Sectoral, policies: Industrial and agrarian. Policies for liberalization and privatization.

Instructions for Candidates

(i) Question paper will consist of eleven questions in all. The first questions (at serial No. 1) will consist of 10.short-answer type questions which will cover the entire syllabus uniformly and will be based on concepts and definitions only. This questions will carry 20 marks in all and each short-answer type question with answer about five lines (fifty words) will carry 2 marks each. The rest of the ten questions (from Serial No. 2 to 11} will be such that there will be two essay type questions each from the five units of the syllabus, which will carry 16 marks each.

(ii) Candidates are required to attempt six questions in all. The question number one (with 10 parts) is compulsory and rest five questions in such a way choosing one question each from the five units.

SUGGESTED READINGS

Unit-I

Bagchi. A. (1982). The Political Economy of Underdevelopment in India. Cambridge University Press Cambridge.

Bardhan. P. (184). The Political Economy of Development in India, Oxford University Press. New Delhi

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Dandekar, V.M & N. Rath. Poverty in India, Indian School of Political Economy, Bombay.

Dana, Bhab atosh (1977). The Contents of Economic Growth, and other eassay. Research India Publication. Calcutta.

Rao, V.K.R. V. (1983). India's National Income: 1950-1980, Sage Publications, New Delhi.

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A.N. Aggarwal (1995). Indian-Economy Problems of Development and Planning, Wishwa Parkashan, New Delhi.

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Goldsmith, R. W. (1969). Financial Structure and Development, Yale University Press, New Haven. Gupta.

S.B. (1979). Monetary Planning for India, Oxford University Press, New Delhi. Gupta. S.B. (1983).

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Rao, V.K.R.V.A.M. Khusro & C.H. Hanumantha Rao (1973). Inflation and Inda's Economic Crisis.

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Unit-III

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Little, J.M. D. T. Scitovsky & M. Scott (1970). Industry and Trade in Sonic Developing Countries.' Comparative Study, Oxford University Press, London.

Nayyar, D. (1970). India's Exports and Export Policies in the 1960's Cambridge University Press, Cambridge

Pancnamukhi, V.R. (1978). Trade Policies of India. A Quantitative Analysis, Concepts Publishing Company, New Delhi.

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Kapila. V. (Ed). Indian Economy Since Independence, Vol. 2. i.e. Academic Foundation. New Delhi.

Unit-IV

Brahmananda, P.R, and V.R. Panchmukhi (Ed.) (1987). The Development Process of the Indian Economy.

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Unit-V

Ahluwalia, LJ. (1985). Industrial Growth in India. Oxford University Press, New Delhi.

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Chakravarty, S. (1987). Development Planning: The Indian Experience, Clarendon Press, Oxford.

Gadgil, D.R (1972). Planning and Economic Policy in India. Orient-Longman Peona. Ghosh. A. and S.K.

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UNIT-I

Prof: H.S. Parmar

GROWTH AND STRUCTUR OF INDIAN ECONOMY SINCE 1950

LESSON-1

GROWTH OF INDIAN ECONOMY SINCE 1950

Unit I of your syllabus requires that you aquaint yourself with the growth and the structural changes that have taken place in the Indian economy since 1950. We have tried to design the study material for this unit in such a way that you get a synoptic view of the Indian Economy and its structural changes. Since it is not possible to deal with every dimension of the economy in detail in the limited space available here, you are advised to go through the suggested books and other study material as given in the syllabus and at the end of each lesson. This lesson is, devoted to the study of the growth of Indian economy since 1950 and some other related issues.

1. Indian Economy: Pre Independence Period

During the colonial era, government's economic policies in India were concerned more with protecting and promoting British interests rather than with advancing the welfare of the Indian population. The administration's primary pre-occupation was with maintaining law and order, tax-collection and defence. These activities absorbed the bulk of meager public revenues. As for development, government adopted basically laissez-faire attitude. The government supported and encouraged large investment in building the railway network. Public investment in irrigation, roads, education and other development-oriented infrastructure was very limited. There was no positive government policy to promote indigenous industry. Indeed it is believed that government policies, far from encouraging development, were responsible for decline and disappearance of much of India's traditional industry. There was some shift in altitudes especially since the 1930s signalling a more active interest in development problems; but this did not make any significant difference. Altogether, the pre-independence period was a period of near-stagnation for the Indian Economy.

At the lime of independence Indian economy was caught up in the "vicious circle of poverty" characterized by one of the lowest per capita consumption and income levels among the countries of the world. Low income levels resulted in low level of saving and capital formation and low productivity of labour, which, in turn, led to a low level of income and this vicious circle perpetuated poverty in the country.

Independence for India meant its simultaneous partition. The country which had for long remained a single, unified economic unit and whose economy was based on inter-regional specialisations and dependence was divided along communal lines.

At the time of independence, the Indian economy was overwhelmingly rural and agricultural in character. Nearly 85 per cent of the people lived in villages and derived their livelihood from agriculture and related pursuits, using traditional, low-productivity techniques. Fertilizers and other modem inputs, which are the key to high productivity, were hardly in use; and irrigation facilities were available only for about one-sixth of the area. The backwardness of Indian economy is reflected in its unbalanced occupational structure with 70 per cent of working population engaged in agriculture. Even with this large proportions of population engaged in agriculture, the country was not self sufficient in food and

raw materials for 'industry. At independence, India still had a traditional agriculture. For most farmers, techniques of production were on the whole those of many generations past. There were, in 1947, a few hundred tractors in all of India's agricultural operations involving about sixty five million rural households. Use of fertilizers was lower per acre as compared to the other parts of the world. And as a result India's productivity in agriculture was low.

To be precise, the pre-independence period was a period of near stagnation for the Indian economy. The economy was generally characterized by the incidence of indebtedness, low and stagnating national and par capita income, lack of incentives for growth and low levels of living of majority of its inhabitants. As the First Five Year Plan 1951-56 (pp. 28-29) document states, "This is primarily because the basic conditions under which the economy can continuously expand have been lacking. The impact of modern industrialism in the latter half of the 19th century was felt in this country initially through imports of machine-made goods, from abroad which reacted adversely on the traditional pattern of economic life, but did not create the impulse for development along new lines. The transition that followed was characterized not by expansion of industry and a diversification of economic structure but by a decay of India's traditional arts, crafts and industries and by an increasing pressure of population on the land. This retrogression led to a decline in productivity per person engaged in agriculture, the adverse effects of which were perhaps softened to some extent by the shock absorbing capacity of the old institution of the joint family. The result was a continuous increase in under-employment and the growth of an attitude of 'pathetic contentment on the part of the people. In such an environment there could be little economic or social progress."

The basic philosophy that guided the Indian economy during the post independence era was basically rooted in mixed economic regime in which public sector had a primacy over private sector, centralized democratic economic planning wedded to the goals of a socialistic pattern of society. When the planning process was initiated in India, there was a legacy of pre-independence debate on India's development problems. This debate centred around the Gandhian approach, an approach that always talked about the voluntary check pm wants, the need for having self reproducing village communities, and about issues bearing on a better balance between man and nature, and the 'modernizing' approach of Nehru. The Gandhian approach has never been seriously discussed by either mains tream economists or by its left-wing critics. Thus the modernizing school under Nehru won the day as their scientism' seemed more compatible with the ideological priorities involved in building up a post-colonial" nation-state, although some vestigial traces of the alternative approach remain in the attitude of certain small scale industries such as hand spinning, generally known as the 'tiny sector'. (Development Planning by S. Chakravarty, pp 7-9). The contemporary writers have called it as the Nehruvian model of planning. The first three five year plans bore the personal imprint of Nehru. These three plans, especially the Second Plan, reflected a major watershed in India's economic thinking.

II. Growth of Indian Economy: Post Independence Period

An overview of the growth of Indian economy over the last six decade does not present a very cheerful and happy face. During the early days after independence, the economy traversed through a centrally controlled path, guided by the Nehruvian model. A dominant public sector was entrusted with the task of steering the economy through difficult times and ultimately of achieving the goals that our democratic nation set for itself. But the public sector did not prove itself up to the task. The country also had to face unforeseen difficulties like wars with neighbors and other natural calamities. Changes were effected in the strategies as well as a result of this in the policies and policy-instruments that decelerate the growth of the economy. (You shall read about different policies in subsequent lessons).

Without going into the details of the planning process, the strategies of planning and policy initiatives resorted to accelerate the rate of growth, we at the first instance, shall look at the traditional indicators, namely the rates of growth of the national income and the per-capita income, to assess the

growth of the economy. Apart from the growth of national income, the changes in the industrial origin of the national product as well as the shifts in the occupational pattern of income are also important indicators of the growth of an economy. However, the occupational pattern of income shall form the subject matter of a subsequent lesson in Unit 1 itself.

Growth Performance:

As stated earlier, a very important indicator of the growth performance of an economy is the growth of the national income and per capita income over a period of time. Table L.I. and Table 1.2 give below present the growth of Gross National Product (GNP), Net National Product (NNP) and Per-Capita net national product of India from 1950-51 onwards.

In the year 1950-51 the gross national product of India was Rs. 9506 crores at current prices and Rs. 139912 crores at 1993-94 prices. The net national product at factor cost was Rs. 9142 crores and Rs. 132367 crores at current and 1993-94 prices respectively in the same year. The Gross National Product, (GNP) at current prices increased to Rs. 16148 crores in 1960-61, Rs. 41936 crores in 1970-

1.1 GROSS NATIONAL PRODUCT AND NET NATIONAL PRODUCT

	Gross National product at factor cost (Rs. crore)		Net national product at factor cost (Rs. Crore)		Per capita net national product (Rs.)		Index numbers (1950-51=100)			
							Nat natinal product		Per capita net natinal product	
	At Current Prices	At 1993-94 Prices	At Current Prices	At 1993-94 Prices	At Current Prices	At 1993-94 Prices	At Current Prices	At 1993-94 Prices	At Current Prices	At 1993-94 Prices
1	2	3	4	5	6	7	8	9	10	11
1950-51	9505	139912	9142	132367	255	2687	100.0	100.00	100.0	100.0
1951-52	10045	143399	9634	135551	264	3714	105.0	102.4	103.6	100.7
1952-53	9916	147540	9474	139379	255	3747	103.6	105.3	100.0	101.6
1953-54	10805	156590	10341	148159	273	3909	113.1	111.9	107.1	106.0
1954-55	10139	163126	9628	154184	249	3994	105.3	116.5	98.0	108.3
1955-56	10322	167535	9776	158001	249	4020	106.9	119.4	97.7	109.0
1956-57	12317	177006	11706	166793	292	4150	128.0	126.0	114.6	112.8
1957-58	12590	174756	11928	163902	292	4007	130.5	123.8	114.6	108.7
1958-59	14071	187925	13299	176483	318	4222	145.5	133.3	124.9	114.5
1959-60	14759	191717	13916	179592	327	4216	152.2	135.7	128.3	114.3

1960-61	16148	205196	15204	192235	350	4429	166.3	145.2	137.6	120.1
1961-62	17018	211287	15900	197514	359	4449	174.6	149.2	141.1	120.7
1962-63	18194	215601	17029	200895	375	4425	186.3	151.8	147.3	120.0
1963-64	20804	226577	19491	210946	420	4546	213.2	159.4	165.0	123.3
1964-65	24291	243472	22814	226640	481	4781	249.5	171.2	189.0	129.7
1965-66	25422	234394	23752	216244	490	4459	259.8	163.4	192.3	120.9
1966-67	28893	236946	26918	217427	544	4392	294.4	164.3	213.5	119.1
1967-68	33967	255843	31745	235418	627	4653	347.2	177.9	246.4	126.2
1968-69	35837	262687	33421	241234	645	4657	365.6	182.2	253.4	126.3
1969-70	39420	279791	36742	257359	695	4865	401.9	194.4	272.7	131.9
1970-71	41938	293933	38968	270597	720	5002	426.2	203.4	282.8	135.7
1971-72	44632	296688	41340	272252	746	4914	452.2	209.7	293.0	133.3
1972-73	49113	295752	45392	270061	801	4763	496.5	210.8	314.4	129.2
1973-74	60235	309950	55896	283061	964	4880	611.4	213.8	378.4	132.4
1974-75	70992	314509	65432	280217	1103	4830	715.7	216.4	433.3	131.0
1975-76	75454	343173	69005	313643	1137	5167	754.8	236.9	446.4	140.1
1976-77	81148	347530	74242	316358	1197	5103	312.1	239.0	470.2	138.4
1977-78	92648	373464	85151	340751	1343	5375	931.4	257.4	527.4	145.8
1978-79	99667	394335	91094	359732	1406	5551	996.4	271.8	552.0	150.6
1979-80	109080	374640	98631	338124	1485	5092	1078.8	255.4	583.3	138.1
1980-81	130523	401970	118236	363417	1741	5352	1293.3	274.6	683.8	145.2
1981-82	152096	425168	137388	384392	1985	5555	1502.8	290.4	779.6	150.7
1982-83	168891	436577	151716	393274	2143	5555	1659.5	297.1	841.5	150.7
1983-84	197686	469293	178121	423265	2464	5864	1948.3	319.8	967.4	158.8
1984-85	221281	489206	198794	440119	2690	5956	2174.4	332.5	1056.5	161.5
1985-86	248118	511058	221401	459185	2932	6082	2421.7	346.9	1151.5	165.0

1986-87	276453	532021	246064	477158	3191	6189	2691.5	260.5	1253.2	167.9
1987-88	313374	551409	279400	493312	3546	6260	3056.1	372.7	1392.3	169.8
1988-89	373995	607207	334302	545572	4153	6777	3656.6	412.2	1630.7	193.8
1989-90	432289	648108	385729	582518	4693	7087	4219.1	440.1	1842.7	192.2
1990-91	503409	683670	450145	614206	5365	7321	4923.7	464.0	2106.8	198.5
1991-92	579009	691143	514607	617372	6012	7212	5628.8	466.4	2360.7	105.6
1992-93	661576	726375	587064	648182	6732	7433	6421.4	489.7	2643.7	201.6
1993-94	769265	769265	685912	685912	7690	7690	7502.6	518.2	3019.5	208.6
1994-95	903975	824816	8059981	734358	8857	8070	8815.9	554.8	3477.9	218.9
1995-96	1059787	886961	941861	787809	10149	8489	10302.2	595.2	3985.4	230.2
1996-97	1230465	959359	1093962	862084	11564	9007	11965.9	643.7	4541.0	244.3
1997-98	1376943	1005946	1224946	891086	12707	9244	13398.6	673.2	4989.7	250.7
1998-99	1583159	1070773	1415093	948580	14396	9650	15478.5	716.6	5652.9	261.7
1999-00	1746407	1137185	1564048	1008114	15625	10071	1707.7	761.6	6135.5	273.1

New Series base year 1999-2000

	At Current Prices	At 1999-2000 Prices	At Current Prices	At 1999-2000 Prices	At Current Prices	At 1999-2000 Prices	At Current Prices	At 1999-2000 Prices	At Current Prices	At 1999-2000 Prices
1999-00	1771094	1771094	1585501	1585501	15839	15839	100.0	100.0	100.0	100.0
2000-01	1902682	1842228	1696387	1643098	16648	16133	107.0	103.7	105.1	101.9
2001-02	2080119	1952241	1847667	1739876	17800	16762	116.5	109.7	112.4	105.8
2002-03	2248614	2028928	1993846	1801130	18899	17075	125.8	113.6	119.3	107.8
2003-04	2531168	2204746	2246465	1959609	20936	18263	141.7	123.6	132.2	115.3
2004-05 (P)	2833558	2367711	2601067	2103350	22946	19297	157.7	132.7	144.9	121.3
2005-06 (Q)	3225963	2580761	2846762	2295243	25716	20734	179.5	144.8	162.4	130.9

P: Provisional estimates. **Q : Quick Estimates**

Source : Economic Survey 2006-07.

1.2 GROSS NATIONAL PRODUCT AND NET NATIONAL PRODUCT

	Gross National product at factor cost		Net national product at factor cost		Per capita net national product	
Year	At Current Prices	At 1992-94 Prices	At Current Prices	At 1992-94 Prices	At Current Prices	At 1992-94 Prices
1	2	3	4	5	6	7
1951-52	5.7	2.5	5.4	2.4	3.6	0.7
1952-53	-1.3	2.9	-1.7	2.8	-3.5	0.9
1953-54	9.0	6.1	9.1	6.3	7.1	4.3
1954-55	-6.2	4.2	-6.9	4.1	-8.6	2.2
1955-56	1.8	2.7	1.5	2.5	-0.3	0.7
1956-57	19.3	5.7	19.7	5.6	17.4	3.5
1957-58	2.2	-1.3	1.9	-1.7	-0.1	-3.7
1958-59	11.8	7.5	11.5	7.7	9.1	5.4
1959-60	4.9	2.0	4.6	1.8	2.7	-0.1
1960-61	9.4	7.0	9.3	7.0	7.2	5.1
1961-62	5.4	3.0	5.0	2.7	2.6	0.4
1962-63	6.9	2.0	6.7	1.7	4.4	-0.5
1963-64	14.3	5.1	14.5	5.0	12.0	2.7
1964-65	16.8	7.51	17.0	7.4	14.6	5.2
1965-66	4.7	-3.7	4.1	-4.6	1.8	-6.6
1966-67	13.7	1.0	13.3	0.5	11.0	-1.5
1967-68	17.6	8.0	17.9	8.3	15.4	5.9
1968-69	5.5	2.7	5.3	2.5	2.8	0.1
1969-70	10.0	6.5	9.9	6.7	7.7	4.5
1970-71	6.4	5.1	6.1	5.1	3.7	2.8
1971-72	6.4	0.9	6.1	0.6	3.6	-1.7
1972-73	10.0	-0.3	9.8	-0.8	7.3	-3.1
1973-74	22.6	4.8	23.1	4.8	20.4	2.3
1974-75	17.9	1.5	17.1	1.2	14.5	-1.0

	Gross National product at factor cost		Net national product at factor cost		Per capita net national product	
Year	At Current Prices	At 1992-94 Prices	At Current Prices	At 1992-94 Prices	At Current Prices	At 1992-94 Prices
1975-76	6.3	9.1	5.5	9.5	3.0	7.0
1976-77	7.5	1.3	7.6	0.9	5.3	-1.2
1977-78	14.2	7.6	11.7	7.7	13.2	5.3
1978-79	7.6	5.3	7.0	5.4	4.7	3.3
1979-80	9.4	-5.0	8.3	-6.0	5.7	-8.3
1980-81	19.7	7.3	19.9	7.5	17.2	5.1
1981-82	16.5	5.8	16.2	5.8	14.0	3.8
1982-83	11.0	2.7	10.4	2.3	7.9	0.0
1983-84	17.0	7.5	17.4	7.6	15.0	5.4
1984-85	11.9	4.2	11.6	4.0	9.2	1.7
1985-86	12.1	4.5	11.4	4.3	9.0	2.1
1986-87	11.4	4.1	11.1	3.9	8.8	1.1
1987-88	13.4	3.6	13.5	3.4	11.1	1.2
1988-89	19.3	10.1	19.6	10.5	17.1	8.3
1989-90	15.6	6.7	15.4	6.8	13.0	4.6
1990-91	16.5	5.5	16.7	5.4	14.3	3.3
1991-92	15.0	1.1	14.3	0.5	12.0	-1.5
1992-93	14.3	5.1	14.1	5.0	12.0	3.1
1993-94	16.3	5.9	16.8	5.8	14.2	3.4
1994-95	17.5	7.2	17.5	7.1	15.2	4.9
1995-96	17.2	7.5	16.9	7.3	14.6	5.2
1996-97	16.1	8.2	16.1	8.2	13.9	6.1
1997-98	11.9	4.9	12.0	4.6	9.9	2.8
1998-99	15.0	6.4	15.5	6.5	13.3	4.4
1999-00	10.3	6.2	10.5	6.3	8.5	4.4

New Series base year 1999-2000

	At Current Prices	At 1992-94 Prices	At Current Prices	At 1992-94 Prices	At Current Prices	At 1992-94 Prices
2000-01	7.4	4.0	7.0	3.7	5.1	1.9
2001-02	9.3	8.0	8.9	5.8	6.9	3.9
2002-03	8.1	3.9	7.9	3.5	6.2	1.9
2003-04	12.6	8.7	12.7	8.8	10.8	7.0
2004-05 (P)	11.9	7.4	11.3	7.3	9.6	6.7
2005-06 (Q)	113.8	9.0	13.8	9.1	12.1	7.4

Annual Average Growth Rates

First Plan (1951-56)	1.8	3.7	1.5	3.6	-0.3	1.8
Second Plan (1956-61)	9.5	4.2	9.4	4.1	7.3	2.0
Third Plan (1961-66)	9.6	2.8	9.5	2.5	7.1	0.2
Three Annual Plan (1966-69)	12.2	3.9	12.2	3.8	9.8	1.5
Fourth Plan (1969-74)	11.1	3.4	11.0	3.3	8.5	1.0
Fifth Plan (1974-79)	10.7	5.0	10.4	5.0	7.9	2.7
Annual Plan (1979-80)	9.4	-5.0	8.3	-6.0	5.7	-8.3
Sixth Plan (1980-85)	15.2	5.5	15.1	5.4	12.7	3.2
Seventh Plan (1985-90)	14.4	5.8	14.2	5.8	11.8	3.6
Two Annual Plans (1990-92	15.7	3.3	15.5	3.0	13.2	0.9
Eighth Plan (1992-97)	16.3	6.8	16.3	6.7	14.0	4.6
Ninth Plan (1997-2002)	10.7	5.5	10.8	5.5	8.8	3.5

P: Provisional estimates. **Q : Quick Estimates**

Note : Growth rate from m 2000-01 based on new series with base year 1999-2000

71, Rs. 130523 crores in 1980-81, Rs. 503409 crores in 1990-91 and to Rs. 1746407 crores in 1999-2000. The estimates as per new series (base year 199-2000) puts the GNP figures at Rs. 1902682 crores in 2000-01 and Rs. 3225963 crores in 2005-2006 (Quick estimates). The Per-capita income

increased from Rs. 255 in 1950-51 to Rs. 15625 in 1999-2000. The new series estimates per capita income at Rs. 25716 in 2005-2006 (Q) at current price and RS. 20734 at 1999-2000 prices. The Index numbers of Net National Product (NNP) and per-capita Net National Product given in Table 1.1 also given you're an indication of the growth of NNP and Per capita income since 1951.

Looking at the annualized growth rate of GNP, NNP and Per-capita NNP (Table 1.2), it is evident that these has been wide variations. But it may be inferred that the rate of growth of GNP and NNP remained low during the early phase of about three decades particularly at base price. The rate of growth of per-capita income was still lower as the rate of growth of population remained higher. This trend was visible despite some years of exceptional performance in the growth of National Income. This phase of the blow growth of Indian economy was characterized as inflicted by the 'Hindu Rate of Growth'. The subsequent phase witnessed the achievement of a higher growth trajectory by the economy.

Considering plan-wise national income trends, one would notice some interesting facts which remain concealed when only trend rate is used to gauge India's development performance up to the fifth FYP, Net National product at factor cost (1999-2000 Price) grew at less than 4.00 per cent, baring second FYP during which average annual growth rate was marginally above 4.00 per cent. After Fifth FYP, the rate of growth was above 5.00 per cent. The annual average rate of growth of per-capita income also looked up after 1980. According to the national income data released by the Central Statistical Organization (CSO), the advance estimates for growth of GDP at factor cost at constant (1999-2000) prices in 2005-06 at 8.1 per cent was up 0.6 percentage points over the 7.5 per cent growth recorded in 2004-05. For 2004-05, the growth of GDP at factor cost at 1999-2000 prices was higher than the 6.9 per cent during the earlier year. The advanced estimates showed a growth of 9.2 per cent during 2006-07, initially estimated at 8.1 percent in Feb. 2006, was revised upward to 8.4 per cent in May 2006, and further to 9.0 per cent in quick estimates released by the CSO on Jan 31, 2007.

The ratcheting up of growth observed in recent years is reflected in the eleventh Five Year Plan target of an average annual growth of 9.00 per cent relative to 8.00 per cent targeted by the Tenth Plan is attributable to the disappointing 3.8 per cent growth in the first year of the Plan and its subsequent surge to 8.6 per cent, on average, in the last four years.

Sectoral Composition of National Income:

Historical pattern of development of the developed countries has followed a common pattern Share of agriculture has seen a steady decline in the national income and output, that of industry registere on increase for a considerable long period, and then has shown a decline. And the share of services has steadily increased all through, but the rate of increased seems to have accelerated in the latter half of the 20th century, the period during which industry has seen a decline in its share and, therefore, is often described as a period of 'deindustrialization' in the developed countries.

This period, characterized by the emerging dominance of services in the economies of developed countries, is also seen as signalling the dawn of a 'post-industrial society' (Papola, T.S.) The timings and the speed of such changes, popularly known as structural changes, have been different among different countries.

In the 'pre-modem' era which ended at different points of time during the 19th century in different countries, agricultural accounted for a half to two-thirds of the total output. In seems to have taken 75 to 100 years for this share to decline to about one fourth in the case of most European Countries. In spite of the difference in the time of entering the era of modem development and in the speed of transformation, the share of agriculture had declined to less than 15 percent in most of the now developed countries by middle of the 20th century and has seen a further decline since than, reducing it to less than 5 per cent in all of them, by the end of the 20th century.

Industry held a share of around 25 per cent at the beginning of the 'Modem' development in most of the developed countries of today. It grew steadily and reached peak of about one-half by 1950's. Almost all such countries have seen a decline in the share of industry in their output since 1950's. The service sector, however, has experienced a secular increase. There has been a continuous, and a relatively fast increase in the share of service since 1960's and by the turn of the 21st Century, it stands at 65 to 75 per cent in all the developed countries, the highest being 75 percent in the case of the USA followed by U.K. at 73 per cent and France at 72 per cent.

In India also during the last over half a century after planning was initiated in independent India, modern development accompanied by structural changes has taken place. Indian economy revealed similar structural characteristics in 1950, as most developed countries of today showed at the time they embarked upon the road to industrialization. With about 60 per cent of GDP accounted for by agriculture, industry contributing about 13 per cent and services about 27 per cent, the Indian economy in 1950 was structurally comparable to the economy of Great Britain in late 18th century, and of Germany at the beginning of the 19th century, of the USA and Italy of mid-19th century and of Japan in 1900.

Economic development in India over a period since independence seems to have followed the same pattern of changes in the sectoral composition of SDP that the developed economics of today as underwent over a period ranging between 150 to 100 years. The share of agriculture in GDP declined from around 60 per cent (59.20 per cent to be precise) to about 35 percent in 1990-91 and to 21.74 per cent in 2005-06 (Table 1.3). The share of manufacturing from 13 percent to over 24 per cent over the same period. Growth of the services sector was very impressive as its share increased from 27.50 per cent in 1950-51 to about 50 percent in 200 and to 54.11 per cent in 2005-06. The share of industry has grown slowly but has stagnated since 1990-91.

1.3 GDP at Factor Cost by Industry of Origin

Year	Agriculture & Allied	Manufacturing etc.	Services (Trade, Finance, Pub. Admn. Etc.)	Total GDP
	At 1993-94 Prices			
1950-51	83154 (59.20)	18670 (13.30)	38642 (27.50)	140466 (100.00)
1960-61	112848 (54.75)	34239 (16.61)	59016 (28.64)	206103 (100.00)
1970-71	142581 (48.13)	58997 (19.90)	94700 (31.97)	29378 (100.00)
1980-81	167770 (41.82)	88605 (22.09)	144753 (36.09)	401128 (100.00)
1990-91	242012 (34.93)	169703 (24.49)	281156 (40.58)	692871 (100.00)

At – 1999-2000 Prices

1999-00	488109 (27.32)	410646 (22.99)	887770 (49.69)	1786525 (100.00)
2003-04	486489 (23.76)	481758 (23.53)	1079486 (52.71)	2047733 (100.00)
2005-06 (Q)	566275 (21.74)	628900 (24.15)	1409357 (54.11)	2604532 (100.00)

Figures in brackets show percentages to total.

The most striking feature of the structural change in the Indian economy in recent decades has been the per-eminence of services sector as the major contributor to growth, raising its share rather sharply in the national output. Industry, particularly manufacturing, which has been observed historically to be the main contributor of growth, at least in the initial period of economic development, has playing only a minor role in India's economic growth in recent years. While this has been the pattern of growth in most of the developed countries since the middle of the 20th century, questions have been raised whether India is already at a level of development to sustain such a change in the sources and pattern of economic growth. In other words, while developed countries entered the phase of predominance of services in their economics after going through a phase of industrialization, and industry having attained a share of 50 per cent in the economy, is India on the way to becoming a post-industrial 'service economy' without industrialization.

Two propositions have been generally advanced to explain such a swift and a historical transition economy directly from an agricultural to a service economy, by-passing industrial development. One, it is argued that technological advancements over the part few decades have led to increasing demand for services even at the relatively low level of per capita income and also, the distinction between products and service has become rather blurred. Development of communication technologies and movements of people across countries have produced demonstration effect creating similar pattern of demand in developing countries as in the developed countries leading to a larger demand for and, consequently production of service. As a result, elasticity of demand for service has become greater than unity even in countries with relatively low per capita income levels, thus leading to a rise in the contribution of services in national product. Second, the classical model of structural change with economic development was based on the experience of nations with more or less autocratic regimes with little international trade, a situation in which domestic product structure of each country has to reflect its demand pattern. With increasing openness of economies and trade playing significant role in them, changes in demand pattern can be met through trade and countries can have a product pattern very different from the pattern of consumption demand, largely based on comparative advantage.

India thus seems to be following a growth path, which is different not only from the one traversed historically by the developed countries of today, but also is at variance with that being currently followed by other countries at similar levels of development and growing in similar global environment of increasing trade and capital flows. This path is characterized by a services-led rather than industry and manufacturing- led growth. And this characteristic seems to have become more prominent with the graduation of the Indian economy from a low-growth to a high-growth trajectory over the past two decades. Distinctiveness of the pattern of India's economic growth over the past few

decades has probably gone unnoticed among most economists, as the jubilation over achieving a high rate of economic growth and emergence of India as one of the fastest growing and a major economies of the world seems to have overshadowed the fact of rather intriguing and somewhat a historical pattern of its growth. Some economists have, however, taken note of it and attempted analysis of causes and implications of this pattern of growth characterized by 'excess growth of the services sector and its sustainability from the viewpoint of its implications for price stability, employment and income distribution and others have asked and attempted to examine the question "Is India pioneering a new development path which gives primacy to services rather than manufacturing as the leading sector?"

Some people doubt if all the growth of services that has taken place, particularly over the past two decades is, in fact, real. It is argued that a good part of this growth merely reflects a relocation of activities from the commodity producing sectors to the enterprises categorized in the services sector. It may be recalled that this phenomenon has been noted by some economists in explaining the increase in the share of services sector in developed countries as well. Changes in technology, production arrangements and market conditions together have facilitated and induced enterprises in industry to 'outsource', activities of 'service' 'nature carried out by themselves earlier, to the service providing enterprises. thus, packaging, labeling and distribution of manufactured goods is now being increasingly carried out by separate organizations and being accounted for in the services sector. Functions like maintenance and security of factory establishments are contracted out to companies and establishments specializing in these services. While these phenomena are being commonly observed in the economy, we, however, have no estimates of the impact of such relocation on the changing share of the commodity producing and services sectors. At the same time, while such relocation may have led to increase in share of services, a real increase in the volume of these services as a result of expanding industrial activity and changes in the demand pattern cannot be denied.

Some Questions and concerns:

What follows is to raise certain questions regarding sustainability and some other implications of the emerging pattern of growth. First, there is the question of macroeconomic balances. How far is the emerging pattern of production compatible with the pattern of consumption demand? The consumption basket of the Indian population still consists predominantly of commodities and only a small part of services. According to NSS data on consumption expenditure, 85 per cent of expenditure of rural and 74 per cent of that of urban households was incurred on food and manufactured goods, services accounting for only 15 per cent in the case of the former 'and 26 per cent in the case of the latter in 1999-2000. A production structure with 51, per cent services and 49 per cent goods already looks highly out of line with the demand pattern. There is no doubt that income elasticity of demand for services is high, but at India's level of per capita income, income elasticity of demand for commodities, particularly industrial goods is also high. For manufactured goods, income elasticity of demand works out to be 1.02 in rural and 1.05 in urban households, the corresponding figures for services are, of course, higher at 1.7 and 1.6. As a result, the demand for industrial goods is also bound to rise along with that for services, and with the production of industrial sector stagnating at around 25 per cent of GDP and that of manufactured goods at 15 per cent, a significant excess demand for them is certain to emerge, leading to inflationary pressures. One condition for ensuring balance between the patterns of demand and production would, of course, be a highly skewed distribution of income, so that a large part of the population remains at low levels of income with little demand for industrial goods, while a segment of population has disproportionately high level of incomes with very high demand for services and little demand for goods—agricultural or industrial. In fact, even the present sectoral pattern of production already suggests such an inequality in income distribution and its further accentuation will have serious socioeconomic consequences.

There are obvious implications of the macroeconomic imbalance between production and consumption for sustainability of economic growth itself. But in a globalizing economy, it can be argued, macroeconomic balance does not have to be maintained on the basis of domestic production and consumption, as trade can be increased to ensure such a balance. In the emerging Indian scenario what it implies is that services are exported and goods imported. The second question, therefore, is the efficacy of the 'export services-and-import goods' inodel. No doubt, export of services has increased rapidly in recent years accounting now for about 31 per cent of India's total exports of goods and services. It still, however, make up only around 3 per cent of GDP, with all exports being 10.8 per cent of GDP (Economic Surrey, 2004-2005). With 51 per cent share, in GDP, exports thus make about 6 per cent of the output of the services sector. Thus, only a small part of the services seem to be tradable or is being actually traded. The tradable component of the services has, however, been increasing and several services like business processing, education and health and legal services, which were earlier regarded as non-tradable, have now become tradable and their exports can be expected to rise. But even if India has the capacity to produce tradable services on an increasingly larger scale, their actual exports will depend on continuation of the current comparative advantage and the extent to which other countries emerge as competitors in the field. The commodity gap, that is, the excess of consumption over production, currently could be said to be around 29 per cent of GDP, with 78 per cent share in consumption and 49 per cent in production. Even if it declines with rising share of services in consumption, service exports will have to rise very fist and make up a major share in total production of services to meet this gap.

Third, there is the question of employment. As noted earlier, share of services in GDP has grown much faster than in employment, thus in 2002 contributing 51 per cent to GDP and only 22 per cent in employment. Contrary to the popular impression, services sector has thus not been generating employment commensurate to its output growth. Against an 8 per cent growth in output, employment in services sector has grown only at 3 per cent during 1994-2000 implying an employment elasticity of about 0.35. Growth rate and elasticity, no doubt, are higher than in the aggregate economy at 1.02 and 0.15 respectively. But the aggregate figures are highly depressed due to the weight of agriculture (60 per cent), which has shown virtually no. growth in employment and as low as 0.02 employment elasticity during this period. Performance of industrial sector has been relatively better with a 2.5 per cent employment growth accompanying a 6.5 per cent growth in GDP, thus yielding an employment elasticity of 0.38. Within the industrial sector, manufacturing registered a higher 2.6 per cent growth in employment. It may also be noted that* employment elasticity of services declined sharply from 0.62 during 1988-1994 to 0.35 in 1999-2000, while in industrial sector it increased from 0.23 to 0.37 during the same period (Papola, 2004). In other words, employment intensity of the services sector is not only low, but has been sharply declining in recent years. Labour-intensive manufactures still hold and will continue to hold comparative advantage and, therefore, growth in their exports holds good prospects for achieving balance of trade and higher employment growth

The fourth question relates to growing income inequality implicit in the present pattern of output and employment growth. As already noted, there is an increasing asymmetry between the sectoral shares of GDP and employment with a strong likelihood of growing inequality in incomes among sectors, groups and individuals. With shrinking share of agriculture in GDP without a commensurate decline in its employment share, the income gap between agricultural and non-agricultural workers is rapidly increasing. With a 50 per cent share in GDP and 74 per cent share in employment, the ratio of per worker agricultural to non-agricultural incomes in 1960 was 1:3; now with 60 per cent workers and 21 per cent GDP in agriculture close to 1:6. Ratio between agriculture and services is 1:7 and between agriculture industry 1:4. With increase in the share of services, this gap will certainly increase the growth is accompanied by an increase in the employment share ofs Employment structure is getting sharply polarized between a few-high end jobs corporations and the mass of low productivity low

earning jobs in the unorganized The services sector. is particularly characterized by large differentials in earnings, with a few jobs in high-tech activities with very high salaries and benefits, on the one ham large mass of low-earning jobs in the informal sector, on the other. Fast grow: Sectors of services like information technology are revealing such chcteristic prominently. The dynamic segments of the services sector are also locationally cone in a few states and large cities and, to the extent the new growth is derived them, inter-regional differences in growth rates and development levels are also increase.

As the pattern of growth in India has been different from the historical as well as contemporary experiences of development, to be studied in its various dimensions to examine its sustainability an macroeconomic and distributive implications.' Prima facie, it appears to be reasonable to argue that the pattern of growth in the Indian economy will have to be sectorally balanced than the present trends suggest. Growth of agriculture is vital not so much for generating more employment, but basically for raising the income levels of the people engaged in it. But industry, particularly manufacturing, needs to grow faster for macroeconomic balance between growing demand and supply of goods, price stat trade balance. And above all, it needs to grow faster to generate employment, as it appears to be the only one among the three sectors, which has a reasonably high and employment intensity. Comparative advantage that India has in labour-intensive manufactured exports needs to be fully exploited, both for achieving trade balance and employment generation. Thus, from every viewpoint, the argument that 'Manafacturing Matters' applies with a strong force in the case of India's future economic growth. For, even with revolutionary changes in technologies and larger trade possibility globalize world, it is not realistic to expect that India will become a 'post-industrial' society without ever industrializing!

Suggested Reading

- Brahmanauda, P.R. and V.R Panchmukhi: The Development Process of the Indian Economy, Himalaya Publishing House, Bombay, 1987.
- Kapila, Uma: Indian Economy since Independence, Academic Foundation, New-Delhi.
- Datt. Ruuddar, and KPM sundaram, Indian Economy, S. Chand, New Delhi (Latest edition).
- Misra, S.K. and V.K. Puri: Indian Economy: Its Development Experience, Himalaya Publishing House, Mumbai (Latest edition)
- Papola, T.S. "Emerging Structure of Indian Economy" in the Indian Economic Journal, April-June, 2006.
- Govt. of India: Economic Survey (different years).

LESSON-2

Prof: H.S. Parmar

NATURE AND MAGNITUDE OF POVERTY, INEQUALITY AND UNEMPLOYMENT

It is rightly acknowledged that the true parameter of development is removal of poverty, inequality and unemployment. The ultimate objective of all human endeavour should be the attainment of happiness and welfare and hence the success of development efforts is expressed in terms of the capacity of a system 'to wipe out tears from the eyes of the poor' or to achieve economic development with 'human face. It is therefore important to look into poverty, inequality and unemployment in India along with its growth performance as has been done in lesson I. As a matter of fact, from the stand point of social welfare and the living standards of the inhabitants of our country, the nature and extent of poverty is perhaps more important than the rate of growth of the economy. This lesson is devoted to the study of this important aspect of the economy. The lesson has been divided into two sections; section I is devoted to the analysis of poverty and inequality where as section II deals with the problem of unemployment.

I. POVERTY AND INEQUALITY

The concept of Poverty:

Although attempts have been made to define poverty yet it has not been possible to arrive at a universal definition. Poverty may be defined as a social phenomenon in which a section of the society is unable to fulfill even the basic necessities of life or when a substantial, segment of a society is deprived of the minimum level of living. All attempts to define poverty are conditioned by the vision or notion of minimum level of living or good life obtaining in a society. There is also an effort in all definitions of poverty to approach the average level of living in a society and as such these definitions reflect the existence of inequalities in a society and the extent to which different societies are prepared to tolerate them. For instance, in India the generally accepted definition of poverty emphasizes minimum level of living rather than a reasonable level of living. It is generally agreed in India that only those who fail to reach a certain minimum consumption standard should be regarded as poor. This may be termed as the concept of absolute poverty. In the absolute concept of poverty, minimum physical quantities of cereals, pulses, milk, butter, etc. determined for a subsistence level and then the price quotations convert into monetary terms the physical quantities. Aggregating all the quantities included, a figure expressing per capita consumption, expenditure-is determined. The population whose level of income (or expenditure) is below this figure, is considered to be below the poverty line. But the experts who have examined the question of poverty quantitatively find it difficult to agree on the amount of income that will ensure the minimum consumption standards at a point of time. A study group set up by the Planning Commission, Government of India in July 1962 had examined as to what is to be considered the nationally desirable minimum consumption expenditure. This study group had recommended a standard of private consumption expenditure of Rs. 20, at 1960-61 prices, per capita per month as a bare minimum. The study group had not clearly elaborated on the basis on which it determined this minimum living standard of the country. Further, no distinction was made between rural and urban areas with regard to differences in the living costs. Despite many shortcomings noticed in the determination of minimum living standard, the Planning Commission accepted the criterion to define poverty in both rural and urban areas. Among individual researchers while B.S. Minhas ("Rural Poverty,

land Redistribution and Development," in Indian Economic Review. April. 1970) and A Vaidyanathan ("Some Aspects of inequalities in Living Standards in Rural India" in T.N. Srinivasan and P.K. Bardhan (eds.). Poverty and Income Distribution, 1974), in their studies of rural poverty used this poverty line while P.K. Bardhan ("On the incidence of Poverty in Rural India," in Economic and Political Weekly, Feb. 1973 (Annual Number), Dandekar and Rath (Poverty in India. 1971) and M.S. Ahluwalia determined their own poverty line. The Plannine Commission has now adopted an alternative dchm-tionol poverty. The Commission constituted in September 1989 an 'expert group' under the Chairmanship ot DT Lakdawala to consider the methodological and computational aspects of estimation of proportion and number of poor in India. This 'expert group' was to look into the methodology for estimation of poverty at national and state level and also to go imp the question of redefining poverty line, if necessary. The 'experts group' recommended the following.

1. The poverty line recommended by me task force was the mid-point of the monthly per-capita expenditure class having a daily calorie intake of 2400 per person in rural areas and 2100 in urbal areas. On this basis the cut-off points turn out to be to Rs. 49 for rural areas and Rs. 57 for urban areas at 1973-74 prices. The 'expert group' recommended that these norms be adopted uniformly for all states.

2. For estimating state specific poverty lines, the standardized commodity basket corresponding to poverty line at the national level-should be valued at the prices in each state in the base year i.e. 1973-74. For upgrading poverty line to the current prices in a year, there-is a need to generate state-specific consumer price index. For this purpose, the consumer price index for the agricultural labourers (rural) and the consumer price index for industrial workers and non-manual employees (urban) should be used- Since prices vary between states and periods, the procedure calls for price adjustments for interstate variations in the base year and stale-specific price movements over time.

3. For the choice of deflator, the 'expert group-suggested that it would be appropriate to rely on The disaggregated commodity indices for Consumer Price Index for Agricultural Labourers (CPIAL) to update the rural poverty line and a simple average of suitably wrighted commodity indices of Consumer Price Index for Industrial Workers (CPIIW and consumer price index of non-manual employees CP1NM) For updating the urban poverty line.

Several others economists and organizations have conducted studies from time to time to assess the poverty in India. Table 1 gives a synoptic view of these estimates you can study more on individual estimations by referring to suggested readings given at the end of this lesson.

Extent of Poverty:

There is utter lack of appropriate and reliable data for direct estimation of the extent and magnitude of poverty in India. This is mainly because no attempt so far has been made in this country to collect statistical information in respect of distribution of income. However the data on consumption expenditure collected in different National Sample Survey (NSS) rounds could be used for the purpose of determination of extent of poverty both in rural as well as urban areas. In India, the data pertaining to consumption expenditure generated by the NSS have been widely used by economists for study of poverty.

The estimates of poverty in India as provided by Dandekar and Rath, Minhas, Bardhan and Ahluwaha are quite old (see Table I) and do not indicate exactly the same magnitude of poverty. These estimates pertain of the period prior to 1970-71. There is also a wide divergence between the results shown by these economists for the year 1960-61 Bardhan estimated that 38.0 per cent of rural population was living below poverty line where as Dandekar and Rath put this figure at 40 per cent and

Ahluwaha puts this figure still higher at 445 per cent for the year 1963-64. Same is true of estimates made for other years. According to Minhas only 37 1 per cent of the rural population was below the poverty-line in 1967-68 as against Ahluwalia's estimate of 56.5 percent and Bardhans' estimate of 54 percent in the same year and Dandekar and Rath estimated 40 Per cent of rural population below poverty line for 1968-69. Ahluwalia Bardhan and Dandekar and Rath had deter-mined poverty line slightly lower than the one determined by Minhas, and yet incidence of poverty according to their estimates was greater than that was indicated by Minhas's estimates. This was mainly because of the use of different methodology by these economists.

There is another set of estimates of the extent of poverty provided by the Planning Commission. These estimates are available since the early 1970,s. Determining poverty line for the rural population at Rs. 49.0 (at 1973-74 prices) per capita per month, the estimate noted that about 51.2 percent of the rural population was poor in population. 1977-78 as against 54.09 per cent, in 1972-73. The bare minimum for the urban.

TABLE - I

ALTERNATIVES ESTIMATES OF POVERTY IN INDIA

(Million Persons)

Author (1)	**Year (2)**	**Rural (3)**	**Urban (4)**	**Total (5)**	**Criterion of Poverty line (6)**
P.D. Ojha	1960-61	184 (51.6)	6 (7.6)	190 (44.0)	Rural Monthly per capita consumption of Rs. 15-18 (1960-61 Prices)
	1967-78	289 (70.0)			Urban Monthly per capita consumption of Rs. 8-11. Monthly per capita consumption expenditure.
EPW Da Costa	1963-64			162 (34.5	Rural Rs. 0-15 Urban Rs. 24
P.K. Bardhan	(1960-61)	131 (30.0)			Rs. 15 at 1960-61 prices using Agricultural Labour Price Index
	1967-68	221 (53.0)			
B.S. Minhas	1956-57	181 (65.0)			Rs. 20 at 1960-61 Prices.
	1963-64	221 (57.8)			
	1969-70	210 (50.6)			

Author (1)	Year (2)	Rural (3)	Urban (4)	Total (5)	Criterion of Poverty line (6)
M. Ahluwalia	1956-57	181 (54.1)			Rs. 15 at 1960-61 prices for rural areas and Rs. 20 for urban areas.
	1963-64	171 (44.5)			
	1967-68	235 (56.5)			
	1973-74	241 (46.1)			
Dandekar & Rath	1960-61	135 (40.0)	42 (50.0)	177 (41.0)	Rs. 15 at 1960-61 prices for rural areas and Rs. 22.5 for urban areas.
	1969-70	166 (40.0)	49 (50.0)	215 (41.0)	
Seventh Finance Commission	1970-71	225 (53.0)	52 (51.0)	277 (52.0)	Augmented Poverty Line by adding to private consumer expenditure norm an estimate of public expenditure.
Sixth Plan (1980-85)	1979-80	260 (50.7)	*57 (40.0)	317 (48.4)	At 1979-80 Prices Rural Rs. 76 Urban Rs. 88
V.M. Dandekar	1971-72	238 (46.0)			Rs. 32.7 at 1971-72 Prices
	1977-78	284 (49.5)			Rs. 54.4 at 1977-78 Prices
	1983-84	286 (44.4)			Rs. 88.4 at 1983-84 Prices
World Bank	1983	252 (44.9)	65 (36.4)	317 (42.5)	Rs. 89.0 for rural areas and Rs. 111.2 for urban urban areas at current prices.
	1988	252 (41.7)	70 (33.6)	322 (39.6)	
Minhas, Jain and Tendulkar	1987-88	284 (44.8)	77 (36.5)	361 (42.7)	Rs. 122.6 for rural areas and Rs. 158.3 for urban areas.

Author (1)	Year (2)	Rural (3)	Urban (4)	Total (5)	Criterion of Poverty line (6)
Planning Commission Experts Group (1993)	1987-88	229 (39.1)	83 (40.2)	312 (39.1)	Rs. 115.43 for rural areas Rs. 165.58 for urban areas.
Planning Commission	1996-97	211 (30.6)	66 (25.6)	277 (29.2)	
NSSO	1999-000	195 (27.1)	65 (23.6)	260 (26.1)	Rs. 211.30 for rural areas Rs. 454.11 for urban areas

Figures in brackets indicate the percentage of the total population in the respective group.

was fixed at Rs. 5700 (at 1973-74 prices) per capita per month. On this criterion the Planning Commission found that 38.2 percent of the urban population lived below poverty line in 1977-78 as against 42.22 percent Mt 1972-73. The proportion of both urban and rural poor taken together to the total population was 48.3 percent in 1977-78. In the Seventh Five Year Plan estimates of the incidence of poverty were provided for the year 1983-84. These were based on the information made available from quinquennial surveys conducted by the National Sample Survey Organization. As per the Seventh Five Year Plan document, 40.4 percent of the rural population was below the poverty line in 1983-84. The corresponding percentage for the urban population was 2S.1. The overall poverty ratio was 37.4 percent. The poverty estimates for the year 1987-88 indicate further decline in the incidence of poverty. The percentage of people living below poverty line declined further to 33.3 percent in 1987-88 in the rural areas and from 28.1 percent in 1983-84 to 20.1 percent in 1987-88 in he urban poverty resulted in the decline in the overall incidence of poverty from 37.4 percent to 29.9 percent during the same period. The Planning Commission attributed this decline in poverty ratio to the achievement of a higher rate of growth of the economy increase of a higher rate of growth of the economy, increase in agricultural production and sustained efforts by the Government at providing employment an rural works through various employment generating programmes like the Integrated Rural Development Programme, the National Rural Employment Programme and the Rural Landless Labour Employment Programme. On the other hand the-developmental efforts, particularly in the areas of health, education and provision of basic amenities like drinking water supply, housing proved effective to reduce the incidence of poverty. Along with this certain target group specific programmes like special programmes for the development of disadvantaged and vulnerable sections of the society like women, children and economically and socially deprived and backward sections led to a significant reduction in the proportion of population below the poverty line. But some economists like Dandekar have raised serious doubts about the claims of the Planning Commission. They assert that the decline in the incidence of poverty between 1977-78 and 1987-88 was quite modest and not as most spectacular as claimed by the Planning Commission and the Government of India.

In view of the criticism of the methodology (the official methodology) followed by the Planning Commission to estimate the extent of poverty, it was felt that the whole issue of poverty estimation needed re-examination. Hence the Planning Commission constituted an expert group to examine the methodology and computational aspects of estimation of proportion and number of poor. The 'expert group' retained the concept of poverty line as recommended by the Task Force. It suggested changes in the price deflator to update-the poverty line for use in later years. Like Minhas, Jain and Tendulkar, the expert group used state specific price índices which can better reflect the changes in the cost of

consumption basket of the people around the poverty line. Itrelied exclusively on the NSS data on consumption expenditure to assess the incidence of poverty without adjusting it to the National Accounts estimates of consumption expenditure. It is quite interesting to note that the 'expert group' estimates of poverty for 1983-84 and 1987-88 provided in indicate much lower proportion of population living below the poverty line in run areas than that shown by Minhas, Jain and Tendulkar though both used the same methodology.

Incidence of poverty is estimated by the Planning Commission on the basis of the large scale qninquennial sample surveys on household consumer expenditure conducted by the NSSO. Economic Surveys for 2003-04 and 2004-05, on the basis of results of the 55th round, had indicated that there has been an impressive decline in the incidence of poverty in the 1990s. Howerver, the extent of incidence of poverty in the proportion of population below poverty line between 1993-94 and 1999-2000 has been a subject of an intense debate by academicians because of the change in methodology for collection of basic data in 1999-2000 and possible non-comparability with earlier rounds of the consumer expenditure survey The latest date available is that of the 61" round for the year 2004-05. The provisional data of the latest NSS 61st round for the year 2004-05 indicate that the poverty ration at the national level was 27.8 per cent if the Uniform Recall Period (URP), in which the consumer expenditure data for all the items are collected from a 30 day recall period), is used, and about 22 per cent if the Mixed Recall Period (MRP, in which the consumer expenditure data for five non-food items, namely, clothing, footwear, durable goods education and institutional medical expenses, are collected from a 365 day recall period, and the consumption data for the remaining items are collected from a 30 day recall period) is used. The corresponding URP based poverty estimated for 1993-94 was 36.0 per cent. The MRP based poverty estimate of about 21 per cent in 2004-05 is roughly but not strictly comparable with the poverty estimates of 26.1 per cent in 1999-2000.

There are wide differences among different states in terms of poverty ratios for total population in major states. In spite of a reduction in poverty, same of the states are having very high poverty ration for the total population. In 2004-05, it was more than 40 per cent in Madhya Pradesh and Uttar Pradesh and between 25 per cent and 30 per cent in Maharashtra, Tamil Nadu, Karnataka and West Bengal. Orissa has the dubious distinction of being at the top in terms of poverty ratio.

POVERTY RATIO: HEAD RATIO BYMAJOR STATES

State	Rural			Urban			All		
	1983	1993-94	2004-05	1983	1993-94	2004-05	1983	1993-94	2004-05
Andhra Pradesh	27.31	16.64	10.85	37.49	37.63	25.41	29.75	22.30	14.80
Assam	41.92	44.43	23.05	23.07	10.19	3.83	40.03	40.46	20.46
Bihar	64.89	57.24	43.06	47.49	36.54	31.66	62.71	54.50	41.53
Gujarat	27.92	22.44	19.76	38	29.44	11.96	31.11	24.26	13.92
Haryana	21.77	26.62	13.41	25.47	17.54	15.06	22.59	24.26	13.92
Himachal Pradesh	17.77	29.27	12.50	16.01	8.26	3.87	17.63	27.37	11.61
Jammu & Kashmir	25.23	19.73	4.81	17.48	7.38	4.81	23.57	16.75	4.81
Karnataka	37.51	30.24	23.73	42.88	39.67	33.4	39.08	33.25	27.15

State	Rural			Urban			All		
	1983	**1993-94**	**2004-05**	**1983**	**1993-94**	**2004-05**	**1983**	**1993-94**	**2004-05**
Kerala	38.46	26.49	12.27	45.11	25.45	20.86	39.81	26.22	14.48
Madhya Pradesh	48.21	40.43	38.17	53.11	48.29	34.44	49.23	42.30	37.21
Maharashtra	45.04	37.66	30.66	39.69	34.74	29.42	43.13	36.50	29.95
Orissa	67.52	50.11	47.76	49.19	41.02	43.34	65.31	48.85	47.07
Punjab	14.3	13.72	9.55	23.52	11.83	5.57	16.88	13.14	8.12
Rajasthan	37.72	26.89	18.91	38.81	31.55	29.81	37.95	27.96	21.48
Tamil Nadu	56.22	32.99	22.96	47.94	38.92	34.06	53.48	35.20	28.31
Uttar Pradesh	46.38	42.33	34.06	49.47	36.15	30.19	46.94	41.08	33.25
West Bengal	64.56	37.35	28.49	31.5	23.24	18.5	53.60	33.45	25.67
All- India	45.76	37.26	29.18	42.27	32.56	26.02	44.93	36.02	28.27

Note: Bihar, Madhya Pradesh and Uttar Pradesh include the reorganized states of Jharkhand, Chhattisgarh and Uttaranchal respectively.

Source: S. Mahendra Dev & C. Ravi: Economic and Political Weekly, Feb. 10, 2007

Absolute Number of Poor

State	Rural			Urban			All		
	1983	**1993-94**	**2004-05**	**1983**	**1993-94**	**2004-05**	**1983**	**1993-94**	**2004-05**
Andhra Pradesh	11.75	8.43	6.33	5.08	7.04	5.52	16.82	15.47	11.85
Assam	7.21	9.31	5.72	0.44	0.28	0.15	7.65	9.59	5.87
Bihar	42.00	46.39	45.31	4.39	4.51	5.18	46.39	50.89	50.49
Gujarat	6.82	6.39	6.70	4.31	4.60	2.55	11.12	10.99	9.25
Haryana	2.33	3.51	2.17	0.78	0.81	1.10	3.11	4.32	3.27
Himachal Pradesh	0.74	1.45	0.73	0.06	0.04	0.03	0.79	1.49	0.76
Jammu & Kashmir	1.27	1.26	0.40	0.24	0.15	0.14	1.51	1.41	0.54
Karnataka	10.36	9.75	8.67	4.88	5.99	6.67	15.24	15.74	15.34
Kerala	8.03	5.85	3.01	2.40	2.00	1.78	10.43	7.86	4.79

State	Rural			Urban			All		
	1983	1993-94	2004-05	1983	1993-94	2004-05	1983	1993-94	2004-05
Madhya Pradesh	21.19	21.80	25.10	6.11	8.11	7.86	27.30	29.91	32.96
Maharashtra	19.26	19.08	17.97	9.40	11.68	13.68	28.65	30.76	31.65
Orissa	16.43	14.33	15.75	1.64	1.89	2.66	18.07	16.22	18.41
Punjab	1.82	2.04	1.61	1.16	0.79	0.53	2.97	2.82	2.14
Rajasthan	10.86	9.88	9.07	3.02	3.47	4.42	13.88	13.34	13.49
Tamil Nadu	18.89	11.93	7.83	7.96	8.34	10.80	26.85	20.26	18.62
Uttar Pradesh	44.62	50.57	51.39	10.60	10.95	12.54	55.22	61.51	63.92
West Bengal	26.15	19.40	17.58	4.82	4.62	4.50	30.98	24.02	22.08
All- India	252.05	247.18	232.16	72.29	77.38	83.31	324.34	324.55	315.48

Source: S. Mahendra Dev & C. Ravi: Economic and Political Weekly, Feb. 10, 2007

II

UNEMPLOYMENT: ITS NATURE AND MAGNITUDE

The study of unemployment or employment is an integral part of the study and understanding of the health of an economy. Although the unemployment of factors of production, particularly the manpower, exists in verying extent and of different forms in almost all the economics, the unemployment or employment situation in less developed and developing countries like India is marred by a number of ugly marks There are large number of people who are unemployed, many arc underemployed. Unemployment does not remain confined only to unskilled workers. Often a sizeable number of skilled workers, sometimes even those who have good training in specialized areas fail to get jobs for long periods. Those employed are no less a part of the ugly scenerio that is far from healthy, with large wage differentials between the organized and unorganized sectors, between industrial and agricultural workers and between rural and urban workers, with trade unions confined largely to the industrial labour, with little social security for most of the working population, and with wide spread exploitation of child labour and minimal social security net Unemployment and underemployment constitutes one of the major socio-economic problems of labour-surplus economics like India. Poverty has been identified with unemployment as well. Usually the economies and the regions where unemployment is high also have very high incidence of poverty.

In common parlance one who is not gainfully employed in any productive activity is called unemployed. However, for any scientific treatment it is necessary to distinguish between voluntarily unemployed and involuntarily unemployed persons. In all modern treatment the term 'unemployment refers to involuntary unemployment. In our analysis also we shall follow this widely accepted approach.

The problem of unemployment in underdeveloped countries is basically different from that in developed countries. In developed countries, unemployment generally assumes two forms, viz. the Keynesian involuntary unemployment and temporary frictional unemployment. This type of

unemployment, as Keynes argued, results, from lack of effective demand. For eliminating involuntary unemployment, effective demand has to be increased. In most of the developed countries this is done by providing various incentives to investors. Arise in investments and/or public spending generally raises the effective demand and thereby solves the problem of involuntary unemployment. In developed countries because of the quick learning process workers quickly adjust themselves with the new technology, and thus the period of frictional unemployment is generally short. The demand for labour is less and employment opportunities limited in underdeveloped countries on account of agricultural backwardness, underdevelopment of industries, and small size of the service sector. Hence, a large number of people who will be too happy to accept jobs at the prevailing wage rates gel none. This unemployment through involuntary in its nature is certainly not what we call the Keynesian unemployment. Unemployment in underdeveloped countries is both open and disguised. Like all other underdeveloped countries. India presently suffers mainly from structural unemployment which exists in open and disguised froms.

Unemployment in India

Most of the unemployment in India is structural in nature. It is associated with the inadequacy of productive capacity to create enough jobs for those who are able and willing to work. In India not only is productive capacity much below the needed quantity, it is also found increasing at a very slow rate. As against this, additions to labour force are being made at a fast rate on account of rapidly increasing population.

During the past three decades population in this country has grown at an alarming rate of around 2.2 percent per annum and with it the number of people coming to labour market in search of jobs has also increased rapidly, whereas employment opportunities have not increased most of the time correspondingly due to slow economic growth. Hence there has been "an increase in the volume of unemployment from one plan period to another." This unemployment, on account of its very nature, can be eliminated only by introducing certain radical reforms in the structure of the economy. Apart from structural unemployment there is some cyclical unemployment which has emerged mainly in urban areas as a result of industrial recession. Until the mid-sixties industrial progress was fast and the cyclical unemployment was not much. This cyclical unemployment is essentially the Keynesian involuntary unemployment and can be eliminated by increasing effective demand, as is done in developed countries. Though presently it would be wrong to ignore the Keynesian involuntary unemployment, yet the structural unemployment remains a greater cause of anxiety. For analytical convenience we shall now classify, unemployment in the country as (i) urban unemployment, and (ii) rural unemployment. Urban unemployment is mainly of two types: (a) industrial unemployment and (b) educated unemployment. Rural unemployment is classified as (a) open unemployment, and (b) disguised unemployment. A special form of open unemployment in the countryside known as seasonal unemployment is of considerable importance in the Indian economy.

There are not many reliable and precise estimates of the size of unemployment in India. But it is generally accepted that a large number of workers are forced to remain jobless both in rural and urbar. areas. There exists very serious conceptual as well as statistical difficulties in estimating the magnitude of unemployment. Mostly accepted estimates are those available from the various rounds of NSSO.

These estimates give the unemployment's rate by the alternative concepts of the Usual Status the current weekly status and the Current Daily Status. The Usual Status concept is meant 10 determine the Usual Activity Status—employed, or unemployed or outside the labour force—of those covered by the survey. The activity status is determined with reference to a longer period, say a year preceding to the time of survey. This concept indicates chronic unemployment because all those who are found 'usually' unemployed in the reference year are counted as unemployed. On the other hand the current weekly status and the Current Daily Status determines the activity status of a person with

references to a period of preceding seven days and for each day of the preceding seven days respectively. A person having worked for an hour or more on any one or more days during the reference period gets the employed status according to the Current Weekly Status. But according to the Current Daily Status if a person works for one hour or more during a day, he is considered as employed for the whole day. This concept provides the most appropriate measure of unemployment.

The unemployment rates the NSS data are given below:

Unemployment Rates (Status-Wise)

	Rural		**Urban**	
1999-2000	**Male**	**Females**	**Male**	**Females**
Usual	2.1	1.5	4.8	7.1
CWS	3.9	3.7	5.6	7.3
CDS	7.2	7.0	7.3	9.4
2004-2005			**2004-2005**	
Usual	2.1	3.1	4.4	9.1
CWS	3.8	4.2	5.2	9.0
CDS	8.0	8.7	7.5	11.6

Usual: Usual Principal Status, CWS: Current Weekly Status, CDS: Current Daily Status.

Source: Economic Survey 2006-07; P.210.

Like the poverty estimation, the latest and seventh quinwuennial NSS survey, namely the 61st round conducted during July, 2004-June-2005, constitutes an important source of information on employment and unemployment. The 61st round of the NSSO survey reveals a faster increase in employment during 1999-2000 to 2004-05 compared to 1993-94 to 1999-2000.

Employment and Unemployment (Usual Principal Status)

	1983	**1993-94**	**1999-2000**	**2004-05**
Labour Force	277.34	343.56	377.88	428.37
Work Force	269.36	334.54	367.37	415.27
No. of Unemployment	7.98	9.02	10.51	13.10
Unemployment rate	2.88	2.62	2.78	3.06

Source: Economic Survey 2006-07, P. 208.

The Tenth FYP (2002-07) aimed at provision of gainful and high quality employment in excess of addition to the labour force to reduce the number of unemployed significantly by the end of the Plan. This plan advocated the need to increase the employment content of growth by promoting sectors and

activities, which employ more labour per unit of output. On the whole, the Tenth Plan aimed at the creation of approximately 50 million employment opportunities 30 million from the normal process of growth and additional 20 million from special initiative during a period of five years. The result of the 61st NSSO round show that above 45 million persons were provided employment during 2000 to 2005.

Net annual addition to employment on Usual Principal Status (UPS) basis went up from 5.47 million during 1993-94 to 1999-2000 to 9.58 million during 1999-2000 to 2004-05. Simultaneously, however, according to the 61st round estimates, during 1999-2000 to 2004-05, labour force grew even faster at an annual 2.54 per cent compared to annual employment growth of 2.48 per cent. As a result, despite the faster growth of employment, unemployment (On UPS basis) was higher at 3.06 per cent of the labour force in 2004-05 compared to 2.78 in 1999-2000. Incidence of unemployment had come down from 2.88 per cent in 1983 (38th round) to 2.62 per cent in 1993-94 (50th round).

It appears that the increased in unemployment between the 55th and 61st rounds of NSSO was primarily because of an increase in such unemployment incidence for females, both in the rural and urban areas. Furthermore, while unemployment among males declined in terms of UPS (usual) and current weekly status (CWS), it increased by the current daily status (CDS) both in rural and urban areas. There are analytical differences (for example, chorine unemployment versus that of the intermittent and disguised variety) in the nature of unemployment according to the UPS, CWS and CDS status. More expert analysis of the recently released data from the 61st NSSO round will reveal the root causes as well as the probable remedies.

The reversal of the declining trend in employment growth-from an annual 2.1 per cent in the ten years ending in 1993-94 to 1.6 per cent in the five years ending in 1999-2000 to 2.5 per cent in the five years ending in 2004-05 is an encouraging development. Nevertheless, there is need for faster employment growth for not only absorbing the addition to the labour force, particularly with the ongoing demographic changes, but reducing the unemployment rate. The share of agriculture in total employment has come down form 61.67 per cent in 1993-94 to 58.54 per cent in 1999-2000, and further to 54.19 per cent in 2004- 05. With the declining share of agriculture in GDP, the scope for absorbing substantial additional labour Force in agriculture appears limited. While construction and services particularly transport, storage and communication, contributed in maintaining employment growth in the economy; employment growth in manufacturing fell short of its potential.

Employment in Organized Sector

Employment growth in the organized sector, public and private combined, declined durin, nineties. Annual employment growth in establishments covered by employment Market information System of Ministry of Labour decelerated from 1.20 per cent during 1983-1994 to -038 per cent per annum during 1994-2004.

Annual Growth of Employment in Organized Sector

(In per cent)

	1983-1994.1	1994-2004
Public Sector	1.53	0.80
Private Sector	0.44	0.61
Total Organized	1.20	0.38

This deceleration happened in spite of an acceleration in annual employment growth in the private sector from 044 per cent to 061 percent during the reference periods, as this acceleration was not enough to make up for the corresponding decline of employment in the public sector. However, the latter decline was mainly due to a decrease in employment in public sector establishments, whereas the private sector showed acceleration in the pace of growth in enjoyment from 0.44 per cent to 0 61 per cent per annum. While the rightsizing of the public sector, whose primary objective is to deliver essential services such as education, health, roads and irrigation and not for providing direct employment, is a welcome development and should continue, there is an urgent need to step up employment growth in the organized private sector.

The Approach paper" to the Eleventh Plan targets generation of additional employment opportunities in services and manufacturing in particular labour intensive manufacturing sectors such as food processing, leather products, footwear and textiles, and in service sectors such as tourism and construction It calls for elimination of distorting fiscal incentives which foster capital intensity: infrastructure investment removal of distortions that hinder competition prevent entry and discourage graduation from unorganized to organized status; and greater emphasis on vocational training and skill development to improve employability of youth. As Village and Small Scale Enterprises (VSE) will have to provide most of 'he THV employment during the Eleventh Plan, the Approach Paper also calls for redressing the problems faced by VSE units and home based workers, particularly women, such as non- availability of timely and adequate credit, unreliable or absence of power supply, requirement of permission from a number of government agencies and burden of multiple inspections. Some direct employment will also be available in the social sector like health and education. Moreover, wage employment programmes like the National Rural Employment Guarantee schemes will help.

Suggested Reading:

- Govt. of India, Ministry of Finance; Economic Survey 2006-07 and earlier issues.
- Ruddar Dutt and KPM Sundharam; Indian Economy, Latest Edition.
- S.K. Misra and V.R. Puri; Indian Economy, Latest Edition.
- An Aggarwal; Indian Economy, Latest Edition Gurpreet Sharma and AJ Singh; "Poverty and Unemployment" in The Indian Economic Journal, Vol.46.
- Himanshu: "Recent Trends in Poverty and Inequality: Some Preliminary Result," In Economic and Political Weekly, Feb. 10, 2007.
- (Also See Economic and Political Weekly, July 28.2007 for special articles on different aspects of poverty and employment.

LESSON-3

Prof: HS. Parmal

CHANGES IN OCCUPATIONAL PATTERN

By occupation pattern of a country we mean the distribution of work force among different occupations. This aspect of an economy is important as it throws light on the size of productive manpower, the industrial structure or the structure of economic activities and the level of economic development of an economy.

The number or the volume of work force constitute the working population of a country. It depends on many factors like age-composition, sex-composition, definition of a worker, etc. Since the factors that determine the volume of work force are different in different countries and change overtime, the population of persons falling in the category of workforce differs. As a general concept workforce is that part of the population which is engaged in economic activity and the proportion of such population to total population is called worker participation rate.

Broadly the economic activities in which workforce is engaged are termed as occupations. Now these occupations have been classified into three broad sectors called the Primary sector, the Secondary sector and the Tertiary sector. Obviously, each sector includes different but comparatively similar occupations. Agriculture, animal husbandry, forestry, fishery, etc., are collectively termed as primary activities constituting the Primary sector of our economy. They are primary because their products are essential or vital for human existence. These activities usually do not need highly sophisticated technology and are carried on with the help of nature. Manufacturing activities, both small and large scale manufacturing carried on by small and large industries, construction-, electricity gas, etc., are known as secondary activities constituting Secondary Sector of the economy. Transport, communications, banking, finance, public administration, defence and other services, etc. are tertiary activities constituting the Tertiary sector. Tertiary sector occupations do not produce any visible commodity on their own but these help other two sectors in promoting their output and increase efficiency in production. The occupational pattern of a country refers to the distribution of division of its working population to different occupations and sectors.

Occupational Structure and Economic Development

As you are aware (you have already studied in 'Economics of Development and Planning' course in Semester II) that there is a kind of dialectical relationship between economic development and structural change; the process of economic development causing structural changes, economic as well as social, and these changes, in turn, influencing the-process of economic development causing' structural changes, economic as well as social, and these changes, in turn, influencing the process of economic development of the many structural change in occupational structure of the workforce of a country. There is a tendency of the workforce to move away from the primary sector towards the secondary and the tertiary sector as the economy progresses. Colin Clark, for instance, pointed out that as the economy of an underdeveloped country develops, the proportion of its labour force engaged in the primary sector declines while that engaged in the tertiary sector increases, in the case of the secondary sector the proportion of labour force engaged in it increases first and then gradually declines as economic development occurs. This points out that the labour force first moves from the primary sector to the secondary sector and than to the primary sector of the economy during the process of its development, Clark, therefore, argues that there is a close relationship between development of an economy on the one hand and occupational structure on the other and economic progress is generally associated with certain distinct, necessary and predictable changes in occupational structure. He says that a high average level of real income per capita is always associated with a high proportion of the

working population engaged in tertiary industries..... low real income per head is always-associated with a low proportion of the working population engaged in tertiary production and a high percentage in primary production. A.GB. Fischer also reaches the same conclusion. An increasing number of job opportunities are created in the non-agricultural sector as the economy grows. Even in the case of agriculture, technological development which are undertaken to increase the productivity release many workers. As a result of this, labour shifts from agriculture to manufacturing industry i.e. the secondary sector and services. A.GB. Fisher in this connection writes that ".....in every progressive economy there has been a shift of employment..... from the essential primary activities.... to secondary activities of all kinds and to a still greater extent into tertiary production. For example, in the USA in 1870 about 50 per cent of the workforce was engaged in agriculture, and the rest was equally divided between the industrial sector and the service sector. In 1950, as a result of development, the proportion of labour in agriculture foll to 12 per cent, while the proportion of labour in the service sector rose to 53 per cent and in industries to 35 percent. Similarly, in Japan in 1877, of the total working population, about 83 percent was engaged in agriculture, 11 per cent in services, and 6 per cent in the industrial sector. In 1950, the occupational pattern was quite different with a much lower percentage in agriculture, 31 per cent in services and 21 per cent in industries, then was a 48 per cent in agriculture, 31 per cent in services and 21 percent in industries.

The reason for such a change in the occupational pattern is simple. While incomes rise with development, there is no corresponding rise in the demand for food and other agricultural products. This is because the income-elasticity of demand for such goods is less than unity. At the same time with more capital and better techniques in agriculture, there is a large increase in the productivity of labour and land. As a result, there is less need for labour in agriculture. This brings down the-proportion of labour-force operating in this sector.

In the case of industrial and services sectors the opposite happens. Rise in incomes brings about a large increase in demand for industrial goods and services because the income elasticity of demand for these goods and services is greater than unity. The use of more capital and modern techniques makes it possible to bring about large increase in production per head. But the demand increase at faster rate than the rise in per head productivity. This process goes on, resulting in an increasing demand for labour for the industrial and service sectors. Besides, in. the non-agriculture sectors there are certain pulls which draw labourers away from agriculture. Such factors as high wages, fixed working hours, better working conditions and availability (modem facilities for living, etc., induce many people to migrate from agriculture to industrial and service sector In this way the proportion of workforce engaged in these sectors increases.

In connection with the changes in occupational structure mentioned above, it needs to be stressed that these are the consequences of development, and are not causative in character. It means that such changes cannot occur in a country with backward agriculture. Nor can they be brought about by mere migrations. For occupational structure to change as described above, there must be simultaneous development of all the sectors. Development of agriculture by raising productivity per labourer, makes available labour as also agriculture surpluses including food for non agricultural sectors. But these labourers and agricultural surpluses can be absorbed, if these is at the same time development of non-agricultural sectors. Changes in occupational structure thus merely symbolize changes, in the economic structure of a country.

Occupational Pattern in India

The occupational structure of the Indian economy since the beginning of the 20th century has been presented in the following Table. The figures in this table depicts the distribution of workforce engaged in different sectors and sub sectors of the economy in percentage terms. The figures are not strictly comparable as there has been changes in the definition of 'worker'. But still these figures do

provide a basis for broad inferences. As is obvious from the listings of table, agriculture sector is still a dominant sector in the economy although its share in terms of engagement of workforce declined from 71.7 percent in 1901 to 61.50 per cent in 2001. More than 50 per cent of total working force were cultivators in 1901 where as this share came down to 31.67 percent. The share of those engaged in industrial sector remained more or less the same over these 90 years. It will be useful to analysis, the changes in the occupational pattern in two different time-slabs, from 1901 to 1951 and from 1951 to 2001. Since this kind of data is generated through decennial population census, 4291 is the latest year for which such data is available. Keeping the limitation of the data with regard to its comparability in mind it may be noticed that since 1901 until now agriculture has remained the main occupation of the people, as the employment in it has never fallen below 64.9 per cent taking primary sector as a whole, till 1971 it had always accounted for around 72 per cent of the labour force. After Independence when India opted for planned development and a high priority was accorded to industrialization under various plans, it was hoped that the proportion of labour force engaged in agriculture would fall to 60 per cent by the middle of the seventies. However, these expectations were belied. According to the 1971 Census, 69.7 percent of the labour force was employed in agriculture and even when labour force employment in-agriculture during the period 1971-91 declined by 4.8 percentage points, it remained as high as 61.5 per cent in 2001. It is understandable that during the pre-Independence period proportion of labour force in agriculture did not decline. The economic" policies of the British and integration of the Indian economy in the world capitalist system as a subordinate partner had left little scope for industrial development Some consumer goods industries were set up during the British period, but on account of their limited linkage effects they failed to alter significantly the occupational structure. However, J. Krishnamurty asserts, there were changes which lie hidden behind these aggregates. Between J901 and 1951 factory employment expanded partly at the expense of the non-factory sectors: the modern branches grew at the cost of a number of traditional ones: and manufacturing output per head increased. While the share of transport, storage and communication rose, for the other branches of services trends are unclear. Many services associated with modernization under colonial rule expanded, in particular public, educational, medical and legal services.

TABLE 1: OCCUPATION, DISTRIBUTION OF WORKING POPULATION (PERCENTAGE)

Sector and Industrial Categories	**1901**	**1911**	**1921**	**1931**	**1951**	**1961**	**1971**	**1981**	**1991**	**2001**
1. Agricultural	71.7	74.9	76.0	74.8	72.1	71.8	72.1	68.8	66.7	61.50
Cultivators	50.6	49.8	54.4	54.1	50.0	52.1	43.4	41.5	38.4	31.67
Agricultural Labourers	16.9	20.6	17.4	24.8	16.7	16.7	26.3	25.1	26.4	26.54
Livestock, Forestry Fishing etc	4.2	4.5	4.2	4.9	2.6	2.3	2.4	2.2	1.9	3.29
2. Industrial Sector	12.6	11.1	0.5	10.2	10.7	12.2	11.2	12.9	12.7	17.17
Mining and quarrying	0.1	0.2	0.3	0.3	0.6	0.5	0.5	0.5	0.6	0.52
Large and Small Industries	11.7	9.0	9.3	8.9	9.0	10.6	9.5	10.9	10.2	13.13
Construction	0.8	1.0	0.9	1.0	1.1	1.1	1.2	1.5	1.9	3.52

Sector and Industrial Categories	1901	1911	1921	1931	1951	1961	1971	1981	1991	2001
3. Service Sector	15.7	14.0	13.5	15.0	17.2	16.0	16.7	16.5	20.5	21.32
Trade and commerce	6.1	5.5	5.7	5.6	5.2	4.0	5.6	5.9	7.5	4.29
Transport, storage and communications	1.1	1.1	0.9	1.0	1.5	1.6	2.4	2.5	2.8	3.34
Other Service	8.5	7.4	6.9	8.4	10.5	10.4	8.7	8.1	10.2	10.69
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

After independence, the process of industrializations was ----- and as a consequence, the absolute number of persons getting employment in the secondary sector substantially increased. But since the population growth was rapid, and the rate of industrial growth ------- labour, force from agriculture to industries and the service sector did not take place. Another necessary condition for the inter-sectoral transfer of population víz, a considerable increase in agricultural productivity could not be fulfilled. To make matters worse little attention was given to manpower planning in the past which explains the miserable performance of the government on employment front The government policies and plans during the past four and a half decades have failed to create adequate jobs outside the agricultural sector, and thus pressure of population on agricultural land has gradually increased creating conditions of widespread disguised unemployment. Planning Commission in Approach to the Fifth Plan admitted, "At the present pace of industrialization any mass-scale transfer of the labour force from agriculture to non agricultural sectors is ruled out. The growing labour force in agriculture has to be provided with fuller employment within agriculture." This observation of the Planning Commission made nearly two decades ago remains as much true even now at it was on the eve of the Fifth Plan:

Secondly, the proportion of agricultural labourers does not reflect a steady trend. Between 1951 and 1961 it had slightly declined. It is suggested that this might be on account of the land reforms in the process of which some agricultural labourers might have declared their status as that of cultivators. Perhaps their expectations were not fulfilled and that is why the proportion of agricultural labourers again increased and in 1971 rose to a record level of 26.3 per cent. Explaining this alarming development the Census Commission stated, "It does not mean that a number of persons who were cultivating land in their own right as cultivators, have now been dispossessed of their land and have now become landless agricultural labourers.....at the 1961 census there appears to have been a definite bias in favour of persons recording, themselves as cultivators, for the purpose of economic activity." The observations of the Census Commissioner are, however, questionable. A number of studies on the implementation of land reforms clearly support the view that a large number of tenants were evicted from land by the landlords legally as well as illegally, and thus it is not at all surprising that the number of agricultural labourers swelled between 1961 and 1971. This is not a new phenomenon in Indian agriculture. Even during the pre-independence period the proportion of agricultural labourers had risen significantly as a result of large-scale evictions. Now what is the meaning of the rise in the proportion, of-agriculture labourers in the recent past? Does it mean development of capitalism in Indian agriculture? Looking at the change in the rural scene superficially, one may say so. But on careful study we notice that most of the cultivators who have been dispossessed of their land suffer from feudal exploitation rather than capitalist exploitation. Utsa Patnaik has underlined this point and has argued that presence of labourers working for wages is an essential condition for the development of capitalism in agriculture but it is by no means a sufficient condition for the development of capitalism in agriculture but it is by no means a sufficient condition for that. Between 1971 and 2001 the proportion

of agricultural labourers has remained more or less unchanged which is indicative of the stability in agrarian relations.

Thirdly, within the primary sector some changes in the occupational distribution of labour force have taken place. In 1901 livestock, forest, fishing, plantation etc. had accounted for 43 per cent of the labour force. Since then their share in the labour force. Since then their share in the labour force declined to 2.4 per cent in 1951 and further to 1.9 pert in 1991. Howeever, mining and quarrying register increase in their labour force. This sector has accounted for a mere 0.1 per cent of the labour force in 1901 Since then it rose to 0.6 per cent of the labour force in 1951. Thereafter share of the mining and quarrying sector in the country's labour force has fluctuated around this level. "Both in 1981 and 2001 mining and quarrying had accounted for 0.5 percent of India's labour force.

Fourthly, considering the overall secondary sector it looks at if very little has happened in this sector terms of employment of labour force. In 2001, 21.32 per cent of the working population was employed in this sector as against 17.2) per cent in 1951. Compared to the position in 1901 when 12.5 percent labour force was engaged in the secondary sector, situation in 1991 could not be deemed as satisfactory. But these inferences are correct only superficially. If we examine the occupational distribution of the labour force for the year 2001 there are indications that the proportion of labour force in the industrial sector and allied activities had creased during the 1971-01 period. Apart from this development, the industrial sector has even otherwise dergone a significant change. During the five decade period from 1951 to 2001 basic and heavy industries had received high priority under the strategy of plan development. This fact is reflected in the changes occupational structure. Until the 1951 Census separate data were not provided for household industry and 01 than household industry, but from other indicators it is obvious that in terms of employment,-household industry was more important. But the situation changed between 1961 and 1981 as the proportion of labour force in other than household industry increased from 4.2 cent in 1961 to 5.9 per cent in 1971 and to 7.8 per in 1981. However, from this point of view there was no change during the 1980s and in 1991 the proportion of labour force in other than household industry was per cent, the same as in 1981. In household industry proportion of labour force declined from 6.4 per cent to 4.17 per cent between 1961 and 2001.

Finally, proportion of labour force in the ten sector has also remained more or less unchanged throughout the twentieth century, but the relative position of the three sub-sectors has not always remained the same. For instance, the proportion of labour force employed in transport, storage and communications steadily increased from 1.1 percent in 1901 to 1.5 per cent in 1951 and further to 3.34 per cent in 2001. This is a welcome development as it reflects improvements in the infrastructure which this country badly requires for stepping up the growth process. Similarly, a decline in the percentage of labour force in other services which include unproductive activities like administration and defence is a change in the desirable direction.

To summarize, we may conclude that there was no substantial change in the occupation structure of the economy as there is a little shift of the workforce from agriculture or the primary sector to the secondary and the tertiary sectors. Only substantial change is in the case of agricultural labour. Prior to independence the agricultural labourers constituted around 20 per cent of the workforce. In 1951 this category of workers constituted 16.7 percent of workforce. After four decades of development, agricultural labourers now (2001) constitute 26.5 per cent of workforce. The basic cause of failure on this front i.e. in effecting change in the occupational structure in the desired direction particularly after independence was the failure of our employment policy. A review of the employment policy during the last four decades reveals that no serious attempt was really made by the Indian Planners to develop the rural economy keeping in view the necessity to mobilize the vast idle labour and to raise the productivity of labour. The programmes of land reforms failed to create small owner holding and did not diffuse the ownership among a large number of cultivators. Secondly, the

programmes for reducing unemployment and under-employment in rural areas failed miserably on account of poor organization.

Another reason was the pancity of efforts by the planners to promote and develop non-agricultural activities in rural areas. There activities include reclamation work, machine repair, rural transport services, etc. Facilities provided by the government in the form of credit and marketing, subsidies, etc. did not benefit the poor peasantry but helped the already prosperous land owning classes. The process of rural development in India did not make a dent either on the problem of rural poverty or the pattern of agricultural employment. Another important factor which had hindered the change in the occupational structure since 1951 is the relatively high rate of growth of labour force as a consequence of rapidly declining death rate but with very little decline in birth rate. With the fast increase of labour force, the problem of decreasing the proportion of population depended on agriculture has become relatively difficult. One of the meaningful ways in which the occupational structure can be changed in desired direction is to encourage cottage and small scale industries, faster the growth of non-agricultural employment in the economy, more specially in rural economy. Apart from creating rural infrastructure in rural areas, it is urgent to control the growth of population. The population has become three limes of what it was in 1950. Such alarming rate of population growth negates whatever gains the nation has been able to achieve in agriculture, industry and services sector.

If we relate the composition of the GDP and the trends therein, (refer to Lesson I) i.e. the trends in the relative share-of each sector in the GDP of India and the occupational structure as detailed in the present lesson, we find that the structural changes have taken place both in the structure of production and structure of employment in the course of the economic development But there is a tendency for the structural change in employment (occupational structure) to lag behind the structural change in production. This tendency can be called the structural lag in the process of economic development of a country. A reason for this structural lag may be slow occupational mobility of labour across different sectors of the economy while technological changes in production and productivity occur relatively faster, particularly in the present scenario of developing countries making use of developed technologies in secondary and services sectors. Consequently, a considerable part of the labour force of the country has to depend upon the primary sector, the original sector or source of employment of labour-in an underdeveloped economy. This phenomenon of structural lag in the process of economic development may have serious implications to the future growth of the economy. This further strengthens the imperative to adopt suitable corrective policies or strategies. One such strategy is to adopt a technology of industrial production that increases the' employment potential of the secondary sector of the economy. The technology of production has to be appropriate to the factor endowment of the country and it is clear that in such a situation labour intensive and capital-saving, technologies of production shall be more appropriate. This shall minimize the structural- lag and shall accelerate the future growth of the economy.

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LESSON-4

Prof: H.S. Parinar

DEMOGRAPHIC TRENDS AND ECONOMIC DEVELOPMENT

Human beings are not only instruments of production but also ends in themselves. Therefore the study of human resources is vital from the point of view of economic growth and social welfare. Before we discuss such aspects of demography, it would be appropriate to look into the demographic trends obtaining in India. The emerging demographic tends overtime shall also help us to come to grips with demographic related problems and challenges. These trends can be ascertained by looking at the size and growth of population, sex ratio, birth and death rates, process of urbanization, density of population, etc.

Size and Growth of Population:

The size and growth of population in India since the beginning of the 20th century is depicted in Table 1. As is explicit from the listings of Table-1, at the beginning of the twentieth century, total population of India was 236 million. The lastest census 2001 puts this figure at 1028 million. In order to have better understanding of the topic issue in hand, the growth of the population has been studied in three distinct phases: The first phase of 30 years from 1891 to 1921; the second phase from 1921 to 1951 and the third phase of post 1951 period.

TABLE-1

India's Population (1990-1991)

Census Year	Population in Crores	Average Annual Growth Rate (Percent)	Density of population (per sq.km.)
1901	23.83	0.30	73
1911	25.20	0.50	77
1921	25.12	0.03	76
1931	27.89	1.06	85
1941	31.85	1.34	97
1951	36.10	1.26	110
1961	43.91	1.98	134
1971	54.82	2.20	167
1981	68.52	2.25	208
1991	84.63	2.14	257
2001	102.86	2.13	321

During the first phase of 30 years from 1891 to 1921 the population of India grew from 236 million in 1891 to 251 million in 1921. There was an addition of only 15 million souls during these 30

years showing an annual compound growth rate of only 0.19. The growth of population was held in check by the prevalence of a high death rate against a high birth rate. During the second phase of 30 years from 1921 to 1951, the population of India increased from 251 million in 1921 to 361 million in 1951 i.e. by 110 million. The compound growth rate of population was 1.22 percent Per annum.

TABLE 2.

Compound Annual Growth Rate of Population

Year	Compound growth rate
1891-1921	0.19
1921-1951	1.22
1951-1981	2.15
1981-1991	2.11
1991-2000	1.93

During the third phase of 30 years from 1951 to 1981, the population grew from 361 million in1951 to 685 million in 1981: If we add another 10 years, the population of the country reached 846 millon by 1991. We shall be crossing the 100 crore mark by the turn of, the millennium. The population increased by a compound annual rate of 2.15 percent during the 30 years period from 1951 to 1981. It further witnessed 2.13 percent compound growth rate during 1991-2001. State-wise growth of population has been depicted in Table 3. The increase that has taken place in the population of the country has not been contributed uniformly by different states. The states whose total growth over the period 1921-81 exceeded the corresponding all- India rate of 172 per cent were Assam, Gujarat, Rajasthan, Karala, West Bengal, Maharashtra, Haryana, Andhra and Karnataka. The population of the country increased by 23.85 per cent during 1981-91. Delhi, Uttar Pradesh, Rajasthan, Sikkim, Madhya Pradesh and north-eastern states have higher growth rate of population during 1981-91. From the point of view of population control, it is important to identify high-growth states and areas and initiate appropriate measures to check population growth so that the benefits of development are translated into improved living standard of the people. Highest priority for planned reduction in fertility should be given to states like Uttar Pradesh, Madhya Pradesh, Rajasthan, Gujarat and Haryana which contribute very large part of India's population.

State-wise Population in India

States:	Population 19991	 2001
Andhra Pradesh	66,508	76210
Arunachal Pradesh	865	1098
Assam	22,414	26656
Bihar	86,374	82999
Goa	1,170	1348
Gujrat	41,310	50671

States:	**Population** **19991**	 **2001**
Haryana	16,464	21145
Himachal Pradesh.	5,171	6078
Jammu & Kashmir	7,719	10144
Karnataka	44,977	52851
Kerala	29,099	31841
Madhya Pradesh	66,181	60348
Maharashtra	78,937	96879
Manipur	1,837	2167
Meghalaya	1,775	2319
Mizoram	690	899
Nagaland	1,210	1990
Orissa	31,660	36805
Punjab	20,282	24359
Rajasthan	44,006	56507
Sikkim	406	541
Tamil Nadu	55,859	62406
Tripura	2,757	3199
Uttar Pradesh	139,112	166198
West Bengal	68,078	80176
Union Territories:		
Andaman & Nicobar Islands	281	356
Chandigarh.	642	901
Daura & Nagar Have	138	220
Daman & Diu	102	158
Delhi	9,421	13851
Lakshadweep	52	61
Pondicherry	808	974
All-India	846,303	1028610

It is perhaps appropriate to explain the three phases in the growth of Indian population the theory of demographic transition that three stages in a sequence of birth and typically associated with the process of development. The theory postulates that during the first three stage, death rates are very high. This is on the fact that-the economies are essentially agrarian and of subsistence nature. Level of living is very low medical facilities are absent and poverty is spread. This keep the death rate very high. Birth are also very high in this-stage as a consequence widespread illiteracy, absence of knowledge of virtues of a small family and family, planning techniques, early marriages, etc. In a primitive society and joint family system, the attitude towards, children is different and they also see advantages in having a

large family. In such societies, the, actual rate of growth of population is not very high since both, the birth rate and the death rates are very high. We in India seem to have been in this first stage of demographic transition up to the early years bf the' twentieth century.

It is postulated that the second stage of the demographic transition is witnessed when an economy start looking up. Rise in income levels of the people improves their diet. Economic development bring about all round development including improvement in health facilities, transport facilities, education, etc. All these factors tend to reduce death rate at a faster speed than the reduction in birth rates. It is in this stage that population explosion' is witnessed. In India, we are still not through this stage, perhaps we are in the thick of it.

The third stage comes as the growth process is furthered and strengthened. This further changes the character of an economy from an-agricultural economy to a industrial 'economy. With the growth of industrialization process, population tends to shift away from rural areas to emerging industrial centre and towns. Then we see all round changes in the socio-economic conditions of the population and sea-change in the outlook. There are also compulsions to keep the number of children minimum. Thus the characteristics of the third stage are low birth rates as well as low death rates, small family, size and low growth of population. This is also the stage of incipient decline of population.

Since the rate of growth of population is contingent upon the birth and the death rates, it is important to look into the trends in these rates. These rates also help us to understand die theory of demographic transition explained briefly earlier. The birth and death rates have been depicted in Table-4.

A mere perusal of Table makes it clear that from 1911 to 2001 there has been some decline in the birth rate. In the same period the death rate has however declined significantly. Now it is just 10.0 per thousand, as against 42.6 in the first decade of the twentieth century. The birth and death rates were almost equal between 1901 and 1921 and this explains why population did not rise in this period. Thereafter in spite of widespread poverty. Some medical facilities improved and. Epidemics were checked. This brought down the death rate considerably. For the last fifty years, there has been a steady fall-in the infant mortality.

In the second decade of the twentieth century infant mortality rate was 218 per 1,000 live births whereas now it is around 80 per thousand 1,000 live births. Small pox which look a heavy toll of lives, has been completely eradicated. Other child diseases have also been checked and thus the infant mortality rate has come down. Over, the year maternal mortality has also, declined in spite of lack of hospital facilities and poverty.

Table-4

CRUDE BIRTH AND DEATH RATES 1901-2001

Year	Birth Rate per 1,000 persons	Death Rate per 1,000 persons
1901	–	–
1911	49.2	42.6
1921	48.1	47.2
1931	46.4	36.3
1941	45.2	31.2
1951	39.9	27.4

1961	40.9	22.8
1971	41.1	18.9
1981	33.3	12.5
1991	29.5	9.8
2001	25.8	8.5

There are host of reasons, economic, social as well as religious, that keep the birth rate very high in India. If one wants to single out one most Important cause, it is perhaps, the "early age marriages" that stands out. This itself may be a result of many factors. But it is a fact that mean age of both male and female, particularly female, at the time of marriage is very low as compared to other developed countries] However, it has been slowly rising. A decline marriages, particularly after 1930's as a result of the enforcement of the Child Marriage Act in 1929 helped in the up ward movement of the average age at marriage. This aspect of the study of marital status of any given population is important in human societies because, especially in India, reproduction mostly continued.

Table-5

Time Period	Mean age at Marriage (years)		Sex Ratio in India	
	Females	Males	Year	Females per 1000 Males
1891-1901	12.8	20.0	1901	972
1901-11	13.1	20.4	1911	964
1911-21	13.5	20.7	1921	955
1921-31	12.5	18.4	1931	950
1931-41	14.9	20.3	1941	945
1941-51	15.4	19.9	1951	946
1951-61	15.9	21.9	1961	941
1961-71	17.2	22.6	1971	930
1971-81	18.4	23.5	1981	934
1992-93 (NFHS)	20.0	25.0	1991	929
2001 (Census)	18.3	22.5	2001	933

Source : Mahendra K. Premi; Population of India.

Takes place in wedlock. Moreover, in societies where early marriages are prevalent, one finds that, on an average, a woman bears a large number of children during the reproductive span as compared to those where late marriage are prevalent.

There has been a substantial decline in the death rate in India particularly after the attainment of independence. This steep fall is, as we know, the result of provision of better diet, safe drinking water, medical and health facilities better sanitation and effective control of many dangerous and fatal diseases which earlier took very heavy toll of human life. During the last decade of 19 century and the first two decades of 20 century, widespread famines and influenza and other epidemics killed lakhs of people in India. Decline in infant mortality also resulted in the decline of death rate.

Although the death rate has consistently declined during the twentieth century, yet it remains much higher. There is a perceptible change in the both death and birth rates over the last century, yet the birth rate has remained high. This has led to population explosion in India.

Sex Ratio: Sex ration defined as the number of females per 1000 males has been adverse to females in India in all the censuses. The sex ratio is important because it determines birth rates, marriage rate and number of children. Table below gives sex-ration in India since 1901. It may be observed that the sex ratio has Constantly declined from the beginning of 20th century.

These was slight improvement in this in the year 1981. The ratio declived from 972 in 1901 to 933 in 2001. Among the various states of India, Karala alone shows a higher proportion of females per 1000 males in 2001 see Table. In Himachal Pradesh, there is a district improvement in sex ratio. This ratio in Himachal Pradesh has declined from 973 in 1981 to 970 in 2001. The Situation in Andhra Pradesh, Tamil Nadu, Orissa and Karnataka has marginally deteriorated but still the number of females per 1000 males is much higher the national average of 933 females per 1000 males. The states which are lower than the national average are West Bengal, Rajasthan, Bihar, Uttar Pradesh, Punjab and Haryana.

In the advanced western countries, the proportion of females in total population is higher than that of males. In India also more females are born per 100 males (108 females per 100 males) but the loss of more females due to insufficient attention and care to female child after birth, a relatively higher proportion of death among females at the time of puberty due to functional derangement and a high death rate among women in the reproductive age bracket on account of early marriage explains to a sufficient degree the fact that the females are not able to maintain a favourable sex ratio in the total population of the country.

State-Wise Sex Ratio

States	**1991**	**2001**
Kerala	1040	1058
Himachal Pradesh	996	970
Andhra Pradesh	972	978
Tamil Nadu	972	986
Orissa	972	972
Karnataka	960	964
Maharashtra	936	922
Gujarat	936	921
Madhya Pradesh	932	920

Assam	925	932
West Bengal	917	934
Rajasthan	913	922
Bihar	912	921
Punjab	888	874
Uttar Pradesh	882	964
Haryana	874	861
All India	927	933

Urbanization:

Urbanization is a art of the development process. In backward stagnant societies the process of urbanization is rather slow, because cities fail employment opportunities to people living countryside. Those who migrate to in such societies are in fact pushed out of villages due to economic and social pressures; they are rarely pulled by the so called attractions of the urban life. In contrast to stagnant backward societies, urbanization process is fast in rapidly growing economies where newly established industries and ancillary activities continuously provide jobs to people who wish to migrate to cities. The economic pull of cities in this phase of development becomes particularly strong if industrial growth is fast and in spite of high capital intensity industries offer jobs in increasing large number. The process of urbanization slows down only when the proportion of urban population to total population in a country becomes very high. This stage has been reached in some 30 odd countries, which are characterized as developed industrialized countries.

Urbanization in India

Year	Population (in Million		Urbanization rate	Number of Cities/towns
	Total	Urban		
1901	238.40	25.85	10.84	1915
1911	252.09	25.94	10.29	1964
1921	251.32	28.09	11.18	2018
1931	278.98	33.46	11.99	2188
1941	318.66	44.15	13.86	2392
1951	361.10	62.44	17.29	3035
1961	439.09	78.94	17.97	2657
1971	548.23	109.11	19.91	3081
1981	683.33	159.46	23.34	3981
1991	846.39	217.55	25.70	4615
2001	1028.61	285.36	27.79	5161

Urbanization Tends in India

Of the 1029 million people in India, 285 million are now (2001) living in urban areas. The urban population as a proportion of total population, therefore, stands at 27.8 per cent as compared to 25.7 per cent as of 1991 census count. The change in the total and urban population over the period is the resultant of various historical, economic and demographic factors-famines, epidemics, industrial growth, country's partition into India and Pakistan in 1947, and the decline in cured death rate especially since the beginning of the planning process in the country, more so in urban areas.

Population and Economic Development

India population is large and growing fast. It is the second most populous country in the world and comes next only to China. India's population because one billion on May 11, 2000 and the population count as on 1st March, 2001 has es populati29 billion. According to the mid 2001 estimates of the world population by the United Nations, of the total population of 6134 million, India accounted for 1025 million persons. Thus, in every 1000 persons in the world, 167 are Indians or every sixth person is an Indian.

Interested as we are in the economic development of the country and the welfare of its inhabitants, it is of utmost importance to look at this vast and growing human resource in this context. In this connection the basic question that is posed is:

Does this volume and growth of population help or retard economic development?

It is the answer to this question that shall enable us to understand the issue and also to formulated correct population policy and assess the measures that are being adopted to harness this human resource.

At the very outset, two things need to be borne in mind to have a proper frame of approach towards the subject. One is that the relation between population and development is not a one way traffic. It is not only that population affects economic development, but the nature and pace of development also shape the characteristics of population, both in its quantitative and qualitative dimensions. Secondly, one should not start with the presumption that the mere fact of rise in population is bad for development Rise or fall by itself is neither bad nor good. Its character needs to be seen and assessed to the context to the conditions in which ibis rise takes place.

In sparsely populated areas, any rise in population is welcome. It makes available more hands to exploit various natural resources including cultivation of land. These very people create demand for a variety of goods that can be produced. Rising demand, increasing labour supply, and vast land resources create an atmosphere for work and enthusiasm to produce more to earn more. In the process capital-formation takes place, decision of labour gets promoted and specialization deepens. The result is development spearheaded by population rise.

In theory, the above is true. But it does not hold good in the conditions in which India finds itself today. The pressure of population on land is already very high and rising further as a consequence of the growing population. In 1991 the density of population per kilometer was 267. whereas 50 yean ago in 1931, it was less than half at 90. Not only that the land-man ratio in general is bad; it is worse when we consider population in relation to agricultural land. This rising pressure of population on agricultural land has led to serious consequences, of which the three major ones are: First, it has obstructed improvements in agriculture. The subdivision and fragmentation of holdings are the direct result of this pressure on land. It has also sapped the capacity and willingness of cultivators to improve upon agricultural practices. All these evils Dave adversely affected the agricultural output Secondly in the absence of improvements in agriculture, there has not been any large increase and in fact sometimes there has been a decrease in the amount of farm-work. As a result we find widespread disguised

unemployment and underemployment in the agricultural sector. The third consequence is associated with the widening gap between the fast rising demand for various food-articles on account of growing population and slower rise in the output of food-articles, partly caused by rise in population. In these circumstances the country has often been forced to import food on a-large scale, causing serious deficits in balance of payments.

It is thus obvious that in India high density and rapidly rising population do not contribute to progress but create difficulties for development. There are people who do not agree with this view. They draw attention to one or two things in this connection. In the first place, ii is argued that the density of population in many countries is higher than it is in India, but it has not blocked development of those countries. Secondly, it is pointed out that agriculture in India has a vast potential for development. So much so that this country's land can produce adequate food not only for the existing population but also for a much bigger population. The third argument lays stress on the point that a lower agricultural production should cause no worry 10 a country which participates in international trade. By increasing the export of manufactured goods, it can import the much needed agricultural goods. It is contended that a dense population is helpful in expanding production and exports because it makes possible specialization and the adoption' of large-scale methods of production.

If we go deep into each one of these arguments, we shall find them weak and untenable, or inapplicable. For example, there is no doubt that in countries like Japan and England, the density of population is much higher than in India. It is also true that the standard of living in these countries is quite high, and that per capita income is constantly rising 'there. But what is forgotten in such discussions is that these countries are industrial countries, whereas India is predominantly in agricultural country. In industrial countries it is possible to accommodate a much large population and ensure a higher standard of living. In this connection it must be remembered that while pronouncing Judgment on whether the population of a country is excessive, we have not to base our analysis on the density of population of other countries, but on the resources of the given country, their utilization and such other associated mailers.

Similarly, it is also true that the productivity in agriculture is very tow as compared to many countries, and that there it a large potential for development-in Indian agriculture. But it also needs to be remembered that this task requires for its completion-capital in ample quantities, economic infrastructure, technical know-now, etc. Unfortunately such means are very inadequate in the country. One cannot establish that a mere rise in population by itself will make available these inputs. On the other Band, the harsh truth" is that an increasing population implies drain on the resources for consumption, reducing what could possibly be made available for raising investment for agricultural improvement.

Let us now take up the argument that high density of population provides in opportunity for large -scale production. Other things being equal, a large population is preferable to a small population because it enables a country to reap the-fruits of division of labour and jarge-scale production. But it does "not follow from this that a mere high density of population is a sufficient condition for it. If it were so, India would have long ago been a developed country. Behind this line of thinking i the presumption that a large population is an assurance for a large demand for products, which in turn provides a favourable climate for production to expand. In Indian conditions this argument just cannot hold water. India's existing population, though very large, is very poor. As such it has not much purchasing power to generate effective demand in the market. Mere increase in the number of persons will not mean an automatic rise iii demand. Even if we assume for the sake of argument that there is a rise in demand, it will only lead to rise in prices: the reason being that the supply side is almost inelastic. India's basic problem is to make the supply side elastic so that it responds to rise in demand. In the country enough labour u available and enough land resources remain unutilized. Yet this is not enough. The missing

factor is capital, which alone can put labour and land resources together and lift the production from the present low level. Thus India's basic problem is not that of deficient demand. It is that of deficient supply of capital Hence this large population does not mate any contribution to development; in fact it makes the problem still more acute.

The other argument which finds extensive support in academic as-well as non-academic circles that rapidly growing population makes increasing demands on resources for unproductive purposes and thus, hinders capital accumulation. And since growth is assumed to be a function of capital accumulation it is quite logical to infer from the /act dot in a country like India, where rate of population growth continues to be bight much development would not materialize. This argument though not entirely wrong misses two bade points having great relevance for any backward economy including India. In the first place, savings in such an economy are done mostly, by the people in. relatively higher income brackets. From whatever limited information is available about birth rates among various sections of people, it is dear, that the birth, rate it far lower among the relatively well off people than the overall birth rate for the country. Therefore, the overall high birth rate is a country like ours does not erode the saving potential on the country. Secondly for the poor people an additional child is not a liability, as they nope to derive greater benefit from him in terms of income services and security than the cost they would be required to incur on his upbringing. Even if their expectations prove 10 be incorrect, the country's savings, would not a affected; the only thing that might happen then would be that their personal consumption would fall Under these circumstances many of these people will find themselves being pushed below the poverty line. Thus in spite of the fact that rapid population growth may not necessarily adversely affect the capital formation and also the rake or economic growth, the well being of the people particularly of those in the lower income category will receive a severe knock. India's case clearly proves this point.

Until 1964-65 the net domestic savings rate in India was less than 10 per cent of the net domestic product. Obviously this was not enough 10 sustain economic development and thus foreign aid was obtained on a big scale. Most economists in this period were convinced that rapid, population growth was a major hindrance in-raising the rate of domestic saving (bough the later experience proved to be otherwise. After 1964-65 the rate of net domestic saving rose to about 11 per cent and thereafter for eight years fluctuated around this level Net domestic capital formation of this order has been considered enough by W.W. Rostow and many others for moderate rate of growth. Rostow asserts mat in, me take-off stage the effective rates of saving and investment rise from 5 per cent to 10 per cent India successfully accomplished, this task during the first two decades of economic planning in spite of the rapid growth of population. Later on though there was no decline in the ate of population growth, the rate of net domestic saving recorded further rise and in 1980-81 was 13.5 per cent During the 1980s growth rate also rose to around 5.5 percent though rate of population growth remained stuck at 2.14 per cent annum. Therefore, a high rate of population growth at least in the recent years did not prove to be a major constraint on capital formation and also did not adversely affect the growth performance of the Indian economy. In the recent yean the net saving rate has failed to rise above 16.0 per cent The existing low level of the saving rate is largely due to negative saving in the public sector and only a negligible amount of saving in the private sector. It has now become, obvious that if the country has failed 10 step up its growth rate to 6 or 7 per cent level, it a not because population growth hampers capital formation bat became there are other constraints on capital formation and development.

One has to look at population as a source of the supply of labour also. Labour is in a way the most important factor of production, and any rise in population should be welcome because it will lead to an increase in labour supply. Since on production can take place without labour, an increase in it should ordinarily result in more production. In advanced countries an increase in this factor has contributed significantly to economic growth.

But in Indian conditions the rise in labour supply may not do what it can do in advanced countries. Before we proceed with this argument, a point must be made about the relation between labour supply and population. A high birth rate, as is the case in India, leads to a larger proportion of children in the iota) population. With high birth rate, population on doubt lends to rise, but it does not increase the proportion of labour force to total population al the same rate. As a result there is an increase in the number of unproductive consumers or dependents on the labour force. This affects adversely enterprise and the efficiency of labour, reducing saving and makes quicker wearing out of the existing meagre capital Beside women are forced to spend more time in looking after children, thus reducing labour time available fo productive activities. Hence the contribution of rapidly growing population to labour supply is not a important as appears to be on the face of it.

But even if we assume for the sake of argument that population growth brings about a big increase in labour supply, such a thing is of no use for India. In present conditions, there is in fact no need for more labour supply. The problem now facing India is that of abundance of labour rather than that of shortage of labour. Unemployment in the country is not only large! it is rising at a fast rate. It is not that there was no increase in job during this period or that there was reduction in them. Under the impact of planned development since 1951, there has been a considerable increase in the work for a large number of people Yet unemployment has rapidly multiplied. This is so because rise in labour force has far outstripped the increase in job opportunities.

For a country like India the immediate problem obviously is to provide jobs to the existing unemployed persons and to absorb new entrants to the labour force. In itself this is a stupendous task. The question of adding to labour supply through rise in population is sheer madness. Rise in population far from helping will add to the number of dependent children, thereby reducing consumption per head and adversely affecting capital formation.

The above analysis leads one to the conclusion that India's rapidly rising population is affecting adversely many facts of the economy, resulting in slowing down, its pace of development The difficult task of capital formation in a poor country has become more difficult. Unemployment is fact increasing. The food problem is nearing on permanent solution. Many essential goods and facilities are becoming scarce, resulting in soaring prices. In spite of a rise in national income, there is no sizable increase in per capita income. It is obvious that to quicken the rate of economic progress, it is of utmost importance that the fast rise in population is checked. For this a correct population policy is a must.

An appropriate policy to control population would be one that is carved out in terms of a development programme. Such a policy would be helpful for development also. For example, it is essential that more should be saved from existing Incomes, and a still greater proportion of additional incomes be diverted to investment. This will be possible only if the rise in consumption is curbed. An immediate result of the control of population growth, as a consequence of reduction in birth rate, would be a rise in. per capita income. This rise can be used for raising saving and investment. A fall in the growth rate of population will make it possible to plough back a part of future additional incomes into development channels. An present, because of the fast growth in population, quite a substantial part of income gets used up in meeting the essential requirements of living, leaving very little for investment.

A reduction in birth rate will after some time affect favourably the supply of labour. The increase in the rate of labour supply will be cut down. A smaller increase in labour force in a country, where there exists large surplus labour and where a high proportion of the labour force is unemployed, will produce no adverse effect. On the contrary, it will be easy to make available large supplies of essential goods and more opportunities for employment Besides, it will be possible to feed better a smaller number of children. These well-cared children wilt on their entry into toe labour force, contribute more to production. In this connection it is worth mentioning that India is making development efforts through the medium of planning. It is therefore, of primary importance that we should plan keeping in view not

only the present population, but also the future population. Equally important is that we should so integrate planning for development and planning for population that economic development affects population in the desired direction.

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LESSON-5

Prof: H.S. Parmar

RATE AND TREND IN SAVING, INVESTMENT AND GROWTH RATE

Along with human resource (subject matter of lesson 4) capital resource is the vital factor that determine the rate of growth of an economy. Capital resource, usually, termed as physical capital refers to things that help in production. In this sense it, is a factor of production. Physical capital includes all those durable goods except land which help in production. Thus plant and equipment e.g. factory buildings, tools, machines, etc. are physical capital. The standard of living of the people, of, an economy and its further improvement depend largely on the stock of physical capital and the rate at which it is increasing. It is so because the production-structure and its level are determined by the magnitude of capital. In developed countries a large stock of physical capital and its rapid growth have made it possible to produce more and a greater variety of goods and services. As a result people lead a higher material life. On the other hand, in underdeveloped economies a smaller stock of physical capital keeps the volume of production low and the variety of goods produced limited, leading to a low level of economic life.

Accumulation of capital (machines, tools, etc.) adds to the capital stock of an economy and thereby raises its productive capacity. It is the process of capital formation that adds to the capital stock of a country. Capital formation is also called investment, An upward trend in capital formation means increasing investment in an economy." Thus investment or capital formation refers to the change in the capital stock of an economy.

Generally in underdeveloped countries when a large pan of the national income is saved and invested, not only the output level rises, but a sound base for further development is also created. The process of capital formation involves three distinct though interdependent activities. The first thing that is required for capital formation is saving. It is through this activity that resources which might be exercised in favour of current consumption are set aside, and thus, become available for production purposes. But most people who do savings in any society are not the ones who make investments. Their savings are to be mobilized, if they are to be used for productive purposes. Thus in the process of capital formation, the second activity is finance. The third is investment itself, the activity that raises the productive capacity of any country.

RATE OF INVESTMENT

Before we take up, the subject, it will be helpful to be clear about the concept of capital formation. It is also called investment. It refers to the change in the capital stock of an economy. It consists of fixed capital and inventories. Fixed capital includes buildings, machines etc., which do not change their form in the process of production. Inventories (also called change in stocks) are stores of raw materials, components, work in progress or finished goods. These are kept in stock to ensure a continuous production, sale and transportation as per the demands for them.

Capital, while in use for the production of goods, undergoes wear' and tear. This is called capital consumption or depreciation of capital. When one estimates capital formation, excluding depreciation, it is net capital formation. Including depreciation, it is gross capital formation. The gross domestic capital formation (GDCF) is all the capital formation that takes place within a country. It indicates measures total efforts at accumulating the capital. Its rate of formation is expressed in terms pf its percentage of

the grossr domestic product (GDP). The net domestic capital formation (NDCF) is a net addition to the capital stock of an economy. Its rate of formation is expressed in terms of the percentage of the net domestic product. The rate of capital formation or *the rate of investment is generally the rate of gross domestic capital formation.*

Trends in Savings and Investment in India

Estimates of saving and investment in India are prepared mainly by two organizations, viz, the Reserve Bank of India and the Central Statistical Organization from time to time. While preparing RBI estimates of Saving and investment, it is customary to divide the economy into three sectors the household sector which comprises productive economic units either run on an individual basis or partnership unincorporated business, the corporate sector which includes the joint stock companies, and the government sector which include the capital assets of the government as also the assets of the enterprises run under state control. The sum of the net change in the value of the assets in a given period in these sectors shall become net domestic capital formation. If the net flow of foreign capital is added to it, we arrive at an estimate of the net national capital formation for the economy. On the other hand, the Central Statistical Organization prepares its estimates by the product method. For this purpose, the estimate is compiled by the type of capital goods viz.. 'construction' and 'machinery and equipment'. Trispart of capital formation is called fixed capital formation. Estimates of 'change of stock' (working capital) are added to gross fixed capital to arrive at the total of gross capital formation.

Estimates of saving and investment (capital formation) prepared by the CSO and the RBI, showed considerable variation from each other. A working group on saving headed by Prof. K.N. Raj was formed to look into this problem. The working group on saving submitted is report in Feb. 1982. On the basis of the suggestion of Raj working group, it was felt that there was a need to co-ordinate the efforts of the CSO and RBI in preparing estimates of saving and investment of the Indian economy. The reforms undertaken in data collection and the combined efforts of the CSO and the RBI have resulted in the correction of over- estimation and under-estimation errors.

DOMESTIC SAVING

For the whole of the planning period, estimates of saving have been prepared by the Central Statistical Organization (CSO), For our analysis we shall rely mainly on these CSO estimates of saving. The CSO defines saving as "the excess of current income over current expenditure and is the balancing item on the income and outlay accounts of producing enterprises, and households, government administration and other final consumers." For the purpose of estimating the domestic saving, the economy has been divided into three broad institutional sectors: (i) household: (i) private corporate: and (ii) Public. Saving of the household sector is measured as (i) the total of financial saving (ii) saving in the form of the physical assets The financial saving involves possession of currency, net deposits, investment in shares and debentures, net claims on government in the form of Central and Slate government securities and small savings, net increase in the claims in the life insurance and provident funds. Physical assets include construction, machinery, equipment and stocks held by individuals, firms and other institutions constituting the household sector, Private corporate sector comprises non-government non-financial companies, private financial institutions and cooperative institutions. The basic data for the non-government non-financial corporate enterprises are obtained from the analysis of balance sheets and profit and loss accounts of these companies. The net saving of private commercial banks, general insurance companies and cooperative banks and societies is broadly taken as the increase in statutory and other reserves. Public sector comprises government administrative departments and enterprises, both departmental and non-departmental. The saving of the government administration is defined as the excess of current receipts over current expenditure.

The net savings of the government companies and statutory corporations are estimated from the results of the analysis of their Annual Accounts.

Estimates of Domestic Saving

During the four and a half decades of planned economic development, the rate of domestic saving has risen considerably though the progress is not as impressive as the planners had expected. According to the CSO's estimates, the gross domestic saving rate (gross domestic saving as per cent of GDP at market prices) was 10.4 percent in 1950-51. Obviously at this rate of capital accumulation no one expected 5 percent per annum increase in the national income unless the incremental capital-output ratio was very low, which in India's case could not be assumed. Therefore, by any standard, the saving rate was quite low in the early phase of economic planning. During the Second Plan period the saving rate recorded a small increase and stood at 12.7 per cent in 1960-61. Since the Second Plan was a bold plan stressing the development of heavy industry, this relatively small rise in the saving rate was rather disappointing. Failure on this front thus necessitated great reliance on foreign aid. During the Third Plan period increase in the saving rate was not as disappointing as in the Second Plan period. The saving rate during me (bird Plan period was around 14.0 per cent However, this fell short of what has been considered necessary for the take-off of an economy. This obviously required a considerable amount of capital inflow. In 1966-67, which was the first year of the three year plan holiday, the saving rate rose to 15.3 per cent. In the next two years it did not remain at this level and declined to 12.8 per cent. The saving rate, however, once again picked up and rose to 18.4 per cent in the terminal year of the Fourth Plan. The rise in the saving rate, however, once again fell short of the target, and consequently the need for substantial amount of foreign aid remained. But the country failed to raise adequate funds from foreign sources on account of certain political factors of which the displeasure of the U.S.A with India's foreign policy, particularly after the Indo-Pak war, was perhaps the most important.

The experience with respect to foreign aid during the Fourth Plan period compelled Indian planners to accord a high priority to self-reliance in the subsequent plan. In pursuance of this policy, the Fifth Plan laid great stress on mobilization of resources largely from domestic sources. It appears that the attempts to raise domestic saving did show some favourable results.

According to the CSO's estimates, the saving rate rose steadily from 17.4 per cent in 1974-75 to 23.2 per cent in 1978-79. Some economists now fed that for the 1970s the saving rate has been a little over estimated yet in the second half of this decade it was due to the impressive performance of the economy that the country could more or less dispense with foreign aid However, 1979-80 was as exceptionally bad year on account of poor harvest The national income and per capita income in ibis year declined by 6.0 per cent and 8.2 per cent respectively. Therefore, a fall in the saving rate in this particular year is not at all surprising. What is surprising is that in spite of a marked improvement in real and money incomes during the year 1980-81, saving rate remained stuck at the 1979-80 level. According to RBI. This decline in saving would suggest an erosion in saving capacity following persistent rise in prices and consequent increase in consumption expenditure. During the 1980s the saving rate remained much below the peak rate of saving achieved in 1978-79. The saving rate, in fact, steadily declined from 23.2 per cent m 1978-79 to 18.2 per cent in 1984-85. Thereafter a recovery started and the saving rate eventually rose to 24.3 per cent in 1990-91 which was the year of revere economic crisis. Since 1991-92 comprehensive economic reforms have been undertaken to improve the performance of the economy. However, contrary to the expectations in the official circles, there were persistent decline in the saving rate for three years since 1990-91.

GROSS DOMESTIC SAVINGS AND CAPITAL FORMATION (RS. CRORES) (NEW SERIES BASE YEAR 1999-2000)

Year	Gross Domestic Savings Gross				Domestic Capital Formation			
	House Hold	Private Corporate	Public	Total	Public	Private	Valuables	Total
1999-200	412516	87234	-15494	484256	144610	349389	15519	509518
2000-01	442136	90143	-40194	492085	144639	14724	346818	506181
2001-02	496958	85203	-46578	535583	156544	372831	14187	543563
2002-03	559074	103965	-14057	648982	149324	451398	13957	614680
2003-04	657327	131355	31822	820504	174597	535416	24572	734586
2004-05 (P)	674834	223512	74682	973028	220487	666088	41054	927629
2005-06 (Q)	797117	288430	71262	1156809	264426	840370	42457	1147254

Source: Economic Survey 2006-07

Total gross domestic savings declined to 23.1 per cent of GDP in 1997-98 from 24.4 per cent of GDP in 1996-97. Public saving contributed 0.5 per cent and private saving 0.8 per cent of GDP to this decline Public saving declined progressively to 1 per cent of GDP from a recent peak of 1.9 per cent in 1995-96. Both household and corporate saving contributed to the decline in private saving rate. Household financial saving sucked the declining tread in saving rates by rising to 10.3 per cent of GDP in 1997-98 from 9.8 per cent in 1996-97. For the year 2004-05, GDS were 31.1 per cent of GDP and this ratio increased further to 32.4 per cent in 2005-06.

Gross Domestic Savings

(As per cent of GDP at Current market prices)

Year	Gross Domestic Saving			
	Household	Private Sector	Public Sector	Total
1	2	3	4	5
(1993-94 Series)				
1950-51	6.2	0.9	1.8	8.9
1960-61	7.3	1.6	2.6	11.6
1980-81	13.8	1.6	3.4	18.9
1981-91	19.3	2.7	1.1	23.1

(New Series base year 1999-2000)				
2000-01	21.0	4.3	-1.9	23.4
2001-02	21.8	3.7	-2.0	23.5
2002-03	22.5	4.2	-0.6	26.4
2003-04	23.8	4.7	1.2	29.3
2004-05 (Q)	21.6	7.1	2.4	31.1
2005-06 (P)	22.3	8.1	2.0	32.4

P : Provisional; Q: Quick estimates

Source : Economic Survey 2006-07.

Secular Trends in Savings:

The rise in the rate of saving since 1950-51 is fairly large. The rise in the rate is by about three times during this period. As a result the rate of saving which prevails at present is quite high. The fact of achievement can be spotlighted if we compare this rate with the one that prevailed before independence which was much lower and stagnated at the low level for long. The fact of high rate can also be substantiated when we find that in comparison with some middle-income countries it stands favourably. Besides, the growth in saving has been faster than in many developing countries and even in some developed countries. Another evidence in support of this good performance of the economy is that it has enabled me country to provide a fairly large, if not hundred per cent adequate, basis for the non-inflationary finance of capital formation. This creditworthy development is also reflected in the small dependence of the country on foreign capital inflow which has remained at a low level of around 2-3 per cent of the nation product. This signifies country's movement towards self-reliance. It may also be mentioned that the present achieved rate of saving is more than what development-economist like W.A Lewis thought to be necessary to attain self- sustained growth. In view of all these considerations, the economy's achievement in respect of saving can be judged as considerable.

While the secular trend is fairly good, there are some unsatisfactory features which have maked the trend. One is the nearly stagnating rate twice in the period. During the 1976-77 and 1981-82. it remained around 21 per cent expect in 1978-79 when it was 23 per cent. Again during around 1982 83 and 1986- 87, it hovered around US-19 per cent. Two, there is a falling of the rate dining the nineties from over 23 per cent in 1990-91 to over 22 per cent in 1992-93. Three, the dismal aspect of the savings-scene is that the contributions of the public sector have shown a steep decline in recent years. As a percentage of gross domestic products, the share of the public sector has varied between 3 to 4 for very many years during the early sixties to the middle of eighties. Since than it went down to between under 1 to 2 percent. Since much reliance has been placed on the government saving for raising investment, this development is a serious matter for the economy.

SAVING AND INVESTMENT (BASE: 1999-2000)

(NEW SERIES BASE YEAR 1999-2000)

	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06(Q)
(as per cent of GDP at current market prices)							
Gross Domestic Savings	**24.8**	**23.4**	**23.5**	**26.4**	**29.7**	**31.1**	**32.4**
a) Public	-0.8	-1.9	-2.0	-0.6	1.2	2.4	2.0
b) Private	25.6	25.3	25.5	27.0	28.5	28.7	30.4
i) Household	21.1	21.0	21.8	22.7	23.8	21.6	22.3
Financial	10.6	10.2	10.8	10.3	11.3	10.2	11.7
Physical	10.5	10.8	10.9	12.4	12.4	11.4	10.7
(ii) Private Corporate	4.5	4.3	3.7	4.2	4.7	7.1	8.1
Gross Domestic Investment	**25.9**	**24.0**	**22.9**	**25.2**	**28.0**	**31.5**	**33.8**
a) Public	7.4	6.9	6.9	6.1	6.3	7.1	7.4
b) Private	17.9	16.5	16.3	18.4	19.4	21.3	23.6
c) Valuables	0.8	0.7	0.6	0.6	0.9	1.3	1.2
Gross Fixed Capital formation	**23.4**	**22.8**	**23.0**	**23.8**	**24.8**	**26.3**	**28.1**
Change in stocks	1.9	0.6	0.2	0.7	08	2.0	2.9
Valuables	0.8	0.7	0.6	0.6	0.9	1.3	1.2
Saving investment gap @	-1.1	0.6	06	1.2	1.6	-0.4	-1.3
Public	-8.2	-8.8	-8.9	-6.6	-5.2	-4.7	-5.4
Private	7.7	8.8	9.2	8.6	9.2	7.4	6.9

Source: Economic Survey 2006-07

Among the three saving sectors, the contributions of the private corporate sector and the public sector have been far from satisfactory. In a growing economy and the one that has the objective of sharply stepping up the rate of capital formation, the role of these two sectors cannot be overemphasized. The private corporate sector, despite its small size, should have done better by cutting down on its wasteful expenditure (like that on unnecessary entertainment, excessive advertising etc.) and more efficient utilization of its resources to earn higher profits. The public sector too lags much behind what it should have done. The failure is both in respect of expenditure and income. On the expenditure side, the fast growth in the non-plan or nonproductive expenditure has eroded considerably the saving capacity of the government. On the income side, there are several weaknesses. For example, some important sectors like agriculture and several affluent sections of population such as

those in various professions, remain outside the tax-net. Again the public sector enterprises too have not done well. In fact quite a large number among them have made losses. No wonder the public sector saving declined sharply in recent years.

Another unsatisfactory aspect of the saving scene is mat it is not being usefully deployed. This is evident from the fact that while a considerable proportion of the total saving is allocated to the new projects, little is earmarked for the maintenance of existing capital assets and their replacements. This neglect has cost the economy dearly in terms of the fast deterioration of these aspects. Besides, there is a decrease in the output of these assets resulting in higher capital-output ratio. A part of the explanation of this- state of affairs lies in the fact that the Planning Commission, in general, uses the concept of gross domestic saving and ignores the estimation of the consumption of capital or depreciation, which gives, the net investment. The result is that all through the successive plans there has been a tendency to use up as much as possible the available financial resources for financing new projects. This has resulted in the neglect of the maintenance and replacement of existing capital assets. Of course, something can be said in favour of this approach of the Planning Commission. In the first place, it is the total investment (including replacement of existing assets) which is material and all embracing and, therefore, correctly based upon the concept of gross saving. Secondly, the estimation of capital consumption to arrive at net investment can never be entirely correct because it is estimated under diverse assumptions of the life of assets and the replacement cost of assets. However, the case for estimating the consumption of capital (and therefore, keeping aside funds for maintenance arid replacement of existing capital assets) is equally strong. In the modern industry, the rate of obsolescence has been increasing at a much, faster rate than the actual wear and tear of capital assets. This necessitates allocation of increasing amount of resources to provide for obsolescence as also to overcome the problem arising out of a finite physical life of assets. This approach will, at the same time, give estimates of the net investment which in fact correctly measures the additions to the capital stock of a country. Hence it is advisable that both the concepts of grow saving and net saving are made use of.

The saving profile of the economy is thus a picture with bright and depressing colours. There is a secular and substantial rise in the saving but 'there is also a decline and stagnation in it. While, the household sector contributed a lot of the saving of the economy the private corporate sector did little. The public sector which was required to do much in raising the saving, in fact contributed to its decline in recent years. The outcome is a mixed one of a good performance on the whole with unsatisfactory features alongside.

Though the saving rate has been encouraging during the last about 45 years of economic planning, it is still far below the warranted rate of growth. It also does not compare favourably with the rate of growth of developed countries. It shall not be possible to achieve a higher rate of growth than what we have achieved so for if the rate of saving remains stuck at the present level. Therefore, it is important to make efforts to raise the rate of saving in the country.

Inspite of the fact that there are many institutional and other constraints to raise the rate of saving there is enough scope for it.

From the point of view of increasing savings, the household sector is the most important one. However, this fact is not to be overlooked that in India, on account of widespread poverty, mass of the population has virtually no ability to save and, therefore, attention has to be given only to such measures which will induce people belonging to upper and middle classes to increase (heir savings. From this angle, the following measures deserve serious consideration (i) production of unnecessary durable goods for which large demand exists in this country should be restricted. In those cases where its production has to be permitted simply because the production capacity already exists, heavy excise duty should be imposed on these products. This will discourage conspicuous consumption, (ii)

exemption limit of savings from income tax should be raised. This will encourage people to save more; (iii) inflationary price rise has to be kepi within reasonable limits. Experience in the past clearly indicates that inflation erodes both ability and willingness on the part of households to save; (iv) people in the country have not developed banking habit as yet. This is perhaps the reason why even those people who have considerable ability to save, actually do not save. To inculcate banking habit among toe rural population, commercial banks will have to introduce flexibility in, their working. Once this happens, even the households with relatively small earning will feel encouraged to save.

The existing contribution of tin private corporate sector to domestic saving in India is insignificant, nonetheless there is tremendous scope for raising the saving level in this sector. To realize the saving potential of this sector, following measures will be necessary: (i) restrictions must be imposed on the expenditures of company directors-and high executives. This is necessary to check misuse of funds which is widespread in the private corporate sector; (ii) a reasonable ceiling must be fixed on the salaries and perquisites of company officials. At present these are too high and should be brought down; (iii) declaration of dividends and their disbursement by companies must be adequately controlled by the State.

There is ample scope for raising the rate of saving in the public sector. At present the public administration is top heavy and little austerity is observed in this sector. The efficiency of the public undertakings is low, and the underutilization of their capacity is very much common. The tax structure suffers from a number of defects. In addition, there is widespread tax evasion. Under these circumstances, it is necessary to make efforts in the following directions: (i) with the increasing commercialization of agriculture, there 'is no justification for exempting agricultural incomes from the income tax. The government should thus extend the net of income tax to agriculture; (ii) luxury articles should be taxed heavily. Affluent people, in any case, will buy them and this will enable the government to collect more revenue which will eventually increase saving in the public sector: (iii) loopholes in the lax collection system must be plugged to check widespread lax evasion; (iv) expenditure on unproductive activities in the government should be restricted. There is a widespread belief that various government departments are overstaffed. This view is not entirely incorrect. Therefore, adequate care has to be taken in sanctioning new staff; (v) efficiency of public undertakings must be raised to enable them to increase their profits: (vi) there should be full utilization of productive capacities of industrial units in the public sector. To be able to realize this objective, suitable measures will have to be undertaken to remove shortage of raw materials, power etc; (vii) a rational administered prices policy should be evolved. It can help in raising the surpluses of the public sector enterprises and eliminate losses in some cases.

In the existing situation savings cannot be full entirely at the will of the people it that is done, the saving rate will immediately decline. For meeting the present capital requirements of economic development, reliance has to be placed on physical controls as well as on fiscal and monetary policies.

Trends in Investment or Capital Formation:

There has been some significant developments in the sphere of capital formation in India. Absolute figures as depicted in Table 1 earlier and the listings of Table 5 reveal that there has been a large leap ahead in capital formation in India. The capital formation has gone up sizably since the 1950's. The jump has been most significant during the eighties. The rate of gross domestic capital formation (GDCF) has; for example, more than doubled by the eighties, and increased by more than two-and-a half-times during the late nineties. In figures, the rate which moved around 10 per cent of the gross domestic product (GDP) during the early fifties, as risen to around 27 per cent at present (Table 14.1). The fixed capital components of the capital formation also went up significantly from around 9 per cent of GDP to about 26 per cent during this period. The inventories (or change in stocks), the other

component of capital formation, was around 1 per cent of GDP in the beginning as also at present, with higher rates in some years in between.

Deducing from the gross domestic capital formation, depreciation (or provision for the wear and tear of capital or for the maintenance of capital intact), the net addition lo the capital stock, as indicated by the net domestic capital formation-, has also been sizeable. The rate of NDCF which was a meager 6 per cent in 1950-51 rose considerably since then on over 19 per cent at present.

In absolute terms, the value of GDCF in 1950-51 was just about Rs. one thousand crores. It rose massively to about Rs. three and a half lakh crore in 1996-97. The rise in the value of net domestic capital formation is no less spectacular. It was a mere one hall of one thousand crores in 1950-51, and over two lakh crores in 1996-97. At 1980-81 prices, the Gross Domestic Capital Formation moved up from 14.7 per cent in 1950-51 to 27.4 per cent in 1996-97. The NDCF has increased from 10.4 per cent in 1950-51 to 19.3 per cent in 1996-97. Real Gross Domestic Capital Formation at 198. 14 prices dropped marginally from 26 per cent of GDP in 1996-97 to 25.6 per cent of GDP in 1997-98. This level is only 0.1 per cent of GDP lower than the average for 1994-95 to 1997-98. The GDCF and GFCF have reached the level of 32.2 per cent and 26.7 per cent of GDP in 2005-06.

A noteworthy feature of the investment-scenario is the large contributions of the public sector in stepping up the capital formation in the country. Its share in the GDCF was just about 25 per cent in the early fifties. This rose substantially to over 40 per cent in the beginning of the eighties, and was as high an about 50 per cent during 1986-87. Thereafter, its share, though considerable in the range of 30-40 per cent, has been a falling one, particularly during the nineties. Its share at present (1996-97) stands at 30 per cent. This change has been a result of the New Economic Policy in operatic since 1991. This policy has assigned a major role to the private sector in most of the economic areas of the country including formation of capital. The share of f the private sector (comprised of private corporate sector and the household sector) was 75 per cent in the ear fifties. This fell, almost continuously till the nineties. There after it has risen and stands at 70 per cent present. Of the two components of the private sector the share of the private corporate sector in the GDC stands at over 32.2 per cent at present. The public sector, though less important then before continues to be a very significant instrument of capital formation even at present.

Another significant feature of the profile of capital formation is that it has been financed largely by domestic savings. This self- financing has been to the extent of as much as 97 per cent to 98 per cent. Ina few years (for example during 1969-70, 1970-71, 1972-73, 1973-74, 1974-75, 1977-78, 1978-79 and (1979.

REAL GROSS DOMESTIC CAPITAL FORMATION

(AS PER CENT OF GDP AT CONSTANT 1999-2000 MARKET PRICES)

	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06(Q)
GDCF	**25.9**	**23.8**	**22.2**	**25.0**	**27.4**	**30.2**	**32.2**
Public	7.4	6.9	6.8	6.1	6.0	6.5	6.9
Private	17.9	16.3	15.8	18.1	19.1	20.6	22.6
Corporate Sector	7.4	5.6	5.2	5.8	6.7	9.5	12.2
Household sector	10.5	10.6	10.6	12.3	12.4	11.1	10.3
Valuables	0.8	0.7	0.6	0.6	0.9	1.3	1.2

GFCF	**23.4**	**22.5**	**22.4**	**23.5**	**24.5**	**25.3**	**26.7**
Public	6.6	6.5	6.4	6.2	6.4	6.2	6.5
Private	16.8	16.1	16.0	17.2	18.1	19.0	20.2
Change in stocks	**1.9**	**0.6**	**0.1**	**0.7**	**0.6**	**1.8**	**2.8**
Public	0.8	0.4	0.4	-0.2	-0.3	0.3	0..4
Private	1.1	0.2	-0.2	0.9	0.9	1.5	2.4
Valuable	**0.8**	**0.7**	**0.6**	**0.6**	**0.9**	**1.3**	**1.2**

Note:

GDCF: Gross domestic capital formation

GFCF: Gross domestic fixed capital formation

Figures may not add up due to rounding

*Adjusted for errors and omissions

Q : Quick

Source: Economic Survey 2006-07

80) the domestic savings have been to the fune of 99 per cent of more of the capital formation. This fact in reflected in the small inflow of foreign capital for use in the domestic capital formation. The inflow of foreign capital (as percentage of domestic product) has been It has varied around 0.1 per cent to 4.2 per cent, with the figure mostly around under 2 per cent This reliance on domestic efforts of build up our capital stock has helped the country to move towards the goal of a self-sustained productive base for the economy.

As stated earlier, the rate of investment has risen considerably during the post-independence period, particularly in the recent past but it can't be considered satisfactory as for as the desired rate of growth anticipated for the economy is concerned, this has remained as a major constraint for the growth of the economy. This is mainly because there has been inadequate rise in the rate of saving, failure of public enterprises to generate adequate surplus for augmenting further investment, lack of adequate and effective mechanism including the policy regime, for promoting investment and lags in the resource mobilization efforts of the governments at the centre as well as at the state level and the planning machinery. This has Longley affected the process of capital formation adversely ant consequently has retarded the growth of our economy.

Recent Trends in Saving and Capital Formation

The increasing trend in gross domestic savings as a proportion of GDP observed since 2001-02 has continued with the saving ration from 26.4 per cent in 2002-03 to 29.7 per cent in 2003-04, 31.1 per cent in 2004-05 and 32.4 per cent in 2005-06. The rise in the saving rate in 2005-06 was contributed by two of its three components; private corporate and the household sector, which as proportion of GDP increased by 1.0 percentage point and 0.7 percentage point respectively. The third component, namely public savings, declined by 0.4 percentage points and made a negative contribution to the overall saving rate.

As much as 0.7 percentage point of the 1.3 percentage points increase in gross domestic savings rate between 2004-05 and 2005-06 has come from the household sector. Two forces have

been acting simultaneously on the portfolio behaviour of Indian household; a construction boom with residential buildings financed from housing loans from banks and the progressive maturing of the domestic financial markets. The increase in saving rate is what is to be expected with high growth rate of the economy and a declining dependency ratio.

In tandem with the rise in the rate of gross domestic savings between 2003-04 and 2004-05, there was a step up in the rate of gross domestic capital formation (GDCF) or investment from 28 percent of GDP to 31.5 per cent of GDP leading to a savings investment gap or a current account definite of 0.4 per cent of GDP in 2004-05. The GDCF rose further to 33.8 per cent of GDP in 2005-06 as per the quick estimates, widening the saving investment gap to 1.4 per cent of GDP.

Indian economy appears to have taken off and moved from a phase of moderato growth to a new phase of high growth. The vital factors like saving and investment also point to such a trend. It is not only the sustained increase in savings and investment, availability of labour at reasonable wage rates, and efficiency increases, but also the opening up of new averages in services, beyond the already known II and ITES, that bolster confidence in the new high growth phase. Bust there should be no complacency. While accelerating growth and the demographic dividend will continues to boost savings and investment, simultaneously policies shall have to be designed in a flexible manner to enhance investments in the economy to lay a robust foundation for growth.

Suggested Readings

1. Govt. of India, Economic Survey 2006-07. Also consult Economic Surveys of different years.
2. Ruddar Datt & KPM Sundaram. Indian Economy (Latest Issue).
3. S.K. Misra & V.K. Puri. Indian Economy (Latest Issus).
4. M. Suresh Babu, "Trends in Savings.. ." in Economic and Political Weekly, May 5, 2007.
5. S.L. Shetty, "Saving and Investment Estimates....." in Economic and Political Weekly, Feb. 12, 2005.

Assignments

Unit-I

1. Critically analyze the growth and structure of Indian Economy since 1950
2. Bring out main trends in the nature and magnitude of poverty and in-employment in India.
3. Write an analytical note on 'population and economic development in the Indian Context.'

LESSON-6

Prof: K.K. Kaushik

Trends in Agricultural Production and Productivity, Constraint Facing Indian Agriculture & Impact of Trade Liberalization on Agriculture

Introduction

Agriculture in India is one of the most important sectors of its economy. It is the means of livelihood of almost two thirds of the work force in the country and its share in Gross Domestic Product (GDP) has declined from more than 50% in early 1950s to about 18% in financial year 2006-07. About 43% of India's geographical area is used for agricultural activity, Agriculture, and especially a variety of crops produced under diverse climatic situations in different cropping systems, supports 115.5 million farm families. The distribution of farm holdings is dominated by small and marginal farmers. Rainfed agriculture constitutes about 60 per cent of the net sown area. These areas are the major domain of oilseeds, pulses and coarse cereals production. The intensity and distribution of rainfall determine the crop prospects in a majority of the areas.

Though the share of Indian agriculture in GDP has steadily declined, still it plays a vital role in the overall socio-economic development. Agricultural growth provides mainly four broad types of growth linkages to the non-agricultural sectors, namely, production, demand, investment, and saving linkages. Production linkage of agriculture occurs through providing its outputs as inputs to the non-farm sector. Demand linkages arise when agriculture makes available markets for consumer non-durables and durables produced by the non-agricultural sectors. Saving linkage occurs when agriculture provides financial saving and demand for insurance services, while investment linkage arises when agriculture provides demand for intermediate inputs and capital goods from the non-agricultural sectors.

One of the biggest success stories of independent India is the rapid strides made in the field of agriculture. From a nation dependent on food imports to feed its population, India today is not only self-sufficient in grain production but also has substantial reserves. Dependence of India on agricultural imports and the crises of food shortage encountered in 1960s convinced planners that India's growing population, as well as concerns about national independence, security, and political stability, required self-sufficiency in food production. This perception led to a program of agricultural improvement called the Green Revolution. It involved bringing additional area under cultivation, extension of irrigation facilities, the use of improved high-yielding variety of seeds, better techniques evolved through agricultural research, water management, and plant protection through judicious use of fertilizers, pesticides and cropping practices. All these measures had a salutary effect and the production of wheat and rice witnessed quantum leap.

Indian agriculture has undergone significant changes and transformation during the last fifty five years. The underlying factors for these changes were different in different periods. During 1950s and 1960s institutional reforms like land reforms and development of irrigation and other rural infrastructure like power, roads communication etc. played a major role in output growth. Technological breakthrough has been the prime mover during 1970s and spread of technological changes to wider areas and crops has been the main factor during 1980s.

The decades of 1960s and 1970s also witnessed high growth in public investments in agriculture which improved infrastructure) base for growth of agricultural output in the country in the following decade and extension along with better crop production strategies also stimulated. Moreover, agricultural growth in 1970s and 1980s had become broad based in terms of crops, allied sectors, farms and regions, besides being more weather resilient. However, the gains from the green revolution areas have been plateauing due to decline in land and factor productivity. Apparently, growth rate in production of many crops has come to stagnate in recent years due to many constraints with almost no hope for increasing area under cultivation.

Growth of crop output can be analyzed in four different periods. (1)1950-51 to 1964-65 is termed as The Pre-Green Revolution Period. (2) 1967-68 to 1979-1980: the beginning of green revolution. (3) 1980-81. to 1990-91: The Maturing of Green Revolution and (4)1990-91 to 2003-04: and 1994-95 to 2005-06: Economic Liberalization and Deceleration of Agricultural Growth.

(1)1950-51 to 1964-65 is termed as The Pre-Green Revolution Period

During this period total agricultural output grew at a rate of 3.15% per annum and mainly achieved through increases in irrigation and rural infrastructural facilities. The yield growth rate was comparatively low. During this period as against the target of 62 million tones, actual foodgrain production came to nearly 67 million tones

Table: 6.1

All India Compound Growth Rates of Area Production and Yield of Major

Crops

Crops	**1950-51 to 1964-65**	**1967-68 to 1979-1980**	**1980-81 to 1990-91**	**1990-91 to 2003-04**	**Av. Growth 1994-95 to 2005-06**
Rice (Area)	1.21	0.77	0.40	0.15	0.25
(Prod.)	3.50	2.22	3.56	1.14	1.53
(Yield)	2.25	1.46	3.47	0.99	1.09
Wheat (Area)	2.69	2.94	0.46	0.74	0.94
(Prod.)	3.96	5.65	3.57	2.13	1.88
(Yield)	1.27	2.62	3.10	1.35	0.85
Fdgn (Area)	1.35	0.38	-0.23	-0.44	0.14
(Prod.)	2.82	2.15	2.85	1.16	1.83
(Yield)	1.36	1.32	2.74	1.11	1.49

Crops	1950-51 to 1964-65	1967-68 to 1979-1980	1980-81 to 1990-91	1990-91 to 2003-04	Av. Growth 1994-95 to 2005-06
NonFdgn (Area)	2.44	0.94	1.12	-0.09	0.86
(Prod.)	3.74	2.26	3.77	1.20	2.36
(Yield)	0.89	1.19	2.31	0.62	1.46
All Crops (Area)	1.58	0.51	0.10	0.25	0.34
(Prod.)	3.15	2.19	3.19	1.18	2.46
(Yield)	1	1.28	2.56	0.90	1.96

Source : GO/Agricultural Statistics at a Glance, Ministry of Agriculture.

(2) 1967 to 1979-1980: the Beginning of Green Revolution

It is interesting to note that during this period the growth rate of total crop output was relatively loss than that of period I, despite the fact that green revolution has already taken strides in wheat and rice crops and led to large increases in the yield levels of wheat and rice. This was possibly due to two reasons. Since new agricultural technology was limited to wheat and rice and not to coarse cereals as rice accounted for nearly 40% and coarse cereals 28.2% of total food grains output. Wheat accounted for only 22% of food grains output during 1970-71. This happened despite the fact that output of wheat almost more than doubled. Area contribution which was to the tune of 50.16% to the crop output declined to 23.29, whereas yield contribution registered a marked increase from 38.41% to 58.45%.

(3) 1980-81 to 1990-91: The Maturing of Green Revolution

The decade of 1980s witnessed the spread of new agricultural technology to some coarse cereals and some commercial crops like sugarcane, oilseeds and cotton. Initially new agricultural technology was confined to north western States viz., Punjab, Haryana, and Western UP but later on it got spread almost to all regions of India. The major part of output increase was due to yield effect which stood at 80.25% as against area affect which was just 3.13%. Yield growth became the prime source of growth during the mid-sixties.

(4) 1990-91 to 2003-04: and 1994-95 to 2005-06: Average Growth: Economic Liberalization and Deceleration of Agricultural Growth.

Economic reforms initiated in India during 1991 have put Indian economy on a higher growth trajectory In the agricultural sector, the key area of reform consisted of liberalizing the working of commodity markets, reforming commodity price policy and gradual withdrawal of input subsidies. The agricultural sector was not targeted directly by the reforms for a couple of years, but it was affected in directly through changes in the exchange rate, export liberalization and terms of trade resulting from dis protection to industry.

Annual growth rate in total gross domestic product (GDP) has accelerated from below 6 per cent during the initial years of reforms to more than 8 per cent in the recent years. Agriculture, which accounted for more than 30 per cent of total GDP in the beginning of reforms tailed to maintain its pre-reform growth or keep pace with growth in the non-agricultural sector. The growth rate of agricultural

GDP decelerated from 3.08% per annum during 1980-81 to 1990-91 to 2.38% during 1992-93 to 2003-04 growth rate of crop output decelerated from 3.19% per annum during the 1980's to only 1.18% per annum during the latter period.

The growth rate of GDP in agriculture and allied sectors turned out to be 3.64 per cent during 1990-91 to 1996-97 which was 0.5 percentage points higher than the previous decade. In fact, during the early years of reforms, gap in the growth rate between agriculture and non-agriculture slightly narrowed down.

Table 6.2: Growth Rate in GDP Agriculture and Non-Agriculture Before and After Reforms

Period	GDP total	GDP agr (& allied)	GDP Agri-	GDP non-A
1980-81 to 1989-90*	5.52	3.12	3.29	6.88
1990-91 to 1996-97*	6.01	3.64	6.697	7.04
1996-97 to 2004-05*	5.72	1.66	1.65	7.06
2000-01 to 2005-06#	6.34	1.97		7.65

Notes : * At 1993-94 prices; # At 1999-2000 prices.

Source : National Accounts Statistics , various issues, Central Statistical

Organisation, Government of India, New Delhi.

Table 6.3: Growth Rate in Output of Various Sub-sectors of Agriculture at 1993-94 Prices

Period	Crop	Livestock	Fruits and vegetables	Cereals
1980-81 to 1989-90	2.71	4.84	2.42	3.15
1990-91 to 1996-97	3.22	4.12	5.92	2.23
1996-97 to 2004-05	0.79	3.67	3.28	0.02

Source : As in the table

However, the situation for agriculture turned adverse with the beginning of 1997-98 and this covered all the sub-sectors of agriculture. Disaggregation of agriculture into sub-sectors shows that the growth rates in output of fruits and vegetables decelerated from 5.92 per cent to 3.28 per cent. (Table.1.3) Output of the total crop sector showed an annual growth rate of mere 0.79 per cent while the agricultural sector excluding fisheries showed a growth rate of 1.65 per cent per annum. A clear implication of this growth trend is that the per capita or per worker income in agriculture is declining. This seems to be one of the factors for rising rural and agricultural distress in the country.

Low and volatile growth rates in Indian agriculture and allied sectors has been reflected in the average annual growth rate of value added in the sector declining from 4.7 per cent during the Eighth Plan (1992-1997) to 2.1 per cent during the Ninth Plan (1997-2002). As against the target of annual growth rate of 4 per cent during the Tenth Plan (2002-2007), agricultural growth rate in the first year (2002-03) was negative (-6.9 per cent) due to a severe drought of 2002. With a favorable monsoon,

growth has been an impressive 10.0 per cent in 2003-04. But deficient rainfall in 2004-05 again led to a decline of food grains production as well as rate of growth of Agriculture and allied sectors to 0.7 per cent. During the financial year 2006-07. The agriculture and allied sector's growth slowed down to 2.7 per cent as against six per cent in the previous year. However, India's economy grew by 9.4 per cent in 2006-07 as against nine per cent in 2005-06. (Economic Survey, 2006-07),

Similarly growth rate of foodgrains output decelerated to an all-period low of 1.16 per cent per which is less than the rate of growth of population (1.95% pa). On the contrary, it witnessed a sharp deceleration in growth after the mid-1990s. This happened despite the fact that agricultural productivity in most of the states was quite low and there was a lot of scope and potential for the growth of agricultural output. India has been targeting a more than 4 per cent growth rate in Indian agriculture, but the actual growth rate has not turned out to be even half of this target. The poor performance of agriculture against the background of an impressive growth of the overall economy is having serious implications.

The pattern of growth of agriculture has, however, brought in its wake, uneven development, across regions and crops as also across different sections of farming community and is characterized by low levels of productivity and degradation of natural resources in some areas. Capital inadequacy, lack of infrastructural support and demand side constraints such as controls on movement, storage and sale of agricultural products, etc., have continued to affect the economic viability of agriculture sector. Consequently, the growth of agriculture has also tended to slacken during the nineties.

One, it is causing wide disparities between income in agriculture and nonagricultural. Two, as more than 50 per cent of the workforce and about same proportion of the total population of the country depends on agriculture for income and livelihood, slow growth in agriculture is putting them in distress. The GDP of agriculture increased annually at more than 3 per cent during the 1980s which was considered a reasonably satisfactory performance of the sector.

Reasons for Deceleration of Agricultural Growth during the 1990's.

Both at the national and state level various factors can be made accountable for slow down agricultural growth during the post-liberalization period. Decline in the public and overall investment is the single most important factor accountable for this slow down. The rate of gross domestic capital formation (GDFC) more than doubled by the 1980s and increased by more than two and a half times during the 1990s. The fixed capital component of the capital formation also went up significantly from around 8 per cent of GDP to around 28.1 per cent during this period. The inventories (change in stocks), the other component of capital formation, has been around 1 per cent of GDP in the beginning as also at present, with higher rates in between.

The Central government has an important role to play through macro-economic policies that affect agriculture by provision of adequate resource transfer to States, and in ensuring that State finances and options are not affected adversely by the macro-economic consequences of decisions taken at the centre. However according to the Economic Survey, 2005-06, there is a rising trend in non-development expenditure while development expenditure as a percentage of GDP is declining. Though nominal public investments in agriculture have tended to rise year after year, the gross capital formation in agriculture as a proportion of the total capital formation in the economy has been declining in both the public and private sector, leading to an overall slump. The total declined from 14.51 % on an average during the decade 1970 to 1980, to 10.40% during the next decade and has averaged only 8.04 during 1990s at 1993-94 prices.

The share of the agricultural sector's capital formation in GDP declined from 2.2 per cent in the late 1990s to 1.9 per cent in 2005-06. This disturbing decline was partly due to the stagnation or fall in public investment in irrigation, particularly since the mid-1990s. However, there is indication of a

reversal of this trend with public sector investment in agriculture accelerating since 2002-03. The share of public investment in gross investment in agriculture increased by 6.5 percentage points from 1999-2000 to reach 24.2 per cent in 2005-06. However, there is an indication of a reversal of this trend with public sector investment in agriculture accelerating since 2002-03. The share of public investment in gross investment in agriculture increased by 6.5 percentage points from 1999-2000 to reach 24.2 per cent in 2005-06. The share of public investment in gross investment increased by over 11 percentage points to reach 29.2 per cent in 2004-05 relative to 1999-2000. The improved availability of credit for agriculture and liberalized trade for agricultural products should enhance private investment in agriculture.

Given the above broad concerns, the growth-deceleration syndrome could be gauged from different angles. First, what have been the trends in agriculture GFCF vis-à-vis aggregate GFCF? Second, how different are the temporal shares of aggregate GFCF in GDP and of agriculture GFCF? Third, whether the share of agriculture GFCF in agriculture GDP has altered over a period of time? Fourth, how comparables are the annual growth rates of public and private investment in agriculture? Fifth, whether the conclusions derived from CSO investment series analysis different from those of broad investment series analysis?

Table: 6.4

Gross capital formation in agriculture New series (at 1999-00 prices)

Year	Investment in Agriculture (Rs. crore)			Share in agricultural gross Investment (per cent)		Investment in Agr as % of GDP at constant prices
	Total	Pubic	Private	Public	Private	
1999-00	43473	7754	35719	17.88	2.2	2.2
2000-01	38176	7018	31158	18.4	T16	1.9
2001-02	46744	8529	36215	18.2	81.8	2.2
2002-03	45667	7849	38018	17.1	82.9	2.1
2003-04	47833	12809	35024	26.8	73.2	2.0
2004-05	43123	12501	30532	29.2	70.8	1.7
2005-06	54539	13219	41320	24.2	75.8	1.9
Source: Economic Survey (2006-07)						

- **Quick Estimates.**
- **Source: CSO**

Some of the reasons for slower growth in public investment in agriculture are diversion of resources from investments to current expenditures in the form of subsidies, large expenditure incurred on maintenance of existing projects, inordinate delays in completing the projects on hand, relatively lower allocation for irrigation, rural infrastructure and research, lack of effective credit support and credit

infrastructure in rural areas, and a belated growth in private investment. The problem of lower rate of capital formation in the rural sector is not merely due to lower investment or mobilization of rural savings for urban lending, but also because of shifting consumption patterns of rural population. Owing to higher propensity to consume, savings tend to be lower and even the meager amounts saved are utilized for consumption purposes, rather than being canalized into investments.

It is argued more public investment in technology-infrastructure-institutional development by phasing out subsidies, removal of restraints on exports, reforms in institutional credit system, public investment support for management of canal irrigation, regulatory policy for containing the problems of negative externalities in private ground water exploitation, public investment for preventing land degradation as well as for rehabilitating degraded land, and institutional transformation and social capital are all intended to create a favourable policy and development support environment for private sector.

Indian agriculture was able to reap the potentials of new agricultural technology because of favourable international research collaboration. Major breakthrough in frontier areas of research is lagging behind. Lack of investment in research and technology has resulted in the non-availability of any new cost reducing technology in agriculture and has led to declining input use efficiency. To blame "technology fatigue" as one of the prime reasons for the slow growth of agriculture experienced since the mid-1990s is right to some extent. The deceleration in productivity of wheat in Punjab and Haryana in recent years cannot be attributed to technology fatigue. In fact, the intensive cultivation of mono-crop (paddy-wheat sequence) along with a heavy dose of chemical fertilizers may have affected the soil fertility, which may be causing deceleration in productivity of crops. Moreover, the decontrol of phosphate and potash fertilizers introduced in August 1992 has created a wide imbalance in the use of nitrogen-phosphate-potash ratio in many agriculturally advanced states, because of which the soil fertility may have been affected.

Total factor productivity in agriculture has started declining. Both technical and economic efficiency in agriculture has shown declining trend during post liberalization period.. Increasing usage of nitrogen fertilizers not only resulted in increasing input subsidies but also in unbalanced use of fertilizers. The structural weaknesses of the agriculture sector reflected in low level of public investment, exhaustion of the yield potential of new high yielding varieties of wheat and rice, unbalanced fertilizer use, low seeds replacement rate, an inadequate incentive system and post harvest value addition were manifest in the lackluster agricultural growth during the new millennium.

The cost of cultivation of crops has been increasing over the years because of increases in wage rate of labour, input prices and other managerial costs. It is needless to mention that when the cost of cultivation increases more than the rate at which the value of output increases, farmers may not be inclined to adopt the assortment of recommended inputs for crop cultivation. Reduction in the use of various yield-increasing inputs obviously would lead to a decline in crop productivity.

In order to find out the reasons for the slowdown in the growth rate of agricultural output, Ramesh Chand (2007) has estimated the effect of various factors on agricultural output and then analyzed change in these factors to link them to output growth in various periods. The study found that rainfall, terms of trade, public sector capital stock and institutional credit turned out to be statistically significant variables impacting agricultural output. The study found that as compared to 1980s there was a sharp increase in the terms of trade for agriculture during the initial years of reforms. Agriculture prices relative to non-agriculture prices increased annually by 0.95 per cent. There was also some improvement in the growth of irrigation during the early years of reforms. Net sown area witnessed a decline at the rate of 0.55 per cent which was not compensated by an increase in cropping intensity. The biggest setback to output of the crop sector came from the decline in terms of trade for agriculture and slowdown in expansion of irrigation. The terms of trade for agriculture after 1996-97 declined

annually by 1.63 percent. Liberalization of trade has led to increased integration of the domestic market with the international market. Accordingly, a downward trend in international prices of agricultural commodities after 1997-98 has been transmitted to domestic prices resulting in deterioration in ToT for agriculture.

As compared to 2.62 per cent annual growth in irrigated area during 1990-91 to 1996-97, the later period shows an annual expansion in irrigation by just 0.51 per cent. Though the net irrigated area has increased substantially from 20.58.million hectares in 1950-51 to 53 million hectares in 1994-95, there is no appreciable improvement in it since the mid-1990s because of inadequate allocation of funds required for completing ongoing projects and poor monitoring of irrigation projects by the state agency. The main causes of slowdown in irrigation are (a) deceleration in public and private sector capital formation after 1996-97. Thus, the main factors which led to a slowdown in agriculture at national level after 1996-97 are: (a) decline in the area under cultivation, which seems to be a result of expanding urbanization and industrialization, (b) deterioration in the terms of trade for agriculture, (c) stagnant crop intensity, (d) poor progress of irrigation and fertilizer, (e) decline in supply of electricity to agriculture, and (f) slowdown in diversification. One more factor related to the performance of agricultural sector is risk in agriculture. Risk in agriculture, measured as deviation from trend in GDP at current prices, shows a more than 50 per cent increase between 1985-86 and 1995-96 and 1995-96 and 2004-05.

The 1990s has been marked by reforms involving, among other things, change in exchange rate and liberalization of external trade. Measures have been taken to promote integration of domestic economy with global economy. These changes in turn have affected domestic prices of several commodities and, terms of trade for agriculture have undergone changes during the decade of 1990s. In the initial years in India agricultural activity was limited to the production of foodgrains and a few cash crops such as cotton, sugarcane and jute, but recent years has seen a remarkable shift in the agricultural scene, including increasing diversity in a range of products and greater sophistication with the creation of critical infrastructural facilities like cold storage, refrigerated transportation, packaging, quality control etc. Percentage areas under different crops have exhibited changes over time. Crops that are more remunerative are replaced by less remunerative ones. As a result, less remunerative crops are pushed to claim less fertile land and this process leads to an. increase in the total area under cultivation. Pressure of population further accelerates this process.

Cereals and pulses occupy about 3/4th of the gross area under cultivation. Percentage area under the cash crops has tended to increase. Plantation crops occupy a very small percentage (less than 1%) of the total area under crops. The gross area under cereals and pulses increased by about 52 percent, while the gross area under cash crops increased by 92 percent or so. Growth of food processing industries and changes in consumption pattern have attributed to an ever-increasing demand for crops like wheat, maize, oilseeds, sugarcane and potatoes. On the other hand, growth of textiles industries using man made fibers and substitution of jute products by synthetic products have affected demand for cotton, jute and Mesta as raw materials.

The Indian Agriculture sector is now set for a leap with the introduction of new technology like IT and biotechnology. India's potential to become a leading player in the agriculture sector is proved by the fact that it already has the makings of one. It is the largest producer of milk, fruits, pulses, cashew nuts, coconuts and tea in the world, second largest producer of rice and wheat in the world, and fourth largest in coarse grains. India is also one of the largest producers of cotton, sugar, sugarcane, peanuts, jute, tea and an assortment of spices. India is poised to become the world's food basket on the back of a number of Government initiatives and investment opportunities across various areas of agriculture.

The increasing economic integration of the Indian economy with global processes has brought considerable challenges at the door of its agricultural sector. These challenges have arisen from two

broad sets of problems. In the first place, a number of major crops have been witnessing a decline in productivity growth, in particular over the past decade. Second, and perhaps more important from a short run perspective, is the fact that Indian agriculture faces unfair competition from cheap imports, which poses an enormous threat to the livelihoods of the farming communities. The magnitude of the problems for domestic agriculture that any drastic reduction in the existing levels of tariffs can cause would be clear from the trends in the international prices of some of the major commodities in the second half of the 1990s. International prices had slumped to their lowest levels during this period primarily because of the weight of the subsidies granted by the major players in the markets for agricultural commodities, in particular the United States and the members of the European Union.

Low productivity has afflicted growth of Indian agriculture. However, international comparisons reveal that the average yield in India is generally 30% to 50% of the highest average yield in the world. Low yield per unit area across almost all crops has become regular feature of Indian agriculture. Though India accounted for 21.8 per cent of global paddy production, the estimated yield per hectare in 2004-05 was less than that in Korea and Japan, and only about a third of that in Egypt, which had the highest yield level in the reference year. Similarly, in wheat, while India, accounting for 12 per cent of global production, had average yield slightly lower than the global average, it was less than a third of the highest level estimated for the UK in 2004-05. For coarse grains and major oilseeds, Indian yields are a third and 46 per cent, respectively, of the global average. In cotton, the situation is slightly better with Indian yields at 63 per cent of the global average. While agro-climatic conditions prevailing in countries may partly account for the differences in yield levels, nonetheless, for major food as well as commercial crops, there is tremendous scope for increasing yield levels with technological breakthroughs (Economic Survey 2006-07).

The growth rate analysis shows that the initial years of reforms were somewhat favourable for agricultural growth, but period after 1995 witnessed a sharp decline in the growth rate of almost all sub-sectors and commodity groups in the agricultural sector. Another disquieting aspect of the recent growth process is that the agricultural and non-agricultural sectors are on a disparate growth path. At the state level, the growth rate has turned negative in four out of 20 major states while six states show a growth rate ranging between 0.10 and 0.95 per cent. The main reasons for deceleration and stagnation in agricultural output after 1995-96 are a slowdown in growth of fertilizer use, irrigation, and energy (electric power) in some cases, stagnation or even a decline in other cases. Crop intensity and area under cultivation have also shown either a poor growth or a decline.

Constraints Facing Indian Agriculture

For Example, Indian agriculture has been progressively acquiring the small farm character, with 40 per cent of the land now being operated by small and marginal farmers. The output mix in Indian agriculture has also under gone a significant shift from foodgrains to non-foodgrains and within foodgrains from cereal to finer cereals. Use of high end inputs such as fertilizers, insecticides, improved seeds, mechanical farm implements, etc., have raised the proportion of inputs and consequently the total outlay on inputs. Despite impressive overall growth performance the agriculture sector in India continues to be inefficient and plagued by constraints resulting in sluggish farm sector growth. This section of the chapter attempts to spell out some of the constraints like, facing Indian agriculture.

As noted above the share of agriculture in GDP has registered a perceptible decline and service sector has emerged a prime mover of the economy which indicates that real income generation in agriculture sector is not taking place. Technology that heralded the process of green revolution during 1970s and 1980s started showing signs of deceleration during 1990s. Agricultural production which grew at an annual average rate of 1.95 per cent per annum during 1970a moved to 3,82 per cent per annum during 1980s slowed down to 2.09 per cent per annum in 1990s..

Natural resource degradation in rural areas is causing serious concern. Sustainable management of land resources is beset with two kinds of problems-managing the quantitative and qualitative dimensions of Land. The qualitative dimension relates to the issues such as increasing human and animal population pressure on land and changes in the land use pattern whereas the qualitative dimension is concerned with the loss of nutrients and the pollution of soil environment by agricultural or non-agricultural activities With regard to the land use pattern over the last decade, one observes that there has been continuous decrease in the net sown area (NSA), while the area under cultivation, gross cropped area (GCA) remained stagnant. Between 1995-96 and 1999-2000, the GCA increased marginally by 3.2 per cent, while the NSA decreased by 6.09 per cent. There has been a substantial decrease in common land resources (CMIE.2004). The problem has been further compounded by rapid increase in the number of small and marginal farmers. This is attributed to increasing population pressure leading to adverse land-man ratio and increased fragmentation of land holding due to family sub-divisions, often making them non-viable and indivisible for technological use. The land reform measures have not been able to address squarely the problem of land fragmentation.

However, with increasing subdivisions and gradual decrease in land concentration, the land lease market is experiencing a significant change during late nineties. The poor cultivators contributed to the demand by leasing-in land primarily due to reasons of subsistence and absence of alternative sources of living. As a result, the share of land-poor lessees forms a large proportion among the lessees, leasing-in most of the land. Tenancy cultivation is characterized by low level of capital investment, inferior quality of land, scattered and fragmented land plots, monocarp cultivation, absence of crop diversification, lower use of improved technology, and lower access to institutional credit.

Technological stagnation is supported by an increasing evidence of stagnating levels of productivity growth of crops in many states as the growth rate of productivity is not consistently upward. The growth has been flat and has started declining in some of the progressive states and to reverse them is a daunting task. This is due to differential levels of adoptions of new techniques, varying degrees of water control, imbalances in infrastructural development and host of other, factors. Ramasamy and Selvaraj's study (2001) revealed that the area under HYVs crops ranged between 2 per cent and 69 per cent across the states and the differential adoption rate accentuates the income distribution among the region. The estimated inequality measure (Gini coefficient) of 0.60 confirms the wide variations among the states in the adoption of HYV of crops. After a long period of technological breakthrough and adoption, yield gap still exists in many of the states and more than fifty per cent of the potential yield even in the case of rice in India is not yet realized. In the case of paddy benefit-cost ratio has tended to decline from 2.45 during 1974-75 to 1.41 during 2000-01. Almost similar trend was found in majority of the states. This has resulted in decline in Total Factor Productivity (TFP). TFP is measured as growth in output minus growth in all inputs considering the Tornquist-Theil index which is derived from translog production function. TFP which grew at 1.37 per cent per annum during 1970s increased to 1.99 per cent per annum has slided downwards, at the rate of-0.9 per cent per annum in 1990s.

Productivity decline can take place due to technology failure or agro-climatic or economic reasons. The deceleration in productivity in recent years is infact to some extent due to mono-crop culture (paddy-wheat sequence) along with a high dose of chemical fertilizers which probably have affected the soil fertility leading deceleration in production of crops. Use of fertilizer in improper ratio of N: P: K is also a major problem for Indian agriculture. While the recommended ratio is 4:2:1 this ratio of N: P: K has been around 8.5: 2.6:1. The all-India average consumption of fertilizers per ha. was up at 104.50 kgs in 2005-06 from 94.52 kgs in 2004-05. This induces initial vegetative growth, susceptible to pests, diseases, lodging and causes poor floral induction and delayed maturity thereby reducing the yield. As the cropping pattern is becoming more intensive, consumption of insecticides has increased more than 100 per cent during 1971 to 1994-95. But in recent past, the consumption of chemical

pesticides has come down from 66.36 thousand MT during 1994-95 to 43.59 thousand MT during 2001-02 registering a decline to the tune of 27.69 per cent. The pesticide use is declining in quantitative terms, due to the increased use of bio- pesticides, cultivation of more resistant varieties and improved pesticides application efficiency. One of the consequences of indiscriminate use of pesticides is the adverse health on society in general and vulnerable population like children in particular.

Studies by FAO have shown that small farms continue between 60-70 per cent of total farms in developing countries and contribute around 30-35 per cent to total agricultural output. Liberalization-era began in India when over 40 per cent of the rural households were landless or near landless.; and over 96 per cent of the remaining 60 per cent owned holdings that belonged to marginal, small and semi-medium size groups. The decade 1971-72 to 1991-92, witnessed a marked intensification of marginalization process. Such small holdings are often over-manned, resulting in disguised unemployment and low productivity of labour. Adoption of modern agricultural practices and use of technology is inadequate, hampered by ignorance of such practices, high costs and impracticality in the case of small land holdings. Irrigation facilities are inadequate, as revealed by the fact that only 53.6% of the land was irrigated in 2000-01 which result in farmers still being dependent on rainfall, specifically the Monsoon season. Large investments, public and private, are needed to improve seed varieties and improve irrigation and plant protection practices. Govemment agencies are promoting diversification in production, research, and farm extension. But successful diversification is likely to require shifting public resources away from subsidies and improving incentives for private investment.

Farmers may have been able to maintain yields of modern varieties through the application of higher amounts of non-land inputs, which means a declining trend in TFP and profitability in farming. The cost of cultivation of rabi crops has tended to increase at a faster rate in comparison to the increase in the price of output implying that in the years to come the real net gain from rabi crops may come down from the current levels). The increase in the cost of cultivation fixed plus variable cost (C2) during 1975-76 and 1985-86 in majority of crops was comparatively less than the increase in the value of output which implies that farmers were able to get back the cost of cultivation. The situations has taken a reverse trend during 1985-86 to 2001-02 as C2 has increased substantially in majority of the crops namely cotton, paddy, wheat, sugarcane, groundnut and gram. In the case of cotton the increase in cost (C2) was nine times against the increase in value of output which was just 5.57 times during 1985-86 and 2001-02. The ratio of value of output to cost of cultivation not only registered a decline but the ratio has been fluctuating widely since the mid-1980s.

Another factor that affects the economic condition of the rural population is their purchasing power which further depends on the profitability of crops grown. There has not been any noticeable increase in output/input ratio over the last decade. Lack of timely and hassle free availability of agricultural inputs like HYV seeds, fertilizers, pesticides, farm implement, etc., are the most important constraints of agricultural production. Apart from inputs, credit forms another major requirement of the farmers, which enables them to meet their working capital and investment needs. It is amazing that despite a large network of Rural Financial Institutions (RFI), a sizeable proportion of the rural population continue to be outside the fold of the formal banking system.

It is well established that that fixed capital formation is essential for sustaining the growth of agriculture as it reduces the transaction cost for private farmers besides reducing the operational cost of cultivation. As mentioned earlier, fixed capital formation by the public sector in agriculture has been continuously declining both in absolute terms and also in relation to agricultural GDP. In fact, public investment (at 1993-94 prices) was almost constant in the period 1990-91 and 2002-03, hovering around Rs 4,000-5,500 crore This reduction in public investment in agriculture is also considered to be one of the reasons for poor performance of agriculture in recent years. The share of government expenditure on agriculture to total expenditure has not increased over years but declined and at present

agriculture shares only 5.2 per cent of the total public outlay. Falling real public investment in agriculture is a cause for major concern.

Convergence or Divergence of Agricultural growth

Regional Dispersion of agriculture Growth and Regional Inequalities

A vast country of sub continental size like India with market regional diversities in agro-climatic environment, resource endowment and population density is likely to be characterized by uneven economic and agriculture development among various regions. During the early seventies, the NAT which led to appreciable increases in the yield of wheat and rice was more or less confined only to Punjab, Haryana and Western Utter Pradesh in North-Western India. During the 70s, the green revolution spread to new areas like coastal Andhra Pradesh and Tamil Nadu, eastern U.P. and part of Rajasthan. A major development during the 1980s was the spread of NAT to the eastern state of India viz, Bihar, Orissa, Assam and West

Bengal. For the first time densely populated states have experienced growth in productivity and output level. As a consequence, the regional pattern of labour and land productivity has undergone a change in various regions during the 1980s.

Another important change during early 80s mid 90s is that a distinct change in cropping pattern from coarse cereals towards oilseed has been observed. This shift was particularly noticeable in the control region but was also prominent though to a lesser extent in the southern regions.

It has been argued that green revolution has led to an increase in regional inequalities. A details study by Sawant and Achutan (1998) also reaches similar conclusions. The main findings of their study are.

(i) All the states whether growing foodgrains of non-foodgrains have performed well during period II (1981-82 to 1990-91) as against period I@ (1968-69) to 1981-82).

(ii) West Bengal recorded the highest rate of growth of productivity 5.05 per cent in period II followed by Haryana (5.10) per cent per annum.

(iii) In Madhya Pradesh output growth rate moved up steeply from 0.88 per cent in period I to 2.37 percent per cent in period II despite a significant negative rate of growth of area from 0.57 per cent to 0.58 per cent.

(iv) The rate of a growth recorded in eastern region has attracted a good deal of attention. Absolute stagnation in production and productivity of foodgrains in period I has been replaced by growth rates closed to or higher than 3 per cent.

The horizontal spread of new agriculture technology can be attributed to many factors viz. expansion in irrigation ad extension services, development of in frastructure required for distribution of inputs, etc. Out of the above mentioned factors, expansion of net irrigated area, which was just 2 per cent in 70s moved up to 24 per cent in the 80s has been identified as the major cause for growth in production and productivity in eastern states.

Another study by Rao and Servas has pointed out relatively successful agrarian reforms as the major force behind the significant growth rates of foodgrains in West Bengal.

However there seems to be a general consensus that in the early period of the NAT, large farmers gained more in comparison to small and marginal farmers. In the later phase of NAT, there is a difference of opinion. Some studies indicated that new technology was scale neutral. Because of improved supply of inputs, especially credit and extension services, small farmers also got benefitted.

There is a general consensus that the adoption of green revolution has reduced labour absorption in agriculture. A study by Sheila Bhalla indicates that the employment elasticity of crop output which stood 0.77 for 1968-69. to 1978-79 declined to 0.59 between 1971-72 to 1983-84. The uneven regional growth was mainly responsible for the low absorption of labour within agriculture.

In recent year a significant development in the pattern of rural labour absorption has been a shift away from crop production into rural non-farm activities like agro-processing industries and other rural industries. The growth of rural industries is positively related to faster agricultural growth displaying higher labour productivity and a higher incidence of wage labour.

The NSS dalta for nineties clearly show up a mixture of gains and losses for rural and urban employment growth rates, the overall rate of growth of employment for rural workers declined form 1.75 per cent per annum during 1983/1993-94 to a low of 0.66 percent per annum during the post-reform. years, for rural males, it declined from 1.94 per cent to 0.94 per cent and for rural females, it declined from 1.41 per cent to an abysmally low of 0.15 per cent. In sum, it is pretty much clear that much clear that the rosy employment friendly picture that was believed by some reform protagonist to follow, has not came off; infact it is the contrary that seems to have happened.

The post-green revolution period has witnessed impressive structural changes taking place in Indian agriculture. The persistent problem of wide regional disparities across states/regions continue to be a serious challenge. This is driven partly by the diversity in production potential and extensive cultivation in marginal areas, and partly by policy priority promoting food production regardless of technical or economic efficiency. There has been enough evidence on regional variations in agricultural performance. The earlier studies have shown that there are large disparities in agricultural performance across regions and this increased in the immediate post-green revolution period. A recent study by Chand (1999) observed that since 1980-81 regional divergences in agricultural productivity and income have grown and the gap between developed and under developed states has further widened.

The deceleration in agricultural growth further revived the debate of convergence and divergence in 'agricultural growth in late nineties (particularly in post-green revolution period). Two set of approaches are followed by researches to deal with the issue of convergence and divergence. First approach is based on regression results while the other approach makes use of index based on measures of inequality. The first approach is based on theoretical basis while the second is based on statistical measures. The study based on second approach shows that regional disparities in agricultural productivity which have shown an increasing trend during 1980s is not seen to have declined in new millennium. Instead they persist and pose a challenge to attain a balanced regional development. Except, Andhra Pradesh, Gujarat, Jammu & Kashmir, Karnataka, Madhaya Pradesh and Maharashtra, all other states have shown deceleration in growth of agricultural productivity. It has been argued that the economic reform did not have overall favourable impact on growth of agricultural sector as the thrust of economic reforms was mainly on price factors and ignored infrastructure and institutional changes. Further, the decline in public investment in agriculture during. 90s had also impacted the growth performance of agriculture. However, Regional disparities in agricultural income have marginally declined, but still it is at a very high level.

Trade Liberalization and its Impact on Indian Agriculture

Indian economy in 1991, faced with a balance of payments crisis, embarked on a historic set of macroeconomic, industrial, and trade reforms to free its economy from four decades of inward-looking policies. Since July, 1991 the country has taken a series of measures to structure the economy and improve the balance of payments position. The New Economic Policy (NEP-1991) introduced changes in the areas of trade policies, monetary & financial policies, fiscal & budgetary policies, and pricing & institutional reforms. The salient features of NEP-1991 are (i) liberalization (internal and external), (ii)

extending privatization, (iii) redirecting scarce Public Sector Resources to Areas where the private sector is unlikely to enter, (iv) globalization of economy, and (v) market friendly state. Research reports reveal that this macro-economic adjustment programme is remarkable for its relatively painless transition compared with similar programmes elsewhere and a large part of the credit for absorption of these shocks is due to the steady increase in agricultural production. The GATT Agreement signed in 1995 will fundamentally change the global trade picture in agricultural sector. It is argued that the three sectors of economy in India (viz., primary, secondary and tertiary), the tertiary sector has diversified the fastest, the secondary sector the second fastest, while the primary sector, taken as whole, has scarcely diversified at all. Since agriculture continues to be a tradable sector, this economic liberalization and reform policy has far reaching effects on (i) agricultural exports and imports, (ii) investment in new technologies and on rural infrastructure (iii) patterns of agricultural growth, (iv) agriculture income and employment, (v) agricultural prices and (vi) food security

Trade liberalization covers measures that move the trade regime towards a more neutral incentive framework and a more liberal foreign trade regime. A neutral framework is one that does not differentiate between exportable and importable, between sales to domestic and export market, or between tradable and non-tradable. Liberal trade policies are those that reduce government controls and replace direct intervention (such as quantitative controls) with price mechanism (such as tariffs). Trade liberalization generally improve economic performance as protection has the effect of encouraging firms to enter protected domestic markets, as majority of firms tend to operate on an inefficiently small scale. Another study finds that protection was associated with an increase in inequality amounting to a drop of four to five percentage points in the share of income of the poorest 60 per cent of the population and a 20 per cent fall in the mean income of the poor. The indirect costs of foreign exchange controls are and non-tariff barriers tend to be large because allocation is based on discretion rather than efficiency. Greater trade openness increases incentives for research and development (R&D) by widening the potential markets and increasing the returns to such expenditures.

Trade policies are also closely related to resource mobilization and investment strategies. Three major changes were effected in agricultural export-import. One, channeling of trade was abandoned and now government does not determine the value and nature of imports and exports, except for few items. Two, most of the quantitative restrictions on agricultural trade flows have been dismantled. There is some reduction in tariffs. India's economic performance has continued to be impressive since 2001-02 and growth has been particularly rapid since 2003-04 averaging over 8.5 per cent with over 9 per cent expected for 2006-07. This performance is largely due to unilateral trade and structural reforms, in particular in services.

Recognizing the important linkages between trade and economic growth, the Government has simplified the tariff, eliminated quantitative restrictions on imports, and reduced export restrictions. It plans to further simplify and reduce the tariff. To help counteract the anti-export bias, inherent in import and other constraints, export promotion measures have gained in importance. The Government has recently announced a further increase in these measures and pledged to reduce export restrictions. The policy has also suggested the creation and strengthening of enclaves such as export processing and special economic zones, which would "immunize" exporters from the constraints affecting the rest of the economy, such as infrastructure and administrative problems. The Government estimates that annual export growth of almost 12% is required in order to raise India's share of world trade from its present level of 0.67% to a target of 1% by 2007.

The impact of trade liberalization on agricultural growth and rural poverty depend upon many factors such as external emanating from international markets as well as on domestic supply capacities and the effects upon livelihood and income distribution within the sector. These variables in turn are affected by land relations and other government policies towards agriculture and rural development,

which determine the degree to which cultivators can take advantage of international markets and the extent to which they are threatened by them. The issues those are directly relevant from the perspective of poverty reduction are those relating to the possibilities for agricultural growth and the viability of cultivation; the effects on employment and livelihood; and the effects or food security.

The impact of trade liberalization ca agriculture works through various channels such as volatile prices, problems in imports and exports, impact on livelihood and other employment opportunities, etc. The critique of trade liberalization in India and their impact has two school of thoughts, viz., one based on an emotional and ideological approach to the problem, and two, making an objective assessment of the policy needs of the country in an increasing globalized world and impact of already adopted liberalization measures on the basis of well known indicators of agricultural development. We shall attempt to follow the latter approach for the assessment of the impact of trade liberalization.

In order to assess the impact of trade liberalization on farm sector's performance, it is opined that performance of the farm sector should not only be viewed from the growth of agricultural production as it gives only a partial view. A more inclusive way should go into the structural changes within the farm sector, the question of distributive justice, and the changes in the status of welfare of rural people and so on. Agricultural growth is, of course, important but it is valuable as it helps to eradicate deprivation and to improve the capabilities and the quality of life of rural people. We shall be briefly analyzing the impact of trade liberalization measures on Indian agricultural development keeping these indictors in focus

For farmers, perhaps the single most adverse effect has been the combination of low prices and output volatility for cash crops. While output volatility increased especially with new seeds and other inputs, the prices of most non-food grain crops weakened, and some prices, such as those of cotton and oilseeds, plummeted for prolonged periods. This reflected not only domestic demand conditions but also the growing role played by international prices consequent upon greater integration with world markets in this sector. These features in turn were associated with growing material distress among cultivators.

It was expected that trade liberalization would lead to notable increases in agricultural exports leading to increases in income and employment for-the workers engaged in agriculture. But an analysis of India's trade performance 'has shown that agricultural exports registered high growth rates during 1990- 91 to 1996-97 but afterwards started to decelerate. This could possibly be due to East Asian Crisis which led to slow down in growth of world trade. Another reason for slow down was declining competitiveness of Indian exports due to big push given to administrative prices of wheat and rice are decline in international prices. Despite the fact that India is exporting rice, the country has decided to import wheat to the tune of 8.5 million tones during 2006-07 to replenish its low stocks of wheat. It has further been argued that in absolute terms, the gains from exports are limited and only a small section of the farming community in selected pockets has gained from them. Consequently, increase in exports although welcome has not been able to make much affect on the living conditions of farmers. India's potential to increase agricultural exports cannot be undermined in the liberalized world once the developed nations agree to get rid of their subsidies which is distorting international prices of agricultural exports. This requires mega investments in rural infrastructure including agricultural research and agro processing not only to realize export surpluses but also to stay internationally competitive through gains in productivity.

The actual impact of trade liberalization would be reflected through change in prices, production and quality of exports and imports. Ramesh Chand's (2001) study shows that the trade liberalization would have the mixed effect impact on the net social welfare of India. The country would be a net gainer in some commodities and it would be a net looser in some others. There is a considerable scope for increasing benefits due to trade liberalization by reducing domestic marketing costs and by tapping

proper markets for imports. Trade liberalization is expected to affect different commodities in different ways. Some commodities which have comparative advantage are likely to be effected positively, while some may not be affected to a significant extent. Trade liberalization is found to be highly beneficial to income from maize production. The negative income effect of removing subsidies is more than offset by liberalization. Free trade is estimated to have appositive impact on net returns from production exportable such as maize and rice, whereas it is going to have small negative impact on net returns from importable such as rapeseed- mustard.

Farming has been adversely affected by the combination of trade liberalization, world trade patterns and changes in domestic policies towards the rural sector. Farmers' have placed greater dependence on monetized inputs and faced rising prices of such inputs as domestic explicit and implicit subsidies have been withdrawn; around the same time, various import controls on agricultural products have been withdrawn, so that the level of domestic output prices is increasingly determined by the threat of potential imports if not actual imports; export subsidies as well as export taxes have been reduced or done away with, so that local producers face international markets and volatile world prices in a rather unprotected manner. The consequence is that farmers in all have been caught in a movement of rising input prices and falling or unpredictable output prices, which has rendered cultivation more risky and often financially unviable. These difficulties have been compounded by the reduction or withdrawal of various government support systems, ranging from output price support to input and credit provision. The attempts to diversify into other primary exports (including horticulture and fishing which are seen as the "sunrise" primary exports at the moment) have mixed employment implications at best. The reduction of employment in primary production is an important source of greater poverty and directly impinges upon poverty reduction efforts.

It is also feared that agricultural trade liberalization would change the cropping pattern away from food, and one third of India's population is below poverty line and cannot afford to buy adequate food grains even with the existing price structure. There are also fears that trade liberalization will result in a steep hike in food grain prices and jeopardize food security and promotion of export oriented crops in some parts of the country will adversely affect marginal and small farmers. The next critical area is that of food security. As noted above, this is a complex issue, because cheaper imports can certainly have the immediate effect of immediately improving food access for the poor who are net buyers of food, as long as they still have employment. However, even in the medium term, high levels of trade dependence, the shift to cash crop production and the exposure to international market volatility all have severely negative implications for food security Finally, the issue of the sustainability of cultivation patterns must be considered. Excessive dependence upon certain crops or natural resources can lead to over exploitation of these resources or unsustainable cropping practices. These are exacerbated when trade liberalization erodes the ability of governments to control such patterns. Unsustainable extraction patterns affect the rural poor more adversely than other groups over time, because they tend to rely more on common property resources in their over all consumption package.

In addition to the broad measures already described, other government policies had direct and indirect effects upon agriculture. The most significant related to the efforts at reducing subsidies which affected both agricultural producers and consumers, and the reduction of public expenditure which would have benefitted cultivation. Thus, both food and fertilizer subsidies were sought to be reduced over this period. However, both of these strategies, which involved raising the prices for consumers of both food and fertilizers, had undesirable and even counter-productive effects, leading to the paradoxical results of reducing consumption and simultaneously increasing subsidies.

CRITICAL EVALUATION AND EMPIRICAL

EVIDENCE, PRICES, WAGES ANDRURAL POVERTY

Trade reform measures, viz., real devaluation and fiscal compression tend to raise agricultural prices. These rises in prices will have mixed effect. Those with a marketable surplus stand to gain. Again it may be noted that the benefit to farmers depend on crop grown. Rice farmers in India may gain with liberalization, while oilseed farmers may lose because of liberalization. Self sufficient farmers might not be affected by the food price increases, although their shadow costs may go up. The numbers of surplus farmers who are likely to gain from rise in prices are small in number. The rise in prices of foodgrains adversely affect the landless agricultural labourers and rural and urban poor. The rise in input prices may work as tax on small farmers. As they are not in' a position to expand input use, production is most likely to suffer. Fiscal compression also results in reducing public investment in rural infrastructure and hence decelerating agricultural growth and foodgrain supplies.

Higher food prices adversely affect landless labourers and all households who are net buyers of food. As per the 50th round (1993-94) of the NSS. on the basis of land ownership, 36 per cent of all households are either landless or own only homesteads and thus are net purchasers of foodgrains. 13.3 per cent of agricultural households with some land make the rough estimate at fifty per cent of total rural population which is being adversely affected by an increase in the relative price of food.

Fiscal Restraint: As is well known that to reduce the deficit by raising tax revenues is practically difficult in most of the developing countries, the only alternative is through reduction in aggregate expenditure the axe of financial discipline falls,-mainly on essential investments in physical and social infrastructure since it is hard to reduce the wage bill

Increase in agricultural employment depends on the output response to prices and,, employment elasticities. The empirical evidence shows mat price elasticities are low even in the long run. The growth of real wages for agricultural labourers has been quite low during the post reform period as compared to the 1970s and 1980s. The demand for labour has been less than that of population growth.

With the emergence of emphasis on a market based system, the share of overall public investment in total investment is declining even from the early nineties. Further the share of public investment has also fallen short planned investment Real, gross capital formation has been around 10 per cent only with 90 per cent going to non-farm sectors, during pre-reform period (1985-91). As against an increase of 46 per cent in overall GCF in (he reform period (1991-97) over the pre-reform period (1985-91), that in agriculture was less than 36 per cent.

Since agriculture is basically a private activity, public investment, has a critical role to play in creating the infrastructure. GCF in the public sector in farm sector both in absolute and relative terms has been rather low and has registered a decline in the latter period.

Amongst the determinates of growth in agriculture, investment in irrigation is of great importance. Investment in irrigation was just 4 per cent higher in the reform period.

There has been a number of studies to establish that credit provided by the nationalized banks has a significant role increasing agricultural and food productivity. Small farmers, marginal farmers and landless labourers have benefitted from the loan disbursed by the banking system. By cutting down the level of credit to the agricultural sector, the government under SAP, would hit the small farmers most severely. And given that there is an inverse relationship between farm size and productivity, this will adversely effect food output and availability.

WITHDRAWAL OF INPUT SUBSIDIES

Another area where cuts are imposed are-input subsidies given to agriculture as it is believed that fiscal savings can thus be obtained while the growth incentives are maintained through better terms of trade for agriculture, there are, however, many consequences of such a policy combination.

Due to high price elasticity of fertilizer use, as indicated by various studies, consumption of essential inputs such as fertilizer is likely to decline, despite the compensating rise in the prices of output. Small and marginal farmers, who, have only a limited capacity to buy expensive inputs are most likely to suffer.

Secondly, a more serious consequence is that prices of outputs will rise more than proportionately to input prices because of the political influence of the large farmers. Whereas output prices increases may more than compensate the surplus farmers, the same is not true for large proportions of small and marginal farmers who may be net buyers of foodgrains. For them input subsidies are more beneficial than increases in the prices of output Though, terms of trade in agriculture may improve but the excessive rise in output prices is bound to have deleterious effect on the food security of large number of landless rural labour households, deficit-marginal and small farmers and urban wage earners.

Thirdly, better allocation of resources can be attained, by removal/reduction in subsidies. Since costs are always inflated because of inefficiencies of operations, subsidies (which are calculated on the difference between average cost of input/services provided and the price charged to the farmers), are exaggerated and their withdrawal and introduction of average cost pricing in no way helps increase the efficiency of operation of the enterprise of economy. 'Finally, the saving need not necessarily be used for development of infrastructure in farm sector as due to relatively greater clout of urban and industrial interests, these savings may be diverted towards reducing deficit.

Terms of Trade

The structural adjustment that followed in the wake of economic reforms, concentrated on industrial delicensing and liberalizing the foreign exchange regime, helped in improving the terms of trade in favour of agriculture from 81 per cent to almost 99 per cent in terms of the 1970-71 prices. The increasingly favourable terms of trade for agriculture is expected to attract private investment in agriculture, thereby leading to growth in output and demand for rural labour. Some of the recent studies on supply response in India have shown that the elasticity of aggregate agricultural output with respect to the agricultural terms of trade is positive and statistically significant. It is repeatedly argued that though changes la price incentives are an important factor to raise agricultural output, non-price factors are more important than relative prices in inducing higher agricultural output.

It-is surprising that despite successful good monsoons for the last ten years, the growth of foodgrain production in the post-reform period has been lower than those for earlier periods. There is no denying the fact that the area under coarse cereals and pulses have been shifted to oilseeds. But, the yield of wheat and rice have been more or less stagnant Thus despite favourable terms of trade, the performance of agriculture has been poor in the post reform period. It shows that non-price factors are more important for stepping 'up growth.

Exports: The economic environment for agricultural trade is changing in a remarkable way due to changes in- the domestic policies as well as in international trade arrangements. The move towards liberalisation and globalisation and their implication for agriculture has been a hotly debated issue. Contributions of agricultural exports to foreign exchange earnings is important for India which faces a chronic balance of payment problem. However, while promoting agricultural experts in a poor country

like India, the implications of export growth on domestic availability of foodgrains, can not be overlooked.

Agricultural commodities can be divided broadly in two categories, foodcrops and nonfood crops. There is an established policy of encouraging exports in commercial crops, and it has to continue. Currently foodgrains occupy nearly 68 per cent of the cropped area and account for the same weight in output. There is a gradual shift in production from foodgrains to nonfood grains, in which, presumably, poor cultivators are also participating. On the supply side, the foodgrain surpluses in developing countries are not adequate to meet the demands of u/k large countries like India and China to any measurable extent.

Though we have a distinct comparative advantage in rice, but the same is not true in the case wheat. The marketable surplus in rice is limited. Rice is the staple food of the majority of people. Even: small rise in price will affect the living standard of the large, vulnerable section. Among our traditional agricultural exports viz, tea, tobacco, cotton, coffee and oilseed, there are demand and supply problems The only bright area is the export of horticultural and floricultural products. Since these products are highly perishable, a highly developed infrastructure is needed in their case.

Producing for exports to generate foreign exchange, has become a national goal throughout the world, despite the environmental and distributional impact of such policies. Emphasis on increasing exports will most likely be accompanied by a move from share cropping to contact farming. The structural adjustment policies seem to be more encouraging to capital intensive technology and saving on labour. Hence policies of export orientation may aggravate the problem of ecological degradation and marginalization of small farmers. Further, the net impact of devaluation is not self generating as it depends on price elasticities of exports and imports, share of tradable and non-tradable goods.

Bureaucrats in the ministry of agriculture in developing countries encouraged conversion of forests into crop land to meet national goals of expanding export earnings and securing borders in remote areas which degraded the environment on the one hand and colonization on the other. Deregulation is not always a good policy. Free trade can also introduce new inefficiencies. More than half of the international trade involves the simultaneous import and export of essentially same goods.

Summary: Agricultural Sector is the mainstay of the rural Indian economy around which sociology economic privileges and deprivations revolve and any change in its structure is likely to have a corresponding impact on the existing pattern of social equity. Sustainable Agricultural production depends on the judicious use of natural resources (soil, water, livestock, plant genetic, fisheries, forest, climate, rainfall, and topography) in an acceptable technology management under the prevailing socio-economic infrastructure. Various research studies and policy papers highlight that the Indian Agricultural sector faces resource constraints, infrastructure constraints, institutional constraints, technology constraints, and policy induced limitations. To achieve sustainable agricultural development, it is essential to combine natural resources, capital resources, institutional resources, and human resources (i.e. to optimally utilize the agricultural resources). As an enabling technology, Information Technology (IT) plays an important role in the rapid economic growth and social transformation in developing countries. Information Technology and Bio-Technology, which are "the drivers" of globalization with their complementarities of liberalization, privatization and tighter Intellectual Property Rights (IPR) are bound to create new risks of marginalization and vulnerability in the Indian Agricultural sector.

A central issue in agricultural development is the necessity to increase productivity, employment, and income of poor segments of the agricultural population. Among the rural poor, the small farmers constitute a sizeable portion in the developing countries. Studies by FAO have shown that small farms constitute between 60-70% of total farms in developing countries and contribute

around 30-35% to total agricultural output. Liberalization era (1990-91) began in India when over 40% of rural households were landless or near landless, and over 96% of the owned holdings and 68.53% (over 2/3rd) of owned land belonged to the size groups (marginal, small and semi-medium). The decade of 1981-82 to 1991-92 seems to have witnessed a marked intensification of the marginalization process - the percentage of small owners increased from 14.70% to 21.75%.

Small farmers emerged as the size group with the largest share of 33.97% in the total land, which is just doubled during this decade. As regards the Large Farmers, they were 1% of the total owners in 1990-91 but owned nearly 13.83% of the total land. An interesting, but speculative, inference is that the changing position of the large owners represents the other side of the marginalization process, i.e., the presence, and possibly growing strength, of a small but dominant and influential group in agriculture. Analytical reports reveal that marginalization process could gather further momentum in the years ahead to become an explosive source of economic and political turbulence, due to the features of prevailing policy-cum-market environment in the country. Trend towards a greater actualization (erratic and low-paid work) of the workforce that was witnessed in the 1980s appears to have continued in the 1990s. Low" productivity and inability to absorb the growing Labour force make the agricultural sector in India witness to a pervasive process of marginalization of rural people. This process is likely to get intensified in the coming years, raising formidable problems in achieving sustained development of rural areas and rural people.

Suggested Readings

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- AN Aggarwal (2006) : Indian Economy Problems of Development and Planning New Age International Publishers 33 edition
- GS Bhalla (2007): Indian Agriculture Since Independence, National Book Trust,
- Ramesh Chand, S S Raju, LM Pandey: Growth Crisis in Agriculture
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LESSON-7

Prof: K.K. Kaushik

FOOD POLICY AND PUBLIC DISTRIBUTION SYSTEM

Governments have intervened in every aspect of agriculture in nearly all countries, from output to inputs, from domestic marketing to international agricultural trade, and from staple food products to fibers and livestock's. The government of India devoted substantial resources to agriculture right from the beginning of its planned effort at economic development. However, in the early years of planned economic development, the view implicitly guiding rural development policy was that Indian farmer was a tradition bound, economically unresponsive individual who lacked motivation and ability to efficiently utilize the resources at his disposal. The presumption, at least in the early years of price policy, was that Indian "farmers live in a non-market oriented economy, and it is essentially for this reason that price incentives and disincentives affect the farmer to a limited extent/The farmer was also seen as being exploited by landowners, money lenders, and traders. Elimination of this exploitation was sought through land reforms, the creation of government sponsored countries-operative credit schemes, and the development of the cooperative market structure. Food is one of the basic necessities of human life and existence. While at the global level nation states rejoice their success of achieving self sufficiency in food production and the available food stocks, at the national leve' the state of food security is still dismal.

The Nobel Laureate in Economics, Prof. Amartya Seri observed that since independence India has accomplished many positive developments. First, pre-independence stagnating agriculture has been firmly replaced by an imposing expansion of the production possibilities in Indian agriculture through innovative departures and expansion of technological limits. However, the Indian food consumption is held up today not because of any operational inability to produce more food, but a far-reaching failure to make the poor of the country able to afford enough food.

The Background: Performance and Policies

In the present lesson, an attempt has been made to analyze the Indian agricultural performance to understand where we are in terms of food policy and agriculture. Food policy is important because much of our agricultural policy is affected by our ideas on food policy. The kind of policy we have followed in the past and its consequences are discussed.

Food policy is the area of public policy concerning the production and distribution of food. It consists of the setting of goals for food production, processing, marketing, availability, access, utilization and consumption, as well as the processes for achieving these goals. The policy may be set on any level from local to global. Food policy comprises the mechanisms by which food-related matters are addressed or administered by governments, by international bodies or networks, or by any public institution or private organization. As a subfield of public policy, food policy covers the entire food chain, from natural resources to production, processing, marketing and retailing, as well as food hygiene, consumption and nutrition.

India faced serious food challenges on the eve of independence. In view of the rising population and serious food shortage problems, the provision of foodgrains to the growing population and self sufficiency in foodgrain production constituted one of the most important objective of agricultural policy and planning in India, land reforms and investment in rural infrastructure and irrigation were given top

priority to meet the challenges of accelerating agriculture and foodgrain growth. Positive price policy emerged another important area of the strategy after 1965.

Though these policies were instrumental in raising growth rate of agriculture during 1950s and early 1960s yet domestic foodgrain fell short of the total demand thereby necessitating imports of foodgrains and country remained food-deficit for a long time after independence. India's dependence on food imports became unsustainable during the mid-sixties due to severe draughts during 1965-66 and 1966-67. Several committees looked into the issue of managing food economy and as a result of the recommendations of the Foodgrain Prices Committee under the chairman ship of Jha(called the Jha Committee), the present food management system evolved.. Government intervention in foodgrain marketing in India began in a big way in the mid-1960s. It was meant to create a favourable incentive environment for the adoption of new technology based on high yielding varieties of wheat and rice, which were seen to possess vast potential for raising grain production Two important institutions namely Food. Corporation of India. (FCI) and the Agricultural Prices Commission (APC) were set up in 1965 to help administer food policy in the country.

In order to achieve goals such as inter-year price stability against a bumper harvest or below-normal production, guaranteed prices to producers, reasonable prices for consumers and food supply at subsidized rates to vulnerable sections, the government has been carrying out procurement and storage(buffer stock) of food grains (rice and wheat) since the mid-1960s. In India, domestic support for agriculture has been provided mainly through two channels: Minimum Support Price (MSP) guarantees for basic staple commodities and provision of inputs subsidies. These measures have been implemented through two important institutions, namely, the Commission on Agricultural Costs and Prices (CACP), which is entrusted with the task of suggesting MSP, and the Food Corporation of India, which carries out the task of procurement to ensure that producers do not get a price below MSP and that foodgrains required for maintaining a reasonable level of buffer stock and for the public distribution system are in place. The stated objectives of the agricultural price policy are to ensure remunerative prices to the farmers, even out effects of seasonality, and promote agricultural diversification.

Recommendations concerning the MSP levels are made by the Commission for Agricultural Costs and Prices (CACP). In formulating its recommendation, the CACP considers a number of factors, including input/output price parity, trends in market prices, demand and supply, inter-crop price parity, effects on industrial cost structure, effects on general prices, cost of living, international market prices, and the terms of trade... Several measures were initiated to achieve the twin objectives of raising food production and improving food availability. These included (a) price assurance to producers using the system of minimum support prices (MSP) implemented through obligatory procurement, (b) inter- and intra-year price stability through open market operations, (c) maintaining buffer stocks, and (d) distribution of foodgrains at reasonable prices through the public distribution system (PDS).

Minimum Support Prices:

MSPs are based largely on costs of production—as estimated by India's Commission on Agricultural Costs and Prices (CACP)—using a "full cost" measure that includes the costs of variable inputs, the rental value of land, the imputed value of family labor, and a 10-percent return to management. Devaluation of the rupee in the early 1990s helped push up the costs of traded inputs. In addition, production cost hikes have likely been compounded as MSP benefits are reflected in the costs of land, labor, and management. Basing MSPs on production costs allowed MSPs to become increasingly disconnected from market conditions as India transitioned from deficits to surpluses. The MSP mechanism is one of the few policy levers available to Indian policymakers in the foodgrain sector and there is a tendency to try to use it to achieve multiple policy goals, including price stabilization and income support. During the late 1990s, the MSPs set for wheat and rice in India fell out of step with domestic and world market conditions. Breaking the historical pattern, wheat and rice MSPs

strengthened relative to both world and domestic prices and moved above domestic market clearing levels on consumers.

Producer price policy has played an important role in supporting the growth of India's wheat and rice output since the 1970s. Price policy for wheat and rice is implemented through minimum support prices (MSPs) for fair-to average quality (FAQ) grain that are revised annually and defended by Indian Government purchases in surplus areas during harvest. For wheat, the MSP is paid directly to farmers in the primary markets where they sell their grain. For rice, about half of total procurement is purchased in primary markets in the form of unmilled rice (paddy) at the MSP and about half is purchased as milled rice through a statutory, fixed-price levy imposed on rice millers in some States. Under the levy, millers are obligated to deliver a share of the rice they process to the government at a fixed, below-market price. The levy shares vary from State to State (from a low of 10 percent to a high of 75 percent) and. particularly in States with high levies, the system results in an actual farm price below the rice MSP under most market conditions. Grain procured in price-support operations is stored by the Food Corporation of India (FCI), a parastatal, which either makes the grain available to State governments for subsidized distribution, holds it in storage, or, when conditions permit, allocates surplus grain for export.

Recent trends in Minimum Support prices:

Table. 7.1 Minimum Support price of Wheat and Paddy Rs/Qti

Year	Wheat	Paddy	Year	Wheat	Paddy
1990-91	275	240	2001-02	620	530
1995-96	380	360	2002-03	620	530
1996-97	475	380	2003-04	630	550
1997-98	510	415	2004-05	640	560
1998-99	550	440	2005-06	650	570
1999-2000	580	490	2006-07	750	580
2000-01	610	510			

Source: Economic Survey 2006-07

From the above Table it can be seen that MSP of wheat has increased from Rs. 275 in 1990-91 to Rs. 750 during 2006-07 showing an increase of 172.72 percent while the MSP of Paddy registered an increase of 141.66 percent despite Failling world prices, Since 2001, following the accumulation of large surplus stocks, there have been relatively small nominal annual increases in wheat and rice MSPs. In real terms, wheat and rice MSPs have declined by 14 percent and 11 percent, although, because of appreciation of the rupee against the dollar, MSPs have continued to rise in dollar terms. MSPs for rice and, particularly, wheat have also tended to decline relative to both MSPs and market prices for competing crops of oilseeds, pulses, and sugarcane. As a consequence, there has been slower growth in wheat and rice output, including both area and yield, slowed growth in government procurement of wheat and rice in price support operations, and real declines in domestic wholesale prices.

The rise in MSP of wheat and Paddy did boost production of these crops and procurement from surplus states. This also dissuaded private sector to hold any stocks as it was not profitable fot them and it increased the liability of Fc i to purchase the entire surpluses. One of the important impacts of this development was the regional segmentation of the markets: for example, prices of food grains in the primary grain markets remained below MSP in some Northern States that substantially reduced private trade from the grain markets and excessive financial costs to the FCI for procurement and storage of foodgrains. Reduction of private trade in wheat and rice in the northern states of Punjab and Haryana also possibly led to "crowding out" of private investment in agricultural marketing channels.

The past ten years witnessed large increases in the MSPs of rice and wheat that resulted in a large gap between the cost of production and the MSP. The main objective of food. Management consisting of procurement, storage and public distribution of foodgrains is to give remunerative prices to the producers and simultaneously to make available foodgrains to the consumers at reasonable price. Open Market operations and imports help in bringing price stability. Procurement is the first stage in food management chain. We have given below the data on procurement of two important crops wheat and rice since 1970. It can be seen from the Table 7.2 that during 1970s wheat was the main component of procurement operations, but after two decades rice procurement also went up considerably. Procurement of both wheat and rice has been rising over time. Wheat procurement has gone up from 5.09 million tonnes in 1971 to 19.39 million tones in 2006-07 registering an increase of 280% and in the case of rice procurement the increase was to the tune of 700%.

Table 7.2

Procurement of Wheat and Rice (In Million Tonnes)

Marketing year	Wheat	% of Production	Rice	% of Production	Total % as % food gr. Prod.
1970-71	5.09	21.29	3.46	8.20	7.89
1980-81	6.59	18.15	6.20	11.57	9.87
1990-91	11.07	20.09	13.02	17.52	13.66
2000-01	12.33	19.86	10.07	13.08	12.42
2001-02	16.35	23.46	21.28	25.04	19.12
2002-03	20.23	28.34	22.13	23.72	20.18
2003-04	19.05	29.36	16.42	233.59	20.36
2004-05	15.80	21.19	22.83	26.24	18.22
2005-06	16.80	23.32	24.46	26.93	20.27
2006-07	19.39		27.65		

Source: Economic Survey 2007-08

The year 2005-06 was a normal agricultural year with adequate procurement of foodgrains. Rice procurement during the kharif marketing season (KMS) 2005-06 at 27.7 million tonnes was higher by around 3 million tonnes compared to 2004-05. Wheat procurement during RMS 2006-07 (as on November 30. 2006) at 9.2 million tones was, however, substantially lower by 5.6 million tonnes than that during RMS 2005-06. In KMS 2006-07, which started from October 2006, procurement of rice up to January 15, 2006 was satisfactory at 11.1 million tones compared to 11.5 million procured in the corresponding period of 2005-06.

Buffer-stock Operations and Public Distribution System

The distribution of essential commodities through fair price shops at government's controlled prices has come to be known as Public Distribution system (PDS). The basic objective of the PDS is to provide essential consumer goods at cheap and subsidized prices to the consumer so as to insulate them from the impact of rising prices of these commodities and maintain the minimum status of our population. These are the various reasons to set up of the PDS in India.

The prices of agricultural products tend to fluctuate more violently than the price of manufactured products and services. This is largely due to the volatility in the supply of agricultural products coupled with the fact that demand and supply are price inelastic. One way to smooth out the fluctuations in prices is to create a buffer stock scheme, Buffer stock schemes seek to stabilize the market price of agricultural products by buying up supplies of the product when harvests are plentiful and selling stocks of the product onto the market when supplies are low.

The Food Corporation of India is the main agency for procurement, storage and distribution of food grains: The FCI has been constructing storage capacity for holding buffer and operational stocks of food grains at nodal points in the country. The storage capacities available with FCI are mainly used for storage of food grains and partly for other commodities and general warehousing, Building up and maintaining buffer-stocks of foodgrains have been an important element of India's food policy. It is, however, being extended to cover more commodities to strengthen the public distribution system, which has now become a permanent feature of the economy.

Buffer and operational stocks operation are the third main component of food management which ensures a regular supply of foodgrains through the PDS through out the year. Technical group first set up in 1975 and reconstituted time to time afterwards recommends the buffer norms to be supplemented by operational stocks of a minimum of 3.5 to 3.8mn tones on 1 April and a maximum of 8.2 to 8.8 mm tones on the 1st July. In 1997/98, the Indian Government revamped the public distribution system (PDS)—a system for distributing subsidized wheat, rice, and other essential commodities through a nationwide network of more than 460,000 "fair price shop"- in an effort to reduce costs and improve targeting to low-income consumers.

Food Management

Procurement higher than the off take had resulted in a build-up of excessive stocks of foodgrains during the two successive years of 2001-02 and 2002-03. Subsequently, however, due to increased off take under TPDS and other welfare schemes, stocks of foodgrains stood at 18.8 million tonnes on January 1, 2006, lower than not only the stocks of 21.7 million tonnes on January 1, 2005 but also the buffer stock norm of 20 million tonnes. The main reason for the decline in stocks was the lower stock of wheat.

Coarse grain procurement was higher at 1.14 million tonnes in 2005-06 as against 0.8 million tonnes in 2004-05. Wheat stocks were depleted down to 2 million tonnes in April 2006 against a buffer stock norm of 4 million tonnes. Poor procurement of wheat further reduced the actual stocks relative to buffer norms. To make up for the shortfall of wheat procurement in the rabi marketing season (RMS)

2006-07, Government decided to import 5.5 million tonnes of wheat through the State Trading Corporation (STC) for the central pool at an average weighted price of US$ 205.31 per tonne, of which 4.5 million tonnes arrived by end of January 2007. In addition, one million tonnes of wheat import on account of private traders was also contracted.

To run this system the government/Food Corporation of India purchases agricultural goods at price that would ensure minimum profit for the farmer, they also help in stabilizing price. At the same time, these goods will be supplied through public channels to consumers especially the weaker section of the community. The PDS has become a stable and permanent feature of India's strategy to control prices, reduce fluctuation in prices and achieve an equitable distribution of consumer goods

Sharp fluctuation in PDS off take is either due to the narrow margin between open market and issue price, or low releases of PDS supplies by the government to dealers, or lack of commitment to PDS as a poverty alleviation measure was sought to be undermined by the new PDS policy. To raise PDS food grain price by 68 per cent was totally unjust both from the paint of view of coverage of population and its impact on the poor.

The revised scheme of distribution known as Targeted Public Distribution System (TPDS) was launched with effect from Ist June 1997. Under TDPS, distribution of food grain operates under two tier system of delivery to households Below Poverty Line (BPL) and Above Poverty Line (ABP), with BPL families receiving food grain at heavily subsidized prices. Each BPL, family is entitled to 10 kgs of food grain per month to be sold at around half the central issue price fixed for the consumers above the poverty line. Seventy two lakh tones of food grain per annum is earmarked which is likely to behalf 6 crore poor families.

The year 2001-02 and 2002-03 witnessed high levels of stock build-up in the central pool. Food grains stocks reached a peak of 64.7 million tones, an all time record, in June 2002. The year 2003-04 witnessed a general easing in the food grains stock with relatively lower procurement of rice and wheat following a bad agriculture year in 2002-03 and relatively high off take of food grains, especially for drought-related relief operations and under the welfare scheme

Table 7.3

Procurement of wheat and rice (central pool)

(Million tonnes)

Marketing Year	Wheat		Rice	
	(April-March)		(October -September)	
	Qty	Percent	Qty	Percent
		Change		Change
1995-06	12.33	3.88	10.07	-26.55
1996-97	8.16	-33.82	12.97	20.80
1997-08	8.30	13.97	15.59	20.20
1998-99	12.65	36.02	12.60	19.18
1999-00	14.14	11.78	18.23	44.68

2000-01	16.35	15.63	21.28	16.73
2001-02	20.63	26.18	22.13	3.99
2002-03	19.05	-7.66	16.42	-25.80
2003-04	15.80	-17.06	22.83	39.04
2004-05	16.80	6.33	24.08	8.10
2005-06	14.79	-11.96	27.66	13.57
2006-07*	9.23	-	9.96	-

* As on November 30, 2006

Source: Department of Food and Public Distribution.

The quantities supplied through PDS have increased from 5 million tones in 1963 to 19 million tones in 1991-92. The off-take from PDS, in recent years, has tended to decline. In fact, the gap between allocation and off take from the PDS has increased considerably from 2.21 million tones in 1991-92 to 23.3 million tones in 2002-03 (Table I]. this is a serious cause of concern as unsold stock in the PDS lead to a heavy handling and storage costs for the government agencies.

TABLE 7.4

Food grains allocation and off take under PDS

Million Tonnes

Year	Wheat		Rice	
	Allocation	**Offtake**	**Allocation**	**Offtake**
1991-92	10.36	8.83	11.36	10.17
1992-93	9.25	7.85	11.48	9.69
1993-94	9.56	6.09	12.41	9.10
1994-95	10.91	5.11	13.32	8.01
1995-96	11.32	5.81	14.61	9.75
2000-01	11.5	4.0	16.3	7.9
2001-02	13.1	5.6	17.2	8.1
2002-03	29.4	6.1	27.3	7.3

Economy Survey: 2002-03

Buffer Stocks: States Contribution

The procurement of food grains by the FCI, is mainly concentrated in three major states (viz., Punjab, Haryana. and Uttar Pradesh) which account for 96% of wheat procurement. In the case of rice four states (viz.. Panjab. Haryana, utter Pradesh and Andhra Pradesh) account for nearly 80% of the rice procured by the FCI during 2001-02.

Table 7.5

	Production			Procurement		
States	**2004-5**	**2005-6**	**2006-7**	**2004-5**	**2005-6**	**2006-7**
Bihar	32.6	32.3	35.8	-	-	0.08
Gujarat	18.05	24.73	30	-	-	-
Haryana	90.58	88.57	100.53	45.29	22.29	33.46
Madhya Pradesh	71.77	59.57	71.59	4.84	-	0.57
Maharashtra	10.16	13	17.65	-	-	-
Punjab	146.98	144.93	145.21	90.1	69.51	67.57
Rajasthan	57.06	58.65	69.25	1.59	0.02	3.84
Uttar Pradesh	225.14	240.73	250.31	5.6	0.49	5.49
Uttara Khand	8.03	6.45	8.01	04	-	0.01
West Bengal	8.41	7.73	7.92	-	-	-
Others	17.54	16.77	11.59	-	-	0.01
Total	**686.37**	**693.55**	**748.9**	**147.85**	**92.31**	**111.04**

Source: FCI

Punjab and Haryana were contributing over 90 per cent of the total procurement by the Centre. For example, during 2006-07, these two northern States, which make up 85 per cent of the country's wheat production, contributed 91.80 lakh tonnes (It) of the total 92.31 It procured by FCI. This season, their contribution is 101.03 It of the total procurement of 111.04 It. (See Table). The contribution of Uttar Pradesh, Madhya Pradesh, Bihar and Uttarakhand is also a cause for concern. Uttar Pradesh, which makes up 10 per cent of the country's wheat production, had contributed 21.11.LT during 2002-03 but last year, it was a meager 49,000 tonnes.

However, even in Punjab and Haryana, the willingness of farmers to sell to the official procurement agencies is a worrisome factor. Punjab, for example, had contributed 98.63 LT during 2002-03. This has progressively declined and this season, it is down to 67.56 LT against 69.51 LT last year. During this period, Haryana's contribution has declined from 58.88 LT to 33.46 LT, though last year, it was even lower at 22.29 LT, Rajasthan contributed a meager 2,000 tonnes last year and this year, it was up at 3.84 LT against 4.61 LT during 2002-03. Bihar's contribution has been negligible, while Madhya Pradesh, which makes up two per cent of the wheat production, has seen its share in the Central procurement fluctuate from 4.25 LT in 2003-03 to 4.84 in 2005-06 to nil in 2006-07 and 57,000 tonnes this year.

In fact, Madhya Pradesh was the first State this year where farmers refused to sell wheat to the procurement agencies. Gujarat, where wheat production has nearly doubled since 2004-05, is another State where there has been no contribution to the Central pool. During 2006 and 2007, nearly 75 lakh tonnes of wheat were imported by the centre to augment the buffer stocks, which are used to meet the needs of the public distribution system and overcome any food emergency. The imports were made despite production rising from 68.6 million tonnes (mt) during 2004-05 crop year (July-June) to 74.89 mt last year.

Reforms of Public Distribution System (PDS)

Several changes have taken place in the PDS in the light of economic liberalization and emergence of large food surpluses during late 1990s which entailed huge expenditure to exchequer. The revamped PDS was renamed the targeted public distribution system (TPDS). The previous practice of offering quotas of wheat and rice to all consumers at one subsidized rate through the PDS was replaced by a system with a separate, highly subsidized rate for consumers certified as below poverty line (BPL) and a higher rate for everyone else (termed above poverty line or APL). For 2004-05, the buffer stock norтpa stand at 16.2 mn tons on 1 April and 26.9 mn tons on Ist of July..

Changes in government food procurement and distribution programs, which accounted for about 20 percent of total wheat and rice consumption during 1995-2005, have been a factor in the slowed growth in wheat and rice consumption since the mid-1990s. As on march 2004, there existed nearly 4 lakh fair price shops-3.05 lakh in rural and 0.94 lakhs in urban areas. A fair price shop covers a population of 2,000. The new rates covered only about a third of the total costs incurred by the Food Corporation of India (FCI). Prices for APL., sales were set 12-30 percent higher than under the PDS, rates that covered about 60 percent of FCI costs in the case of wheat and 75 percent in the case office. An additional change made with the goal of better reaching low-income.

During the initial years of implementation of the new TPDS and other welfare schemes (1997/98- 2000/01), total distribution of wheat and rice declined and remained well below the amounts procured in price-support operations. Under the TPDS, BPU distribution initially remained low. Largely due to administrative difficulties in certifying poor households, there was very limited distribution through the APL channel because API, prices were typically above market prices. The new welfare programs also began slowly due to implementation delays. The net impact of government operations during this period was lo reduce market supplies of wheat and rice available for consumption, with the PCS either adding grain to public stocks or making it available for export.

In recent years, there has been expansion in wheat and rice distribution through the BPL program and various welfare schemes, and reduced API. Prices have also boosted sales through that channel. Welfare programs have shown the most growth, rising from about 11 percent of total distribution in 1997/98 to nearly 40 percent in recent years. The TPDS and welfare programs continue to face criticism because of difficulty in accurately identifying and reaching targeted groups and

because of problems with "leakages" of subsidized grain into the open market (Government of India. Ministry of Consumer Affair Food, and Public Distribution, 2002)

India's government food distribution programs, including both the old PDS and the current TPDS, have been criticized for their limited impact on the poor, and for inefficiency. Although large amounts of grain appear lo have been distributed through the PDS and TPDS, poor households still rely primarily on the market for their supplies of wheat and rice. Because a high proportion of India's food subsidy costs stem from the Government's involvement in owning, transporting, and storing grain, a shift to a program based on food stamps, such as that used in the United States, would have the potential to significantly reduce government costs. With a food stamp program, physical handling and distribution of grain would lie with the private sector, thereby reducing or eliminating a large share of current government costs. Another issue is concern about loss of government control of physical grain markets and private traders in the current system.

Since 1970, India's trade in cereals has shown a-trend from net imports to net exports of both wheat and rice-a trend that reflects shifts in trade policy, as well as longer term changes in supply and demand Through the 1980s and early 1990s, Indian agriculture had export restrictions and overvalued exchange rates that resulted in net taxation of the farm sector. Exports of agricultural goods, including wheat and rice, were restricted through various regulations to bolster India's domestic food security. For wheat and rice, quantitative controls on imports and exports were administered through the Food Corporation of India (FCI).

In the mid-1990s, trade policies were changed when quantitative restrictions on imports were lifted and replaced by tariffs. The wheat tariff was initially set at zero, but was raised to 50 percent in 1999 to curb imports into southern India at a time when surpluses were growing in the north. The rice tariff has remained at 70 percent, a level that prohibits trade from occurring. Export restrictions on wheat and rice, historically imposed through State trading, quotas, and minimum export prices, have been progressively liberalized In 2000, India began to provide budgetary subsidies to support exports of surplus wheat and rice when the combination of declining world prices and higher domestic prices made Indian wheat and rice uncompetitive in world markets. In 2005, the Government halted export subsidies because of tightening domestic supplies and reduced Indian competitiveness in international markets, although private traders remain free to export wheat and rice.

The International Food Policy Research Institute (IFPRI) was founded in 1975 to develop policy solutions for meeting the food needs of the developing world in a sustainable way. IFPRI receives its principal funding from governments, private foundations, and international and regional organizations known as the Consultative Group on International Agricultural Research (CGIAR). If is one of 15 CGIAR research centers. IFPRI researchers work closely with national counterparts and collaborate to strengthen research capacity in developing countries. IFPRI also strengthens the links between research and policymaking through its regional networks. It communicates the results of its research to influence policymaking and raise public awareness about food security, poverty, and natural resource issues.

Criticism:

The PDS in India has been criticized on various-counts. The main criticism is as follows:

The PDS in Indian has been criticized on various counts. The main criticism is as follows:

1. Many studies indicated the limited benefit of PDS to the vulnerable section of the society. The cost effectiveness of PDS is rarely low. The PDS is a very inefficient way of providing income support to the poor. For every rupee that is delivered to the poor, the government spends Rs. 5 on the PDS, whereas it spends only Rs. 2 on Employment Guarantee Programme. ECG has the

advantages of being self-targeting to the need of people, self adjusting to the changing demands, and sell liquidating when it - becomes redundant PDS does not differentiate between the rich and the poor. It gives everyone more or less the same amount and is not cost effective.

Table: 7.6

Food Subsidy in Rs. Crores

Source: Economic 2007-08

Year	Food Subsidy	Annual growth	%of GDP
1997-98	7500	30.23	0.52
1998-99	8700	15.19	0.52
1999-00	9200	3.67	0.48
2000-01	12060	27.84	0.57
2001-02	17499	45.10	0.77
2002-03	24176	38.16	0.98
2003-04	25160	4.07	0.91
2004-05 RE	25800	2.54	0.83
2005-06 BE	26200	1.56	0.82

Source: Economic Survey

2. PDS has remained limited mostly to urban areas for a considerable period of planning while the coverage of rural areas was very insufficient. Though this bias stand corrected in the 80s and 90s but that does not ensure the effectiveness of PDS in delivering the goods. The percentage of people who purchase all their cereals from PDS is very small: One to ten per cent gets cereals in Punjab, Haryana, Bihar and Rajasthan whereas in West Bengal the percentage is more than 25.

3. There is hardly any correlation between number of fair price shops in a state and off take. Bihar accounts for 13.2 per cent of total number of ration shops whereas its percentage share in off take is merely 5 per cent. There are considerable regional disparities in the distribution of PDS benefits. Delhi with 1% of the population and having the highest per capita income accounts for 5 per cent of the grains distributed through PDS to the country.

The burden of food subsidy has increased substantially from the Rs: 662 crores in 1980-81 to Rs.9200 crores in 1999-2000. Growth of expenditure on food subsidies has been sharp in absolute terms, have grown from Rs 2,450 crore in 1990-91 to Rs 25,800 crore in 2003-04 a tenfold growth at a time of reforms when fiscal austerity was supposed to be the rule. This has happened in spite of the fact that the central issue price for foodgrains to the below poverty line consumer has increased by 61 per cent in the period 1997-98 to 2003-04, while general rise in the consumer price index for agricultural labour was only 25 per cent. This means that issue prices have not been depressed unduly and policy-makers have resisted populist pressures for still lower issue prices. High minimum support

prices for foodgrains not only lead to high subsidy bills, but also to other adverse economic consequences apart from high subsidies. Farmers are induced to concentrate on production of foodgrains to the exclusion of oilseeds and pulses when the country is facing shortages.

5. The operations of PDS have resulted in all round price rise. Net quantities available in the open market is reduced due to large procurement of foodgrain every year by the government. Scarcity and speculation adversely affects market prices.

6. There are leakages from PDS in the form of losses in the transport and storage and diversion to the open market. Instead of selling ration at fur price shops at subsidized rates, shopkeepers sell them the open market at higher prices.

Suggested Reading

1. GS Bhalla (2007). Indian Agriculture Since Independence, National Book Trust,
2. Remash Chand (2005) "Whither India's Foods Policy? From Food Security to Food Deprivation," Economic and Political Weekly, March 12, 2005.
3. Economic Survey (2006-07) Ministry of Finance, New Delhi.

Lesson - 8

Prof: N. K. Sharda

Industrial Growth: Performance and Problems

Since the middle of the twentieth century industrialization came to be recognized as a potent means of repid economic growth in the developing countries. Industrialization in these countries has been identified with higher marginal productivity of labour, technological improvements, rising levels of skills, etc. It has also been considered as a necessary means of raising the levels of living of the people.

Modern industry in India started coming up in the middle of the nineteenth century. However, during the pre-independence period not only the structure of industry was lopsided but also the overall industrial growth had obtained a very low level. Thus soon after independence the factory establishments or the organized industrial sector contributed only 5.6 per cent to the GDP in India. The total labour force employed in these established was only 1.8 per cent of the total labour force. These two indices of industrial growth point towards the facts that there was a lack of well-designed policy of industrial development and a deficiency of basic industrial infrastructure. Besides, there was a near-absence of capital market as well as the required managerial and skilled manpower. It was, therefore, imperative that if the process of industrial growth was to materialize after independence, these shortcomings were overcome through an effective policy intervention.

As a consequence, during the post-independence period acceleration of industrial growth became one major economic policy concern in India. This was sought to be accomplished through the process of planning. As compared to the pre-independence period, the period since 1951 has witnessed a sea- change in the industrial structure of the country, in spite of the fact that industrial growth has not remained steady and sustained. The dissatisfaction with our industrial progress sometime arises due to the fact that some other developing countries like China, Brazil, Thailand, Malasia, etc. than India in the industrial growth performance, especially since 1970's, But per se-our industrial growth during the last six decades has by no means a small achievement. There are several indices of industrial growth but just one index will make this point clear. In 1947-48 the share of manufactured articles in our total exports was 49% By 1997-98 it had risen to 7.6 and in 2006-07 this share stood at 69 per cent. From a predominantly raw material exporting country India has now turned into a major manufacturing exporter.

One can identify broadly four distinct phases of growth performance of industrial sector since the planning era on the basis of index numbers of industrial production, growth rates and other indices. These indices point out that growth has not been uniform. In what follows we shall discuss the phase of industrial growth in India. In order to understand the uneven growth rate of industrial output in India we may look at the plan-wise figures given in Table 1.

The first phase covers the period of the first three Five-Year Plans (1951-65) when the industrial growth rate was fairly high. The average annual growth rate was close to 8 per cent. Fifth and Sixth Five Year Plans the average. The period 1956-57 was especially marked by faster growth (in excess of 10 per cent per annum) in metals and metal products, Machinery, Chemicals , Paper and Wood.

Consumer goods industries grew rather slowly in the only exception of foot ware industry which grew at over 10 per cent.

Table-1

Plan-Wise Rate of Growth of Industrial Output in India

Five Year/Annual Plan(s)	Annual Growth Rate (%)
I. 1951-52 to 1955-56	7.3
II. 1956-57 to 1960-61	6.6
III. 1961-62 to 1965-66	9.0
Annual Plans 1966-67 to 1968-69	2.0
IV. 1969-70 to 1973-74	4.7
V. 1974-75 to 1978-79	5.9
Annual Plan 1979-80	-1.4
VI. 1980-81 to 1984-85	5.9
VII. 1985-86 to 1989-90	8.5
Annual Plans 1990-91 and 1991-92	4.4
VII. 1992-93 to 1996-97	7.6
IX. 1997-98 to 2001-02	4.6
X. 2002-03 to 2006-07	8.0
XI. 2007-08 to 2011-12 (Target)	9.9

However, this growth rate could not be sustained subsequently and then followed the second phase of slow-growth or declaration which extended from 1965-66 to 1979-80. During this period, covering the Fourth growth rate could not be sustained and the same came down to 5.5 per cent. The corresponding growth rates for the registered manufacturing during these two periods were 7.6 and 5.5 per cent respectively. The second phase of industrial growth is referred to as the phase of industrial stag-nation in India. Although there was revival of sorts in the industrial growth after mid-1970s, yet even during the Sixth Plan the growth rate could not reach above those attained during the first three Five Year Plans. The period of stagnation seems, however, to have ended by 1975-76. The period of the Seventh and Eighth Plans is generally regarded as the third phase in the industrial growth of the country. The latter part of the 1990s experienced even greater fluctuation in the industrial growth rate. This is clear from the fact the during the Ninth Plan this sector registered annual growth rate of 4.6 per cent only. The fourth phase of industrial recovery started after the turn of the century and the Tenth Plan registered an impressive growth rate of 8.0 per cent per annum. In the early 1990s, it was the impact of general economic crises which pulled down the industrial growth rate. But after 1995 there has been what is variously described as the industrial recession of slow down. We shall come to these aspects of latest deceleration later in this lesson.

Let us first look into the industrial stagnation since mid-sixties which became an issue of heated discussion amongst economists in India. The economists who took part in this discussion included K.N. Raj, Deepak Nayyar, Prabhat Patnaik, L.J. Ahluwalia, R. Nagraj, etc. A number of hypotheses were offered for the industrial stagnation between 1965-79. The first hypothesis given by economists like K.N. Raj and A Vaidyanathan was that India's performance on agricultural front was poor during this period and it directly affected the growth of industrial output due to inter-sectoral linkages. Some economist like Prauab Bardhan, I.J. Ahluwalia and Sukhamoy Chakravarty, while giving an alterative explanation of stagnation, held deceleration in public investment responsible for it. The economists like Ashok Mitra and Deepak Nayar held demand constraint responsible for stagnation. They argued that due to worsening economic disparities large majority of masses in India were not able to generate adequate demand for wage goods which slowed down the industrial growth. Yet another explanation of industrial stagnation is advanced in terms of exhaustion of opportunities of import substitution. Had India adopted export-let growth strategy, stagnation might have been avoided. It has also been argued that industrial stagnation was a consequence of excessive state regulation of industrial sector through the mechanism of controls which throttled private initiative and capital formation. Pranab Bardhan, while putting forth another strand, argued that a nexus between big business, laudlords, and bureaucracy generated a system of concessions and subsidies which generated inefficiencies in the government sector. This is turn, reduced public savings and public sector capital formation. All this got reflected is the form of industrial stagnation.

Let us no look into the third phase of industrial growth in the 1980s. During this period there was an intense debate whether the industrial stagnation had indeed ended or not. Whether the industrial upturn was there to stay? In order to improve the quality of date of Index of Industrial Production (ITP), a revised. series of this index with 1980-81 as the base year was adopted by the government. The new series had shown a distinctly higher rate of growth of industrial output compared to that obtained during the period of stagnation. However some economists like C.T. Kurien argued that the new series of IIP had an upward bias for growth rates in the 1980s due to the fact that the new series replaced the supposedly slow growth industries with faster growing ones. This argument implied that that industrial stagnation had not in-fact ended even during 1980s. The opposite view that since the mid-1970s India had indeed registered higher industrial growth rates, which were distinctly above those registered during 1965-75 period, the industrial recovery did take place was put forth by K.N. Raj ay Y.K. Alag. During the third phase there took place fast growth of consumer durables (around 14 per cent). The growth of capital goods sectors such as electrical machinery also picked up considerably as did chemicals to a certain extent. However the other basic intermediate and capital goods industries continued to grow between 4 and 7 per cent per annum.

The issue in the debate regarding genuineness of industrial growth during 1980s was clinched by R. Nagraj who, by using the alternative National Accounts Statistics data, observed that the growth rate of real manufacturing gross value added during 1980-81 to 1986-87 was not only higher than that during 1956-66 and 1970-80 but could also perhaps be comparable to that attained during 1959-60 and 1965- 66 period. This lent support to the authenticity of new series of IIP data. Thus view was also endorsed by Rajiv Kumar and V.L. Kelkar. Both attributed the higher rate of industrial growth to the policy changes followed by government after the mid-1970s.

In the later part of the third phase, the period of 1990s, the industrial growth rates have been far from uniform as there have been wide fluctuations in the growth of industrial output. Starting with 1991-92, the annual growth rate dipped to 0.6 per cent compared to 8.2 per cent during the preceding year. From 1992-93 to 1995-96 there was a steady recovery and during the latter year the annual growth rate was 13.0 per cent whereafter it again started declining, though not uniform-ally. This can be observed from Table II.

To sum up, the first three phases of industrial growth, the diversification of industrial output in favour of producer goods was concentrated during the first phase; the focus of growth had shifted to consumer durables towards the end of the first phase. The availability of consumer durables may also have received a supply side fillip from liberalized regime of the eighties which permitted many tie ups of Indian business houses with foreign companies.

Table II

Annual Growth Rate of Industrial Production

(Based on IIP, Base 1993-94-100

Year	Mining & Quarrying	Manufacturing	Electricity	Overall
Weights	10.47	79.36	10.17	100.00
1995-96	9.7	14.1	8.1	13.0
1996-97	-1.9	7.3	4.0	6.1
1997-98	6.9	6.7	6.6	6.7
1998-99	-0.8	4.4	6.5	4.1
1999-00	1.0	7.1	7.3	6.7
2000-02	1.2	2.9	4.0	5.0
2003-04	5.2	7.4	5.1	7.0
2004-05	4.4	9.2	5.2	8.2
2005-06	1.0	9.1	5.2	8.2
2006-07	5.4	12.5	7.0	11.6
2007-08	4.9	9.8	7.0	9.2

*Pertains to April-November period

Source: Central Statistical Organization quoted in Economic Survey 2007-08, P. 182

The last deceleration in the industrial growth rate between the period 1996-97 and 2002-03 has been variously referred to as industrial recession or slowdown. A number of explanations put forward for it are: excess capacity build up is some industries like cement and automobiles in the earlier years; tight money and credit policies followed in 1995-96 resulting into high interest rate regime; slump in the stock market, high level of political uncertainty, etc. In addition, exposure to external competition in the wake of economic reforms, cut back in capital formations in the public sector, infrastructural constraints and sluggish growth of exports were also the contributory factors to industrial slowdown.

The fourth phase of industrial growth pertains to the post-2003-04 period. It has been a period of industrial resurgence. First, the growth of industrial sector, from a low of 2.7 per cent in 2001-02 revived to more than 7.0 per cent during the years following 2003-04. Second, the growth of industry as a proportion of the corresponding growth in service sector, which was 78.9 per cent on an average between 1991-92 and 1999-2000, improved to 88.7 per cent during the last seven years. Third, within industry, the growth impulses seem to have spread to manufacturing. Industrial growth further improved in the years 2006-07 and 2007-08 due to considerable improvement in the mining and quarrying and electricity sub-sectors. However due to an all time high crude prices in March 2008, appreciation of Indian currency during this very period, and high interest rates are likely to leave an adverse impact on industrial growth in the time to come. The picture with regard to forward looking variables such as investment, especially in the corporate sector still continues to be encouraging. The government has also taken some measures, though half- hearted, to tide over the slow down in export-oriented sectors. The ultimate solution in this regard lies only in enhancing the competitive strength of Indian industry.

Structural Change in Indian Industry.

At the commencement of First Five-Year Plan Indian industrial structure was dominated by consumer goods industries. To ensure repid industrialization there was an urgent need to develop our own capital goods production capacity. The Mahalanobis model of planned development underlying the Second Plan was in fact based on the logic that the rate of growth of the economy depended on the volume of capital, goods within the country. Therefore in the Second and subsequent Plans top priority was accorded to the development of basic, capital goods and intermediate goods industries, especially within the jurisdiction of public sector. Thus Second Plan onwards, the share of capital goods industries vis-à-vis the consumer goods industries continued to increase in the total industrial output. Before taking up this aspect of structural change, let us first look at the change in the ownership structure of our industrial sector which has undergoing a significant change during the post-1950s period.

If we look at the change in the percentage distribution of Indian industries (covered under the Annual Survey of Industries) and change therein since 1973 as reported in Table III some facts stand out clearly. First, during this period the share of public sector almost doubled.

Table III

Percentage Distribution of Indian Industries by Ownership

Value of Production (Average)

Ownership	1973-74 to 1975-76	1979-80 to 1981-82	1993-94
1. Public Sector	18.8	26.0	30.0
2. Joint Sector	6.6	7.2	4.0
3. Private Sector	74.6	66.8	66.0

The joint sector has not been very significant and the private sector continued to hold its commanding position. The public sector has failed to realize the goal of attaining the commanding heights of the economy as was visualized in the Second Plan and Industrial Policy Resolution of 1956. But for the recent slow down of economic reforms under the U.P.A. government, there would have been a further dilution of value of production in the public sector due to the economic policies.

The change in the industrial structure can also be understood in terms of changes in the share of output of different types of industries over time. For this purpose the industrial output can be looked at from end users categories. Accordingly the producers goods are sub-divided into three categories, i.e. basic goods, capital goods, and intermediate goods. Consumers goods are divided into durable and non- durable categories. Such a change is brought out in Table IV below.

Table-IV

Change in Composition of Industrial Output (By End User Base)

Sr. No.	End Use	Average annual growth rate (Percentage)					
		1951 to 1955	1965 to 1976	1980-81 to 1991-92	1997-98 to 2001-02	2000 to 2007	2007-08
1.	Basic Goods	4.7	6.5	7.4	4.1	6.6	8.4
2.	Capital Goods	9.8	2.6	9.4	4.7	14.4	20.8
3.	Intermediate Goods	7.8	3.0	4.9	5.8	6.2	10.1
4.	Consumer Goods	4.8	3.4	6.0	5.5	9.6	5.2
	(a) Durables	-	6.2	10.8	10.7	8.8	-1.7
	(b) Non-durable	-	2.8	5.3	3.8	10.0	7.8
5.	General Index	5.7	4.1	7.8	5.0	8.2	9.2

From the perusal of above average annual growth rates the first noteworthy fact that emerges is that over the period 1951 to 1992 the growth rate of producers goods had remained generally higher than that of the consumer goods and the latter remained lower than the growth rate of general index of industrial production. During the post-1997 period, especially during Tenth Plan the durable consumer goods registered impressive growth, though not as good as the capital goods. These two together may be held as the prime movers of india's industrial resurgence. The overall implication of the growth rates of industrial output by end-user categories between 1951 to 2008 is that the share of producer goods has risen while that of consumer goods has declined over time. This conclusion also stands vindicated if we examine the nature of industrial diversification within this sector reflected in the following Table.

Table V

Diversification Within Industrial Sector

(Weights of Use-Based Sectors in the Index of Industrial Production)

End use	1956	1960	1970	1980	1990	2007
Basis Goods	22.3	25.1	32.3	39.4	38.4	35.5
Intermediate Goods	24.6	25.9	20.9	17.5	17.5	26.5
Capital Goods	4.7	11.8	15.2	16.4	23.7	9.3
Consumer Goods	48.4	37.2	31.5	23.7	20.5	28.7
Non-durables	-	(31.6)	(28.1)	(21-1)	-	(23.3)
Durable	-	(5.7)	(3.4)	(2.6)	-	(5.4)
Industry	100.0	100.0	100.0	100.0	100.0	100.0

The changes in the weights of use-based sectors between the period 1956 to 2007 as shown above indicate a steady shift away from consumer goods to the producer goods. For instance the three categories comprising producer goods accounted for 51.6 per cent in the weight of industrial production

in 1956 and their combined share increased to 71.3 per cent by 2007. In other words the industrial economy of India has undergone a significant and positive structure change which has corrected the structural imbalance that existed at the time of independence. J.C. Sanderara in Industrial Policy and Planning 1947-91 regarded the above-described inter-temporal change as the diversification of industrial sector in India.

Problems of Industrial Development

From the preceding discussion it is clear that during the post-independence era India has taken big strides in the matter of industrialization in terms of growth and diversification. A number of problems were bound to arise during this process and quite a few of them were resolved through government intervention. Still others still persist. In the following pages we shall discuss in brief some major problems facing the Indian industry.

(i) Industrial Sickness: The problem of industrial sickness is not new. Over time it has become more and more acute and has affected adversely the performance of different segments of industry. Before going into the details, let us notice how precisely industrial sickness has been defined. In fact up to 1985 there was no single definition of sickness and it was defined differently in view of the purpose at hand. The Reserve Bank of India in its report in Trends and Progress of Banking in India (1977-78) two indices of industrial sickness: (i) when the industrial unit has incurred cash losses in one year and the financing bank feels that it is likely to incur such losses during the current and next year as well, and (ii) there is an imbalance in the financial structure of the unit in the form of ratio of current assets to current liabilities being less than one. Subsequently the Sick Industrial Companies (Special Provision) Act, 1985 defined a sick unit as the one 'which has been registered as a company for not less than seven years and which has accumulated losses equal to or exceeding its entire net worth (paid up capital plus reserves) and has also suffered cash loosed in such financial year and the preceding year. In Dec. 1991, public sector companies were also brought under the preview of 1985 Act. The 1992 amendment introduced in Feb. 1994 altered the earlier criteria. The unit then onwards needed to be registered only for five years and the criterion of cash losses for two successive years was done away with.

In the small scale sector a unit was defined as sick if it (a) incurred cash loss in the previous accounting year and was likely to do so in the current year and erosions on account of cumulative cash losses to the extent of 50 per cent or more of its peak net worth during the last five years and/or (b) continuously defaulted in meeting four consecutive installments of interest or two half-yearly installments of principal on term loan and there were persistent irregularities in the operation of its credit limits with the bank.

The industrial units which display features such as the foregoing also exhibit symptoms of sickness like failure to repay statutory liabilities like provident fund and insurance premium, failure to repay public deposits, accumulation of inventories, low capacity utilization, frequent industrial disputes, etc.

The definition of a sick industrial company was changed by the Companies (Second Amendment) Act 2002. As per new provisions a sick unit meant a company having (i) accumulated loosed in any financial year which are equal to 50 per cent or more of its average net worth during four years immediately preceding such financial year; or (ii) failed to repay its debts within any three consecutive quarters on demand of the creditor.

Extent of sickness in Indian Industry: The extent of industrial sickness can be ascertained in terms of number of industrial units and the outstanding bank credit against such units. The figures pertaining to these two aspects presented in Table VI show a sharp rise in the incidence of sickness, especially among the small scale units over time.

Table VI

Extent of Industrial Sickness in India

	Large & Medium	Small	Total
Number of Units			
Dec. 1980	1,401	23,149	24,550
March 1990	2,269	2,18,828	2,21,097
March 2000	3,269	3,04,235	3,07,399
March 2003	3,396	1,67,980	1,71,376
Outstanding Bank Credit (Rs. In Crores)			
Dec. 1980	1,502	306	1,809
March 1990	6,926	2,427	9,353
March 2000	19,047	4,608	23,656
March 2003	29,110	5,706	34,816

The figures in Table VI make it clear that the number of small sick units has risen faster in comparison to the large and medium units Second, the major share of outstanding bank credit was accounted for by the large and medium sick units. If the industrial sickness is so widespread, especially in the SSI sector, where a high proportion of industrial units have fallen sick, it is natural to look into the causes of sickness which can be divided into internal and external factors.

The internal factors relate to those actions for which the unit itself is responsible. The most obvious case is of such units which do not plough back surpluses for repairs, renewals or expansion. Another factor relates to setting up of units primarily to obtain subsidies and cheap credit and then to declare the unit as sick. Lack of proper project planning is still another factor often landing the unit in crises. Wrong decisions regarding location, demand forecasting, poor industrial relations are some eta actors responsible for sickness.

At times the industrial units fall sick not due to their internal actions or policies but by factors completely outside their control. Faulty economic policies of government and their timing have on several occasions harmed the industrial units. In fact the Import substitution or Inward looking policies are to be largely blamed for the lack of competitiveness among several segments of industry. The administered price policies have also pushed several industrial units on the brink of disaster. The wage legislations are biased in favour of industrial workers and not linked to performance.

(ii) Capacity Utilization in Indian Industry: A higher rate of capacity utilization implies greater production, greater employment of labour and optimum utilization of capital stock. The study of capacity utilization in Indian industry is constrained by data inadequacies with regard to the actual shifts operating in an different industrial units. Still some estimates of capacity utilization by broad categories

of Indian industries available in R.B.I., World Bank, UNIDO and Centre for Monitoring of Indian Economy (CMIE) publications.

In early sixties the capacity utilization ratios were fairly high in respect of producer goods and consumer goods industries. Together this average was above 86 per cent. During the period 1971-75, which was a period of industrial stagnation, capacity utilization ratios declined in both the user-based broad industry groups and the fall was more pronounced in capital goods where it came down to 60.2 per cent. During 1980 a modest recovery was made. The average & between 1970-83 were: basic goods (76.5%), capital goods (57.8%), intermediate goods (84.3%), and consumer goods (85.7%). C.M.I.E., in its study of 600 industries reported that in 1986 about 35% industries operated below a capacity utilization rate of 60 per cent.

Low rate of capacity utilization in the Indian industries is often attributed to the demand constraints and supply constraints. In addition, the policy environment in which the firms have to operate has also an important role in capacity utilization. Whenever there takes place a decline in demand for a particular product, the units producing it would be constrained to slash the output. A decline in the capacity utilization by capital goods industries after mid-sixties and an upsurge of consumer goods (especially durables) explains during recent three years (2004-07) explain respectively the decline or upturn of capacity utilization. The supply constraints include factors such as lack of raw materials and inputs, infrastructural bottlenecks such as power shortage, lack of means of transport and communications, poor industrial relations, etc.

III. Regional Imbalances in Industrial Development: During the pre-independence period certain economic, historical and other factors led to the concentration of industries in a few cities/provinces of the country. After 1950 a more even regional distribution or dispersal of industries was considered necessary and this was sought to be accomplished through the setting up public sector units in the hitherto unindustrialized areas and incentives to private sector for starting industrial units in the such areas. A number of studies by R.H. Dholkia, R.T. Tewari and J.C. Sandesara dealt with the issue of regional distribution of industries and inter-temporal charges therein. In 1960 only four states-West Bengal, Maharashtra, Gujarat and Tamil Nadu accounted for 58 per cent of total factory employment. Further only 12 states had a combined share of 92 per cent of total factory employment during this year. By the end of 1980s the share of above mentioned industrially leading states came down to 46 per cent in total factory employment and that of the first twelve states to 89 per cent. In other words the inter-state disparities have not narrowed down significantly over time.

In 2001-02 the industrially developed states-Maharashta, Gujarat and Tamil Nadu together (having 20.4 per cent of country's total population as per 2001 Census) accounted for 43.9 per cent of gross industrial output, 42.2 per cent of value added, 44.2 per cent of invested capital, and 38.3 per cent of employment in the factory sector. These figures are a substantial proof of regional concentration of industries in India.

It we look at the state-wise distribution of employment of central public enterprises, in 2002-03 there was neither any such employment nor a working unit in as many as seven states.

The approach paper to the Eleventh Plan released by the GO.I. on June 14, 2006 also adinitted the irrelevance of policy instruments like industrial licensing in promoting balanced regional development. It went on further to admit that "..... investment must be allowed to flow to locations perceived to have on attractive investment climate and better infrastructure facilities. While this has definitely generated efficiency, there is an evidence of increasing regional divides." P62.

The recent strategy of ensuring speedy industrial development of through Special Economic Zones may also further aggravate regional imbalances as already industrially developed states are preferred in this matter.

(IV) Problems of Public Enterprises (PSUs): A major problem of industrial development in India has been that of poor performance of public enterprises which were accorded a commanding height in the economy. These enterprises were conceived of as an instrument of policy for achieving multiple goals such as to direct scarce resources to the priority areas and regions, to stabilize prices, to generate financial resources for domestic capital formation, etc. None of these objectives has been realized to a any significant extent even more than fifty eight years after the commencement of planning. Why do we fell so concerned about the working of PSUs? It is because the government has invested a huge amount of scarce financial resources in these enterprises. On April 1, 1951 the total number of central PSUs was only 5 with total investment of Rs. 29 crores. On April 1, 1992 there were 246 CPSUs with an investment of Rs. 1,35,445 crores. On March 31, 2007 the CPUs numbered 244 with a cumulative investment of Rs. 4,21,089 crores and an employment of 16.14 lakh persons. The profitability performance of CPSUs, through slightly improving in recent years, has been largely unsatisfactory. Their net profit after tax was (-) 1.1 per cent in 1980-80; 2.3 per cent in 1990-91, 4.8 per cent in 2000-01, and 7.7 per cent in 2002-03. Thus the contribution of CPSU to the resource mobilization for domestic capital formation has been far from satisfactory. In fact, during the post-reform period there has been a termed us pressure on CPSUs to ensure financial viability and adequate profitability and to restrict the future role of these enterprises is the areas of these enterprises is the areas of market failure.

Suggested Readings

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Lesson - 9

Prof: N. K. Sharda

MONOPOLY AND INDUSTRIAL CONCENTRATION IN INDIA

In this lesson we shall discuss the existence of monopoly and industrial concentration in India. In the 1950s, our country started pursuing the goal of establishment of a socialist pattern of society. In this context, therefore, it became necessary for the policy-makers to adopt measures to curb monopoly and industrial concentration. During the Nehru era, reduction of inequalities, control of monopoly and checking industrial concentration became an important component of the policy-making process. In the present lesson, we shall first of all try to assess the extent of monopoly and industrial concentration in India, and we shall notice what has been the nature of public policy towards this socio-economic phenomenon.

1. Extent of Monopoly and Industrial Concentration:

The industrial policy of the 1950s and the 1960s as well as the over-all policy regime of this period in India was strongly oriented towards regulating private sector industry so that economic inequalities in general and monopoly and industrial concentration in particular could be kept under check. Due to such an orientation of the policy framework of this period, and in fact of the subsequent period extending roughly up to the mid-1970s, various studies by individual researchers organizations and official agencies focused on the extent of monopoly and industrial concentration in India. For this period, there are several estimates available whichi show the extent of monopoly and seller concentration in Indian Industry. We shall discuss some of these below. However, since the mid-1970s and particularly in the 1990s, as a result of policy reversal in this respect, going now by the names of liberalization and privatization, the policy framework has ceased being much concerned about control of monopoly and industrial concentration in the country, That is why it is somewhat difficult to corne by any meaningful estimates of the extent of monopoly and industrial concentration in India for the 1980s and the 1990s.

Before taking up the discussion of extent of monopoly and industrial concentration in India, let us acquaint ourselves with the forms, in which this phenomenon has been visualized and looked at in various studies. Thus Monopoly industrial concentration or concentration of economic power have been viewed in various studies as interlinked phenomena and these are manifested in the following forms:-

(a) Concentration of ownership:- In the past, some (usually 20) top business houses were identified and the extent of shares of value of assets owned by them in different industries as well as its ratio to total value of industrial assets in the country was estimated. These industrial houses were also referred to as monopoly houses by certain researchers since they represented the monopolization of industrial assets and through these the industrial output The industrial houses which have usually figured in the list of the top 20 businesses are such names as Birlas, Tatas, Bangurs, Thapars, etc.

(b) Concentration of Industrial Control:- Another form in which monopoly and industrial concentration are viewed in India is what is called interlocking of directorates. The control of an industrial enterprise is vested in the board of directors of the company. It has been observed that in many cases, a single person gets elected as the director of several companies. Through this mechanism, the directorships and the control of these otherwise independent companies get interlocked. This indeed is a method of concentrating control of industries in the hands of a few

influential persons. This is a manifestation of monopoly of industrial control and centralization of economic power.

(c) Concentration of production:- This is what was termed as seller concentration. Concentration of production takes place in an olligopolist market where only a few large firms rule the roost. Each of the large firms enjoys a relatively large market share. Because each Firm supplies a significant share of the total output of the industry, concentration of production in the hands of a few firms takes place. This has also been referred to as product-wise concentration in India.

Coming now to the extent of monopoly and industrial concentration in India, the earliest attempt in this respect was made by Mahalanobis Committee (1961) which had estimated that in 1951, twenty leading business groups had an interest of one kind or another in as many as 983 companies with a share capital of Rs. 352 crore. According to the Committee, at the end of ten years of planning in the country, an excessive industrial concentration had occurred in the hands of few persons in the private sector. Since the government of the time was committed to the establishment of a socialist pattern of society in the country, it set up a Monopolies Inquiry Commission in April, 1964 to go into the question of extent of monopoly and concentration of economic power in private hands. The Commission submitted its report in two volumes in 1965.

The Commission studied monopoly and industrial concentration in India in the following two forms-

(a) Product-wise Concentration:—The Commission studied the phenomenon of prevalence of oligopoly in Indian Industry, showing how the articles of common consumption were being supplied in each industry by a few dominant firms. The Commission studied the percentage share of three top enterprises in the total industrial output of some important commodities, as shown in Table L The Commission in fact selected 100 products from the point of view of their importance to the ordinary consumer and estimated their concentration ratios. The ratios shown in Tablel are only for the conventional necessaries and medicines.

TABLE 1

Product-wise Concentration (1961)

Name of the Product		No. of enterprises	Percentage share of top 3 enterprises
Conventional Necessaries:			
1.	Matches	2	100.00
2.	Soap	52	77.5
3.	Leather Footwear (indigenous type)	4	99.9
4.	Leather Footwear (western type)	8	98.9
5.	Rubber & Canvas Footwear	16	75.2

6.	Toothpaste	8	77.6
7.	Talcum Powder	19	76.7
8.	Razor Blades	5	95.9
9.	Cigarettes'	9	83.3
Medicines:			
1.	Sulphapyridine	1	100.0
2.	Sulphagonidine	2	100.0
3.	Sulphadiazine	2	100.0
4.	Sulphatluazolc.	2	100.0
5.	Choloramphenical	2	100.0
6.	Penicillin	2	100.0
7.	Streptomycin	2	100.0
8.	Vitamin A	2	100.0
9.	Vitamin B 6	2	100.0
10.	Vitamin B 12	2	100.0
11.	Vitamin C	2	100.0

It would be noted in the Table that the share of the largest-three producers was found to be nearly 100 per cent in most conventional necessaries and it was 100 per cent in all the medicines. Important as all these items of consumption are for the ordinary consumers, their production was concentrated in the hands of a couple of producers in each of these industries. Thus, the Commission found most Indian industries to be highly oligopolistic where price, output or both could be manipulated by the firms to the common detriment.

Besides product-wise concentration the Monopolies Inquiry Commission also studied die extent of country-wise.

Concentration in India: This was also referred to as inter-industry concentration. This was defined as the share of each dominant business group in the assets of different industries in the

country. A business group was taken "to comprise all such concerns which are subject to the ultimate decision-making power of controlling interest in the group—the group master."

The Commission obtained data regarding 2259 companies and prepared a final list of 75 dominant business groups. The assets of all these 75 groups, owned by them in as many as 1536 companies,- amounted to Rs. 2605 crore. Table 2 below provides fuller details of country-wise concentration in respect of the top-most 5 out of a total of 75 of the dominant business houses in the country.

TABLE 2

Country-wise Concentration (1961)

Rank	Name of Business Group	Total No. of Companies in the Group	Total No. of Companies with not leas than Rs.1 crore assets	Total assets of Companies in coluam 4 (Rs. In crore)
1	**2**	**3**	**4**	**5**
1.	Tatas	53	27	385
2.	Birlas	151	54	211.0
3.	Martin Bum	21	9	144.7
4.	Bangul	81	15	58.4
5.	A.C.C.	5	3	76.0

The data in Table. 2 above shows that in early 1960s, the Tatas were the biggest business group in the country. There were 53 companies in the group out of which 27 companies owned assets worth more than Rs. 1 crore each and their total assets amounted to Rs. 385 crore. The group was the biggest- in terms of the last-mentioned figure. Birlas controlled even larger number of companies, although these owned assets of smaller worth.

The Monopolies Inquiry Commission provided information for the year 1961. Studies of R.K. Hazari and (he Industrial Licensing Policy Inquiry-Committee (Dutt Committee) had-also dealt with the question of monopoly and industrial concentration in India for that early period. Some information in this regard is also available for the 1970s and the 1980s. The concepts of monopoly and industrial concentration in India were also changed a little for this later period. Nirmal K. Chandra used the concepts of aggregate concentration and disaggregate concentration. The former was defined as the ratio of assets of top twenty business houses to assets of the entire private corporate sector, while the latter term was used for product- wise concentration or seller concentration.

According to N.K. Chandra, the share of top twenty industrial houses-in the total assets of the entire private corporate sector was 61.45% in 1972, which further increased to about 71% in 1983. This shows a relatively high degree of concentration of economic power in the industrial sector of the country. It could also be seen as the monopolization of industrial activity by a handful of industrialists.

These top 20 industrial houses, which were also referred to as monopoly business houses during this period further consolidated their position during the 1980s, as is clear from data in Table 3

TABLE. 3

Monopoly and Aggregate Concentration in India in 1980s

S. No.	Name of Industrial House	Number of undertakings controlled	Value of assets (Rs. in crore)	
			1980	**1989-90**
1.	Tata	85	1539	8531
2.	Birla	66	1431	8513
3.	Reliance	15	176	3600
4.	Tbaper	49	348	2177
5.	J.K. Singhania	62	413	2139
6.	Larsen and Toubro	7	216	1682
7.	Modi	44	199	1399
8.	Bajaj	34	179	1377
9.	Mufatlal	44	427	1377
10.	M.A. Chidambram	35	44	1373
11.	Hindustan Liver	16	–	1209
12.	United Breweries	47	–	1189
13.	T.V.S. lyenger	39	–	1177
14.	I.T.C.	17	–	965
15.	Shri Ram	28	–	934
16.	A.C.C.	7	–	903
17.	Oswal	3	–	870
18.	Mahindra	9	–	774
19.	Essar	12	–	756
20.	Kirloskar	27	–	736

It would be seen in Table 3 that these top 20 industrial houses owned/controlled as many as 558 firms in the country in 1989-90. The aggregate value of assets owned by these firms amounted to Rs. 41635 crore. Further, it would be noted in the Table that the value of assets of top ten out of the 20 business houses increased by a little over eight times. The comparative figures for the remaining ten, for the year 1980, are unfortunately not available. Interestingly, the value of assets of Reliance (which in the late 1990s is the biggest industrial house of the country) multiplied by as much as 20 times. Overall, it is clear from figures in the Table, that the decade of the 1980s was a period of increasing monopolization and industrial concentration in the country.

Now let us take up the extent of industrial concentration or disaggregate concentration in the country. A World bank study entitled India, Industrial Regulatory Policy Study, 1986 provides the data on this aspect industrial concentration in the country for the years 1976 and 1983. These data are reproduced in Table 4 here ahead.

TABLE. 4

Concentration Levels in Selected Industries

S. No.	Product Category	Percentage share of largest Tour firms in industry output		
		1976	1983	Change (%)
1.	Acrylic fibre	100	100	0
2.	Newsprint	100	100	0
3.	Pig iron	100	100	0
4.	Jeeps	100	100	0
5.	Motor Cycles	100	97	-3
6.	Cars	100	100	-0
7.	Three-Wheelers	96	93	-3
8.	Malted foods	98	98	0
9.	Cigarettes	96	96	0
10.	Commercial vehicles.	93	95	2
11.	Soaps	86	94	8
12.	Soda; ash	100	91	-9
13.	Polyester fibre	100	90	-10
14.	Boilers	80	88	8

15.	Baby milk products	79	84	5
16.	Nylon yam	100	84	-16
17.	Detergents	88	82	-6
18.	Dry cells	66	80	14
19.	Viscose fibre	69	80	11
20.	Ball/roller bearings	76	74	-2
21.	Cement machinery	89	73	-16
22.	Dyes	75	72	-3
23.	Electric motors	48	68	20
24.	Auto tyres	35	61	26
25.	Agricultural machinery	54	56	2
26.	Textile machinery	42	53	11
27.	Cement	60	41	-19
28.	Vanaspati	26	30	4
29.	Pane/products	43	29	-14
30.	Jute textiles	17	25	8
31.	Sugar	4	7	3
32.	Drugs, pharmaceutical	21	18	-3

The data in Table 4 shows that in 1983, there were 24 important industries for which the industrial concentration (i.e. the share of the largest four firms in industry output) was fairly high. In these cases, the share of the largest 4 firms ranged between 60% and 100%. Out of the 32 industries, for which data have been given in Table. 4, concentration ratios in 7 industries remained constant, in 11 industries it declined and in 13 it increased between the years 1976 and 1983. The figure in the Table over all give an impression of widespread monopolization of industrial output in the country.

2. Need for Control of Monopoly and Industrial Concentration

As noted at the beginning of this lesson, the national leaders in the immediate post-independence years were against concentration of economic power in the hands of a few persons or households. They gave to the country a national goal, viz. the establishment of a socialistic pattern of society. In other words, a more equal distribution of income, wealth and property was to be attained. Naturally therefore, in the light of this national goal, monopoly and industrial concentration were to be

curbed. As we shall notice in the next section, several policy measures were adopted with this objective in view.

Here the question that arises is what was the precise need of controlling monopoly and industrial concentration in general and under the special circumstances of the country in particular? In the first place it is obvious that when the country attained independence, majority of the population was very poor. A process of development was to be put into operation. Clearly, the national leaders could not visualize a situation where the development process would benefit only a small minority or these who were already affluent. The development process was aimed at benefiting the majority which comprised of the poorer sections of society. Besides Jawahar Lal Nehru, the first Prime Minister of the country had been immensely influenced by the egalitarian process of development being experimented with at the time in the erstwhile Soviet Union. This, therefore, required emergence of monopoly and industrial concentration to be strictly kept under control. The over-all sentiment in the country was in favour of establishment of a socio economic order in which there was not place for monopolistic exploitation and glaring inequalities. For achievement of these national goals it was considered necessary to control monopoly and industrial concentration.

Secondly, everywhere in the world, monopoly and oligopoly have usually been associated with restrictive and unfair trade practices. Wherever a single or a few sellers control the entire market the consumers and industrial workers naturally become victims of such practices. Among the restrictive practices that may be followed in such a market situation are for example the restriction of output and creation of secrete in the market, or use of fraudulent practices of the market. Unfair trade practices include charging a monopoly price supplying a shoddy product or service and falsely claiming through advertisements the product to be superior to that of the rivals, victimization of the workers, etc. In India too monopoly industrial concentration have been sought to be curbed with a view to prevent the private sector from indulging in such restrictive and unfair trade practices.

Thirdly, monopoly and industrial concentration are the very antithesis of competition. The former thwarts the exit of inefficient firms from industry and the entry of new firms into it. In a developing economy like India, there is need for creation of circumstances under which new and small entrepreneurs are nurtured and encouraged to start business wherever opportunities exist. Monopoly and industrial concentration help in encouraging the vested interest of the existing firms to get more and more entrenched in an industry. The existing industrial houses become bigger and stronger which provides them economic power and unfair advantage to keep out the weaker competitors. In India, the big industrial houses were actually found in the 1960s to use the industrial licensing system of the government to keep out the potential rivals. This, therefore, justified state policy to curb the rise of monopoly and industrial concentration in the country.

Thus, we have noted above that measures to control monopoly and industrial concentration in India were justified partly on ideological grounds of the felt need for establishment of a socialistic pattern of society in the country and partly on grounds of the need to protect consumer and workers' interests as well as the general economic arguments against a market structure where, free play of the forces of competition is suppressed. What were the precise policy measures adopted in this respect? We turn to a discussion of those below.

3. Policy Measures adopted to Control Monopoly and Concentration

The policy measures with a view to control monopoly and concentration of economic power in the country can be broadly divided into two categories viz. (i) those undertaken under the industrial and fiscal policies and (ii) the legislative measures these are discussed in some detail ahead.

The industrial policies of 1948 and 1956 provided the following four distinct measures to build up an economic structure wherein private monopoly could be contained, its growth prevented' and an equitable distribution of income and wealth brought about:

(a) Extension of the public sector.

(b) Licensing system for industries under the Industries (Development and Regulation) Act. 1951.

(c) Extension of the co-operative sector, and

(d) Progressive taxation.

We shall consider the efficacy of the first three measures from the point of view of preventing monopoly and reducing disparities an income. The use of the fourth measure, viz. progressive taxation, is self-evident and will not be discussed here.

Extension of the public sector and its growing role in the economy is very much different in its nature from the growth of private sector. The growth of public sector does not lead to disparities in the income and wealth in the sense that it is owned by the public and exists only for the benefit of the public. Earning of the public sector are ploughed back or utilized for the common good. No single person or business house is the owner of the enterprise, and its earnings and therefore extension of public sector reduces the growth of the private sector in that field is certainly welcome. However, in order that the object of restraining the growth of private monopolies is achieved, public sector must extend, besides the field of public utilities, into other industries.

In pursuance of the policy of growth and extension of the public sector, and the sector grew phenomenally in the post-independence period as is evident from figures in Table. 5 below

TABLE, 5

Growth of Public Sector in India

S. No.	Year	No. of Central Govt. enterprises	Total investment (Rs. in crores)
1.	Commencement of First Plan	5	29
2.	1960-61	48	953
3.	1970-71	87	3606
4.	1980-81	168	18207
5.	1995-96	239	173870
6.	2006-07	244	421089

It is thus clear from the above figures that the post-1951 period has been an era of stupendous growth of the public sector enterprises in India. Besides the achievement of other socio-economic goals, such growth of the public sector also aimed at creating a countervailing power for curbing private sector monopoly and industrial concentration. The industrial policy resolutions of the government, except the one announced in June 1991, have reserved wide areas of operation to the public sector.

Even those segments of industry which were normally left for the private sector, were not out of bounds for the public sector.

Some other indices of the growth of the public sector in India are: (a) the share of public sector in total investment in industry rose from 16% in First Plan to 33% in the Eighth Plan, and (b) the share of this sector in gross value added in manufacturing rose from 5.4% in 1960-61 to 32.1% in 1992-93.

Another measure adopted by the government to control monopoly and industrial concentration was the Industrial Licensing Policy. Before the process of liberalization of Indian economy started in 1991, industrial licensing was an important component of the policy to regulate and control private sector industry. Those industries which were covered under the Industries (Development and Regulation) Act, 1951, were required to seek a license before setting up a new enterprise or carrying out a substantial expansion of existing firm. Industries involving investment of less than a certain amount did not require any license under than this Act. But why was it necessary to obtain a license to set up an industry? A person who is prepared to invest should be left free to decide about the industry, the place of its location according to his own choice, one may say. Why should it be necessary for him to apply for license to set up an enterprise? This leads us to examine the purpose underlying the system of industrial licensing.

There were in fact several objectives behind the licensing policy as originally adopted. One of these was to so regulate the industrial structure as to harmonies the private gain with social interest. Thus, industries harmful to the social interest-could be denied an industrial license. Secondly, regional dispersal of industries could be ensured by granting licenses to industries mainly in the backward regions. Thirdly, big business houses could be denied licenses so as to prevent concentration of economic power in the hands of a few rich families and the licensing authority could encourage the growth of new entrepreneurship in the country. Thus, the licensing policy was to serve as one of the instruments of curbing monopoly and concentration of economic power. The policy was all but abandoned in the Industrial Policy of 1991. Most industries have been taken out of the purview of this policy. Now only those industries which are of security and strategic concern are subject to licensing. Even their number is being reduced. In 1997-98, their number was reduced from 14 to 9.

The extension of the co-operative sector was also thought to contribute to achieve the same objective. However, this form of business organization has never really been seriously used as an instrument o' monopoly control.

Next, let us discuss the legislative measures of control of monopoly and concentration of economic power. The legislative measure was the Monopolies and Restrictive Trade Practices Act, briefly referred to as MRTP Act. The Act (1969) was an instrument to prevent concentration of economic power and control of monopolistic and restrictive trade practices. It attempted to control monopoly formation by making approval of the central government obligatory in respect of mergers and amalgamation under Section 23 of the Act.

The Act defined a monopolistic undertaking as one which produced, supplied or distributed not less than one half of total goods produced, supplied or distributed in India or any substantial part thereof. A dominant undertaking was one which produced, supplied, distributed or otherwise controlled not less than one-third of the total goods produced supplied or distributed in India or any substantial part thereof.

Concentration of monopoly power is accentuated when an existing monopolistic or dominant undertaking strengthens its position by expansion of undertakings, establishment of new undertakings, mergers, amalgamation and takeover. Sections 21, 22 and 23 of the Act provided enough safeguards in this respect. It was obligatory under the Act to put forward an application/scheme/proposal for the approval of the Central Government and further steps in this direction were possible only with the

approval of the Central government. In the case of expansions, application was to be made with regard to only such expansions as would increase the value of assets or the production, supply or distribution by not less than 25%.

The MRTP Act provided for the creation of a MRTP Commission which scrutinized all proposals for capacity expansion by all large firms and approval was often tied to export commitments. Large business houses, which came to be termed as 'MRTP undertakings', had to be got registered under the Act and were either covered under the asset criterion and/or the market dominance criterion.

Most analysits were very critical of the way the MRTP Act had been implemented with a view to check monopoly and industrial concentration. According; to for example, Sunil Mani, "The MRTP Act has failed miserably in carrying out its primary objective or reducing concentration. The act has literally existed only on paper". In any case, the New industrial Policy Statement, July. 1991 had diluted most of the provisions of the MRTP Act.

In spite of a plethora of measures being devised by the government to regulate the activities of the private sector and to particularly check the growth of big business houses in India, the intended objectives were never achieved. Either the implementation of these policies was faulty or their very design was unsatisfactory. It was also contended by many that the policy framework to check the growth of private sector was based more on ideological and political bias against the sector father than on firm economic logic or even the overall interest of the people in general. It has also been argued that the growth of the so- called monopoly houses in the country was the result of the superior entrepreneurial talent of those who controlled these industrial empires rather than on their supposed exploitative practices. The anti-monopoly law was, therefore, considered to be perversely aimed at punishing the more efficient and hard working class of entrepreneurs of the country. Besides, the antidote for growth of monopoly and industrial concentration, viz. the encouragement provided to the expansion of the public sector, also did not seem to have the desired effect. Public sector itself has been afflicted with numerous problems in the country. No wonder, therefore, that the anti-monopoly measures seemed to be a futile exercise and it was consequently abandoned in the last few years.

In the last one decade and a half, realization has dawned upon the policymakers and economists of the country regarding the need for a closer co-operation between the government and the industrial houses rather than the fostering of an atmosphere of animosity between them. This has been the result of the experience gained by the countries of the Far East like Japan, South Korea and other Asian Tigers. In these countries, now Asian multinational corporations are emerging as a result of the co-operation between the government and the private sector industry. Japan has several of these MNCs which are dominating markets even in the developed world of the west. Besides South korean MNC.'s like Daewoo and Hyundai are taking swift strides forward. Majority of them have been helped and prodded to grow by their respective governments. It is now being realized that India could also have nursed the growth of a few MNCs (like Birlas and Tatas) of its own by now, had the government not pursued a futile policy of checking their growth in the name of controlling monopoly and industrial concentration. This is, however, a matter of intense debate in the country and even today there is a class of writers and commentators who would, like the big business houses to be kept in tight leash and the public sector to be kept in tact.

At the policy level, the government is no longer bothered by the extent of monopoly and industrial concentration. Even the extent of this phenomenon in the country is not being studied with the same vehemence that was characteristic of the industrial debate in the first twenty years after independence. The latest credo in this respect is to promote increasing competition in different industries and to help in the emergence of new entrepreneurship. This, it is hoped, will keep monopoly and industrial concentration in check.

Competition Act, 2002

The corporate sector in India was not satisfied with the amendments in the MRTP Act made in Sept. 1991. It wanted the MRTP Act to be scrapped altogether as only large companies could become globally competitive. As such there was a need to promote competition. Accordingly the government exacted Competition Act 2002. The Act provided for the setting up of Competition Commission of India (CCI) to eliminate practices having adverse effects on Competition; for promoting and sustaining Competition in the Indian markets; for protecting the interests of consumes; and ensuring freedom of trade carried on by other participants in markets in India. Some votaries of corporate sector felt no justification of having a competition commission on the plan of self-correcting market mechanism and what according to them was needed was the dismantling of licensing system and entry barriers. However, the unfair and restrictive business practices and the process of mergers and acquisitions always warrant some effective regulatory arrangement and as such the setting up of CCL

The Competition Act 2002 seeks to ensure: (a) Prohibition of anti-competitive agreements, (b) Protibition of abuse of a dominant position, and (c) Regulation of combinations. Thus the major purpose of the competition Act 2002 is to ensure free and fair competition rather than controlling the concentration of economic power stipulated under the MRTP Act. Second, the Competition Act is not averse to dominance but prohibits the abuse of dominance. Third, the Competition Act omits unfair trade practices. Fourth, the Act 2002 is proactive and flexible with a prime mandate of competition advocacy.

FURTHER READINGS

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Lesson-10

Small and Cottage Industries

The small scale sector has acquired a prominent place in the socio-economic development of the country during the last about six decades, contributing to the overall growth of Gross Domestic Product, generation of greater employment opportunities, foreign exchange eamings, etc. This sector covers a wide spectrum of industries including (1) small scale units, (2) ancillary units (3) export-oriented units (4) tiny units (5) small scale service enterprises, (6) small scale industry-related business enterprises, (7) village and cottage industries, and women entrepreneurs' enterprises. In several countries small scale enterprises are defined in terms of employment. But India is among a few countries which use investment as a criterion to define small scale industries. Further the definition of a small scale industry (SSI) differs for differs for different purposes. For instance the Factories Act defines a factory as the one which employs 10 workers or more if the unit uses power, or 20 workers or more if it does not use power. The units covered under this Act are called registered units and fall within the organized sector. Another definition of SSI is meant for giving fiscal concessions. At present the units having a turnover of Rs. 30 lakh an usually are fully exempt from excise and there is a sliding scale of concession available for small enterprises having a turnover up to Rs. 3 crore.

The investment limit of SSI units has kept changing upward from time to time. In 1950 it was up to Rs. 5 lakh in fixed assets, in 1966 it was raised to 7.5 lakh. It was raised to 300 lakh in 1997 but in 1997 there took place a downward revision of investment limit and it was lowered to 100 lakh. This limit was finally revised upward on Oct. 2, 2006 to 5 crore.

SSI Reservation Policy

The policy of identifying certain areas of production exclusively for the small scale sector was introduced in 1967. The rationale for reservation was based on the advantage of small scale sector like labour intensity and adaptability to local environment. It was also intended that the SSI products more competitive. In April 1967 only 47 items were reserved for SSI units, this number increased to 873 in Oct. 1984. in Oct. 2004 the number of reserved items was 605 and the phased deletion of products items reserved for SSI and micro enterprises continued. On March 13, 2007 another 125 items were deserved; 79 items were deserved on Feb. 5, 2008. As of now only 35 items remain under the reserved category. The dereservation process point towards the fact that this has been done to make small scale sector more competitive and for reducing the burden of direct/indirect subsidization. It was also noted that out of the items reserved, very few SSI units undertook the production of items reserved for them. In the second census of small industries it was found that as many as 90 products were founds to be manufactured by just one SSI unit each.

Third Census of SSI Sector (2001-02)

The summary results of the Third SSI census throw light upon some important dimensions of this sector covering the units permanently registered till 31 March 2001. The unregistered units were covered through a sample survey. The census 2001-02 revealed that the SSI sector comprised of 1,05,21,190 units out of which 87 per cent were in the unregistered sector. The tiny units with an original value of dominated the total SSI sector accounting for 95.5 percent of the total establishments. The size of registered SSI sector was only 13 per cent but they accounted for 72 percent of total production and 87 per cent of total exports from this sector.

Another major structural change which has occurred within the SSI sector is the increase of percentage of service sector industrial units from 3.24 percent in 1987-88 to 34.45 per cent in 2001-02. Another noteworthy feature of this census is that compared to the second census the per unit employment declined to 4.48 is the organized and 2.05 percent in the unorganized/unregistered sector, for the total SSI sector it was 2.37. However, the fixed investment per unit increased over the two census periods (1987-88 and 2001-02). During the latter year it was Rs. 6.68 lakh for registered, 0.68 lakh for unregistered and Rs. 1.47 lakh for the total SSI sectors. Sickness in the form of closure remained a continuous feature in this sector, the percentage of closed units being 37.25 in the Second and 39 in the Third Census.

Size and Performance of the SSI Sector

The size performance of SSI sector can be ascertained in terms of growth of number of units, output, employment, value added, export performance, etc. Since the definition of small industries continued to change form time to time, a long period analysis of its expansion carries little significance. As such we shall confine our discussion to the recent years only. The appropriate figures of relevant indicators have been presented in Table 1. The figures for the year 1991-92 are not comparable with those of the subsequent years due to definitional problems. As such inter-temporal analysis of each indicator has been made in terms of average annual growth rates for the period 1995-96 and 2006-07. These annual growth rates were: SSI units 3.72 per cent; output 10.12 per cent; employment 3.87 per cent; and export earnings 13.74 per cent. The inter-temporal comparison makes it clear that there has been a slow growth of SSI units. Given the facts that the growth of output has been faster than the growth of SSI units there appears to be a tendency of increase in the concentration ratio between the period 1987-88 and 2006-07. Earlier sandesara had arrived at a similar conclusion by comparing the First and Second census of SSI sector. The NCAER survey of 657 small scale enterprises in 1992 also found a highly skewed distribution of the units in terms of their output. This implies that within the SSI sector there are clear indications of monopolistic competitions with an.

Table-1

Size and Performance of SSI Sector

Year	No- of units (In Lakh)	Value of output (Rs. In Crores)	Employment (Lakh Nos)	Exports (Rs. in Crores)
1991-92	20.82	1,78,699	129.80	13,883
1995-96	82.84	1,48,290	197.93	36,470
2000-01	101.10	2,61,289	239.09	69,797
2001-02	105.20	2,82,270	249.10	71,244
2002-03	109.49	3,06,771	263.68	86,013
2003-04	113.95	3,11,993	275.30	97,644
2004-05	118.59	3,51,427	287.55	1,24,417
2005-06	123.42	4,18,884	299.85	1,50,242
2006-07	128.44	4,71,663	312.52	N.A.

Source; Economic Survey 2007-08, p.198 for 2005-06 onwards and its other relevant issues for earlier years excessive number of tiny unit crowding in to share the rent created the through the policy of protection and subsides, the success is however confined only to a few registered enterprises.

Coming next to the growth of output of SSI sector in recent years, from 1996-97 onwards the rate of growth of output in money terms was maximum in 2006-07 (According to rough estimates of 2003-04 the SSI sector accounted for more then 40 percent of gross values of output in a per cent) and the lowest in manufacturing sector and about 34 per cent of country's total exports. An inter-temporal analysis of the behaviour of size structure within SSI sector brings out that the -share of unregistered segment it the total output of this sector has been falling for quite some (6.06 percent). When compared to the rate of growth of industrial sector as a whole, the SSI sector has dose extremely well in each year since 1996-97. For instance in 1980-81 it was 43 per cent; in 1997-98 it declined to 32 per cent in 2001-02 as per the Third Census.

It we look at the spatial distribution of small scale industries, out of more than six hundred districts in India, 85 districts of the country had more 2000 SSI units each and they accounted for 51 percent of total establishments. More than 81 per cent of SSI units were concentrated in 204 districts and more than 50 per cent districts of the country did not have any significant number of SSI units. Further, out of total units 55.21 were located in the rural areas. Thus the objective of dispersed development of SSI units in the rural and industrially backward areas has not been achieved to a significant extent.

As regards export performance of SSI sector, the volume of exports was Rs. 39,248 crore in 1996-97 and it increased to Rs. 1,50,242 crore in 2005-06. During seven out of nine years annual growth rate was higher than the SSI exports registered double-digit growth. In spite of high growth rates of output and export in some recent years a controversy has always remained regarding the question of efficiency of small scale and the issue of SSI versus large scale industries continues to be debated still. Dhar and Lydall's study (1961) on the relative efficiency of SSI sector concluded that this sector was fairly capital intensive and did not generate more employment per unit of capital than large scale industry. Earlier similar conclusions were arrived at in Sandesara's study relating to the years 1953-58. Biswanath Goldar's study of relative efficiency of modern small scale industries in India relating to 37 industries, for the year 1976-77 found that in comparison to large scale industries, the SSIs generally have low labour productivity, higher capital productivity, lower capital intensity and lower factor productivity. The relative efficiency of SSIs varied directly with capital intensity and these industries could not be relied upon as a source of efficient employment generation. Rakesh Mohan pointed out that the policy of reservations for SSI rector has had a very deleterious effect on the growth of both employment and exports of manufacturing sector. A large number of categories of manufacturing in which we enjoy comparative advantage had been reserved for SSI sector. Consequently the Indian industry remained inefficient and technologically poor to be able to compete globally. In the post- reform period, however, after rapid de-reservation of very large number of items, the performance of manufacturing sector has improved significantly, especially during the period 2002-07.

Quite a few studies take a diametrically opposite view and have mustered considerable empirical evidence in support of SSI sector vis- a- vis large industries. Ramsinh K. Asher's study pertaining to the period 1960-65 based on ASI data brought out that the SSI sector combined the largest number of workers with a rupee's worth of fixed capital and the value added by a rupee worth of fixed in small factories was at least three times as large as that of a large unit. The study undertaken together by SIDBI and NCAER for the period 1980-94, observed that by investing only 7 per cent to 15 per cent of total manufacturing sector's capital the small scale industries contribute to nearly one-fifth of total industrial output and between 35 to 40 per cent of total employment in the industrial sector. Whereas labour productivity was slightly higher in large scale sector, the capital productivity was higher

in small scale sector during the reference period. The analysis of total factor productivity in the two sectors proved small scale industries to be more efficient. Finally the third census of SSI sector also found this sector to possess a better employment generating capacity as the employment generated by it per Rs. one lakh was 1.39 as against only 0.20 in respect of large manufacturing sector.

Small Scale Sector Industrial Policy and Programmes

After independence the government policy towards SSI sector was greatly influenced by the ideas of the leaders of Indian- National Movement, especially those of Mahatma Gandhi. The steps taken for their development included provision of adequate institutional framework, greater allocation of resources (especially credit) reservation of certain areas of production, continued to be increased horizontally and vertically during different Plans. However, simultaneously with the adoption of industrial policy of 1956, a greater reliance was placed on the development of large scale basis, capital goods, and intermediate goods industries in the public sector. In other words large scale sector become a fovoured competitor of SSI sector in the matter of public investment and the former continued to enjoy greater patronage of the government. The change of guards in the year 1977 brought about a major change in the industrial policy with the Janata Party government assigning a key role to the SSI sector and negating the relevance of large industries in the Indian socio-economic environment. This strategy lasted hardly for three years; with the change in the political establishment, the status quo ante was once again restored in fovour large sector mainly on the plea that a prolonged industrial stagnation can be removed only by gradual deregulation and active role of large industries. The decade of nineteen eighties witnessed a steady deregulation.

Before discussing the SSI policy of 1991 let us take stock of the more actions taken by the government for the programmes development of SSI sector. In the year 1947 the Cottage Industries Board was set up which was split into three different boards during the First Plan.

These were: All-India Handloom Board, All-India Handicrafts Board, All-India khadi and village Industries Board. Another three boards were also set up during this Plan. National Small Scale Industries Corporation (1955), four Regional Small Industrial Service Institutes, Small Industries Development organisation (1954), and Small Industries Development Organisation (1954) also came up during this Plan. It is obvious that the creation of institutional framework for SSI sector was an important achievement of the First Plan. A notable development during the Second Plan was the establishment of Khadi and Village Industries Commis- sion. In the Third Plan, the main objectives with regard to SSI sector were to improve labour productivity, better provision of finance, and spatial diversification of this sector. The Fourth Plan, besides continuing with the objectives of earlier Plan, emphasized rapid development of agro-based and ancillary industries. An important step taken for the development of SSI sector was the introduction of the Programme of District Industries Centers in 1979. During the Fifth Plan efforts were made to enhance capacity utilization, promote entrepreneurship, and promote growth cantors. In order to extend financial support the Small Industries Development Fund was set up in 1986, National Equity Fund in 1987, and the Single Window Scheme in 1988. However, the most significant step was the setting up of Small Industries Development Bank of India (SIDBI) in 1989.

Small Scale Industrial Policy 1991

The G.O.I. announced its policy towards SSIs in Aug. 1991. Its main features were to impart more viability and growth impetus to SSI sector to enable it to contribute its might fully to the economy. The ceiling of tiny enterprises was raised to Rs. 5 lakh, location restrictions on setting up of these enterprises were removed and their scope was enlarged to include all industry- related service and business enterprises. It was decided to widen the scope of the National Equity Fund Scheme to cover projects Rs. 10 lakh for equity support (up to 15 per cent). Single Window Scheme was enlarged to

cover projects up to 20 with working capital margin up to Rs. 10 lakh. It was decided to shift the emphasis from subsidization or cheap credit to adequate flow of capital on a normative basis.

To provide access to capital market and encourage modernization and technological up gradation, it was decided to allow equity participation by other industrial undertakings in the SSI sector not exceeding 24 per cent of the shareholding. Technology Development and Modernization Fund Scheme was launched for modernization and technological up gradation of export-oriented units.

The 1991 Industrial Policy statement laid emphasis on making SSI unit more viable and growth--oriented by making them more competitive through deregulation. It provided for a sustained support to the tiny units unlike earlier approach of giving them our-time benefit. The diversification of SSI sector was sought to be accomplished through business and industry related services. But this policy statement did not take note of a large number of sick SSI units.

The Ninth Plan followed the strategy providing incentives and support to SSI sector to facilitate their growth and ensure that foreign investment did not displace such industries. It was felt that investment limit for SSI Sector needs to be revised to enable it to achieve economies of scale and upgrade technology to with- stand competition. It was also envisaged to review the list of reserved industries. Need was also felt to improve the flow of credit to SSI sector. Special steps were stipulated for the promotion of sericulture, woolen and food processing industries. During this Plan a comprehensive policy package was announced for SSI sector on Aug. 30,2000. A number of concessions were announced which included: (i) raising the exemption limit for excise for Rs. 50 lakh to Rs. 1 crore, (ii) providing credit-linked capital subsidy of 12 per cent against loans for technology upgradation in specified industries, (iii) raising the investment limit in the industry related services and business enterprises from Rs. 5 lakh to 10 lakh, (iv) raising the limit of composite loans from Rs. 10 lakh to Rs. 25 lakh (v) encouraging SSI associations to develop and operate testing laboratories, etc.

The Tenth Plan (2002-07) also admitted the vital role of SSI sector in 'providing a vehicle for entrepreneurship' and 'achieving a broader regional spread of industry'. It underlined the importance of Khadi and village industries in promoting non-farm employment in rural areas. It emphasized: liberalization of controls over SSI sectors at state level and greater provision of credit. It however opposed reservation of products for SSI sector on economic grounds and advocated for phasing then out. This Plan, while admitting a complementarily between large and small industries, felt the need for extending investment limit in SSI units immediately, though this was done in 2006. While expressing concern over the slow pace of ancillarisation, the plan underscored the need to identify the policies that impede it and remove them. The plan document made it clear that the principal responsibility of achieving competitive efficiency rested with the private enterprises themselves. 'The policy environment cannot always be used as an alibi for non-performance''.

The approach paper to the Eleventh Plan also acknowledged that the dispersed and decentralized village and small industries sector posed a special challenge and opportunity to our policy makers. 'With the successful infusion of design skills, modern marketing and appropriate technology, this segment can form the basis for a self-sustaining culture of creative and competitive industry. The paper lamented that the benefits of government support are limited to only a small fraction of SSIs as only 13 per cent are registered. It proposed to extend the benefits to unregistered units as well. It emphasized the need to change the approach from reliance on subsidies to creating an enabling environment through cluster approach.

Problems of SSI sector

Before winding up, it seems important to take note of the problems facing SSI units. The problems are many and varied some of these are listed below.

1. Inadequacy of working capital, delay in sanction of working capital and time lag between sanction of term loan and working capital
2. Poor and obsolete technology.
3. Problems related to procurement of raw material.
4. Inadequate demand and other marketing problems.
5. Non-availability of skilled labour
6. Vulnerability to variations in exchange rates.
7. Infrastructural (especially power) constraints.
8. Poor management
9. Near- absence of Research and Development
10. Misuse of subsidies and other incentives
11. Onslaught of liberalization in the from of cut throat competition

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Lesson 10-A

Impact of Liberalization on Industrial Sector

The terms 'liberalization' means unshackling or deregulation. After independence India adopted the strategy of inward looking industrialization process which ensured high rates of industrial growth between 1956 and 1966. However the weaknesses of this strategy soon became evident and inefficiencies crept into the system which turned the economy into an increasingly high cost one. Over years this techno- logical lag resulted in poor export performance. In sum till mid-seventies the growth performance left much to be desired. It was felt that excessive regulation of the industrial sector through government controls was primarily responsible for industrial deceleration and a major shift in industrial policy paradigm was immediately required. The process of liberalization started in 1980s itself in a steady manner. But the year 1991 is an important landmark in this context. The country passed through a severe economic crisis triggered by a serious balance of payments situation. The response to the crisis was to put in place a set of policies aimed at stabilization and structural reform. The structural reforms introduced in the early 1990s broadly covered the areas of industrial licensing, foreign trade, foreign investment, exchange rate management, and financial sector

From the point of view of industrialization, the changes in the areas of licensing foreign trade and foreign investment had important implications. One early step taken as a part of structural reforms was to dispense with licensing. Changes in the foreign trade policy focused on reducing the tariff rates and dismantling quantitative controls over imports. Tariff rates were brought down in stages. The policy towards foreign investment (FDI) underwent a significant change with foreign investment given the freedom to own majority share holding over a wide spectrum of industries. In short the new policy of liberalization was intended create a more competitive environment in the economy to improve productivity and efficiency in the economy. While the industrial policy sought to bring about greater competitive environment domestically, the trade policy aimed at improving international competitiveness subject to degree of protection offered by the tariffs. Our concern in this lesson is with the industrial sector, the impact of liberalization measures in the rest of the sectors will not be taken up for discussion.

The impact of liberalization policies can be looked at in terms of a number if indicators such as growth of industrial output as whole, within industrial sub-sectors (organized vs. unorganized, producer goods vs. consumer goods, etc.), behaviour of employment, trends in productivity, so on and so forth. We shall not dwell upon growth aspect too much as this question has already been dealt with elsewhere. Rest of issues are being discussed below.

Neogi and Ghosh analyzed the impact of liberalization on Indian industries by dividing the entire time period in to three dub-periods. The first sub-period relates to industrial performance during 1989-92, 1.e. the per-reform period, second sub-period relates to 1991-94, and the third to 1989-94. The average annual growth rate of value added during the post-reform years was lower than that during the per-reform period except for chemical industry. The growth rate of K/L ratio registered a sharp rise during the post- reform period except in case of electrical industry which recorded a negative growth.

The impact of liberalization on industrial sector has been seen by a number of scholars in terms of the behaviour of industrial productivity. Industrial productivity measures are: labour productivity, capital productivity and Total Factor Productivity, (TFP). Labour Productivity is measured in terms of output per person or output per unit of labour time. Capital productivity is measured in terms of incremental capital-output ratio (IC OR) the inverse of ICOR indicates high industrial productivity and vice-versa. Labour and capital productivity measures are regarded as partial measures of industrial

productivity, The TFP, on the other hand is a complete and composite measure and it relates output to all the conventional inputs simultaneously. It is defined as a ratio of real value added to weighted sum of all the inputs used in the process of production.

A number of studies have reached the conclusion that the total factor productivity in Indian industry was lower during the post-reform period as compared to the one during per-reform period. Neogi and Ghosh arrived at such a conclusion in case of all industries except chemical. The growth rates of labour productivity also followed the same pattern as that of value added. This conclusion points towards inefficient use of productive resources. The R.B.L. study on factor productivity during per- and post-reform periods brought out that TFP growth during the former period (1980-90) was 3.9 per cent per annum and it declined to 2.1 per cent per annum during 1991-2000. Capital productivity fell from 1, 3 per cent annually to (-) 0.7 per cent; but labour productivity increased from 6.5 per cent to 7.8 per cent annually (for details see R.B.I., Report on Currency and Finance, 2002-03 (Mumbai, 2004).

Bullet Unel in his study of the productivity trends in India's manufacturing sectors concluded that TFP growth in total manufacturing and several sub-sectors improved after the reforms as compared to the preceding decade. Whereas during 1979-80 to 1990-91 the average annual growth rate of TFP was 1.8 per cent for total manufacturing, it was 2.5 per cent 1991-92 to 1997-98. The Tata Services Ltd. (TSL) index of TFP for the period 1981-82 to 1990-91 works out the annual average growth as 0.49 per cent and it increased to 1.20 percent over the period 1991-92 to 1999-2000. However Bishwanth Goldar pointed out some serious methodological problems in both the studies and pointed out that TFP in fact fell down during the decade of 1990s.

Pulaper Balkrishnan and M.S. Babu in their study, "Growth and Distribution in Indian Industry in the Nineties," (EPW, 38 (38) Sept.2003) observed that there took place faster rate of growth of output across manufacturing since 1991. But this, by no means, can be regarded dramatic. There also took place an increase in employment, though it lagged behind the rate of growth of output. The main factor responsible for output growth has been investment which increased substantially during 1990s. The share of investment reflects the response to liberalization policies which energized the supply side of the economy. There also took place a marginal increase in the share of profits which provided incentive to invest via a higher return on capital. The authors also investigated distribution from the point of view of allocation of gains from the change in the policy regime since 1991 and found that within the manufacturing sector capital had gained. Even the labour's gains in terms of rising product wage got extinguished by a state intervening on behalf of surplus farmers.

In yet another study Jeemol by Uni. et.al. "Economic Reforms and productivity Trends in Indian Manufacturing," (EPW, 36 (41), Oct. 13,2001) brought out that the growth of value added, employment and capital in the organized manufacturing sector as a whole surged forward during the post-reform period. However, this growth was achieved with an inefficient use of resources as reflected by the negative and declining total factor productivity. Across the use-based categories, this growth on value added, employment and capital was reflected in consumer durables in the organized sector. This was accompanied by a decline in capital intensity and an increase in capital productivity. The growth in the organized manufacturing sector peaked in the initial phase of liberalization (1978-85) and it tapered off during the period of reforms. It was also expected that efficiency in the use of resources would improve in the less restricted regime. R. Nagraj in his study of industrial policy and performance since 1980 found that the manufacturing output had grown annually by 7 per cent since 1980-81, with economic reforms making little difference to this trend in the 1990s. But growth decelerated after attaining its peak in 1995-96. After 2002 the acceleration in industrial growth happened due to commendable performance of manufacturing sector. Nagraj further maintained that the erratic performance of industrial sector during the reform period is attributable to the fact that the policy framework narrowly focused on policy-induced restrictions on supply, ignoring the demand constraint due to reduction in public infrastructure investment since 1980s and indifferent agricultural performance in the 1990s.

Nonetheless the liberalization policies have been able make the industrial markets more competitive, and product quality and variety have improved substantially. A relative cheapening of machinery and construction have made fixed investment more productive. Expressing the association between reforms and growth as suspect, Nagraj calls for a need to address the demand side constraints for sustained industrial growth.

In yet another study Sudip Chaudhuri focused on the impact of economic reforms on industrial structure and productivity. His study also revealed a disappointing performance of output and employment growth due to the nature of policies followed under the regime of reforms. We have already discussed much about growth of output and with out going into further details (refer to sudip Chaudhuri, "Economic Reforms and Industrial Structure in India," EPW (Jan. 12.2002 pp. 155-62) let us look in to the behaviour of employment in the registered manufacturing sector in the wake of liberalization. Between 1990-91 and 1998-99 the rate of increase in employment has been very modest. It has increased at a compound annual rate of growth of 1.59 per cent. More importantly, the annual growth remained negative during five out of nine years. The employment figure in 1998-99 was 5.5 per cent lower in absolute terms than that in 1995- 96. The authoer also examined the data on growth of employment in case of 26 important three digit industry groups, each with a share of more than one per cent of total employment of workers on 1990-91. These 26 groups together accounted for 61 per cent of total employment in 1990-91. There took place a negative or negligible growth of employment between 1990-91 and 1997-98 and most of these important industries such as cotton spinning and weaving, processing in mills, rail wagons, sugar, iron and steel, etc. However, textile garments, inorganic chemicals and plastic products experienced significant employment growth.

As per the data reported in Economic Survey 2007-08, the employment growth ion the organized sector, public and private sectors combined, has declined between the years 1994 and 2005. This has occurred mainly due to the decline of employment in the public organized sector. Employment in establishments covered by Employment Market Information system grew at 1.20 per cent per annum during 1983- 94 but decelerated to the (-) 0.31 per cent per annum during 1994-2004, This decline was due to decline in employment growth in public sector. On the other hand the private sector has shown an increase in employment growth from 0.44 per cent to 0.58 per cent annually during the corresponding periods.

Suggested Readings

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- R. Nagraj, "Industrial Policy and Performance since 1980: which Way Now?," E.P.W., Aug.. 30, 2000.
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Unit III

Dr. Sanju Karol

Lesson - 11

FACTORS DETERMINING INTEREST RATE, MONEY SUPPLY AND INFLATION:

FINANCIAL SECTOR REFORMS

Every country in the world today has an organized money market in which the forces of demand and supply interact with each other to determine the nature and volume of financial transactions. As a country enters the modem era and the level of development rises, these forces operating on the two odes of the market tend to become more and more complex. In India too, this has been happening over the last five decades.

The money market is a market for, borrowing and lending short-term funds. The borrowers-.in India are the companies, traders, individuals and the Govt. They create demands for surplus investible funds available on the supply side of the market The supply is created by the body of lenders of such funds mainly comprising the Reserve Bank of India, the State Bank of India and other nationalized banks, the private sector banks and the co-operative banks and societies. Besides, in India there is also an unorganized segment of the money market, consisting of the indigenous bankers and money lenders.

Dear Students, you have already studied in your course on Macroeconomics, the meaning of demand for money and the supply of money. Just to remind you, the demand for money in the ultimate analysis is the demand for cash balances or the liquidity preference of individuals, households and firms. On the other hand, supply of money has several connotations, but there are the broad money supply and narrow money supply versions, which are more frequently used in this connection.

In the present lesson, we shall attempt to interpret the ground realities of the Indian money market in terms of the theory of demand for money and supply of money. Let us first or all look at the demand for money in India.

Demand for Money in India

The question of demand for money, whether in its theoretical form or the empirical nature, has been addressed in two parts: (i) what is the nature or forma demand function for money, and (ii) whether function is stable or unstable. Both these question received attention while analyzing the nature of den for money in-India.

In its simplest Keynesiari form, toe demand] function is stated as follows:

$$\frac{M}{P} = f(y, i)$$

Where M = Stock of nominal money held by public,

P = Price level.

Y, = Real Income,

i = Rate of interact

Stated in the above form, this demand function snows that the demand for real money balances (i.e. liquidity preference, varies directly with real income, or as real income increases, the real amount of money demanded also increases, but an increase in the rate of interest has the opposite effect In other words, the real demand for money is inversely related to the rate of interest

There is also a more complex form of the demand function for money associated with the name of Milton Friedman and the monetarist school which Friedman heads. According to this form, demand for money Is a function of bond interest rate, the interest rate of equities, the expected rate of inflation, wealth (including human capital), and any variables which represent tastes and preferences.

For studying the form of the demand function for money for India and other developing economies, he simpler Keynesian function is adopted, and besides, some other explanatory variables arc also included in the function, such as relative shares of agricultural and non-agricultural incomes, yield on ordinary shares and long term govt. bonds, expected rate of inflation, and degree of monetization. In India, till recently the interest rates had been administered by the R.B.I, and were not therefore sensitive to changes in market forces.

A number of studies, appearing from time to time in the Indian Economic Journal, have attempted empirically (i.e. by using India data) to ascertain the nature of the demand function for money. Different studies have adopted a different set of above-mentioned variables for their empirical studies. S.B. Gupta asserts that the best estimate of the income elasticity of demand for money in India is that it is equal to one. In other words, as income rises, the demand for money in this country rises proportionately. According to the study of M.S. Trivedi (The Indian Economic Journal July-Sept, 1980), the demand for money, in India is a declining function of the expected rate of inflation. Besides, changes in the distribution of-income as between the agricultural and the nod-agricultural sectors (represented by variations in the ratio Y/NNP) were found to affect negatively The demand for money. In other words, as the share of agricultural income, (Y) in total national income (NKP) falls, the demand for money increases.

R, K. Sampath and Zakir carried out a test regarding the interest elasticity of demand for money. They found that in India, the long term interest rates were not even remotely determining the demand for money. Even the short term interest rates yielded parameters (values) which were statistically too insignificant.

As noted earlier, a second question in this connection has been the stability of the demand function for money. By stability of the function is meant that the estimated co-efficient of the explanatory variables remain constant over time. This has great importance in the context of the effectivements of monetary policy. Suppose interest rates are to be lowered so as to influence investment. If interest elasticity co-efficient is found to be 0.25 (i.e. an increase of 1% in money-supply by the Central Bank of the country lowers the interest rate by 0.25%) an appropriate change will be made in the money supply to bring about the already predicted change in the rate of interest. However, if interest elasticity of demand for money is variable, a given change in money supply, under the monetary policy, will no have the desired change in the rate of interest. Consequently, the target change in investment may not tike place. So the effect of monetary policy remains unpredictable. This however will not happen if the demand function for money is stable in the above mentioned sense.

Several tests of stability of the demand function for money in India have been carried out. For example Derek Deadman and Subrata Ghatak (in Indian Economic Journal, 1981) took data for the period 1948-76. If the narrow version of money was taken, they found indications of instability of the/ unction. But the use of a broader money version found much greater stability in the function.

Y.L. Mahajan (in Indian Economic Journa, 1979) also investigated the question of stability of demand for money in India. His study bad come to almost identical results as the above-mentioned study of Deadman and Ghatak. The former found the money demand function to be quite unstable for narrow money. Although there was some instability even in the case of broader money, but there was evidence of increased stability as one proceeds to using broader definitions of money. Although different researchers on the subject have used widely different methods of testing the stability of the demand function for money yet the consensus (which is essentially tentative) seems to show that in India there is a structural shift in the demand function for money if one takes the narrower definition of money, though there is evidence of the stability of the function if a broader version of money stock is taken. The evidence of 'relative instability of the function may be indicative of why the monetary policy has been less successful in India compared to the fiscal policy.

Supply of money in India

As you dear students, are already aware, the traditional definition of money supply takes it as the sum total of currency with the public and the demand deposits with commercial banks. This has been referred to as harrow money (M,).

In 1961 the Reserve Bank of India sat. up a Working Group on Money Supply which defined money supply as consisting of (i) notes and coins with the public (ii) demand deposits of scheduled banks, non-scheduled banks and co-operative banks and (iii) deposits held by the banking system with the R.B.I. The, Group suggested that inclusion of time deposits of the commercial banks would give a more meaningful indication of money supply in the country. In consequence, the R.B.I. started publishing "Aggregate Monetary Resources" data regularly, based on this broader concept of money supply.

The R.B.I, set up a second Working Group in 1977. The Group defined money supply in four different layers, taking first the narrowest concept and then increasing the coverage of more and more monetary and progressively making the concept broader. The four concepts have been in use since then. The four concepts are:

M_1 = currency with the public + demand deposits of banks + deposits of salary earner's societies + "other deposits" with R.B.I.

It needs emphasis that the M_1 so defined, highlights the medium of exchange, characteristic of money.

M_2=M_1 + saving deposits-of post offices.

M_1 M_1 + time deposits of banks

M_4 = M_1 + total deposits with post offices, excluding the national saving certificates.

The R.B.I, has been publishing M_1 and M_3 data on a fortnightly basis and M_3 and M_4 data on a monthly basis.

Total money supply is also referred to as the money stock. It is clear that above definition of money supply that the aggregate money stock of the country depends on the governments currency liabilities and the commercial banks' deposit-liabilities.

TABLE

Sources of Change in Money Stock (M,)

(Rs. Crores)

		Outstanding as on Jan, 1997	2005-06
I.	M_1 (Money supply with the public)	2,24,494	6,82,553
II.	M_1 (Broad Money)	6,63,786	21,96,876
(i)	Currency with the public	1,28,918	3,54,871
(ii)	Demand deposits with banks	90,071	2,62,382
(iii)	Time deposits with banks	4,39,292	16,50,114
(iv)	Other deposits with R-B.I	5,505	5,447
III. Sources of change in Money stock (M)			
1.	Net R.B.I, and commercial bank credit to Govt.	2,86,528	21,96,876
2.	Bank credit to commercial sector	3,56,398	12,25,825
3.	Net foreign exchange assets of banking sector	88,531	5,98,123
4.	Government's currency liabilities to the public	2,847	7,374
5.	Banking sector's net non-monetary liabilities other than time deposit	70,518	3,87,833

*These non-monetary liabilities of. the banking sector comprise deposits with R.B.I., such as account No. 1, Compulsory Deposit Scheme deposits, Profits of the R.B.I. held temporarily by it, etc.

The break-up of the main factors or sources on which the money supply or money stock depends in India, are shown by the R.B.I periodically as given in the Table here. It would be observed in the Table that, as on January 2005. M_1 stood at Rs. 614759 crore. Under II (i) to (iv) in the Table are shown the components of the aggregate monetary resoujrces of the country i.e. M_3. U III, 1 to 5 are shown the factors or sources of change in the total money supply in India, or any other country, money supply depends on currency with the public and bank credit. This is vividly brought out by the sources of change in money stock in the Table under III. Aprat from the currency with the public (i.e. government's currency liabilities to the public), which is a relatively small amount money stock changes are brought about primarily by bank credit to the commercial sector and to the Govt. (in that order). Besides, the net foreign exchanges assets (i.e. the foreign currency purchased minus foreign currency sold) of the banking sector also add to money supply.

A dollar purchased by a bank entails payments in rupees which result in rise in bank deposit. Out of the above sources of change in money stock arc deducted the non-monetary liabilities of the banking sector, so as to arrive at the net change in total money stock in the country.

The foregoing definitions of money supply or money stock has-come in for sharp criticism at the hands of S.B. Gupta a leading authority on monetary economics. Gupta calls the approach of the R.B J. as purely accounting and export. That means the money supply analysis of the R.B.I. lacto any theory behind it. The result is that the approach fails to explain the effect of policy measures like the open market operations on money supply. Gupta therefore, favours the money multiplier theory in this respect. This theory is favourite of the monetary economists in different countries. Gupta points out another "serious error" in the R.B.I. analysis of money supply in India, viz. that it adds up the high

powered component of money with its other components, while in reality the latter depend/ on the former.

It is not that the R.B.I. completely ignored the money multiplier analysis. Rather its attitude has been ambivalent in this respect In fact, since 1972-73, the R.B.I.'s Report on Currency and Finance has regularly carried a brief discussion of money multiplier in India. Since 1978 the R.B.I. Bulletin has also carried data on high-powered money and its components as well as an analysis of sources of change in high-powered money.

The Second Working Group on Money Supply (1977) had admitted that the R.B.I, had adopted the money multiplier approach for its long-term projection of credit and money supply. However, the Group itself had rejected the approach.

The R.B.I Committee to Review the Working of the Monetary System, also called the Chakravarty Committee (1985) had carried out an exterisive analysis-of money supply in India in terms of the money multiplier theory and had recommended that "The sources of reserve money, and the factors influencing the behavior of the money multiplier require to be studied closely in order to explain changes in money supply."

Before proceeding further, let us briefly state the money multiplier theory of money supply. According to the theory: $M_1 = mH$

where M_1 = nominal money supply.

m - money multiplier

H = high-powered money (or reserve money, monetary base, base money, primary money or government money)

The above equation represents s nominal money supply function, which says that any change in reserve money (H) will lead to a multiple change in money supply (M) depending upon the value of money multiplier (m).

The Chakravarty Committee made a through going analysis of both determinants of money supply the reserve money: and the money multiplier. According to this analysis, money multiplier, in India is influenced by two ratios, viz. the currency-deposit ratio, and the deposit money multiplier. Let us take the two ratios separately and see bow each of them affects the value of the money multiplier.

The currency deposit ratio depends on the people's preference between keeping their cash balance in the form of currency of bar* deposits. The more people hold on to currency, the less win be the ability of the banks to create deposits. People's preference for currency depends on availability of banking services, payments habits in the economy, legal requirements regarding mode of payments, desire for precautionary cash balance, rate of inflation, level of Income, and so on. In India, as the banking habit has steadily grown, the currency deposit ratio has fallen since the 1950s. In March, 1951 the ratio was estimated to be 1.53 which had fallen to 0.30 in March 19984 and has since further fallen to 0.18 in January 2005 (as can be inferred from figures given in the Table of this lesson earlier).

The deposit money multiplier on the other hand ratio of deposit money to bank reserve. The bank reserve are primarily of two types in our country, the cash in hand with banks, and the banks balances with the R.B.I. The former are maintained by bank essentially to meet the cash requirements of their clients. These are a small pan of the reserves of Indian banks und are estimated lo be around 2 per cent or less of their total deposits. The banks' balance with the R B.I. partly depend upon the growth of deposits, as the spare cash out of money deposited with the banks goes into these balances. But mainly these balances depend upon the statutory stipulations regarding cash reserves of the banks. These stipulations are mainly covered under the cash reserve ratio (CRR) and the addition)

conditions imposed by the R.B.I. under the incremental cash reserve ratio (ICRR), which require the banks to maintain additional cash reserves out of the additional deposits. Naturally, the higher these reserve requirements, the lower the capacity of the banks to create credit or what is called deposit money. Thus, the higher the CRR and ICRR, the lower would be the deposit money multiplier. In the list five decades, the deposit money multiplier had slightly fallen, from 9.14 in March, 1951 to 7.68 in March, 1984, but has again risen a little since then, to be 9.06 in January, 1997 and fell again to 5 per cent in 2005. It also needs, stressing that sometimes the banks bold reserves in excess of the statutory requirements because there is not enough demand for bank credit due to sluggish business conditions. This would also reduce the, value of the deposit money multiplier.

Primarily on account of the fall in currency-deposit ratio in the post-independence period, as noted earlier, the money multiplier has been rising. It was estimated to be 1.54 in March, 1951 and had risen to 2.98 by March, 1984. By January, 2005 the money multiplier is adduced to 4.85. The recent rise in money multiplier is adduced to substantial reductions effected by the R.B.I, so as to promote credit creation by the banking sector to stimulate economic growth. That has also, however, increased the potential of money supply growth in the country.

As noted earlier, according to the multiplier theory of money supply, besides money multiplier (m), the other factor involved in the process of change in monetary stock i.e. reserve money or high-powered money (H). 'Now, what determines changes in H? Reserve money represents certain liabilities of the K.B.I, and the currency liabilities of the Govt. mainly the former increases quantity of money in order to support a larger volume of business transactions in the country. The notes and coins issued by the R.B.L. and the govt. partly or wholly come to the other banks in the form of deposits and this becomes their reserve money. On the basis of the reserve money, the banks create credit or bank money. Thus changes in H lead to multiple changes in M_1

In India, main sources of reserve money are the following:

Reserve money = Net R.B.I. credit to Govt.

+ R.B.I. credit to banks

+ R.B.I. credit to commercial sector

+ Net foreign exchange asserts R.B.I.

+ Governments currently. ... to public less net non monetary liabilities of R.B.I.

R.B.I. credit to the Central and State Government, consists of R.B.I.'s holdings of treasury bills, including ad hoc treasury bills, Govt. bonds and R.B.I.'s advances to State Governments. The R.B.I. credit to banks which was earlier being provided as refinance to banks has been discontinued since 1982. R.B.I credit to commercial sector needs a word of explanation It is the aggregate of R.B.I.'s investments In shares and bonds of financial institutions (e.g. IDBI and ARDQ, loans and advances, to such institutions, and internal bills of exchange discounted.

If you refer back to the Table given earlier this lesson you will notice that as on January 3, 2005, the first component of reserve money, viz. net R.B.I. credit to Govt. stood at Rs. 2196876 crore. R.B.L at Rs. 12,25,825 crore (which in the Table forms a part of bank credit to commercial sector), net foreign exchange assets of R.B.I. at Rs. 598123 crore and governments currency liabilities to the public at Rs. 7374 crore. It would be noted, that out of all these components of reserve money, the first component, viz. net R.B.I, credit to govt. is the single largest item, accounting for as much as 82 per cent of the total. Most of this component of reserve money is created through the budgetary mechanism where the R.B.L, has to hand over newly printed money to the govt. to finance the fiscal deficit. The creation of so much reserve money year after year has a great 'potential for Unleashing inflationary pressures on the

economy, since through the operation of the money multiplier, this reserve money creation leads to a multiplier increase in total money supply.

As is evident from the foregoing, if we apply the money multiplied theory to analyses the money supply generation in India, both the factors operating in this respect have created a situation of rapid increase in the money stock of the country. On the or hand, the money multiplier (m) has been rising and on the other hand, reserve money (H) has been increasing primarily on account of net R.B.I, credit to the Govt. Thus had obviously created a dangerously huge potential.....inflationary pressures Something had to be .....it. In 1994-95, an agreement war arrived at ..... government and the R.B.I. to ..... borrowing from the bank .....upto a ceiling of Rs. 9000 crores a year, The objective was to ultimately phase out the ad hoc treasury bills as a mechanism of R.B.I, credit lo the govt. This has been achieved in the budget for 1997-98, where the system of issue of ad hoc treasury bills as a method of financing the budget deficit has been abolished and in its place the system of getting ways and means advances from the R.B.I, has been adopted. This is a method of seeking financial accommodation from the R.B.I. wherever a temporary mismatch arises between revenue receipts and public expenditure. This means that if the flow of revenues into the Govt. treasury in at particular month is lower than the financial outgo from government treasury, the R.B.I. will temporarily meet the excess expenditure. However, the (LBJ. will recoup the amount when the flow of revenues picks up. Thus, white the R.B.I. purchase of ad hoc treasury bills monetized the budget deficit i.e. it added to reserve money stock, the ways and means advances will not do so, and thus the over all money supply will not grow as fast as it did under the earlier system. Only the time will tell whether the new system workers as expected and helps in restraining the growth of reserve money, and through it, the growth of money supply.

PRICE LEVELAND INFLATION

To a large number of common people, to whom economics boils down to the simple proposition of earning a subsistence income, spiraling prices of goods of daily consumption have become a nightmare. The consumer has either to pay more to buy the quantity he needs or make do with scarcity of goods needed. At the same time there are those too who grudgingly pay the higher prices but pay it all the same and buy what they need. There are also a privileged few very small in number, who seem to be totally unaffected by the high prices because they can afford to buy their requirements, cost what these may. To this phenomenon or rising prices, we generally give the name of inflation.

As commonly understood inflation means a rapid and continuous increase in prices. But thus is not complete explanation of the phenomenon. For example in period following depressions or in a situation a where artificial controls and rationing exist, prices may be low hut that is not the position of equilibrium. Once you let the chain tome, the price will spring up. Neither the low level of prices can be called a situation of controlled prices, nor the steep rise in the prices be termed as inflation. The toner increase is only a recovery boot fee previous abnormal situation.

Classical economists defined inflation as an increase in the ratio of money to purchasable goods and services consequently leading to rising prices Inflation is a situation when aggregate demand in the economy is in excess of aggregate availability of goods and services. This aggregate demand is, of course, backed by effective money which is constantly rising due to currency expansion, deficit financing, increase in bank credit or increase in the velocity of circulation of money.

There are other definitions of inflation also, most of which attempt lo go beyond the description of inflation in terms of its causes. For example, quite frequently, inflation is defined-as consisting of ail increase in the quantity of money, or of an increase, in the quantity of money at a faster rate than real national output Many a time, U is defined to terms of a sustained government deficit in budget, and U is often defined as a situation of chronic excess demand for goods and services. There is one thing

common in these definitions, it, they attempt to define inflation in terms of what is thought as the causes of inflationary pressure. But this is not the best approach to define in nation, because (here may be a situation in which the condition to which these may be totally absent still the economy might face inflation. The best definition of inflation can be shortest one that it is a situation of sustained high price rise.

Price movements are significant in studying the growth of an economy. First of all, price variations indicate the general economic condition of a country's economy. Secondly, price stability is an essential condition for stability in economic life as well as economic growth. Fluctuations in prices not only create an atmosphere of uncertainly, but also affect changes in the distribution of national income which in turn affect different sections of people iniquitously.

Inflationary tendencies in the Indian economy were visible as far back as 1939 when World War II was declared. The war created shortages of almost all goods and particularly of basic commodities like foodgrains. Part of the output was shifted to meet war needs and only a limited quantity was available for civilian consumption. At the same time, due to Government's war expenditure and the consequent increase in the income of the public, demand for goods and services expanded to a great extent Even after the end of World War II, the price level continued to rite because of (i) the partition of the country in 1947 which resulted in the influx of people, from Pakistan on the one hand, and dislocation of productive activities within the economy on the other, (ii) devaluation of the rupee in September, 1949 and rise in prices afterwards; (iii) removal of price controls and the subsequent support in prices and (v) pressure of increasing population.

Prices Movement since Independence

One of the declared objectives of the First Five Year Plan was to combat inflationary pressures. Aided by bumper crop, the First Five Year Plan largely succeeded in achieving this objective. At the end of the First Plan period, the general price index number stood at 99 (with 1952-53=100) but the index number of food articles had declined to about 95 and cereals and pulses stood lower a 88 and 77 respectively. Thus, during the First Five Year Plan the price situation was very favourable

The success of the First Plan and the favourable movement of prices encouraged the Government of India to launch still more elaborate plans and undertake still greater degree of deficit financing. Throughout the Second Plan period, there was a gradual and steady rise in prices. Between 1955-56 and 1965-66 the price level rose steadily at an annual rate of 6 per cent. This certainly caused hardships to certain sections of the society but did not cause couch chaos and confusion. From 1966-67 onwards (expecting during 1975-76 and 1977-78) prices rose at an alarming rate of more than 9 per cent per annum

In the whole of the planning period, it was only during the First Plan that general price level recorded a fall. The Wholesale Price Index Number (WPI) with base year 1961-62=100 which stood 89 in 1950-51 declined to 74 in 1955-56. During the First Plan period deficit financing was not much. fact, expansion in the supply of money fell short of the increase in output causing the general price level to come down

The period starting from 1956-57 and continuing up to 1965-66 may be characterized as a period of moderate rise in the price level As stated earlier, price level rose at an annual rate of about 6 per cent The WPI (base 1961-62=100) which stood at 74 to 1955-56 went up to 132 id 1965-66. In this manner, over a period of ten yean, (be general price lever rose by 78.4 per cent. The national income also went up by about 35.8 per cent during this period. Whether this rise in income and also in the general price level can be explained completely in terms of expansion in the supply of money, b a point to be debated, but it is rarely disputed that more than doubling of money supply with the public in this period was a major factor that caused the inflationary price rise.

Even though the price-level in India has been steadily rising since the beginning of Second Five Year Plan, the upward movement of prices since the Fourth Five Year Plan has been extremely significant. The rise in the general price level was rather slow in the beginning of the Fourth Plan but gathered momentum later. The rise in the first three years of the Fourth Plan ranged between 7 points to 9 points; and in the final year (1973-74), the general price level went up by 47 points. Heavy taxation during the Fourth Plan period, large influx of refugees from Bangladesh, the vide-spread failure of Kharif crops in 1973-74 and the complete failure of the wholesale trade in WDCA' resulted in an unprecedented rise in the price level in 1973-74. This was aggravated by a fourfold increase in crude oil prices toward the end of 1973. The world wide inflation of this period and the depredation in the external value of the rupee vis-a-vis many currencies c. the word pushed up the costs of imports and aggravated the domestic inflationary situation. Reflecting the cumulative impact of these factors the WPI of all commodities stood at an all time high of 331 in September 1974 (with 1961-62=100).

This kind of inflationary pressure created a veritable crisis in the country and a lack of public confidence in the ability of the government to manage the price situation. The Government took a number of steps, both fiscal and monetary, to check prices. These steps included impounding of "a pan of the additional deamess allowance as well as the entire increase arising from the revision of wages and salaries of employees, imposition of limits on declaration of dividends, and credit sequeeze by the Reserve Bank of India. At the same time, the use of stringent measures against smugglers, hoarders and black-marketees was made.

The latter half of the 1970s: was a period of only a mild rise in the price level. This was due to the anti-inflationary measures adopted by the Govt. in the wake of the much higher rises in the price level experienced in the first half of that decade. For the WPI the base was also shifted to 1970-71. But in the early years of (be 1980s, the inflationary pressures again started bounding up. In 1980-81 itself, the price rise was as much as 16.7 per cent As would be noted in Table 1 below, the inflationary presents were quite heavy during the 1980s. The WPI (with base year 1970-71=100..... from 246.2m in 1980-81 to 435.3 in 1988-89. This marks use of a much as 70 per cent in about eight year. The use in the prices of agricultural product was even higher. In the early 1980s the base year of WPI was shifted to 1981- 82-100. Thus, between this base year and 1990-91 the WPI rose by about 83% to 121.6 in 1995-96, to 195.6 in 2005-06. Figures in Table 1 shown that the prices of both manufactured goods and agricultural products contributed nearly equally to inflation in the county, although the prices of the latter group of articles contributed slightly more.

Table 1

Index number of wholesale price

Year	**General Index of wholesale Prices**	**Index of manufactured products**	**Index of agricultural products**
(Base: 1970-71 = 100)			
1971-72	105.6	109.5	100.4
1975-76	173.0	171.2	157.3
1980-81	256.2	257.3	210.5
1985-86	357.8	342.6	309.6
1986-87	376.8	359.4	330.1

Year	General Index of wholesale Prices	Index of manufactured products	Index of agricultural products
1987-88	405.4	393.8	372.3
1988-89	435.3	414.4	400.7
Base: 1981-82=100)			
1982-83	104.9	105.3	107.3
1985-86	125.4	124.4	129.1
1986-87	132.7	129.2	142.8
1987-88	143.6	138.5	161.8
1988-89	154.3	151.6	170.9
1989-90	165.7	168.6	174.4
1990-91	182.7	182.8	198.3
1991-92	207.8	203.4	236.8
1992-93	228.7	225.6	255.5
1993-94	247.8	243.2	271.4
(Base : 1993-94 = 100)			
1994-95	112.6	112.3	116.1
1995-96	121.6	121.9	125.9
1996-97	127.2	124.4	136.4
1997-98	132.8	128.0	140.3
1998-99	140.7	133.6	157.2
1999-2000	145.3	137.2	159.1
2000-01	155.7	141.7	163.3
2001-02	161.3	144.3	169.5
2002-03	166.8	148.1	175.3
2003-04	175.9	156.5	182.8
2004-05	186.7	165.5	188.5

agricultural product has contributed more to inflationary pressures in the 1990s.

The overall conclusion which emerges from this discussion of the inflationary trends in the Indian economy in the post independence period is that but for the early 1950s, this entire period has

witnessed heavy prices rises, particularly in the last two and a half decades. There has hardly been any respite to the people from the rise in the general prices level.

Causes and Consequences of Inflation

There is not a single and proved theory for inflationary rise in prices. The old quantity theorists and the present day monetarists explain inflation in terms of expanding money supply on the one hand and an inelastic supply on the one hand and an inelastic supply of goods and services. The Keynesian concept of "inflationary gap" emphasizes excess demand for goods and services over their available supplies. Excess of money supply, excess of cash balance, excess of demand-all these factors are generally understood to trigger inflationary pressure and propagate propagate it. The structuralizes attempt to link inflation to economic development brings about. They believe that the developing economies like India suffer from supply rigidities, bottlenecks and structural imbalances, which result in inflation and also make it cumulative.

Dear students, we hope that you can explain the general causes of inflation in terms of the demand- pull and the cost-push factor. Here, we shall attempt to explain the caused of inflation in India in terms of these two sets of theories of inflation.

First let us take up the demand pull set of explanations of inflation in the last few decades. As might be already known to you, the demand-pull set of explanations of inflation make a general proposition that excess demand factors cause persistent and significant rises in the price level. Now in India the existence of excess demand at macro and micro levels has been an accepted fact of life. Which are the major areas where excess demand has existed or which are the major areas where excess demand has existed or which are the main contributory factors leading to excess demand?

In the first place, excess demand exists in the markets of nearly all the essential goods in India whether these are food items of.....Or non-food items (e.g. living .....) or industrial raw material,

Secondly, a potent factor generating excess demand m UK; economy has been persistent and high fiscal detects and the expansionary policies of the Govt. The heavy expenditures of the Central and State governments over and above their normal revenues, year after year, have been responsible for budgetary or fiscal deficits bad started assuming crisis proportions. For example, the fiscal deficit in 1990-91 was as high as 8.4 per cent of the GDP. These fiscal deficits are met through two types of borrowings: from the public (i.e. from the banking system), and from the R.B.I. It is the latter called the monetized deficit, which by adding to the money supply year after year causes a situation of excess demand and leads to inflation.

Thirdly, excess demand is also generated by the existence of black money. There are various estimates of black money existing in Indian economy. For the early 1980s, the National Institute of Public Finance and Policy estimated the black money in India to be about 18 to 21 percent of the GNP. Other estimates have placed the figure to be high as half the size of the GNP Black more encourages unproductive and unnecessary expenditures and- therefore, generates excess demand, (hereby fueling the fires of inflation.

Fourthly, there are some longer term factors which are at play on the demand side. One of these is the rapid and large increase in population, and toe second is the rise in the money incomes of the people, households und businesses. Both these shift the demand curves for goods and services upwards without adding much to their supplies. These factors have also been operating in the country since the 1950s.

Let us now consider the supply or cost-push factors accounting for inflationary pressures in India. Firstly Indian economy is characterized by a general inflexibility in the supply in other words a low

elasticity of supply) of most goods and services. Due to various shortages of inputs and infrastructural facilities, the supply does not respond to change in demand rapidly. Thus supplies lag behind demand, thus causing a price rise. This is a persisting problem and thus causes rise in prices as a cumulative process.

Secondly, the domestic shortage cannot be met entirely even through inputs die to a persistent balance of payments constraint. So there is a low elasticity of supply of imports. Lack of foreign exchange has been a continuing problem for the country. The external factor as a cause of inflation in India has operated in another way also. This is the result of what are termed as supply shocks. One of these shocks has been in the form of recurrent international rise in petroleum prices since 1973. Another was the Gulf War which disrupted supplies of petroleum, causing scarcity and rise in prices of this category of essential products.

Thirdly, the cost-push in India has appeared at regular intervals in the form of raising of administered prices by the Govt. There is a whole host of goods and services in India whose prices are administered (controlled) by the Govt. These include among others: railway fares and freights, bus fares, prices of goods supplied through the fair price shops, water and electricity, petroleum product including cooking gas, etc. When the administered prices are revised upwards, these push up the general price level, since many of these goods and services enter as inputs in the production of other goods.

Lastly, the low elasticity of supply of essential articles from domestic and foreign sources creates an, environment of inflationary expectations. When the general public and the business community expect the prices to rise due to general scarcities, the former indulge in stockpiling of essential goods, while some members of the latter board- goods or build up inventories. All this, being the result of inflationary expectations, further fuels the fires of inflation.

The foregoing have been toe major causes of inflation in India. The process may also have been further accelerated through droughts, floods and other natural disasters Price Stability and Growth: Is there a trade-off.

It is generally argued that the attempt to reduce the inflation may affect output growth in the economy. Or in other-words bat is the relationship between money supply growth and output growth in an economy. Or to put the question differently can money be considered neutral in relation to real economic variables. It requires the appropriate understanding of the process of economic growth' itself and the forces that bring about economy in the real economy to answer the above raised questions.

As most growth theories are non-monetary in nature and money has no role in either initiating or sustaining the growth process. These theories assume that growth depends on real factors viz. capita, formation, accumulation, population, technology and innovation.

The perception regarding the money neutrality proposition, however, underwent a significant change with the Keynesian revolution emplacing that an increase in money supply will decrease real wages and bring down unemployment. The well known Fillips curve exhibited the relationship between percentage change in wage rue or inflation rate and the unemployment rate. Since Phillips curve ignored the role of expectations and was theoretically and empirically got invalidated in the 1970s due 10 prolonged period of stagflation in many countries.

Empirical research on inflation and growth linkage, leads to a general finding that inflation adversely affects growth in the long run. The estimates presented by Fischer (1994) show that a 10 percentage point increase in inflation rate results in 0.4 per. cent decline in output growth per annum and 0.18 per cent decline in-productivity growth. Another, study by Barro (1955) reported that over a long period, a 10 percentage point permanent increase in inflation rate is estimated to bring down the

level of real GDP by 4 to 7 per cent There is, however, some inconclusiveness regarding the relationship between price stability and growth in the short period.

The main criticism against this relationship is that hidden cost of inflation is not taken into account If all efficiency costs and welfare costs of inflation were to be quantified and given due weight, the 'trade off would become even more unfavorable 10 growth. A recent macro-econometric model for the Indian economy for the period 1970-71 and 1993-94 (Rangarajan and Mohanty 1997), simulated shows that an increase in investment spending financed by money creation has a positive effect on output There is also an adverse external implication of this financial policy as it leads to a deterioration in the current account deficit in the balance of payments through import linkage and loss of competitiveness of exports. This needs to be weighed against the "trade off that it might have in terms of output gain in the immediate sheet run.

Consequences of Inflation

Apart from uncertainty in production, inflationary pressure has caused serious imbalances in the Indian economy. Price relationship have been badly distorted and production pattern has gone out of line with demand. Besides, capital resources available in the country have been diverted from long-term to short-term uses and production has also shitted from essential but controlled goods to non-essential and free goods. Inflation also has led to economic recession in many sectors of the economy. As a result of inflation, prices of certain important articles of consumption such as textiles have increased to very high levels forcing the demand for such goods to declined. While growth of demand may have decelerated, production growth has slowed down even more due to shortage of raw-materials, transport, power, etc. All round rise in prices has eroded the volume of investment in real terms.

Most serious effect of inflation are on the distribution of income in India. Inflation has brought about a mal-distribution of incomes. The producers, traders and speculators have gained ..... through ever rising profit and margins and through illegal gains and windfall profits, due to boarding', speculation and black marketing. On the other hand, people living on fixed incomes and on past savings have been hard hit by continuous deperda6on of the purchasing power of the currency. Working, classes, particularly those of the unorganized sectors, have suffered badly. Inflation therefore, has brought about shifts in the distribution of income from the poor and the weak to the rich and the strong.

In order to control inflation, the govt. has adopted several measures in the mid-1990s. The measures have been taken both on the supply side as well as the demand side. The supply side measures include the following: Allowing freer imports of" edible oils (including palmolien for distribution through PDS), sugar, pulses and wheat; adjustment in trade and tariffs to ensure greater competition in the domestic market; substantial reductions in excise duties, whose benefits are expected to be passed on to the consumers through price reductions, and strengthening of the public distribution system and its expansion in Revamped Public Distribution Scheme (RPDS) areas, which' include tribal, hill and arid areas.

The demand side measures including the following: Repeated attempts at reduction of fiscal deficit since 1991, so as to bring down the volume of excess demand; placing a cap on the Central government's borrowing from the R.B.I.; phasing out of ad hoc treasury bills through which money supply was increasing year after year.

Lesson - 12

Dr. Sanju Kavol

Financial Sector Reforms in India and Growth and Structure of Subsidies in India

The economic reforms in India, initiated in 1991, were based on the premise that macro economic crisis was a result of 'micro economic' inefficiencies that distort the structure of incentives to producers. After a short period of 'stabilization with the usual package of devolution, temporary import compression and fiscal and monetary contraction accompanied by a sharp increase in the interest rates in the economy, the main focus of the reforms programme has been confined to what is known as 'structural adjustment.'

The deregulation of the industrial and financial sectors has occupied the pride of 'place in India's structural adjustment programme (SAP). There are three essential elements of this package of reforms. First, deregulation and liberalization of all markets: second, increasing competitiveness in all spheres of economic activities; and third, living within our means or a strong budget constraint on all economic agents. The financial reforms programme, follows the well known path of deregulating capital markets and banks, interest rates, with drawing directed credit and subsidies, and encouraging stricter income recognition norms and'' integrating the domestic financial markets with global financial flows, in conformity with the 'Washington Consensus.:

The financial institutions have an important role to play-commercial banks in the case of individual* and the central banks in the case of governments. The third clement is self evident because one cannot live beyond one's means of current and borrowed income. If expenditure exceeds income, current plus borrowed, prices will increase to make them equal. However, there is a degree of freedom in one's ability to borrow and this is where' the financial institutions have a role to play. They have to ensure that current borrowing matches with the future streams of income without which an essential plank of economic reforms based on price stability will collapse.

Actually the maintenance of this budget or the fiscal discipline may be regarded as an essential precondition for a successful implementation of other contents of economic reforms, as without that the economy would be exposed to expectations of rising inflation, which could distort all the price and income signals for appropriate allocation of resources by the market

The Indian-economy has always been a market economy with an overwhelming bulk of all transactions being settled in die market place. The past has shown that the only way to influence the market would he to play with market forces, with price and income related instruments, because any attempt to control or regulate those market variables would normally create parallel markets and generate pockets of scarcities and rents frustrating the implementation of these policies.

The financial markets are markedly different from other markets and therefore, the market of financial services is most prone to imperfections and market failures are likely to be pervasive in these markets. In capital markets, money today u exchanged for a promise of returns in the future. The promise is always, in effect, a contingent promise in the case of bond the promise takes the form, I will pay a certain amount provided that I can; and if I can't, 'certain other consequences follow.' In the case of equity, the promise takes the form, 'I will pay a fraction of my profits. I will decide the fraction, and I will decide how * profits arc defined If I don't pay a dividend, I will reinvest the money in the firm, and you will receive a return in the form of capital gain'. Because of above mentioned difference in toe bond

and equity payments the financial markets are not run, and cannot be run as auction markets. Prices (interest rates) play a role in the allocative mechanism, but the allocative mechanism is* fundamentally a screening mechanism, in which prices play a secondary role.

Banks perform in the case of loan able funds four important functions viz. agglomeration function, the transfer function's the selection function and the control function. Both these last functions are susceptible to failures. The selection function is even more difficult to perform because by changing the price of the loans (interest rates; the banks may not be able to get the best allocation of loan able funds.

Financial Sector Reforms:

India's financial sector experienced rapid growth and deepening during the first four decades of economic development. Given the fact that capital markets in India were small and weak, these development financial institutions (along with state-owned insurance firms) helped to develop and deepen the capital market through their underwriting activity. The critics of state intervention in financial markets characterize Indian financial sector as 'repressed' with high reserve requirements, interest rate controls, and direction of credit to priority sectors. The repression, it is argued is harmful to resource mobilization and efficient resource allocation. Liberalization of the financial system would enhance saving rates and enable the financial system to perform its role of allocating scarce capital more efficiently. This calls for a deregulation of both the capital market and the banking sector, building of new institutions to respond to ever-increasing financial innovations and technologies that lower transaction time.

The financial sector in India underwear profound transformation during the first-four decides of independence. Indian banks were mainly providing working capital loans to trade and were reluctant to lend to the small industrial enterprise or to tin fanners. The government promoted various development financial institutions mainly IDBI, IFCI and ICICI to overcome the lack of long term finance-essential for launching long gestation industrial projects in the private sector.

A policy of greater social control over the private banks, making it obligatory for them to lend a greater proportion of their advances to the small firms and agriculturists was embarked by the state in late 60s. Failure of policy led to the nationalization of large private banks in 1971. Over the years these banks emerged as a major source of lending for the government and quasi-government institutions in the form of statutory liquidity ratio (SLR).

This policy resulted in rapid increase of banking network throughout the country and led to an increase in financial savings. The banks also provided resources to the FDI at low rates, as their borrowings were guaranteed by the central bank and others formed pan of He approved securities for computing SLR. During 1971-85 inflation remained moderate and real interest rates were mildly positive and this system helped in avoiding severe financial repression.

The major abort comings of the Indian financial system as identified by the system as identified by the Narasimhadın committee are given below.

A large pact of banking resources were preempted by the government. Along with the high cash liquidity ratio, more than half the deposits of the banking sector were not available for private sector. The government paper was held at low rates of interest, farcing toe banks to recover their costs from the advances made to the private sector, thus raising the cost of borrowing to private sector in 1980s. Of the resources available for private sector a substantial part was directed inwards priority sectors, which included export sectors, a few industrial sectors targeted (e.g. fertilizer industry) and small and medium business and the farm sector.

Interest rates were tightly regulated and the ban management was left with hardly any control over their profitability except for control over costs. It was also found that directed credit policy did not succeed. In meeting its purpose doe to low interest fixed by regulators for what ------ the Priority sector lending resulted in deteriorating the health of the banks. The ---------- of administered interest rates highly complex and right ---------- not related to market conditions. The capital structure of banks was also cause of concern with the net worth of banks as low as 1-2 percent of their advance.

---------- Not Readable data----------

its own borrowing. Incremental cash reserve ratio (CRR) of 10 percent removed and one third of the impounded cash balances under incremental CRR released.

The number of administered interest rates on bank advances has been reduced from 20 in 1989- 90 to 2 in 1994-95. The interest rate on loans above Rs. 2 Lakh has been fully decontrolled and the ceiling interest rate on external rupee account term deposits is reduced from 11 to 8 per cent Banks has been allowed to raise capital contribution from foreign institutional investors up to 20 per cent and from NRI's up to 40 per cent.

New income recognition norms based on international accounting standard committee have been gradually enforced and provisioning for bad debt introduced Under the new norms the ratio of non- performing advances (NPAs) was estimated to be as high as 24 per cent in 1993-94 and by 1998 stood at 16 per cent of all advances. Provisioning requirement for NPAs of less than Rs. 25.000 raised to be 10 per cent in 1995-96.

Capital adequacy of 4 per cent attained by all banks by March 31, 1993 has been raised to 8 percent by end March 1996 and projected to go up by 10 per cent by 2000. Interest rates have been largely deregulated with the credit worthiness of the borrower determining the interest rate.

Capital adequacy of 4 per cent attained by all banks by March 31, 1993 has been raised to 8 per cent by end March 1996 and projected to go up by 10 per cent by 2000. Interest rates have been largely deregulated with the credit worthiness of the borrower determining the interest rate.

Banks have been given freedom to.....new branches and upgrade extension counters on attaining capital adequacy norms and prudential accounting standards. They have been permitted to wind up non- viable branches other than in rural areas.

Banks lending norms have been liberalized and they are given freedom to decide levels of holding of individual items of inventories and receivables. Some all India development banks have introduced floating interest rate on financial 'assistance.

Financial institutions access to SLR funds have been eliminated and they are encouraged to approach capital market for funds.

A significant change, was in the source of funding for the DFIs. Their access to Government guaranteed funds from the banking sector and. long term (LTD) funds from the Reserve Bank were cut off. The second Narasimham committee recommended mat DFIs should convert themselves into banks. The proportion of funds to be invested by LIC, GIC and in government securities and socio-oriented sectors has been reduced from 70 per cent to 45 per cent.

External Sector Liberalization

In addition to the changes in the financial sector, India embarked upon major deregulation of its external sector. After a sharp devaluation of the rupee in 1991-92 the central bank gradually moved to a market determined mechanism for determining the exchange rate. By 1993-94 the rupee was made convertible on current account with market determined exchange rates. This was combined with significant trade liberalization which included phasing out of import quotas (move to open general license) with the exception of agricultural and consumer goods, sharp reduction in import duties and reduction in non-tariff barriers. Import of gold was allowed leading to a sharp drop in smuggling and a corresponding undermining of the black market in foreign exchange.

Large firms have been permitted to access funds from abroad as global depository receipts and commercial borrowing. They have been permitted to access overseas bond markets. Foreign portfolio investment have been extended to bonds and their share 1993 foreign institutional investors (F11) registered pension funds (PF) were allowed to invest in the Indian sink exchanges.

However, the most significant liberalization of capital account for residents was the permission granted 10 them to retain foreign exchange abroad. Domestic exporters were first permitted lo retain their earnings abroad for 180 days, as short-term investments. In addition, the domestic banks were permitted in 1997 to invest up to 15 percent of their Tier I capital abroad. Individual Indian funds were allowed to be inserted up to $ 50 million abroad. These measures formally linked the domestic money market with the foreign exchange market, faded this has been one of the stated objectives of the central bank's deregulation.

A surge in the inflows into the capital account was realized due to liberalization of the external sector. The portfolio Investment alone was more then $ 3.5 billion in 1993-94 with additional inflows of $ 2.7 bn in 1995-96 and $ 3.3 bn in 1996-97. The country received nearly $ 10 ..... foreign portfolio investment in the first three years. This large inflow in the capital account led ..... upward pressure on the value of the rupee b the foreign exchange markets forcing the central bank to repeatedly intervene to mop up excess supply of dollars. The Large inflow continue during the next two years till the financial crisis East Asia led to a decline of portfolio inflows from FIIs during 1998.

India's experience with financial deregulation has been far from happy and has shown the limitations of the assumptions made by the Narasinham Committee. A basis presumption was that the financial repression and draft on banking resources government (through SLR) has raised the cost of capital to private sector which was crowded out of the credit was to lower the cost of borrowing or the one hand and efficient allocation of resources on the other. Their aim was to widen the access of domestic turns to global market by integrating global capital inflow with domestic money markets. Better income recognition would force banks to improve risk assessment The new income recognition norms showed between 22 to 24 per cent of the total loan were non performing. Where as the earlier tax norms income recognition used to distort the true balance sheet. In many stronger banks NPA ratio was as low as 10-12 per cent and in the weaker banks it was ..... in 1996. This part of the reform has been largely successful.

Sharp reduction in the cost of borrowing to the medium and large industry was not realized as interest rates rose to 16 to 20 per cent in the early phase of stabilization programme. The surge for higher profits encouraged many public sector banks to divert their money illegally to the stock market which resulted into losses due to stock market scandal during (1991-93) period. The real interest rate both for the working capital as well as for long projects remained quite high. It is argued that not only real interest rose sharply after the reforms, but me availability of credit to private sector was also severely curtailed. The total foreign investment inflow remained, disproportionately large to the historically levels as well as to the funds raised in the domestic capital market.

Against the background of a poor fiscal position of the central government and-slow investment response from the private sector, the immediate impact of the surge of fund inflows was to generate rapid increase in domestic liquidity as Reserve Bank accumulated increasing international reserves to avoid an appreciation of the exchange rate. The real effective exchange rate appreciated by 4 per cent in 1993-94, another 7 per cent during the next two years.

Two depreciation Episodes viz. 1995-96 Episode & 1997-98 Episode in recent times show that how as a result of these market with external market, the RBI's monetary policy was in fetters. Despite low rates of inflation, the interest rates remained quite high, largely to prevent large outflows and -to prevent an erosion in the value of the rupee. It has led to decline in flow of credit to industry. Sharp increases hi long term interest rates has led to slow down in investment and industrial growth. Industrial growth rate which stood at 12.8 per cent in 1995-96 stowed down to 6.6 percent in 1997-98.

The increasing entry of multinational corporations has charged the competitive scenario in India, where domestic funds emerging from a regime of controls over size location, technology etc, find themselves at a disadvantage. All this has made Indian firms very attractive takeover targets.

Growth and Structure of Subsidies in India:

The subject of subsidies has become-quite controversial in recent years. During the present era of liberalization, globalization, privatization and economic reforms where the main policy thrust seems to be downsize the role of government in the functioning of the economy, the subsidy issue has assumed great importance. Though the subsidy issue appears quite simple yet analysis of its philosophy, politics and economics and measurement is full of problems and difficulties. The study of subsidies occupies a significant place as it is part of the key area of public expenditure analysis.

The main function of government is to collect taxes >in order to spend or public or collective goods that are made available to all, and indeed no one could be excluded from receiving the benefits from them. There are other areas where government needs to use the tools of taxation and expenditure. Both equity and efficiency considerations require state intervention. While the former aims at redistributing wealth and income to bring about an equitable economic society, the latter relates to toe need for preventing distortion that emerge as a result of externalities. Externalities arise as a consequence of the divergence between social and private costs or benefits government takes action by imposing appropriate taxes or subsidies to equalize private and social valuation.

In an ideal society where all costs and benefits can be internalized by the economic agents and where an ideal distribution of income is present, neither taxes nor subsidies need be present But it is not so in real life. By interfering in the market, taxes and subsidies tend to distort the way resources are allocated. Subsidies, depending upon whether they are for positive or negative reasons, induce people to produce (and consume) more or less of those good and services. Thus a positive subsidy induces people to const services that are valued at less than their cost and hence it is inefficient. If however, there were positive eternities associated with these subsidized goods and services, the subsidy has toe effect of enhancing .....

Subsidies are of three kinds: (a) those that help id increasing production or consumption of goods and services, e.g. education, food; (b) those that help to increase the use of particular factors of production, e.g. fertilizer and (c) those that are special purpose subsidies to achieve some broad social objective, e.g. export subsidies. There are also negative-tax type of subsidies provided basically to desist from undertaking certain kinds of productive activity as for example the subsidies given to the American farm sector to curtail production with the intention of maintaining prices at a higher level.

Subsidies could he explicit with an actual of law of funds from the government to the private sector or they could he hidden where the flow can only be imputed as in the case of special tax

concessions of loss guarantees. In many cases, a subsidy may not flow the public to the private sector, but from one section of private sector to another. This form, of cross subsidization occurs when some consumers are charged higher prices to enable other consumers to pay lower prices. There are many situations where unintended subsidies exist because of sheer mismanagement of public resources that resources in a flow of resources from the public to the private sector.

Growth and structure of subsidies:

A significant feature of Indian public finance since independence is its pro-active nature. From the beginning, there existed a consensus that the-government will actively use its fiscal tools to improve (he efficiency and equity of the Indian economic system. With the steady expansion of the economic activities of the government, the part played by subsidies also widened. During the period since 1971 explicit subsidies provided by the central government have gone up by no less than 120 times. The total sum of explicit subsidies has gone up from Rs. 140 crore in 1971-72 to Rs. 19, 644 crore in 1997-98 (RE).

Although there is some consolation that as a proportion of QDP, it has fallen (from: 2.3 per cent in 1990-91 to around 1.4 per cent in 1997-98), in absolute number the growth has been quite substantial. Bulk of this has been in the areas of food, fertilizers, railways and interest payment. While the average growth rate of this increase is approximately 20 per cent in current rupee, in real terms (at 1980-81 prices) it is around 10 per cent per annum. Even during the 1990s when the government of India undertook to reform the Indian economy the amount spent on subsidies not only did not abate, but actually registered a substantial increase. 'Subsidies' are an economic category and though we can define it precisely for analytical purposes, computation of the actual subsidies is difficult under the most easy circumstances where the processes of public finances are transparent.

The main thrust of our agricultural policy has been on growth high-yielding varieties expansion of irrigation, and increased use of chemicals. The main policy dilemma has beeri to find a way to provide to fanners incentives to grow more through remunerative prices and at the same time keep the food prices low enough for the consumers. This has been accomplished by a policy of low output prices and low prices for agricultural inputs of water, power and fertilizers. Consumer are further protected through the PDS. As a consequence, the prices fanners receive for their produce are in'-general below international prices. The gap between domestic prices and international prices is due to price distortions in input and output prices. Much of the subsidy given in agriculture is, in fact, subsidy to consumers. In the present lesson, an attempt is made to discuss the growth tad structure of Fertilizer and Food subsidy in India.

FERTILIZER PRICING POLICY & SUBSIDY

The twin objectives of fertilizer price policy in India are (i) to make fertilizers available to the fanners at low and a affordable prices to encourage intensive, high yielding cultivation and (ii) to ensure fair returns on investment to attract more capital to the fertilizer industry. By keeping fertilizers prices constant and low, government has been able to increase the demand for fertilizers, Fertilizer subsidy becomes necessary due to the twin objectives of fertilizers pricing policy mentioned above. Under this pricing policy, the fanner get fertilizers at a low rate which is already fixed, called the maximum selling price. The manufacturer is paid an amount, which is high enough to cover his costs including a margin of profit, at 12 per cent (post tax). This price is known as the retention price. The difference between selling price and retention prices is terms as subsidy.

For imports, the subsidy is equal to the difference between the cost of imported material and the selling price. Due to ever, rising volume of production and imports and also because of increasing margin between the retention price/imported cost and the selling price to the fanner over the years, the fertilizer subsidy has gone up enormously as has been indicated in the Table below.

Table

Fertilizer: Production, Imports and subsidies (Selected years).

Year	Production (N+P) (000 tones)	Imports (N+P+K) (000 tones)	On imported fertilizer	On domestic fertilizer	Total
1980-81	2005	2759	335	170	505
1985-86	5756	3399	324	16.00	1924
1990-91	9046	7/58	659	3730	4389
1995-96	11335	4008	1935	43.00	6235
1996-97	05.99	2014	1350	4743	6093
1997-98	10086	2976	826	9200	10026
2001-2002	14632	2398	47	8044	12595
2002-2003	14468	1757	0	7790	11014
2003-04	14265	2019	0	8521	11847
2004-05	15063	1384	473	8143	12662

Source : Economy Survey 2004-05, P-183

The burden of fertilizer subsidy, has increased from Rs. 505 crore in 1980-81 to Rs. 10026 crore in 1991-98.

The next question is whether fertilizer subsidy is dispensable or not.

As mentioned earlier that the main reasons for fertilizer subsidy were (i) to encourage the use of fertilizers by all farmers to increase foodgrains production so that increasing requirements of the population could be met at affordable prices and (it) to ensure a reasonable return on investment through the retention price scheme (RPS). The heavy burden of fertilizers subsidies has created serious financial problems and such a high level of subsidies is not sustainable and there is an urgent need to bring it down as it created a serious crunch on resources to implementation of Five Year Plans. U is in this context that the hike of 3Q per cent in fertilizer prices announced in July 1991 and the decontrol of fertilizer prices announced in August 1992 has to be looked into.

Though there has been a great resentment against this price rise by the farmers' lobby but this did not demotivate the farmers to use fertilizers. The empirical evidence suggests that procurement/support prices of paddy and wheat increased enough over the years whereas the prices of fertilizers were held down at a low level due to the subsidy. More over, as pointed out by Kirti Parikh, a large part of the subsidy (more than half) is a subsidy to high cost producers of fertilizers in India. Thus, half the subsidy is to producers and not to farmers. Abolition of the cost-plus Pricing Scheme..... the subsidy.

According to Ajit Kanade and S. Mahendra Dev food and fertilizer subsidy was 56.3 percent of total subsidy part of non-plan budget of the Central govern meat in 1990-91 and has increased to 85:5 per cent in 1995-96. As percentage of total non-plan expenditure of the Central government, food arid fertilizer subsidies have gone up from 3^1.8 per cent in 1990-91 to 54.6 per cent in 1995-96.

In addition to food and fertilizer subsidies, other important subsidies to agriculture are on irrigation, power and credit. Irrigation subsidy, i.e. the implicit subsidy which is the difference between the real cost of supplying irrigation and what farmers actually pay for ii has increased from Rs. 364 crore in 1980-81 to Rs. 12.000 crore. Power subsidy is defined as the difference. between the cost of generating and distributing power electricity to farmers by State Electricity Boards and the price paid by the farmers to (SEB). Electricity subsidy is expected to act as an incentive to farmers to invest in pumpsets, bore wells etc. Subsidy for power has in creased from Rs. 369 crore in 1980-81 to Rs. 10,000 crore in 1997-98. Credit subsidy which is the difference between interest charged to farmers, and actual cost of credit to banks, plus other costs such as write-offs on bad loans has moved up from Rs. 517 crore in 1980-81 to Rs. 7.000 crore in 1997-98.

These rising subsidies for agriculture have hurt all of us because they have crowded out various Government investments and expenditures in many desirable social sectors. In fact, they have crowded out investment in agriculture sector itself and the government is not able 10 expand surface irrigation which use.

To conclude, subsidies on the technologically new inputs like chemical fertilizers in the initial stages of green revolution in India did induce the farmers to readily adopt new technology. Over a period of lime, however, these subsidies began to mount, even as the fanners became fully conscious of the profitability of new technology. Moreover, the hidden subsidies arising from the inability to recover economic rates from the fanners for the use of irrigation water from surface sources on power for pumping water, rose steeply. The amount of these subsidies - open as well as hidden-on fertilizers, irrigation, power and credit-reached the level of total productive investment in agriculture by the government in the early nineties.

These subsidies have a most deleterious impact in terms of reduced public investment in agriculture on account of the erosion of investible resources and wasteful use of scare resources. Further apart front causing unsustainable fiscal deficit, these subsidies, by encouraging the intensive use of inputs in certain pockets, have led to lowering the productivity of inputs, reducing employment elasticity of output through the substitution of capital for labour and lowering water tables, on the other.

Food Policy & Subsidy

The broad objective of food policy in India has been to make available food to the people at reasonable prices. The more specific objectives include providing remunerative prices to cultivators, supplying food at subsidized prices to the undernourished, controlling in flationary pressures stabilizing prices for consumers and producers stabilizing prices for consumers and-producers reducing fluctuations in food availability and achieving self sufficiency in food grain production. The Food Corporation of India (PCI) was set up in 1964 to act as a nodal agency for the procurement, storage interstate movement or transport and distribution of food commodities. In short, the PCI is responsible for implementing central government policies on procurement, storage, transport and distribution In certain operations such as the maintenance of national buffer stock, the FCI has sole responsibility where as in certain other operations such as procurement, the FCI has to work with state government organizations and within the purview of state government policies

The food subsidy as defined in the government budget includes the entire operational deficit of the state-owned FCI. Food subsidy in India has increased iron) Rs. 662 crore in 1980-81 to Rs. 7500 crore in 1997-98. In nominal terms, the food subsidy has been rising rapidly particularly after the mid-

1980s, and it look a big jump in 1993-94. In reail terms, the expenditure on food subsidy, rose in mid-1980s and then remained uncharged until a bent 1989-90. It dipped between 1990-91 and 1992-93 and rose in 1993-94.

However the food subsidy as a share of CDP appears to have remained more or less unchanged over the last 20 years, peaking at 0.63 percent in 1985-86 and 0.64 per cent in 1993-94. Interestingly, the food subsidy as a share of government expenditure shows large year-to-year fluctuations and the share was higher in 1976-77 (3.84 per-rent) than in 1993-94 (3:56 per cent). Foe* subsides in Lanka account for 13 per cent of GDP (in 1984), in Mexico accounts 0.63 per cent of GDP. In India, over (he 31 year period 1966-1997, the food subsidy accounted on average 0.31 per cent of GDP and 2.35 per cent of central government expenditure.

The four major items of food that are handled by the PCI are rice-(and paddy). Wheat, imported edible oils and sugar. Now (he central food subsidy includes the subsidy on sugar and this is likely to vary in different years. In 1993-94, for example, absent 86 per cent of the total food subsidy was.on account of the cereal subsidy.

The PCI handles buffer stock operations and the total food grain subsidy includes the costs associated with mainting buffer stocks (such as handling costs, costs of storage, interest payments and administration).

A diagrammatic sketch of the components of ..... costs is shown in figure I. The subsidy is defined as the difference between economic costs and the pries obtained from sales (or sales realization) that is.

Subsidy = Economic Costs Sates Realization.

The economic cost, is defined as the sum of procurement price procurement related costs and distribution costs as follows:

Subsidy a Procurement Price + Procurement Cost +Distribution Cost—Sates Realization.

The procurement price is the price paid by the FCI to producers for the purchase of grain. Procurement costs are the initial costs reported under the following sub headings: statutory charges, labour charges, amount paid to state agencies for establishment, storage and interest for stocks procured and other costs. Distribution costs are the costs involved in storing and transporting grain to the final distribution points. The components of distribution components are final distribution points. The Components of distribution cost are freight, handling expenses storage and interest charges, losses and establishment costs.

The first feature of the basic data in Table 11.1 on economic costs, sales realization and subsidy is the grown gap between economic costs and sales realization, particularly in the last two years. The economic costs of procuring and distributing both rice and wheat have risen steadily in the 1990s: The economic cost of procuring and distributing wheat has increased at an annual growth of 10 per cent per anum from Rs. 365-50 per quintal to Rs. 807. In during 1990-91 to 1998-99. The economic costs of procuring and distributing rice grew at 9.7 per cent a year over the same period from Rs. 457.52 to Rs. 980.36. Average sales realization did not register fast growth as economic costs did.

In addition to sales to PDS and other social security programmes, the PCI also engages in open market sales and exports The unit subsidy on wheat grew more rapidly than the unit subsidy on rice. In 1990-91, the subsidy paid the PCI was Rs. 116.55 per quintal of wheat and Rs, 127.5 per quintal of rice. In 1998-99 the unit subsidy was Rs. 419.62 for wheat and Rs. 379.18 for rice. From 1991-92 onwards, with the exception of one year, the ratio of the wheat subsidy to the rice subsidy has been greater than one.

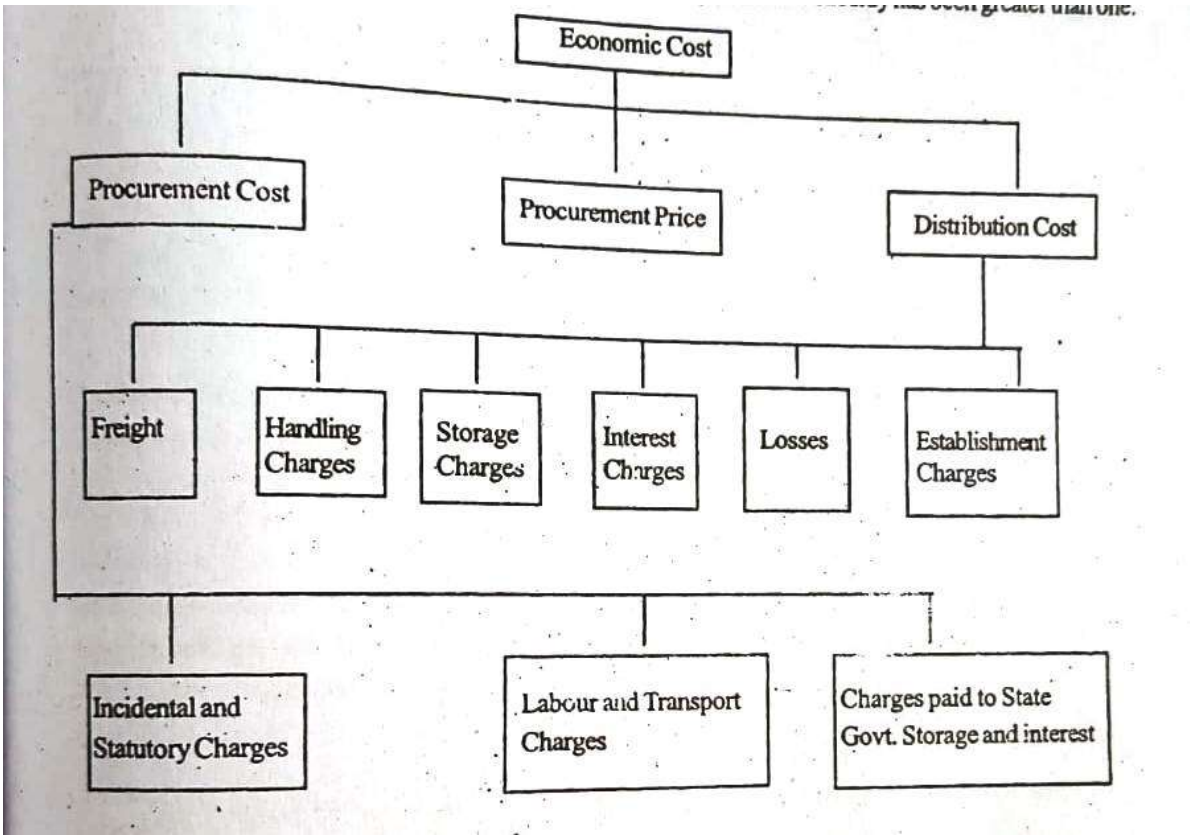

Table .....

Economic Costs and Consumer Subsidy

Fiscal Year	Ecost Nic Cost		FCI's Average Sale Realization		Consumer Subsidy	
	Wheat	Rice	Wheat	Rice	Wheat	Rice
1991-92	390.70	497.04	251.68	365.58	139.11	131.46
1992-93	504.10	585.27	279.36	442.40	224.74	142.87
1993-94	532.03	665.10	335.88	500.42	176.15	164.68
1994-95	551.17	694.71	407.89	600.75	143.28	93.96
1995-96	533.95	762.82	411.94	613.34	172.01	149.48
1996-97	640.16	847.69	433.20	610.57	206.96	237.12
1997-98	800.50	940.40	395.87	610.80	404.63	329.60
1998-99	807.95	1076.00	388.33	601.18	419.18	379.18

1999-00	887.50	1074.80				
2000-01	883-78	1137.07				
2001-02	852.90	1098.00				
2002-03	884.00	1165.00				
2003-04	952.50	1253.00				
2004-05	924.80	1265.50				

Source : Economic Survey 2004-05

The 1998-99 union Budget projects the food subsidy to go up further to Rs. 9000 owe in 1998-99 due to the fact that there has been a rapid increase in procurement of wheat and rice, storage costs have gone up and the procurement price of wheat, has been raised.

Food subsidy to FCI consists of two parts:

(i) consumer subsidy and (ii) buffer stock subsidy. Buffer stock subsidy refers to the reimbursement of the carrying costs on buffer stocks held by the FCI on behalf of the government. The burden of buffer stock subsidy has increased from Rs. 263 crore in 1977-78 to Rs. 1,254 crore in 1993-94.

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LESSON-13

MONETARY AND FISCAL POLICY OF INDIA

1. Monetary Policy and Central Banks

The Central Banks all over the world are an institution which among other things, is expected to oversee the monetary system of each country. In many countries, the Central Banks are owned by the governments of their countries. But even when they are not, they work in close concert with the finance and other ministries of the government Money (including currency and bank credit) is said to be a good servant but a bad master. It means that money supply has to be kept under control otherwise it can rain an economy and the society. It is for this reason, among others, that the Central Banks are created so test they keep a watch on the monetary system of the country. Besides this rather negative feature of their activities (i.e. not to allow the monetary system of the country to let money become a master and to keep it in leash as a servant), "the Central Banks in tandem with the government departments design policies so as to control the flow of bank credit into socially desirable forms of investment Thus, one of the important functions of the Central Bank is to design s suitable monetary policy based on (he social and economic; needs of the country and to implement that policy.

Monetary policy includes the control of money supply, regulation of rates of interest, and usually the channeling of bank credit into pre-determined activities, industries and sectors of the economy. Mainly the term monetary policy refers to the regulation of quantity and the cost of credit. The Central Banks help in designing the monetary policy and are charged with the responsibility of implementing it. This is a statement announced twice in a year (October and April) till recently (1998-99). Beginning with 1999-2000, the RBI has decided that the policy announcements will be an annual affair.

2. Objectives of Monetary Policy in India

The Reserve Bank of India (RB1), like all other Central Banks also advises the government in designing the monetary policy and in bringing about changes in it. It of course also implements that policy. The Reserve Bank of India Act, 1934 charged me Bank with performing the function of securing monetary stability in India and generally to operate the currency and credit system of (he country to its advantage." Thus, the R.B.I. helps in designing the monetary policy and then implements it

The main objectives of monetary policy in India have been essentially determined By me exigencies of economic planning in the country. Monetary policy has until recently of necessity, worked as a handmaiden of economic planning. The core, objective of planning in the country has been to secure economic growth with stability. Thus economic growth and price stability have the twin objectives of monetary policy has become dominant. For securing the achievement of these two objectives the monetary policy in the past aimed at controlled expansion of total quantity of money as also the allocation of bank credit to per-determined industries and sectors of the economy. The R.B.I had to ensure that money supply increased in consonance with the requirements of (a) increasing monetization of Indian economy, and (b) production, purchase and sale of an ever rising quantum of goods and services in the country. The production sectors need increasing quantities of funds for investment. The RBI had therefore, to arrange adequate quantities, the Bank had also to ensure allocation of credit by the banking system into (hose industries and sectors which bad been accorded priority in the plans of the country. These industries and sectors of the economy were: (i) the core basic industries like iron and steel, coal and engineering, (ii) priority sectors like agriculture, small scale' industry, exports trade etc., and (iii) the socially important programmes aimed a amelioration of poverty

and unemployment; for which the R.B.I. bad to ensure availability of finance at concessional rates of interest

In the post-liberalization period, not only has then, been a reversal in emphasis on objectives of monetary policy. With price stability receiving pre-eminence over economic growth, as stated above, but the very nature of the activist monetary policy of the earlier years has changed. The regulatory role of the R.B.I. in determining the interest structure has come to be the emphasized. The financial institutions have been great freedom in setting their deposit and lending rate Limits have been placed on the RJB. 1 credit to the govt. Thus, monetary policy is now no longer as important a: instrument of planning and financial management as was the case in the pre-1991 period.

Money supply has to increase at a rate which satisfies the requirements of increasing monetization of the economy and the growth of the national product. When money supply exceeds the limits of this requirement, it generates inflationary pressure and thus destabilizes the economy. This is why stability an important elective of monetary policy in India.

The ninth Plan (1997-2002) envisaged an average inflation rate in the regain of 7 per cent per annum, the growth of money supply at 16 per cent and the growth rate of the economy at 6.5 per cent.

3. Instruments of Monetary Policy In India

Keeping in view the above-mentioned objectives of monetary policy, the RBI has been using certain instruments of monetary or credit control. These methods or instruments of credit control are discussed in some detail below:

(a) The Bank or Discount Rate Policy

Bank or discount rate is that rate at which the RB.I boys or rediscounts eligible bills of exchange or other commercial papers. But the bills market is not sufficiently developed in India. Besides, the R.B.I has developed other forms of leading (such as against government securities). The bank rate is not considered to be a very efficient instrument of credit control. One reason for this is that in a seller's market, such as we have in India for many years now, even a high bank rate may not discourage the-investors from borrowing- and the banks from creating credit because of inflationary expectations.

Although the bank rate was continuously raised between 1951 sod 1974 from 3% to 9%, yet the changes in it nave been sporadic. In 1991, it was yet again ..... from 10% ID 11%. The R.B.I has not relied upon it as an important instrument of credit control, although the bank rate policy has been traditionally considered as a leading method of credit control.

(b) Open Market Operations

The term refers to the purchase and sale of government securities by the RJ3.1. The Bank is banker of the government and is also responsible for managing its public debt Therefore, in order to perform these functions, it buys all the unsold government bonds and sells them in the open.....

The open market operations are an effective method of credit control. When the government bonds are purchased by the R.B.I, (normally from commercial banks) and payment made through currency credited to the accounts of the seller banks with the R.BJ., The commercial bank's reserves rise, on the basis of which they create more credit. On the other hand, when the R.BJ. sells bonds to the public (again normally to the commercial banks), the latter's liquid resources decline (because their liquid resources go transferred to the R.B.I) and they correspondingly have to reduce credit

Even open market operations is not an important instrument of credit control and monetary policy in India: There are several reasons. First the government securities '(bonds) market is not well-developed in India. Secondly, the R.B.I is a monopoly seller and a significant buyer of government

bonds which diminish the effectiveness of the working of this instruments of credit control. Thirdly the RB.I does not normally buy and sell government securities with a view to control credit The weightier consideration is to mobilize borrowings for the government Thus, for credit control, the R.B.I has relied mainly on other instruments of monetary control.

(c) Variations in Reserve Requirements

The commercial banks keep cash resources to meet their liabilities to the depositors. These resources are partly in the form of cash in hand and partly as "balances with R.B.L' both taken together serve partly. as 'required reserves' which are reserves that the banks are required to maintain statutorily under the R.B.I. rules, and partly these are excess reserves which the banks use for meeting the cash requirements of their clients. The statutory 'required reserves' form the basis of cash reserve ratio' (CRR) which is calculated as average daily reserves held as a proportion of the total demand and time liabilities. The R.B.I, is empowered to fix the CRR anywhere between 3% and 15% of the total demand and time deposits of the banks. It serves as an effective instrument of monetary policy in that raising of CRR impounds a greater proportion of the reserves of the banks which correspondingly reduces their capacity to create credit Conversely, when credit creation by banks is to be encouraged, the CRR is reduced.

The R.B.I makes a distinction between avenge CRR which is the ratio of statutory reserves to the total demand and time deposits, and incremental CRR, which is the ratio of increment in statutory reserves of the increment in demand and time deposits (i.e., additional reserves to be made out of the additional deposits received by banks). Since 1973, the R.B.I has used the CRR increasingly as «n instrument of credit control. It is more frequently changed now than earlier, so that swift changes in the availability of bank credit could be effected. CRR was revised upwards servers times so that in 1991 it stood at its maximum of 15%. But since then it has been gradually reduced and stood at 10% in 1996-97. Thus variations in the reserve requirements of commercial banks are turning out to be one of the main instruments of monetary policy in India.

(d) The Statutory Liquidity Ratio

This is another instrument of credit control available to the RJJJ. The statutory liquidity radio (SLR) is defined as below.

$$SLR = \frac{ER + IS + CAB}{L}$$ where ER = Excess

Reserves (as defined under (c) above), IS = investment in unencumbered government or other approved securities, CAB-current account balances with other banks, and L = total demand and time deposits. Each commercial bank receives a certain amount of demand and time deposits (L). Out of these, some amount is retained as excess reserves (ER) to meet the day to day cash liabilities of the bank. The ER take the form of cash in hand and deposits with R.B.I (minus the statutory reserves with the R.B.I). The rest is invested in such a way that a pan of it is nearly as liquid as the ER and a part of investments takes the form of varying degrees of liquidity. The former is comprised of IS and CAB, These are highly liquid (i.e.. these can be converted into cash at short notice and without much cost). Thus, ER, IS and CAB constitute the total liquid assets of a bank. The banks are required 40 maintain with themselves a certain proportion of their total liabilities in the form of liquid or near liquid assets. This proportion is called the statutory liquidity ratio (SLR).

The use of SLR can apparently be made for regulation of credit in that as SLR is increased, it curtails the capacity of commercial banks to increase credit. The banks would be required (in the event of SLR be mf raised) to increase their holdings of government and other securities or cash in-hand instead of creating credit. Besides, it helps in allocating fund to the government, through the purchases

of government securities by the banks, rather than to the private commercial sector. Under the rules the SLR can be raised up to a maximum of 38.5 per cent of the total deposits of the commercial banks.

The SLR has increasingly been raised in India in recent years. In 1964 it was 20%. Since then it has been periodically raised sad by 1998 it had attained a b value of 38% In the early 1990s it had been rated" the maximum of 38.5%, However, the rise is SLR was motivated mote by the desire so make the commercial banks hold a larger proportion of government securities than by the need of controlling money supply. In the post liberalization period, fee monetary policy has increasingly timed at giving the banking sector more autonomy. Therefore, the SLR has also been matched in this period. It cams down from its maximum value of 38.5% in 1991-92 to 27% by December, 1996.

(e) Moral Sulston

The R.B.I. periodically writes to the commercial banks. Through these letters and circulars it on always advise and put pressure on bank to restrict or expand credit, or to create credit for a particular purpose or not to issue loans for some other purposes. Thus, though moral suasion (which b a method of presentation. R.B.I. is in a position to control both the quantity of credit and its uses. However, it is a moot point whether and to what extent moral suasion really tea as an effective method of credit control.

(f) Selective Credit Controls:

While the foregoing methods of credit control are by and large quantitative instruments of monetary policy (Le. these can help in increasing or reducing the quantity of credit created), selective credit controls art qualitative in nature. These help hi allocating credit for specified uses. Through these controls the R.B.I. influences the distribution of bank credit among different uses. Bank credit can be made scarce and costly for certain socially less desirable activities and conversely, more abundant and less costly for certain activities claiming high social priority.

The methods of-selective credit controls include prohibition of credit for hoarding of sensitive commodities, differential rates of interest for different categories of advances, varying of minimum margin requirements on different categories of bank loam etc. First introduced in 1956 the selective credit controls have since been used in the case of a wide variety of goods. These include sugar, gur and Khandsari, cotton, and cotton textiles, foodgrains major oilseeds and vegetable oils, etc.

(g) Credit Authorization Scheme (GAS)

The Scheme was adopted by the R.B.I. in 1965 to especially control bank credit to the large borrowers. The main idea behind the CAS was to prevent a disproportionately large claim of bulk borrowers on commercial bank credit, especially at the cost of the other borrowers. Under the Scheme a bank has to seek prior authorization of making a large loan to any borrower, from the R.B.I. There is a prescribed limit above which a loan would attract the provisions of this scheme. The limit is subject to revision from time of time. In the year of the introduction of the scheme, the limit on working capital credit was fixed at Rs. 1 crore. The limit has been raised subsequently. The scheme applies both to working capital credit as well as term loans.

As apart of the liberalization of the Indian economy on a wide front, the CAS has also been liberalized and modified recently, A review of the working of CAS was made in September, 1998, which showed that a large majority of borrowers coming under purview of CAS were complying with the norms laid down under the scheme and that the basic financial discipline by them was being observed. Consequently, the R.B.I. decided to-dispense with prior authorization of big loans by the R.B.I. From October 1998, the banks have been asked to submit cases of working capital loans exceeding Rs. 5 crores, only foe post sanction scrutiny by the R.B.I. The Scheme has also been renamed as Credit Monitoring Arrangement. Similarly, the cases of tem loans falling under purview of the CAS earlier, are now required to be submitted for only post-sanction scrutiny.

(h) Administered Interest Rates

Till the deregulation of the banking system and the money market in the 1990s, administered interest rates (a structure of interest rates on different types of bank loans and deposits) were announced by the R.B.I. from time to lime and were used as an important instrument of monetary policy. To pursue a tight money policy the whole structure of interest rates could be jacked up, and while following an expansionary monetary policy, the whole gamut of interest rates could be brought down!

Within the structure, these were different rates of interest on treasury bills, dated securities, bank deposits, basic Sending rates of banks on commercial loan£ and interest rates on loans to the priority sector. The interest rates determined the cost of borrowing of different categories of loans.

Although several of the interest rates are still announced by the R.B.I., quite a few of the interest rate have now been deregulated. In 1995 and 1996, the bans have been given freedom to determine their own interest rates on, for example, banks deposits or over one year, bank credit of over Rs. 2 lakhs, post- shipment credit of beyond 6 months, and deferred credit of beyond 180 days.

4. Limitations and Constraints of. India's Monetary Policy

There are certain inherent limitations of monetary policy which have come to be observed even in the developed countries. Such limitations grow more serious as one moves the focus from a developed to a developing economy. In the case of the Indian economy, there are three inherent limitations of the monetary policy (i.e. the capacity of the R.B.I. to influence the total supply of bank credit, its cost and its allocation among different used). These are: (a) The large unorganized segment of the Indian money market which is not subject to any direct control by the R.B.I. (b) The relatively undeveloped nature of even the organized segment of the Indian money market where such financial instruments as commercial bills of exchange and treasury bills (through which the monetary policy could be operationalized) are not freely purchased and sold, (c) The lack of-banking habit among a large section of Indian society which, in a large majority o. cases, still uses cash rather than bank generated monetary instruments. Due to these peculiarities of the Indian money market, the scope for the effectiveness and use of the monetary policy gets severely restricted.

Secondly, the scope and effectiveness of monetary policy of the R.B.I in India gets restricted because of the competing role of fiscal policy in strongly influencing the supply of money-in India, sometimes monetary policy and fiscal policy work at cross purposes in India. In order to notice the conflicting roles of the two, it needs to be understood that deficit financing (as a component of fiscal policy) strongly influences, money supply in our country, in the event of a deficit budget the government borrows from the R.B.I by selling treasury bills and other Govt. securities to latter, The R.B.I. issues new currency to the government. Such high powered money increases the total money supply by a multiple of the currency issued, depending upon the value of the marginal money multiplier. Thus it may happen that while a restrictive monetary policy is being followed to curb inflation, the government may have come out with huge budgetary deficit which will help increase the money supply, the latter will in such an event negate the former. In fact, budgetary deficits have become a rule in this country. This has markedly reduced the scope for a restrictive monetary policy.

Thirdly Money supply has been increased almost consistently in this county over the last massy years. It is natural that when money supply moves only in one direction due to a certain policy being followed in this respect there is little scope for the use of monetary policy. Monetary controls require that money supply is manipulated in accordance with die requirement of the economy. It should be increased in the interest of Increased investment when then is relative price stability 'in the country. ON the other hand money supply should be reduced when inflationary pressures start building up in the

country. A Arid, earlier money supply has only invernesses in this country over prolonged period, with a very occasional fan in fall growth rate.

With the deregulation of the financial sector in the 1990s, monetary policy is going lo play a. salt less active role in promoting economic growth in the years lo come. It is going to be increasingly used for a limited purpose of achieving price stability.

The foregoing clearly brings out the fact that monetary policy operates in this country wider severe constraints. Some of these constrains are inherent in the nature of the economic system of me country while others are a product of the nature of the mix of economic policies pursued by the government The preeminent position of fiscal policy has further undermined the importance of monetary policy in the country.

Fiscal Policy In India

A 'developing country needs special policy measures to cope with tweeds of rapid growth It has 10 overcome the shortage of capital and technical know how. These two resources are very vital for economic development. While under-developed countries have human resources, they do not have sufficient savings for investments on new projects. The private sector was initially found to be lacking resources to make required investment needed for industrialization in a large stale. The State, therefore, had to take up to increasing role in economic life of the nation. Resources bad to be diverted to savings by applying restraints on consumption and to divert investments from un-productive used to development projects. In order to maximize the tale of growth and to ensure that it proceeded along desired lines, a great part of me investment had to be nude In the public sector. This has been true of India as well.

Objectives pad Instruments of Fiscal Policy In India

Before going into the question of objectives instruments of fiscal policy in India, let us first of all be clear about the meaning of the term, fiscal policy. The policy operates through the instrumentality of the budget and, therefore, fiscal policy synonymous with budgetary policy. It refers to the use of taxation and expenditure to regulate or influence the aggregate level of economic activity. In a country like public expenditure can also be used for achieving certain sectoral objectives as we shall notice below.

Let us then analyze come of the objectives wok fiscal policy in India seeks to achieve and the price instruments available with in the budget which are on for the achievement of these objectives. Before we that, it needs stressing that the alias of fiscal policy India have perhaps never been explicitly enumerated and stated. However, by making a broad analysis of way the policy has been formulated and modified from time to time, certain goals of the policy dearly stand out These briefly discussed below.

1. Resource Mobilization for Development

Since the 1950s when planned development launched in the country, the ruling elite adopted widely held view then prevalent in the underdevelopment world that through taxation, public borrowing deficit financing the Govt. must mop up and mobilize much resources as possible, since savings left in pt hands get used for unproductive purposes sue purchase of gold, real estate speculation and hoarding Plan after plan, efforts were made to mobilize resources for productive and planned investment through the budget and the above-mentioned instrument taxation, public borrowing and deficit financing. Through the budget, resources get mobilize planned public investment in the form of: (a) balances from current revenues, (b)-surpluses of public sector enterprises, (c) Govt. market borrowings, and (d) deficit financing (ie. using the newly created money by the R.B.I. to fill UK uncovered deficit in the budget). Clubbing the first three of these under "the term "domestic budgetary

resources", the figure show that these "resources" amounted to Rs. 1440 crores in the First Plan and rose to as much as Rs, 385400 crores according to the projection for the Eighth Plan. Similarly, the amount of deficit financing rose from Rs. 330 crores to Rs. 20000 crores in the same period. Thus massive amounts have been mobilized through the budget for plumed investment in £be country. However, with the passage of time, £e overall importance of Govt. market borrowings has risen by leaps and bounds. Unfortunately, the normal revenues of the Govt. have barely sufficed to meet the burgeoning non-plan expenditure of the Govt. Therefore, the contribution of balance from current revenues and additional taxation has tended to shrink with vise passage of time. This would be dear from the fact that during the Eighth Plan, the projected "domestic budgetary resources" were to be composed of the following shares: balances from current revenues-9% contribution of public sector enterprises 38% sod public borrowings-53%. Clearly, thus the normal revenues now contribute very little to resource mobilization for planning. The Govt. increasingly relies on borrowings for investment of the public sector.

2 Promotion of Private Savings and Investments

Since the Govt. has been wedded to the concept of a mixed economy right from the inception of planning, the Govt. in addition to public saving and investment, has also endeavored to promote private saving and investment through its fiscal policy. This has been sought to be done in order to push up aggregate domestic saving and investment. In order to promote savings, incentives have been provided in the taxation system from times to time to encourage the household sector and the corporate sector to save more. For the former, many a time, the budgets have offered deductions from taxable income for savings in the form of contributions to the provident fund, payment of insurance premier investment in mutual trusts and postal saving schemes; etc. For the corporate sector, incentives to save have been provided in the form of tax free depreciation allowances and tax holidays on new investment. Besides, fiscal policy has also been used to in private investment by households and firms.

For this purpose both the instruments of taxation as well as public expenditure have been used. For example, take the budget for 1996-97. In this budget, long-term capital gains have been exempted from tax, if (a) the net amount accruing from the transfer of a capital' asset is invested in specified assets for a period of three years, or (b) if the entire capital gains are invested in specified assets for a period of seven years. Similar tax exemptions and rebates have been offered c investments made in the operation or development of an infrastructural facility. On the expenditure side, subsidies have been offered to various sectors and industries to promote investment in them.

3. Promotion of More Equal Distribution in Income and Wealth

In the most Five Year Plans, except the recent ones, 006 of the objectives of planning in the country has been to ensure t more equal distribution of income and wealth. Fiscal policy was sought to be used to attain this objective. In the budgets, both taxation as well as public expenditure were understood to have been med for this purpose in fact, one of me traditional objective of direct taxation everywhere has been to ensure redistributive justice by making direct tax rates more progressive. In other words, the rate of tax Increases as we go from lower to the higher income brackets. The principle in that broader shoulders should bear heavier burden. As richer people are taxed more heavily income is supposed to get redistributed in favour of the poor-In India, there were times when income tax rates were made highly progressive. The marginal income tax rate on highest incomes al one time was a staggering 97.5 per cent Besides this, in different budgets, such taxes as estate duty, wealth tax expenditure lax etc, have' been used for purposes of ensuring a more equal distribution of wealth and income. On the expenditure side, beside' raising budgetary allocations to social sectors like education, public health, welfare of disadvantaged classes like women, children and labour etc. programmes such as IRDP and NREP have received increasing allocations since the Fifth Plan. The objective of such public expenditure has been to redistribute income in favour of Die poorer or weather sections of

society. These fiscal measures may have achieved a. measure of redistribution of income and wealth, but most studies on the subject show that fiscal policy, by and large, failed on this account thanks to poor designing and implementation of such programmes.

4. Balanced Regional Development

Different Five Year also aimed at bringing about a more rational inter-regional balance in the level r>l economic development. Whether one takes per capita income as an index, or other indices such u per capita consumption expenditure, literacy rate, etc., there has been a great deal of inter-state diversity in India. These diversities can not be completely ironed out, but the gaps can be bridged to an extent. For this purpose fiscal policy has been sought to Be used. In this respect centre-state financial transfers (which you studied earlier in Lesson 14) have been used. Both through the transfers effected by the Planning Commission and the Finance Commission, as also the ad hoc grants occasionally made by the Centre, the claims of more backward States for greater transfer of..financial resources have been met Pew example, for distribution of the central taxes between the Centre and States, the Finance Commissions have, used such criteria as the "distance" of the per capita income of a State from that of the State with the highest per capita income, and a composite index of backwardness, as the basis of devolution to the States. Besides, the Sixth and the subsequent F.Cs identified some eight States which had practically no resource base of their own and special grants- in aid were recommended for them. These were fiscal measures to achieve, what is termed as horizontal or inter-State equity through the instrument of Finance Commissions.

5. Price Stability:

Perhaps the least pursued objective of fiscal policy in India has been price stability. That the instruments of taxation, public expenditure and deficit financing can be inflationary or deflationary in their impact is indisputable. But price stability his been pursued, if it all, through the fiscal policy in India only marginally. A raise in the rates of indirect faxes or a widening of the indirect tax net can be inflationary. As noted earlier in Lesson 12, indirect taxes have played a dominant rote in India's taxation system. These taxes have been increasingly used to mobilize more resources. It is only occasionally that changes in the indirect tax system have been effected with a view to curb its inflationary potential, an increase in public expenditures, especially in the components like defense expenditure and civil administration (e.g. An increase in Salaries and allowances of Govt. employees) does add to inflationary pressures. But it is rarely that the public expenditure has been held in check in order to achieve price stability. Of course, while planning mobilization or resources through deficit financing, considerations of price stability have certainly weighed with the Govt. The recent concern over the rather high fiscal deficit and its monetization through newly created money made available by the R.B.I. as well as the measures taken since 1994-95 to put a cap on such financing of the budgets shows the use of fiscal policy to achieve price stability.

LONG TERM FISCAL POLICY (1985)

The Long Term Fiscal policy (LFP) announced in December 1935 was intended to impart a definite direction and coherence to the sequence of annual budgets. It was designed to assist evolution of a greater role for rule-based fiscal and financial policies besides providing a much mote integrated approach to economic policy and its management It also sought to serve as effective vehicle for strengthening the operational linkages between the fiscal and financial objectives of the Seventh Plan and annual budgeting exercises during the plan period. In addition it was to serve as a bridge" between the five Year financial target of the Plans and the annual budgets by providing as indicative, a year wise financial framework for fiscal policy.

The trends public finance during the Sixth Plan and the budgetary projections for the Seventh Plan excluding additional, resource mobilization indicated the emergence of a' serious resource crunch

in the public sector, which has persisted ever since. Hence, a long term strategy for fiscal management and policy for improving productivity in the public sector was adopted.

Fiscal policy involves more than raising resources for the government sector. It comprises powerful instruments for influencing macro-variables such as savings, investment, the price level and costs as well as the allocation of resources. An these must be employed to the best advantage. Indeed, a proper fiscal policy stimulates growth and savings and these hi turn laid to a faster rate of growth of government revenues:

A great merit of the LFP lay in removal of mysticism attached with the annual budget and also the uncertainty connected with Government's fiscal policy. Eminent tax consultants like Nani Palkhiwala often expressed, opinion that tax laws should be for long term bases, because that would facilitate any person involved in economic activities to plan well in advance his-her activities. This would make enforcement and compliance easier and may reduce the scope for disputes and minimize distortions. The direct effect of the LFP is that the fiscal consequences of the Plans are now clearly set forth which will guide the major economic decisions of both the Government and the public during the' plan period. Its objective was to induce higher rate of savings in the household sector and to reduce significantly the volume of blade income generation, to rationalize indirect tax structure, to international competitiveness of out industrial products and services with a view to benefiting economy, thus leading to buoyancy in revenues.

Mobilization of Plan Resources

The LFP statement clearly spelt out the resources required by the Plan for each of five years of the Seventh Plan. The means of financing the proposed outlays for the next years were dearly delineated the spectrum of which was portrayed in the accompanying table computed from LFP Table

Pattern of Mobilizations of Plan Resources by the Centre

	Average 1971-76	**Average 1976-80**	**Average 1980-85**	**Average 2002-07**
Plan Resources Mobilization by The Centre as per cent of GD.P.	5.0	7.8	9.2	
Pattern of Resource Mobilization (Percentage Distribution) 1. Public Savings	36	31	30	38.9
(a) Balance From Current Revenues	22	17	8	1.3
(b) Contributions of Public enterprises	14	14	22	37.6
2. Net Capital Inflow from abroad	21	14	13	1.7
3. Domestic Borrowings	43	55	57	59.4
(a) Market Borrowings	14	11	23	-
(b) Budgetary Drficit	17	14	14	-

(c) Others	12	12	20	-
	100	100	100	100

The table reveals that in the pattern of resource mobilization by the Centre, the contribution of public savings which includes balance from current revenues (BCR) plus savings of public enterprises, had declined from 36 pa cent during the first half of the seventies to less then 30 per cent at the end of the Sixth Plan. What is more alarming was that the relative share of BCR took a big jump from the spring board of 22 per cent during the first half of the seventies to nose-dive rock-bottom of 3 per cent in 1984-85.-At the some time, however, the most serious drawback of the policy was that it froze the prevailing inequitable tax structure. Table 5 in the LFP Statement shows that the direct taxes collected by the Union Government as i proportion of tax collection had declined from 27.2 in 1970-71 to 21.0 in 1984-85, white the store of indirect taxes had rises from 728 to 79.0 during the same period. In particular the share of income tax had declined from 14.2 per cent in the first half of the adventives to 9,1 per cent during Sixth Plan with corporation tax remaining stagnant. The LFP thus, failed to provide any solution to the key problem of raising resources for the plans.

Rise in Non-Plan Expenditure

As shown in the above Table, and as has happened since the mid-1980s the declining share of public saving in general, and BCR in particular, in the Centre's budget is attributable to faster growth rate of non-plan expenditure over the revenue receipts. The sharp reduction of BCR as a proportion of GDP bad stagnated around 10.5 per cent during the test decade of 1973-85. In the case of tax revenue the had been a relative fall the share of tax revenues of GDP had recanted a fall from 8.2 per cent during the Fifth Plan period to 19 per cent during the Sixth Plan period. In contrast to it, the non-plan expenditure of the centre, particularly subsidy and interest payinents, had risen steadily throughout the preceding decade and a half. Since, the relative contributions of public savings in the Ceritre's phoned resources had declined the Centre had become dependent more Mod more on borrowed resources from public investments. As borrowing baa increased the interest payment had also gone up and this had caused further erosion in BCR. The interest burden which was about 20 per cent of centre's non-plan revenue expenditure during the period 1971-76 had increased to about 25 per cent during the Sixth Plan am) was expenditure. The only way to break this nexus between current borrowings and future borrowings would be to increase the current tax and non-tax revenues.

Performance of the Public Sector

The figures in the foregoing table reveal that the of performance of public enterprises was better in mobilized plan resources during the Sixth Plan period which according to the LFP increased from 14 per cent during 1971-76 period to 22 per cent during 1980-85 period and was expected to rise further to 26 per cent in 1984-85. These were estimates in nominal terms but if measured in real terms, they were far below the original estimates. It may also be noted that major contribution to the improvement in saving of public enterprises was due to the increased surpluses generated by the public sector oil companies resulting from sharp increase in indigenous oil production. There was a little prospect of having a similar growth in the Seventh Plan period.

The issue of Prices Stabilization

How the prices are to be controlled in future was a major issue about which LFP should have spelt out in clear terms the methods of tackling it. The finances needed for the plans must rise if die plan is to be implemented in the real setae of the term. Consequently, the inflationary situation may affect allocation of public investment more significantly in the annual budget than the Plan. Since price

stability with growth was an important objective of planning fiscal policy must include within its framework certain crucial choices. What they are, were not clearly brought out?

How do we intend to reconcile stability with the strategy of agricultural growth emphasizing rising physical output irrespective of input intensity? Would not liberalized import policy bring about a rise in price level affecting the domestic price level if import prices were rising? Would not a refusal to allow price increase in public enterprises usurp their surpluses? These are some of the problems towards which the LFP had not contemplated providing the solutions.

The policy statement while emphasizing the issue of raising resources had confined itself only to the Central Government* the rote of stale and local bad been completely ignored. We had been following a multi-planning system in which the states and the agencies at the tower level were involved. Assuming the LFP as a step of determine afresh the relationship between -the process of plannu.$_0$ and budgeting the states together with agencies operating at the lower level should have been involved in this important exercise since it covered the entire fiscal system of the country. Without this, one wonders bow the planning in the federal polity was going to derive strength and support from suck & policy is the state budgets still remained an 'areas of hocus-pocus.

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LESSON NO. 14

Dr. S.K. Garg

DIRECTION AND COMPOSITION OF INDIA'S FOREIGN TRADE AND BALANCE OF PAYMENTS

Dear Student, the fourth unit of Indian Economy on international trade policies will be divided into four lessons. The first lesson will deal composition and direction of India's foreign trade and balance of payments. The second lesson will be on Foreign Capital, that is, foreign direct investment. The third lesson will be dealing with export promotion and export substitution. And the fourth lesson will discuss Exchange Rate Policy and the convertibility of rupee.

In this lesson we will discuss direction and composition of India's Foreign Trade and balance of payments. Direction of foreign trade means with which countries you are trading either import- ing or exporting. Before independence, we used to trade only with U.K. but now a days we trade with so many countries like U.K., U.S.A., Germany, Singapore, Korea etc. Composition of trade means what items we export and what items we import. Since independence, both direction and composition of India's Foreign Trade has gone under a change.

Some important features of changes in the direction of trade in the post independence period are as follows:-

1. New trading partners:-

Before independence, U.K. was the principal trading partner for India, accounting for 34 per cent of India's exports and 30 per cent India's imports. After independence, an important feature of direction of trade was increase in number of trading partners for India. At present according to Economic Survey of 2006-07, the top eleven trading partners of India (Ex- ports and imports combined) during 2005-06 were as follows: USA (share 10.6 per cent), China (share 7.0 per cent), UAE (share 6.2 per cent), Germany (share 3.8 per cent), UK (share 3.6 percent), Singapore (share 3.5 per cent), Belgium (share 3.0 per cent), Switzerland (share 2.8 per cent), Hong Kong (share 2.7 per cent), Japan (share 2.6 per cent) and Malaysia (share 1. per cent). This geographical diversification has helped India to go for diversification of industries alongwith specialization in certain goods and secure new markets for her products.

2. Larger Sources of imports:-

The increase in the number of countries from whom we buy has been necessitated by many factors. First, the planned economic development and the tremendous increase in the requirements for machinery, equipment, industrial raw materials, etc. could not be met by UK alone or even by USA. Secondly, grant of aid and assistance by international institutions like World Bank allowed India to buy from the cheapest sources (through global tenders). Thirdly, tied aids and grants from some countries willing to help India in her planning efforts necessitated India to import from particular countries. Fourthly, foreign exchange shortage induced India to make bilateral rupee arrangements with U.S.S.R. and other socialist countries. Lastly, because of hike in the prices of oil, India's imports from Iran, U.A.E., Kuwait, Saudi Arabia and other members of O.P.E.C. went up:

3. Large and more attractive outlets for exports:-

India has been diversifying her exports to match her imports. Naturally, she has to search for new countries to sell her goods. Even though U.K. continues to buy a large number of volume of goods from India, it has been relegated to second and even third place. U.S.A. has become the biggest buyer of Indian goods. Likewise Germany and Japan alongwith USA and UK constitute the first four leading countries absorbing 37 per cent of India's exports. These are the rich countries with high national and per capita incomes and they provide excellent markets for India's traditional goods (cotton and jute manufacturers, especially carpet backing, leathers manufacturers) and non traditional items such as marine products, pearls and precious stones etc.

Composition of India's Foreign Trade:-

In order to study the composition or structure of India's foreign trade, it is necessary to analyse the changing pattern of imports and exports.

Pattern of imports:

Imports have been classified into bulk imports and non bulk imports. Bulk imports are further subdivided into Petroleum, oil and lubricants (POL) and non POL items such as consumption goods, fertilizers and iron and steel. Non bulk items comprise of capital goods (which include electrical and non electrical machinery), pearls, precious and semi precious stones and other items. Important facts regarding the composition of different import items are as follows:

Food Grains:-

The imports of food grains were necessiated for a number of years to meet the domestic requirements of the country despite Green Revolution. Their share in imports stood at 16 per cent in 1960-61, 13 per cent 1970-71, 25.5 per cent in 1975-76 and 36 million U.S. dollars in 2005-06. This shows that the food grains requirements go on changing in India.

2. Petroleum, Oil and Lubricants (POL):-

There has been a substantial rise in the import expenditure on POL. This substan- tial increase was due to two hikes in oil prices.

3. Gold and Silver:-

Since 1999-2000, data on imports of gold and silver have become available as their imports are now channelised through the official routes. In 2005-06 imports of non-ferrous metals stood at $13,162 million which was 8.8 per cent of total import expenditure. Thus imports of non-ferrous metals now occupy second position in total expenditure

4. Non-Electrical Appliances:-

Import expenditure on 'non-electrical machinery, apparatus and appliances' rose considerably from $ 341 million in 1970-71 to $ 11,086 million in 2005-06. In percentage term, its share was 15.8 per cent in 1970-71 while in 1980's and 1990s; it has varied between 8-12 percent

5. Gems and Jewellery:-

Due to increasing demand of gems and jewellery industry (which has emerged as an important export earning industry) the imports of 'pearl, precious and semi-precious stones" have increased significantly. In fact, this item accounted for 11.3 per cent of import expenditure in 1993-94 and occupied the second place. Imports of pearls, precious and semi precious stones in 2005-06 stood at $9134 million which was 6.1 per cent of total import expenditure.

6. Edible oils:-

Edible oils also have to be imported on a large scale in certain years because of increasing domestic demand. For example, in 1987-88 edible oils worth $ 969 million had to be imported. However 1989-90 the imports of edible oils fell to only $ 127 million because of the increase in production in our own country. But again in 2005-06 imports of edible oils went to $ 2024 million. It was 14 per cent of the total import expenditure.

7. Iron and Steel:-

The substantial quantities of iron and steel has continued to be imported because increasing domestic production has failed to keep pace with the rising demand. While in absolute terms, the imports of iron and steel rose from $ 194 million in 1970-71 to $ 1178 million in 1990- 91, in percentage term they have more or less consistently fallen from 9.0 per cent in 1970-71 to 4.9 per cent in 1992-93. In 2005-06 their share in export expenditure was only 3.1 per cent.

8. Fertilizers:-

Following the adoption of New Strategy in Indian Agriculture, the imports of fer- tilizers were stepped up. In percentage term, the share of fertilizers in total imports has varied between 3.5 to 6 per cent over the period 1970-1971 to 1995-96. In 1995-96 its share in 1 import expenditure was of the order of 4.6 per cent. However, subsequently, in 2005-06 the share of fertilizers in the total import expenditure declined to 1.3 per cent.

Pattern of Exports:-

Exports of India are broadly classified into four categories. (1) Agriculture and Allied products which include coffee, tea, oil cakes, tobacco, cashew kernels, spices, sugar, raw cotton, rice, fish and fish preparation, meat and meat preparation, vegetable oils, fruits, vegetables and pulses; (2) Ores and Minerals include manganese ore, mica and iron ore; (3) Manufactured goods include textiles and ready-made garments, jute manufacturer, leather and footwear, handicraft including pearls and precious stones, chemical, engineering goods and iron and steel; and (4) mineral fuels and lubricants. The marked feature of the composition of exports is that over the years there has been a decline in the importance of agriculture and allied products and a substantial increase in the importance of manufactured products. For example, the share of agriculture and allied products in total exports declined considerably from 44.2 per cent in 1960-61 to 10.2 per cent in 2005-06, and while that of manufactured products increased from 45.3 per cent to 72.2 per cent over the same period. This clearly shows the changing production structure of the economy and the journey from an under developed, backward, primary goods dependent economy to a more industrial economy. The important facts regarding different export items are as follows:

1. Jute:-

Jute was the most important export item in 1960-61 which contributed 21 per cent of the total export earnings. Since then its share has continuously decreased to 12.4 per cent in 1970-71 and further 0.3 per cent in 2005-06.

2. Tea:-

Tea was the second most important item in 1960-61 and It contributed 19.3 per cent of total export earnings. Its share also decreased persistently to 9.6 per cent in 1970-71 and 0.4 per cent in 2005-06.

3. Engineering Goods:-

The exports of engineering goods rose substantially during the planning period because of the industrialization process. The exports of engineering goods rose from $ 46 million in 1960-61 to $ 261

million in 1970-71 and further to $21,315 million in 2005-06. During most of the recent years, it has occupied either second or third place in our export earnings.

4. Gem and Jewellery:-

This export item showed a spectacular increase in the exports of our country. The exports earning of this item increased from $ 96 million in 1970-71 to $ 15,529 million in 2005-06 and occupied the second place in India's export income after engineering goods.

5. Chemicals and Allied Products:-

The results of industrialization has also been expressed through the increases in the export earnings of chemicals and allied products which rose from $ 39 million in 1970-71 to $ 11,935 million in 2005-06 and occupied the third place.

6. Ready-made Garments:-

It has emerged as a significant foreign exchange earner in the recent years. For example, the export of ready-made garments was only of the order of $ 2 million in 1970-71 which went up to $ 8,572 million in 2005-06 and it occupied the fourth place.

7. Cotton Yarn:-

This particular industry of yarn and fabrics got fifth position in export earnings during the year 2005-06 with the share of 3.8 per cent.

8. Iron Ore:-

This export item got sixth place in export earnings in 2005-06. In 2003-04, ex- ports of iron ore were just $ 1,126 million which rose to considerably to $ 3,277 million in 2004-05 and further $ 3,801 million in 2005-06. The main reason for this sudden jump was the increased demand for iron ore made by the Iron and Steel Industry of China.

9. Leather:-

The export earnings from leather and leather manufacturers including footwear was of the tune of $ 2,691 million in 2005-06 and got seventh position in export bill.

10. Fish and Rice:-

In recent years substantial quantity of rice have been exported. For example, export earnings from rice stood at $ 907 million in 1997-98, $ 1,493 million in 1998-99 and $721 million in 1999-00 and $ 1,405 million in 2005-06. Fish and fish preparation increased their share in exports earning from 2.0 per cent in 1970-71 to 4.3 per cent in 1994-95. It was of the tune of $ 1,589 million in 2005-06 and it was just 1.5 per cent of export earnings.

Balance of Payments:-

After discussing direction and composition of foreign trade, we will discuss now balance of payments. In the course of international trade, a country has monetary transactions with the other countries of the world. The record of such transactions is made in the balance of payments accounts. The balance of payments is an important concept concerned with transactions between one country and the rest of the world. It provides a systematic record of the monetary payments of a country to the foreign countries and its receipts from them, in a given period of time (normally one year). In short, 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 during a year.

All transactions in the balance of payments accounts is classified according to the payments or receipts that would arise from it. Transactions that lead to a receipt of payment from foreigners is recorded in the balance of payments accounts as a credit. For example, exports of goods and sale of assets abroad are credit items. These transactions represent the supply of foreign exchange in the foreign exchange market. Transactions that lead to a payment to foreigners are recorded as debit. For example, imports of goods and the purchase of assets abroad are debit items. These transactions represent the demand for foreign exchange in the foreign exchange market.

The concept of balance of payments is different from the concept of balance of trade in the sense that balance of trade includes only visible items whereas balance of payments includes both visible as well as invisible items. In practice, we use the concept of balance of payments because now a days every country transacts visible as well as invisible items. The structure of balance of payments accounts varies from country to country. Its classification into various groups is a matter of convenience rather than that of principle. The practice in India is to classify various entries in the balance of payments accounts into two main groups: (i) Current Account (ii) Capital Account. Current account means international transactions relating to visible (goods), invisible (services) and unilateral transfers. Capital accounts represent international capital transactions which include borrowing and lending of capital, repayments of capital and sale and purchase of assets (such as bonds, equities, loans, bank accounts etc.). The components of balance of payments and the accounting procedures vary from country to country. The components of India's balance of payments and the accounting procedures followed in India are as follows:

1. Trade Balance = Exports-Imports
2. Current Account Balance = Trade Balance and Net Invisibles
3. Capital Account Balance or Capital Account Total = Foreign investments (net) + External assistance (net) + Banking (net) Rupee debt service + Other capital (net) + Errors and Omissions.
4. Overall Balance = Current Account Balance + Capital Account Total.

The balance of payments, in the accounting sense, must always balance. Debits must always equal credits. Thus, there cannot be disequilibrium in the balance of payments as a whole. But in a functional sense, there may be disequilibrium in the balance of payments of a country. Operationally, a country at a time may be receiving more payments from abroad than what it has to make. Thus, when total receipts exceed total payments, there is a surplus in balance of payments. It is regarded as a Favourable Balance of Payments. Sometimes, a country has to make more payments abroad than what it receives. Then there is a deficit in its balance of payments, It is regarded as an unfavourable balance of payments.

Disequilibrium in the balance of payments arises owing to a large number of causes or factors. How- ever, following are the important causes producing disequilibrium in the balance of payments or adverse balance of payments of a country.

1. Cyclical fluctuations cause disequilibrium in the balance of payments because of cyclical changes in income, employment, output and price variables.
2. Huge development and investment programs in the developing countries are the root cause of the disequilibrium in the balance of payments of these countries. The large scale development pro- grams increase the necessity for imports of capital equipments, raw materials, technical know how, energy resources etc. On the other hand, there is a decrease in the scope for exports.

3. A continuous rise in the price level encourages imports and discourages exports, resulting in a deficit balance of payments.

4. Changes in the structure of both developing and developed countries in regard to the production of food grains, raw materials etc. also cause disequilibrium in the balance of payments.

5. Demonstration effect is also an important factor causing deficit in the balance of payments of a country especially of an under-developed country. When people of under-developed countries come into contact with those of advanced countries, there is demonstration effect on the life style and consumption pattern. It increases their imports causing adverse balance of payments.

6. Sometimes, political instability may also cause instability in the business field. Consequently there may be large scale capital outflow from the country and it may create disequilibrium in the balance of payments.

7. Because of changes in the social structure and social norms there may be changes in the taste nature and fashion of the people. It affects propensity to consume, exports and imports of the country. This change may also cause disequilibrium in the balance of payments.

8. Rapid rise in population is also an important cause for adverse balance of payments especially in. developing country.

After discussing causes of disequilibrium in the balance of payments we will discuss the measures to correct the disequilibrium in the balance of payments. In each country monetary as well as fiscal measures are adopted to correct disequilibrium in the balance of payments. Besides these measures, import quotas, import substitution etc. is also adopted. Now we will discuss the measures adopted in India from time to time to correct disequilibrium in the balance of payments particularly in the late eighties and early nineties. India's balanced of payments position reached an alarming level during late eighties and early nineties is evident from the fact that: (i) the trade deficit had been consistently on the rise averaging Rs. 7,600 crore during 1985-89 and exceeding Rs. 10,000 crore in 1990- 91. (ii) the foreign exchange reserves had slumped to very low level in early nineties. They were just sufficient to finance import bill for 3 weeks. (iii) India became the third largest debtor country after Brazil and Mexico with its external debt amounting to merely over Rs. 1,30,000 crore with debt services ratio rising to 30 per cent in 1990-91. (iv) the worsening of current account deficit in 1990-91 was partly on account of the Gulf War. But the basic factor behind huge trade deficit was deteriorating invisible surpiuses and remittances. The unprecedented payment crisis which immersed in the early 1990-91 was sought to overcome by a concerted policy reforms initiated by the Government in the form of devaluation, liberalisation and internal trade. As a result of these measures foreign currency assets which touched the bottom showed signs of improvement.

Remedial Measures:-

This crisis is not insurmountable. India has weathered many ups and downs in the past but still some remedial steps have to be taken towards:-

1. Import saving and Substitution:- Our import mix largely comprises of essential items. Any undue restriction and curtailment would accentuate domestic shortage, inflate prices and affect production, export, employment and ultimately the rate of economic growth. Thus a cautious approach reads to be adopted. Wherever import saving and substitution is possible should be tapped. For instance, in petroleum and petroleum products saving can be brought about by avoiding wastage, increased use of oil efficiently and technologies saving fuel. The oil exploration efforts both off shores and on shores be intensified and non-conventional sources of energy be continuously explored. We should

mobilize our own resources efficiently to turn out domestic substitute for imported products.

2. Accelerating Exports:- The major thrust for balancing our trade and payments has ultimately to come from our export sector. This is the area which has remained significantly unutilized in India. The time has come when the Government and business should work together to bring amount a jump in exports. To boost exports it is necessary to cut out the promising export sector, identify the markets which can absorb our potential products and select the right export units which can undertake the ultimate responsibility of penetrating the overseas market. The ultimate responsibility of promoting exports lies with the Indian businesses. We have a mushroom growth of exporters. Some of them have no experience, many being a one shot performer, quite a few indulge in under cutting each other. With the result, neither the exporters are beneficiaries nor the export promotion effort. It is, therefore, necessary that some degree of statutory compulsion is exercised over exporters. This would help to correct the image of the economy, eliminate cut throat competition and help to get a higher unit value realisation.

3. Mobilizing other sources of earning foreign exchange:- In India it is equally important to tap other sources of generating foreign exchange. Take tourism for instance. A continental size country like India attracts less than half a per cent of the world tourist traffic which is very small than a small country like Austria. We have all the attraction which a tourist wants. Similarly, service sector should be tapped sufficiently and at length. Now a days, India has a bright future in the service sector particularly in information technology.

4. Devaluation:-Devaluation means lowering the official value of the money in terms of foreign currency or gold. It means that the local currency is made cheaper in relation to the foreign currencies. A country devalues its currency when there is a continuous adverse balance of trade and payments. The major objective of devaluation is to promote the competitiveness of the Indian exports in the world market. The external value of the rupee has been adjusted from time to time in India to achieve this objective.

Suggested Readings:

1. Misra and Puri Indian Economy
2. Ruddar Dutt and K.P. M. Sundharam Indian Economy
3. Different Issues of Economic Survey of India

LESSON NO. 15

Dr. S.K. Garg

FOREIGN CAPITALS COLLABORATION

Dear student, in this lesson we will deal with the policy towards foreign capital collaboration. If an underdeveloped country is interested in rapid economic development, it will have to import machinery, technical know how, spare parts and even raw materials. One method of paying for the imports is to increase exports. This is possible only if the government is prepared to curtail consumption drastically and export more. Russia, China and others adopted this method after the establishment of communist government in these countries. This type of method involves a lot of sacrifice. The second alternative of getting foreign technology and equipment is to depend upon foreign capital in one form or the other. Most of the countries of the world depended on foreign capital to some extent for their rapid economic development. The capital may be in the form of:-

1. Direct Foreign Investment:- Foreign capital can enter India in the form of direct investment. In the past, companies had been formed in advanced countries with the specific purpose of operating in India. Sometimes, these companies start their subsidiary offices or branches and affiliates themselves in India. Alternatively, foreigners may subscribe to stocks and debentures of Indian concerns. This is known as portfolio or financial or rentier investment. Portfolio investment refers to the purchase of an asset that does not give the purchaser control over the asset. It strengthens speculative trading in shares. It is linked with stock market.

2. Foreign Collaboration:- In recent years, there has been joint participation of foreign and domestic capital. India has been encouraging this form of foreign capital. There are three types of foreign collaborations. (a) joint participation between private parties (b) between foreign firms and Indian government (c) between foreign government and Indian government

At the time of independence, the attitude of Indian government towards foreign capital was one of fear and suspicion. This was natural on account of the previous exploitive role played by U.K. in draining away resources from our country. This suspicion and hostility has been expressed in the industrial policy of 1948 which, though recognising the role of private foreign investment in the country, emphasis that its regulation was necessary in the national interest. Because of this attitude expressed in 1948 regulation, foreign investors got dissatisfied and as a result, the flow of imports of capital goods was obstructed. To remove his dissatisfaction the late Prime Minister Nehru made statement in April 1949 giving three important assurances to foreign investors:

1. India would not make any discrimination between foreign and local undertakings
2. Foreign exchange position permitting, reasonable facilities would be given to foreign investors for remittances of profit and repatriation of capital
3. In case of nationalization of the undertaking fare and equitable compensation would be given to foreign investors.

The industrial policy regulation of 1948 and as well as Mr. Nehru's statement on foreign investment constitute the basis of the government policy on foreign capital till 1991 when the new industrial policy was announced. The new industrial policy 1991 was a landmark in the field of foreign

investment. The industrial policy 1991 accepts the fact that foreign investment is essential for modernisation, technology upgradation and industrial development. The important measures announced from time to time promoting foreign investment over the period 1991-2008 are as follows:

1. Approval was given for direct investment up to 51 per cent foreign equity in high priority industries. The limit was raised from 51 per cent to 74 per cent and subsequently 100 per cent for many of these industries. Moreover, many new industries were added to the list over the years. The condition was that the foreign equity covers the foreign exchange requirement for the import of capital goods.

2. The payments of dividends were monitored through the Reserve Bank of India so as to ensure that outflows on account of dividend payments are balanced by export earnings over a period of time.

3. To provide access to international market, majority foreign equity holding up to 51 per cent equity will be allowed for trading companies primarily engaged in export activity.

4. Prior to 1991 the government generally discouraged foreign equity holdings in service areas except for hotels. The 1991 policy invited foreign equity holdings up to 51 per cent by international trading companies. In addition to hotels, 51 per cent equity was also allowed in other tourist related areas.

5. A special empowered board has been constituted to negotiate with a number of large international firms and approve direct foreign investment in selected areas. There would be a special programine to attract substantial investment that would provide access to high technology and world markets. The investment programmes of such firms would be considered in totality, free from pre-deter- mined parameters or procedures.

6. Hiring of foreign technicians and testing of indigenously developed technology abroad earlier required case-by-case approval by the government. This involved unavoidable delay. This requirement has been waived and thus no permission is now required for these purposes.

7. To hasten the progress in the ailing power sector, the government (in a policy decision announced on July 31, 1991) allowed 100 per cent foreign equity participation for setting up power plants in the country. Hundred per cent foreign equity participation allows free repatriation of profits and other incentives.

8. NRIs and overseas corporate bodies (OCBs) predominantly owned by them, have been allowed to invest up to 100 per cent equity in high-priority industries. These investments have full benefits of capital repatriation. Foreign citizen of Indian origin are now allowed to acquire house property without the permission of the Reserve Bank of India.

9. Disinvestment of equity by foreign investors no longer needs to be at the prices determined by the Reserve Bank. From Sep 15, 1992 it has been allowed at market rates on stock exchanges with permission to repatriate the proceeds of disinvestment.

10. Foreign companies have been allowed to use their trade mark on domestic sales from May 14, 1992.

11. Foreign Institutional Investors can invest in a company under the portfolio investment route be- yond 24 per cent of the paid up capital of the company. In the Union Budget for 2002-03, the Finance Minister announced that portfolio investments will not be subject to the sectoral limits for foreign direct investment except in specified sectors.

12. Foreign equity investments in Non-Banking Financial Companies (NBFCs) have been permitted in various categories of NBFC activities such as merchant banking, stock broking, housing finance, leasing in financing, financial consultancies etc.

13. Foreign investors can set up 100 per cent operating subsidiaries without the condition to disinvest a minimum of 25 per cent of their equity to Indian entities, subject to bringing in US dollar 50 million.

14. Automatic route is available to proposals in the Information Technology sector, even when the applicant company has a previous joint venture or technology transfer agreement in the same field.

15. In the process of liberalisation of FDI policy, the following policy changes have been made: (1) 100 per cent FDI permitted for business to business e-commerce; (2) removal of cap on foreign investment in the power sector, and (3) 100 per cent FDI permitted in oil refining.

16. FDI up to 100 per cent is allowed with some conditions for the following activities in the telecom sector: (1) Internet service providers (ISPs); (2) Infrastructure providing dark-fiber, (3) electronic mail; and (4) voice mail.

17. FDI cap has been increased from 49 per cent to 74 per cent in basic and cellular telecom services. The revised cap includes both FDI and portfolio investment.

18. Foreign firms have been allowed to pay royalty on brand name/trade mark as a percentage of net sales in case of technology transfers.

19. FDI up to 26 per cent is eligible under the automatic route in the insurance sector, as prescribed in the insurance act, 1999, subject to their obtaining licence from insurance regulatory and development authority (IRDA)...

20. FDI up to 100 per cent is permitted in airports, with FDI above.74 per cent requiring prior approval of the government:

21. FDI equity cap in domestic airlines sector has been enhanced from 40 per cent to 49 per cent under the automatic route. However there cannot be direct or indirect equity participation by foreign airlines.

22. FDI up to 100 per cent is allowed with prior approval of the government in courier services subject to existing laws and exclusion of activities relating to distribution of letters.

23. FDI up to 100 per cent is permitted with prior approval of the government for development of integrated townships and regional urban infrastructure, tea sector, advertising and films.

24. FDI up to 100 per cent permitted on the automatic route in hotel and tourism sector and for Mass Rapid Transport Systems in all metropolitan cities including associated commercial development of real estate.

25. The defence industry sector has been opened up to 100 per cent for Indian private sector participation with FDI permitted up to 26 per cent, both subject to licensing.

26. In January 2004, the government raised FDI limit to 100 per cent in petroleum sector. FDI up to 100 per cent was allowed for petroleum products pipelines and for natural gas.

27. In January 2004, the government allowed FDI up to 100 per cent in printing scientific and technical magazines periodicals and journals.

28. Foreign investment in the banking sector has been further liberalised by raising FDI limit in private sector bank to 74 per cent under the automatic route including investment by foreign institutional investors.

29. Press note 18 which placed various restrictions on foreign investors and companies setting up business in India was reviewed and fresh guidelines issued in January 2005. This press note stated that if a foreign company has a joint venture in India, it could not get automatic approval from the Reserve Bank for another joint venture in the same field and the application was required to be routed through the foreign investment promotion board. This, in fact, meant that the foreign investors were required to give the detailed circumstances under which they found it necessary to set up new joint ventures or enter into new technology transfer. The foreign investors regarding this press note as a hurdle according to the fresh guideline issued on January 12, 2005, automatic route is available for new proposals for FDI provided the proposed activity is on the automatic route and the foreign investors did not have an existing joint venture/collaboration in the same field.

30. Conversion of external commercial borrowing/loan into equity has been allowed under the automatic route provided the activities covered under the automatic route and the foreign equity after such conversion falls within the sectoral cap.

31. Conversion of preference share into equity has been allowed under the automatic route provided the increase in foreign equity participation.

32. FDI up to 51 per cent with government approval for retailed trade of single brand produce bus been allowed.

33. The requirement of mandatory disinvestment of 26 per cent foreign equity in B2B e Commerce has been dispensed with.

A critical evaluation of policies towards Foreign Collaborations: - The main arguments put forth by the protagonists of liberalization to permit larger doses of foreign collaboration are as follows:-

1. The days of East India Company are gone. The inflow of foreign collaboration through multinational corporations (MNCs) or their subsidiaries does not imply subjugation. The share of India in direct foreign investment when compared with China, Brazil, Maxico etc. is very low. India has not been able to benefit much from foreign direct investment despite the red carpet spread by it for the foreign investors.

2. Transfer of technology can also be effected with more investment being made by technologically advanced MNCs. These gains are not disputed by the critics, but the fact of the matter is that these are the aspects of foreign direct investment which seriously impinge on people's welfare and national sovereignty. It is these aspects which needs serious considerations.

3. About 67 per cent of the foreign investment is in the nature of portfolio investment which strengthens only speculative trading in shares. The critics are of the view that although we feel happy over the strengthening of the share market but we do not realise the fact that we may be sitting on a volcano.

4. Foreign direct investment is catering to the needs of the upper middle and affluent classes. In this sense they feed a new consumer culture of colas, pizzas, gems, ice-

creams, processed foods etc. Consequently, there is an utter neglect of the wage goods sector.

5. Portfolio investment made in India is in the nature of hot money which may take to flight if the market signals indicate any adverse trends. Therefore, it would be a mistake to treat portfolio investment as a stable factor in our growth.

6. A larger inflow of foreign direct investment, more so in the financial sector will lead to building of reserves which in turn will expand domestic money supplied. Consequently, inflationary trend of prices gets strengthened in the process. If this sector grows at a very fast rate as is happening in India, it may render any efforts of monetary management by the Reserve Bank of India ineffective.

7. Multinational Corporations are rapidly increasing their share holding in Indian companies and are thus swallowing Indian concerns. This has resulted in a number of takeovers by the MNCs and thus the process of Indianisation of the corporate sector initiated by the late Prime Minister Jawahar Lal Nehru has been totally reversed. This is the reason that industrialists have raised their voice against the discriminatory policies of the government to woo foreign capital at the cost of indigenous capital.

8. It has recently come to light that some multinationals have decided to expand their business in India by adopting the wholly-owned (100 per cent) subsidiary route at the cost of their established and listed subsidiaries. Therefore, thousands of Indian minority share holders feel cheated by this move of multinational. It is therefore urgent necessity that the government should take remedial steps through SEBI and RBI to plug this abuse.

To sum up, while capital inflows by multinationals may be permitted, direct foreign investment may be encouraged but this should not be allowed at the cost of Indian national interests and sovereignty. The government should, therefore, not have an open door policy but should be more selective in its approach on the account of inflow of foreign capital.

Suggested Readings:

1. Misra and Puri — Indian Economy
2. Ruddar Dutt and K.P. M. Sundharam — Indian Economy
3. Different Issues of Economic Survey of India

LESSON NO. 16

Dr. S.K. Garg

FOREIGN TRADE POLICY

Dear Students, in this lesson we will discuss the Foreign Trade Policy since independence. In foreign trade policy the government tries to promote exports and substitute imports. It means export promotion and import substitution are the policies of foreign trade policy. Export promotion refers to those policies and measures which can result into maximum increase in the exports of a country. Exports are the lifeline and motive power for economic growth and development. Thus it needs a policy which may cause to enlarge the market orbit for export goods. Import substitution means to replace the imported commodity or commodities by indigenous production. In other words, it means to produce at home what we are importing from abroad, so that the imports of such commodities are done away with.

The objective of the export promotion is: (i) self reliance (ii) reduction in the deficit of foreign trade (iii) to accelerate economic growth. Import promotion policy objectives are: (i) substitution of import of raw material, spare parts by domestic product (ii) to reduce the import components in each and every unit of domestic output (iii) to produce chemical goods by domestically produced raw material (iv) to explore alternatives of imported goods (v) to increase domestic production of imported items like food grains, fertilizers etc.

The foreign trade policy in India was very much restricted after the industrialization process in the Second Five Year Plan. Only import of capital equipment, machinery, components, industrial raw materials, spare parts was allowed. Import of all inessential items was strictly controlled. But import of food grains was allowed from time to time in order to meet the domestic demand for them. This continued for the decade of sixties. In Seventies, few relaxations were made. In eighties, however, special arrangements were made to liberalize imports in a big way. This was done in order to promote exports and increase competitive skills of the exporters. Many fiscal and monetary concessions were granted to exporters such as duty draw back scheme, cash compensatory scheme, monetary concessions. The systems of 100 per cent Export Oriented Unit (EDU) and Export Processing Zones (EPZs) were started. A number of organizations such as the Export Promotion Council, Commodity Boards, The Federal of Indian Export Organizations, the Trade Fair Authority, The Indian Institute of Foreign Trade etc. were geared up to promote exports.

However, as discussed in balance of payments, India continued to face deteriorating situation in balance of payments in late Eighties and early Nineties. Over the years, significant measures have been taken in the direction of removal of restrictions on exports and imports, reduction of the licensing requirements and simplification of procedure. Towards this end, to start with, devaluation of rupee was under- taken in 1991. This was followed by announcement of new Export-Import policy (EXIM) 1992-97. The five yeass EXIM Policy-1992-97 aimed at eliminating licensing and quantitative restrictions significantly. Under this policy, exports and imports were allowed freely subject to the regulation by a Negative List of exports and a Negative List of imports. This EXIM policy 1992-97 replaced the complex system of import licensing by a single Negative List. Consumer goods could be freely imported by large exporters to the extent of about 5 per cent of value of their exports under Special Import Licenses (SILs). This policy has been continuously liberalized. It has provided a new thrust for agricultural and allied sectors and services in which the country had comparative advantage. The list of items to be imported against special licenses has been expanded. New superstar trading houses were promoted with higher import entitlement.

Export promotion received further emphasis under the EXIM policy 1997-2002. Negative List of imports had been pruned so that it now included three prohibited items, 65 restricted items and 7 canalized items. Exporters were given income tax rebate on their export earnings. Special incentives were given to the industrial units set up under Export Processing Zones (EPZs). The measures also include favored access to import of capital goods (under the Export Pron ..... Capital Goods (EPCG) scheme) and restricted imports (under the Special Import License (SIL)

The Export-Import policy 2001-02 has derived some of its policy announcements from the WTO agreement which envisaged removal of all quantitative restrictions by 2003. Quantitative restrictions on 715 items was removed. A number of non tariff barriers were erected to give domestic industry a chance to survive and build its competitiveness. Special Economic Zones (SEZs) were given further benefits. They were given tax holidays. Automatic custom clearances were allowed to status holders and green card holders.

The EXIM policy 2002-07 was announced in 2002 with the aim of facilitating sustained growth in exports. The measures included, removing quantitative restrictions on exports except a few sensitive items, promoting agricultural exports by announcing certain measures, promoting cottage and handicrafts again by announcing certain measures, identifying and promoting towns of export excellence, announcing measures for promoting Gems and Jewellery, allowing further benefits to special economic zones and so on. With the change in Government at centre, the EXIM policy 2002-07 was replaced by foreign trade policy 2004-09 discussed below:-

Foreign Trade Policy (2004-09):-

The new Foreign Trade Policy (FTP) takes an integrated view of the overall development of India's foreign trade and goes beyond the traditional focus on pure exports. This would be clear from the following statement in the policy document, "Trade is not an end in itself, but a means to economic growth and national development. The primary purpose is not the mere earning of foreign exchange, but the stimulation of greater economic activity."

Objectives and Strategy of FTP, 2004-09

In line with the above focus, the FTP lays down two major objectives:-

1. To double our percentage share of global merchandise trade within the next five years
2. To act as an effective instrument of economic growth by giving a thrust to employment generation.

Strategies proposed to achieve these objectives include the following: -

1. Unshackling of controls and creating an atmosphere of trust and transparency in dealing with business.
2. Simplifying procedures and bringing down transaction costs.
3. Neutralizing incidence of all levies and duties on imports used in export products.
4. Facilitating development of India as a global hub for manufacturing, trading and services.
5. Identifying and nurturing special focus areas which would generate additional employment opportunities, particularly in semi-urban and rural areas.
6. Facilitating technological and infrastructural upgradation of all the sectors of the Indian economy, especially through import of capital goods and equipment.

7. Avoiding inverted duty structures and ensuring that domestic sectors are not disadvantaged in trade agreements.

8. Upgrading the infrastructural network related to the entire Foreign Trade chain to International standards.

9. Revitalizing the Board of Trade by redefining its role, and inducting into it experts on trade policy.

10. Activating Indian Embassies abroad as key players in the export strategy.

Main features of FTP, 2004-09

The main features of FTP, 2004-09, are as follows:

1. Doubling share of global merchandise trade. FTP (2004-09) envisages a doubling of India's share in world exports from 0.75 per cent to 1.5 per cent by 2009.

2. Five thrust sectors, Sectors with significant export prospects coupled with potential for employment generation in semi-urban and rural areas were identified as thrust sectors. FTP announced specific strategies (termed 'Special Focus Initiatives) for five such sectors: Agriculture, Handicrafts, Handlooms, Gems & Jewellery, and Leather and Footwear sector. Main strategies announced for the five sectors outlined in the FTP are as follows:

i in agriculture, a new scheme called Vishesh Krishi Upaj Yojana was introduced to boost exports of fruits, vegetables, flowers, minor forest produce and their value added products. Export of these products would qualify for duty free credit entitlement equivalent to 5 per cent of the value of exports. In addition, the policy made capital goods imported for agriculture under the Export Promotion Capital Goods (EPCG) scheme duty free.

ii. The package for gems and jewellery sector includes (i) duty free import of consumables for metals other than gold and platinum up to 2 per cent of the value of exports; (ii) duty free re-import entitlement for rejected jewellery up to 2 per cent of the value of exports; (iii) duty free import of commercial samples of jewellery increased to Rs.1 lakh; and (iv) allowing import of gold of 18 carat and above under the replenishment scheme.

iii. As far as the handlooms and handicrafts sector is concerned, the FTP announced that a new Handicraft Special Economic Zone would be established. In addition, duty sops for trimmings and embellishments imported by handlooms and handicraft producers were increased to 5 per cent of the value of exports.

iv. In the leather and footwear sector, the duty-free entitlements of import trimmings, embellishments and footwear components were increased to 3 per cent. This is expected to help the leather and footwear sector save up to to 5 per cent of its import costs. In addition, duty free import of specified items for leather sector was increased to 5 per cent of the value of exports.

3. 'Served from India' to be built as a brand. Presently services contribute more than 50 per cent of the country's GDP. To provide a thrust to service exports, FTP advocated a number of steps. These include: -

i Served from India brand will be created to catapult India the world over as a major global services hub.

ii. An exclusive Export Promotion Council for services would be set up in order to map opportunities in key markets, and develop strategic market access programs.

iii. Individual service providers who earn foreign exchange of at least Rs.5lakh, and other service providers who earn foreign exchange of at least Rs. 10lakh would "be eligible for a duty credit entitlement of 10 per cent of total foreign exchange earned by them.

iv. Stand-alone restaurants would be entitled to duty credit equivalent to 20 per cent of the foreign exchange earned. In the case of hotels, the entitlement would be 5 per cent.

v. Healthcare and educational institutions would be entitled to duty credit of 10 per cent of the foreign exchange earned.

4. New categories of star export houses. The FTP announced new categorizations of status holders. Under the new scheme, export houses were divided into five categories depending upon their export performance in three years. The categories were (i) One Star (export of Rs. 15 crore); (ii) two Star. (Export of Rs.100 crore); (iii) Three Star (export of Rs.500 crore); (iv) Four Star (export of Rs. 1,500 crore); and (v Five Star (export of Rs.5,000 crore).

A star export house was entitled to get license, certificate, permission and custom clearances for both imports and exports on self-declaration basis. The star export house was also granted the benefit of 100 per cent retention of foreign exchange in Export Earners Foreign Currency (EEFC) account. It was also to be eligible for consideration under the Target Plus Scheme and enjoy a number of other privileges (like exemption from furnishing Bank Guarantee).

5. "Target Plus' Scheme. Exporters who exceed the annual export target were to be rewarded under the Target plus Scheme. This reward was in terms of entitlement to duty-free credit based on incremental export earnings. With the target for 2004-05 being fixed at 16 per cent, the lower limit for qualifying for these rewards was pegged at 20 per cent. Target plus scheme was abandoned in the second supplement to Foreign Trade Policy announced on April 7, 2006.

6. Setting up of Free Trade and Warehousing Zones (FTWZs) The FTP introduced a new scheme to establish Free Trade and Warehousing Zones (FTWZs) to create trade-related infrastructure to facilitate the import and export of goods and services with freedom to carry out trade transactions in free currency. This is aimed at making India into a global trading hub. Each zone would have minimum outlay of Rs 100 crore and 5,00,000 square meters built-up area. Foreign direct investment would be permitted up to 100 per cent in the development and establishment of the zones and their infrastructural facilities.

7. Sops for EOUs. The FTP announced a number of benefits for the export-oriented units (EOUs). These include: (i) EOUs to be exempted from service-tax in proportion to their exported goods and services; (ii) EOUs to be permitted to retain 100 percent of export earnings in EEFC accounts; (iii) Income tax benefits on plant and machinery to be extended to D'TA (Domestic Tariff Areas) that convert into EOUs; and (iv) Import of capital goods to be of) self-certification basis for EOUs.

Critical Evaluation of FTP

The above discussion shows that the Foreign Trade Policy, 2004-09 introduced a number of schemes for promoting exports and opening up trade. However, it has been criticized on a number of grounds which are as follows:-

1. Burden of export promotion schemes:-

The various export promotion schemes have resulted in a substantial loss of revenue to the government. This loss was Rs. 37,590 crore in 2005-06 and is estimated to have touched the figure of Rs. 53,768 crore in 2006-07. It is difficult to appreciate the plethora of liberal giveaways to the various categories of exporters like duty free entitlements for status holders, service providers and agri-exporters and easier status recognition norms. While the FTP has announced a number of concessions and exemptions, it says nothing on business or businessmen who avail duty exemptions but do not fulfill their obligations.

2. Danger of circular trading:-

At the time FTP, 2004-09, was announced, some critics had expressed the apprehension that the target plus scheme could lead to a sharp rise in 'circular trading' in the guise of increasing exports. This is due to the reason that the scheme had given incentives for achieving higher exports without any linkage to the volume of imports. For instance, suppose that an ex- porter, with a turnover of Rs. 500 crore in 2003-04, imported inputs worth Rs. 1,000 crore in 2004-05. He could claim credit for 100 per cent export growth by re-exporting the imported goods even with a nominal value addition. Under the target plus scheme, the exporter would then be eligible for an incentive of up to 15 per cent on the incremental value of his exports (for 100 per cent incremental export growth, the incentive was 15 per cent). This would translate into a reward of Rs. 75 crore (15 per cent of Rs. 500 crore) on a nominal value addition. Thus, the Target Plus Scheme carried the danger of circular trading. This could create problems for the government in the long run.

The actual working of the Target Plus Scheme showed that the above criticism was correct as it led to a substantial revenue leakage. Accordingly, the government abandoned this scheme in the second supplement to FTP announced on April 7, 2006.

3. Risk of importing outdated machinery:-

The FTP allowed the import of second-hand machinery without any age limit. This might result in the import of very old machines from the Western countries which could be outdated and duplicated. Import of such machinery can become a burden on the economy. In any case, it is not likely to help exports at all.

4. Policy fails to take a holistic view of Trade Issues:-

The most important criticism of the FTP is that it fails to take a holistic view of the issues and concerns connected with foreign trade or draw up a clearer road map to achieve the targeted export growth. As correctly pointed out by Rajagopalan, the FTP says next to nothing about the government's negotiating stance at the WTO, trade relations with neighbors, approach towards bilateral trade agreements, integration of development and globalization strategies helping market penetration, market access issues, competitiveness, project exports and so on.

Third Supplement to FTP Announced in April 2007

The First Supplement to FTP, 2004-09, released on April 18, 2005 kept the export target for 2005-06 at $ 92 billion which was exceeded as the exports touched the level of $ 103 billion in this year. The Second Supplement to FTP, 2004-09, released on April 7, 2006 kept the export target for the year 2006-07 at $ 120 billion which was again exceeded as the exports touched the level of$ 125 billion. Since exports were $ 63.84 billion in 2003-04, this means that exports have almost doubled during this three year period. This implies an annual compounded growth of 25 per cent compared to 12.73 per cent in the previous three years. Emboldened by this, the Third Supplement to FTP, 2004-09,

released on April 19, 2007 has set the export target for the year 2007-08 at $ 160 billion. The highlights of the Third Supplement are as follows:-

THIRD SUPPLEMENT TO FTP, 2004-09 (ANNOUNCED IN APRIL 2007)

Export target:-

28 per cent growth target, i.e., a target of $160 billion in 2007-08.

No service tax on exports:-

Service tax on export of goods and services removed (which was levied at the rate of 12.24 per cent on exports from India).

New status holder scheme:-

The status holder scheme has been revamped. Under the scheme to classify exporters, the categories have been re-christened as Export House (earlier known as One Star Export House), Star Export House (earlier known as Two Star Export House), Trading House (earlier known as Three Star Export House), Star Trading House (earlier known as Four Star Export House) and Premier Trading House (earlier known as Five Star Trading House). The exporters will be granted such status on achieving aggregate exports of Rs. 20 crore, Rs. 100 crore, Rs. 500 crore, Rs. 2,500 crore and Rs. 10,000 crore over four years.

Focus Market Scheme extended:-

Focus market program which covers 57 countries has been extended to include 16 more countries (which includes 10 central Asian economies formerly with the Soviet Union). Under the program, exporters can claim duty concessions totaling 2.5 per cent of the value of exports to these countries.

Focus Product Scheme:-

Buoyed by the success of the Focus Product Scheme, mica and its variants, barley, oats, soyabean, cigar and cheroots, bovine fats and copra included under it. Total allocation for the Focus Market and Focus Product scheme increased to Rs. 1,000 crore from Rs. 650 crore.

Scope of VKGUY expanded:-

To boost exports of farm products from India, the scope of the Vishesh Krishi and Gram Udyog Yojana expanded to include exports of value-added variants of several agricultural and forest products, including coconut oil, soyabean oil, potato flakes, meals and flour. Exporters can avail duty credit equivalent to 5 per cent of the freight on board value of notified items under this scheme.

Two new export promotion schemes launched:-

Two new export promotion schemes incentivising Hi-tech exports and agro-processing launched. The new scheme on Hi-tech exports envisages a duty credit of 10 per cent on incremental export growth to the exporter subject to a Ceiling of Rs. 15 crore for each firm.

In order to give incentives to the agro-processing sector, a new export promotion scheme has been unveiled under which duty credit equal to 10 per cent of the value of agricultural exports will be provided for duty redemption on imports of cold storage, pack houses and reefer vans.

OEPB extended:-

The Duty Entitlement Pass Book Scheme (DEPB) extended till March 31, 2008 to be replaced by a new scheme by next year.

Credit to Small and Medium Enterprises:-

Commercial banks are required to lend 15 per cent of their total credit to export-oriented undertakings. It has been observed that most banks meet the criteria by lending to a handful of large undertakings. It was, accordingly, proposed to request the Reserve Bank to ensers that about 50 per cent of the total credit to exporters is given to small and medium enterprises.

Period under EPCG extended:-

The tiny and cottage industry, which has been adversely hit by the rupee's appreciation, has been given 12 years to complete its export obligations instead of the normal 8 years.

Sops for SEZ Investors:-

The developer and the co-developer of the special economic zones (SEZs) would be entitled to all-duty exemption and remission schemes like the advance authorization scheme, and DEPB and Duty Free Import Authorization.

Issues of Concern:-

As stated above, the exports have shown remarkable buoyancy in the past three years and have doubled indicating a robust 25 per cent compounded annual increase during this period. However, there are certain issues of concern:-

1. While exports have increased rapidly, imports have risen at a still faster rate with the result that trade deficit is increasing fast. The trade deficit touched $ 46.07 billion in 2005-06 and rose further to $ 57 billion in 2006-07 (as imports crossed $ 180 billion). While exports all targeted to increase to $ 160 billion in 2007-08, imports are likely to touch $ 223 billion. Thus, trade deficit is likely to increase further to $ 63 billion in 2007-08.
2. The export target of $ 160 billion in 2007-08 is based on the assumption that the rupee depreciates to Rs. 43 to a dollar (the rate in April 2007 being around Rs. 42 to a dollar).
3. The export growth has been achieved at a considerable cost to the exchequer. As stated earlier, the revenue foregone on account of export promotion schemes was as high as Rs. 37,590 crore in 2005-06 and is estimated to have touched the figure of Rs. 53,768 crore in 2006-07.

Suggested Readings:

1. Misra and Puri — Indian Economy
2. Ruddar Dutt and K.P. M. Sundharam — Indian Economy
3. Different Issues of Economic Survey of India

LESSON NO. 17

Dr. S.K. Garg

EXCHANGE RATE POLICY AND CONVERTIBILITY

Dear Student, in this lesson, we will discuss exchange rate policy and convertibility. Before discussing these topics, better to understand the meaning of the followings:-

1. Convertibility:-A convertible currency is one which can be converted into foreign currency freely and can be used for payment of goods and services, including travel without any limitations. This is to be contrasted with a controlled currency which cannot be converted into foreign currency without prior authorization because of exchange controls imposed in that country.

2. Current Account Convertibility:- It is defined as the freedom to buy or sell foreign exchange for the following international transactions (i) all payments due in connection with foreign trade, current business, including services and normal short term banking and credit facilities (ii) payments due as interest on loans and as net income from other investments (iii) payments of moderate amount of amortization of loans or for depreciation of direct investments and (iv) moderate remittances for family living expenses.

3. Capital Account Convertibility:- It implies the right to transact in financial assets with foreign countries without restricts.

Different countries use different currencies for their domestic markets. The currency of one country is not accepted in the markets of another country except 'Euro' which is comparatively recent phenomenon, having been adopted by the European Union Countries. It poses problem for international trade and international payments. For instance, Indian rupee can buy goods and services in Indian market but it cannot buy goods in the American market or in British market. What is the solution? In order to solve this problem of international payment, we require a stock of foreign exchange. What is foreign exchange? Foreign exchange refers to all currencies other than the domestic currency. Now the question is how to acquire foreign exchange? In order to acquire foreign exchange the currency of a country is converted into the currency of another country. For example, if an Indian firm wants to import goods from U.S.A., first of all Indian rupees are required to be exchanged for dollars and then the actual payment is made in dollars. The rupee, therefore, can buy goods in a foreign country not directly but indirectly, with the help of foreign currency. From this emerges the problem of converting one currency into another one and fixing the rate at which the two currencies are to be exchanged.

Now let us understand the meaning of exchange rate. The rate at which one currency is exchanged for the other is known as the rate of exchange or foreign exchange rate. In other words, it is the price of one currency in terms of another currency. Thus the rate of exchange of a currency expresses its external value or purchasing power in terms of a foreign currency. This can be explained with the help of an example. For example, if the exchange rate between dollar and rupees is Rs. 40-$1 it implies that the price of one dollar in terms of rupees is Rs. 40 Conversely, it can be said that the price of one rupee in terms of dollars is $ 1/40. It is, therefore, clear that the rate of exchange measures the external value of the national currency. The quantity of goods, which an Indian merchant is able to import, depends on the dollar-rupee or rupee-dollar rate of exchange. If the rate of exchange of rupee

falls from $1=Rs.4Q to $1 Rs. 50, he is able to import less and if the rate of exchange increases from $1=Rs.40 to $1=Rs.30, he is in a position to import more with the same amount of expenditure in terms of rupees. Thus, the rate of exchange determines the purchasing power of a currency in the rest of the world.

The Role of Exchange of the Rupee

The rupee was historically linked to the British Pound Sterling till 1946. Soon after the Second World War, IMF was set up and as the founder member of IMF, India had to fix and maintain the external value of Rupee in terms of gold or the U.S. dollar within a short period of 15 to 16 years. A member of IMF, India had adopted multi lateral payments but actually it had long followed strict exchange control. The purpose of strict exchange control was to prevent the wrong use of the available foreign exchange resources and to utilize them for importing machinery and raw materials so essential for India's economic development.

The foreign exchange controls led to serious difficulties to both importers and exporters and to the general public. As part of the liberalization of the Indian economy and doing away with the licensing and controls regime, the Government of India started dismantling the foreign exchange control system 1991-92 onwards.

Dual Exchange Rate System in 1992-93

During 1992-93 the Government of India introduced a dual exchange rate system. Under this system:

(a) The Government of India accepted the existence of two exchange rates in the country - the official rate of exchange (which was controlled) and the market rate of exchange (which was free to move or fluctuate according to market conditions).

(b) All foreign exchange remittances into India earned through export of goods or services or through inward remittances were allowed to be converted in the following manner:-

60 per cent of the export earnings to be converted at the free market determined rate; this amount could be used freely for current account transactions and payments (i.e. for import of goods, for travel and for remittances abroad).

The balance 40 per cent of the earnings should be sold to RBI through Authorized Dealers (ADs) at the official rate of exchange (to be made available by RBI for financing preferred imports, bulk imports, etc.).

This system of dual exchange rate of the rupee enabled the exporters to convert (at least) 60 per cent of their export earnings at the market rate of exchange. The Government hoped that this would be sufficient incentive to promote exports and increase foreign exchange reserves. The performance of the external sector was indeed quite spectacular.

However, the existence of the dual exchange rate hurt exporters and Indians working abroad who had to surrender 40 per cent of their earnings at the official rate which was lower than the market rate of exchange. It was to remove this defect that the Government adopted full convertibility of the rupee on trade account-Indian exporters and Indian workers abroad could convert 100 per cent of their foreign exchange earnings at the market rates. As the next step Dr. Man Mohan Singh, the then Finance Minister introduced the convertibility of the rupee on the current account, that is, liberalize the access to foreign exchange for all current business transaction including travel, education and medical expenses, etc. -the objective of the Government was to eliminate reliance upon illegal channels for such transactions. Dr. Man Mohan Singh justified his decision for convertibility of the rupee on current account falls because of his success in the international sector; spectacular rise in forex reserves,

increase in exports but stagnancy in imports in dollar terms and improvements in balance of payments on current account. If this step succeeded, the next step would be convertibility of the rupee on capital account also.

The Case For and Against Capital Account Convertibility

Capital account liberalization or full capital account convertibility has been viewed by many economists as an important component of the overall opening up of global trade and financial markets. Therefore, alongwith removal of restrictions on merchandise trade and full current account convertibility, they have advocated full capital account convertibility as well. The arguments put forward in favor of full capital account convertibility are as follows:

1. Liberal capital account leads to faster economic growth.
2. Developing countries need external capital to sustain an excess of investment over domestic savings and an open capital account can attract foreign capital. It is also argued that such capital flows can have favorable 'spillover' effects also in the form of technology, skills, and introduction of new products as well as positive externalities in terms of higher efficiency of domestic financial markets resulting in improved resource allocation and efficient financial intermediation by domestic financial institutions.
3. Since effective implementation of capital controls becomes more and more difficult in a globalized economy, this de facto situation should be recognized de jure by lifting controls on capital account transactions.
4. Full capital account convertibility will force governments to behave more responsibly on fiscal balances. Unsustainable deficits would frighten investors, leading to capital flight from the country and this danger would force governments to act more responsibly in controlling fiscal deficits.

However, none of these arguments stands to close scrutiny. As far as the first argument is concerned, A. V. Rajwade has pointed out that there is no conclusive evidence to suggest that a liberal capital account leads to faster economic growth. On the other hand, there are clear risks in liberalizing the capital account Therefore, for judging the desirability or otherwise of capital account convertibility, one must carefully weigh the risks as against the rewards. While rewards are uncertain risks are very obvious as a liberal capital account can amplify and prolong a crisis. In this context, Rajwade points to the experience from the East Asian crisis of 1997-98: Malaysia imposed capital controls and escaped the crisis which engulfed and imposed countless costs and hardships on the economies of Thailand, Indonesia and South Korea.

As far as the second argument is concerned, Rajwade argues that there is no necessary link between increased capital inflows and full convertibility on capital account-China has attracted huge capital inflows without the currency being convertible even on the current account. This shows that from the point of view of the foreign investor what matters is the economic and industrial performance of the country and not capital account convertibility.

The third argument is a 'non-argument- one cannot justify (or legalize) a wrong just because it exists. For example, one knows that there is widespread corruption in India. Similarly, there are thefts and robberies and other crimes in violation of the laws. "Can this be an argument for legalizing corruption or theft, obviously no.

As far as the argument that full capital account convertibility will force the governments to act more responsibly on the fiscal front is concerned, Rajwade points out that such optimism is not borne out by empirical evidence. Moreover, in a democratic country, it is for the citizens to discipline the

political masters and they should not depend on a hundred odd currency and bond dealers, focused on short-term trading profits, to do so at an enormous cost to the real economy.

As the above discussion shows, the arguments in favor of full capital account convertibility do not stand a close scrutiny. On the other hand, the case against full capital account convertibility is quite strong. This rests on the various risks associated with capital account liberalization like potential macroeconomic instability arising from the volatility of short-term capital movements; the risk of large capital outflows and associated negative externalities; export of domestic savings from capital scarce developing countries; and weakening the ability of authorities to tax domestic financial activities. The experience of Mexico in 1994, East Asian countries in 1997, Russia in 1998, Brazil in 1998-99 and more recently of Argentina in 2001 has highlighted the risk of capital account liberalization. For instance, the East Asian countries had undertaken several steps in 1980s and 1990s to open up their capital accounts and had removed most of the restrictions on their financial markets. These steps led to massive capital inflows in these countries. A major part of these inflows were in the form of hot which were extremely vulnerable to expectations and speculation. Failure of finance companies in Thailand to honor their commitments led to a speculative attack on Thailand's currency baht forcing the Thai authorities to abandon their earlier exchange rate system of Plugged currency and allowing the baht to float on July 2, 1997. This floating of the baht led to its immediate devaluation by nearly 20 per cent against the dollar. The contagion effect of the currency crisis in Thailand was felt in other countries of Southeast and East Asian region as well particularly Indonesia, Philippines and South Korea. There was a large-scale reversal of short term flows from these countries. Short-term flows to Asia declined from net inflows of US $ 69 billion in 1996 to net outflow of US $ 104 billion in 1997.

As is clear from the above, if the domestic economy does not perform well for any reason whatsoever, there is a tendency for money to flow abroad. Thus, the benefits of outflows are negatively correlated to the health of the domestic economy. Under full capital account convertibility, if an economy does not perform well (or if some other economies perform much better), there will be massive capital outflows from the economy. Thus, an already 'bad' situation would Jurn 'worse'. While a few individual investors would benefit, the country would lose. "The risk: reward relationship of liberal outflows by residents is not acceptable as it will benefit only the few, and that too when the many, if not most, are in misery.

India's Approach to Capital Account Convertibility

On account of the dangers of full capital account convertibility and the unhappy experience of other countries that opted for such convertibility, the Reserve Bank of India opted for a gradualist and phased capital account Liberalization program. It started off by opting first for current account Liberalization in stages. By August 1994, this process was completed with India accepting obligations under Article Vill of the IMF's Articles of Agreement. Subsequently, capital account transactions were gradually liberalized. Restrictions on inflows were relaxed first. While liberalizing the inflows, there was an emphasis on encouraging foreign direct investment and portfolio investment which were progressively liberalized. Liberalization of commercial borrowings was also undertaken but focus here was concentrated on Liberalization of long- term borrowings while short-term debt-creating inflows were discouraged. Recently, with consolidation in the external sector, restrictions on outflows have also been liberalized. Convertibility of non-resident investment has all along been a basic tenet of Indian foreign investment policy.

The framework of Reserve Bank's approach to capital account convertibility was provided by the Report of the Committee on Capital Account Convertibility (Chairman: S.S. Tarapore) submitted in May 1997. For the purpose of its Report, the Committee defined capital account convertibility (CAC) as the freedom to convert local financial assets into foreign financial assets and vice-versa at market determined rates of exchange. It can be, and is, co-existent with restrictions other than on external

payments. It also does not preclude the imposition of monetary/fiscal measures relating to foreign exchange transactions which are of a prudential nature. The Committee did not recommend unlimited opening up of capital account, but preferred a phased liberalization of Controls, on outflows and inflows over a three-year period (ending 1999-2000). Even at the end of the year period, capital account was not to be fully open and some flows, especially debt would continue to be managed. The three crucial preconditions laid down the Committee for attaining CAC were (1) fiscal consolidation, (ii) a mandated inflation target, and (ii) strengthening of the financial sector. As a prerequisite for CAC, the Committee had laid down that the current account deficit should not exceed 1.6 per cent of GDP and the combined fiscal deficit of Centre and States should be around 3.5 per cent of GDP. In addition, the Committee stressed that important macroeconomic indicators should also be assessed on an on-going basis.

Important Capital Account Liberalization Measures

"The purpose and the spirit of measures undertaken in India since 1997-98 to open up the capital account have been broadly in line with the recommendations of the Report of the above-mentioned Committee, while the time table itself has assumed lesser significance. Important capital account liberalization measures undertaken in India during recent years are as follows:

1. All deposit schemes for NRIs have been made fully convertible.
2. NRIs will be free to repatriate in foreign currency their current earnings in India such as rent, dividend, pension, interest and the like based on appropriate certification.
3. Indian citizens have been' permitted to maintain foreign currency accounts out of foreign exchange earned/retained from travel expenses.
4. Both, listed Indian companies and resident individuals have been permitted to invest abroad, in companies listed in recognized overseas stock exchanges, and having at least 10 per cent shareholding in a company listed on a recognized stock exchange in India, on Jan 1 of the year of investment such investments should not exceed 35 per cent of the Indian company's net worth as on the date of the last audited balance sheet.
5. Indian companies are allowed to access American depository receipts and global depository receipts through an automatic route without approval of the Ministry of Finance subject to specified norms and post-issue reporting requirements.
6. FDI is allowed up to 100 per cent on the automatic route in most sectors subject to sectoral rules/regulations applicable.
7. The new policy announced in January 2004 significantly raised the ceiling under the automatic route from US $ 50 million. ECBs (external commercial borrowings) have now been allowed under an automatic route up to US $ 500 million (for ECBs with average maturity of more than 5 years) and up to US $ 20 million (for ECBs between 3 to 5 years of average maturity).
8. Indian parties are allowed to make direct investment in a joint venture wholly owned subsidiary outside India without prior approval of the Reserve Bank/Government subject to certain conditions.
9. Investment in overseas financial sector is also permitted subject to certain terms and conditions.
10. A person resident in India being an individual is permitted to acquire foreign securities by way of gift, inheritance or under cashless Employees & lock Option Scheme (ESOP). In addition, employees or directors of the Indian office/branch/subsidiary of a foreign

company or an Indian company are permitted to acquire ESOPs against remittance without any monetary limit.

11. Indian corporate who have set up overseas offices have been allowed to acquire immovable property outside India for their business as well as staff residential purpose.

12. Two categories of EEFC (Exchange Earners' Foreign Currency) account holders have been specified, one those who can retain up to 100 per cent of their receipt in foreign exchange and others who can retain 50 per cent. A 100 per cent Export Oriented Unit (EOU) or a unit situated in (a) Export Processing Zone (EPZ) or (b) Software Technology Park (STP) or (c) Electronic Hardware Technology Park (EHTP), status holder exporters, professionals are eligible to credit up to 100 per cent of their foreign exchange receipts to their EEFC account.

13. An NRI is permitted to purchase/sell shares and/or convertible debentures of an Indian company through a registered broker on a recognized stock exchange under certain conditions.

14. ADs (Authorized Dealers) in India are permitted to borrow in foreign currency subject to certain conditions.

15. ADs have been given freedom to undertake investments in overseas markets subject to the limits approved by the banks' Board of Directors.

16. Commercial banks have been permitted to provide, at their discretion, buyers credit/acceptance finance to overseas parties for facilitating exports of goods and services from India subject to certain conditions.

17. Mutual Funds have been permitted on application, after obtaining necessary permission from SEBI, to invest in ADRs/GDRs of Indian companies and rated debt instrument in overseas market. Recently, they have also been permitted to invest in equity of overseas company, subject to conditions applicable to corporate/individuals. The overall cap of US $3 billion food for investment abroad- has been raised to US $4 billion.

18. General permission has been granted to registered foreign institutional investors to purchase shares/convertible debentures of an Indian company through offer/private placement subject to specified ceiling

19. Banks fulfilling certain criteria have been permitted to import gold. Banks have also been permitted to accept gold under the Gold Deposit Scheme.

20. On February 4, 2004, the Reserve Bank allowed the resident Indians to remit up to $ 25,000 a calendar year for any current or capital account transaction, or a combination of both (this limit was raised to $50,000 in October 2006 and further of $ 1,00,000 in April 2007). This provision enables resident Indians not only to open and operate foreign currency accounts outside India, but also to use the money remitted to those accounts to acquire financial or immovable assets without prior approval from Reserve Bank.

21. In a further step towards capital account convertibility, the government relaxed remittance norms further on February 6, 2004. As a result of these relaxations (i) no permission is now needed to buy health insurance from abroad; (ii) short-term credit for overseas offices will not need Reserve Bank permission; (iii) advertisements on foreign television channels have been allowed without any ceiling; (iv) no Reserve Bank approval is required for payment of royalty and fees for technical collaborations; (v) restrictions on use of trademarks and franchise have been removed; and (vi) dancers,

wrestlers and entertainers will not require Reserve Bank permission for making remittances abroad.

22. As per guidelines issued on January 12, 2005 (i) transfer of shares in an existing Indian company has been allowed under automatic route except in (a) financial sector and (b) where the provisions of Securities and Exchange Board of India (substantial acquisitions of shares and takeover) regulations are attracted; (ii) conversion of ECB/loan into equity has been allowed under the automatic route provided the activity is covered under the automatic route and the foreign equity after such conversion falls within the sectoral cap; and (iii) conversion of preference shares into equity has been allowed under the automatic route provided the increase in foreign equity participation is within the sectoral cap in the relevant sectors and the activity is under the automatic route.

It is generally agreed that full capital account convertibility of rupees both on current and capital account is a welcome measure and is necessary for closer integration of the Indian economy with the global economy. The major difficulty with the Tarapore Committee was that it would like the capital account convertibility (CAC) to be advised in a 3 year period 1998 to 2000. The period was too short and the preconditions and macro economic indicators could not be achieved in such a short period. Finally, the committee failed to appreciate political and the complete absence of political will and vision to carry forward the process of economic reforms and economic liberalization.

The committee did not recommend the opening up of capital account fully. But some economists have however, been advocating full capital account convertibility. The Prime Minister also advocated full capital account convertibility in March 2006 and urged the Reserve Bank of India to draw up a roadmap for this based on current realities. The Reserve Bank, accordingly, constituted another committee on capital account convertibility again under the chairmanship of S.S. Tarapore. The committee submitted its report on Fuller Capital Account Convertibility (hereafter FCAC) on July 31, 2006 which was placed in public domain on Sept 1, 2006.

Objectives of FCAC

According to the Committee, FCAC is not an end in itself, but should be viewed only as a means to realize the potential of the economy to the maximum possible extent at the least cost In its view, given the huge investment needs of the country and the inability of domestic savings in meeting these needs fully inflows of foreign capital become imperative. In this context, the objectives of FCAC are: (i) to facilitate economic growth through higher investment by minimizing the cost of both equity and debt capital; (ii) to improve the efficiency of the financial sector through greater competition, thereby minimizing intermediation costs, and (iii) to provide opportunities for diversification of investments by residents.

The Roadmap to FCAC

Conscious of the risks in the movement towards fuller convertibility of the rupee as emanating from cross country experiences in this regard, the Committee calibrated the Liberalization road map to the specific contents of preparedness-namely, a strong macroeconomic framework, sound financial systems and markets, and prudential regulatory and supervisory architecture. After reviewing the existing capital controls, it detailed a broad five year time frame for movement towards fuller convertibility in three phases: Phase I (2006-07); Phase II (2007-08 to 2008-09); " and Phase III (2009-10 to 2010-11). The Committee recommended the meeting of certain indicators/targets as a concomitant to this movement like meeting FRBM (fiscal responsibility and budget management) targets; shifting from the present measure of fiscal deficit to a measure of the Public Sector Borrowing Requirement (PSBR), segregating government debt management and monetary policy operations' through the setting up of the Office of Public Debt independent of the Reserve Bank; imparting greater

autonomy and transparency in the conduct of monetary policy, and slew of reforms in the banking sector including a single banking legislation and reduction in the share of Government Reserve Bank of India in the capital of public sector banks; keeping the current account deficit to GDP ratio under 3 per cent; and evolving appropriate indicators of, adequacy of reserves to cover not only import requirements; but also liquidity risks associated with" present types of capital flows, short-term debt obligations and broader measures including .....

Measures towards FCAC

Some of roadmap include: the significant measures to be implemented in a sequenced manner as per the given roadmap include:

1. Raising the overall external commercial borrowing (ECB) ceiling as also the ceiling for automatic approval gradually.
2. Keeping ECBs of over 10 year maturity in Phase 1 and over 7 year maturity in Phase II outside the ceiling and removing end use restriction in Phase I.
3. Monitoring import-linked short-term loans in a comprehensive manner and reviewing the per-transaction limit of $ 20 million.
4. Raising the limits for outflows on account of corporate investment abroad in phases from 200 percent of net worth to 400 per cent of net worth.
5. Providing Exchange Earners' Foreign Currency Account holders access to foreign currency current/savings accounts with cheque facility and interest bearing term deposits.
6. Prohibiting foreign institutional investors (FIIs) from investing fresh money raised through Participatory Notes (PN), after providing PN-holders an exit route so as to phase them out completely within one year.
7. Allowing non-resident corporate (and non-residents) to invest in the Indian stock markets through SEBI-registered entities including mutual funds and portfolio management schemes who will be individually responsible for fulfilling know your customer (KYC) and Financial Action Task Force (FATF) norms.
8. Allowing institutions/corporates other than multilateral ones to raise Rupee bonds (with an option to convert into foreign exchange) subject to an overall ceiling which should be gradually raised.
9. Linking the limits for borrowing overseas to paid up capital and free reserves, and not to unimpaired Tier I capital, as at present, raising it substantially to 50 per cent in Phase I, 75 per cent in Phase II and 100 per cent in Phase III,
10. Abolishing the various stipulations on individual fund limits and the proportion in relation to net asset value.
11. Raising the overall ceilings from the present level of $ 2 billion to £ 3 billion in Phase I, to $ 4 billion in Phase II, and $ 5 billion in Phase III.
12. Raising the annual limit of remittance abroad by individuals from existing $ 25,000 per calendar year to $ 50,000 in Phase I, to $ 1,00,000 in Phase II and $ 2,00,000 in Phase III.
13. Allowing non-residents (other than NRIs) access to Foreign Currency Non-Resident [FCNR(B)] and Non-Resident (External) Rupee Account [NR(E)RA] schemes.

Move towards FCAC

Keeping in view the recommendations of the Tarapore Committee, the Monetary Policy 2007-08 announced by the Reserve Bank on April 24, 2007 adopted the following measures.

1. **Rationalization of Overseas Investment.** (i) As far as investment in joint ventures/wholly. Owned subsidiaries abroad in concerned, the overseas investment limit (total financial commitments) for Indian companies was raised from 200 per cent of their net worth to 300 per cent of their net worth, as per the last audited balance sheet. (ii) as far as portfolio investment overseas is concerned, the limit for Indian companies was 25 per cent of their net worth, This was raised to 35 per cent of their net worth. (iii) The aggregate ceiling on overseas investment by mutual funds was raised from US $3 billion to US $ 4 billion.
2. External Commercial Borrowings. Prepayment of ECBs upto US $ 400 million has been allowed (the previous limit was US $ 300 million).
3. Facilities for Individuals. The limit for investment overseas for individuals was raised from US $ 50,000 to $ 1,00,000 a year.

Suggested Readings:

1. Misra and Puri — Indian Economy
2. Ruddar Dutt and K.P. M. Sundharam — Indian Economy
3. Different Issues of Economic Survey of India

Unit V

LESSON-18

Prof: N. K. Sharda

LESSONS OF INDIA'S DEVELOPMENT EXPERIENCE

Economic development has a larger connotation than economic growth. Growth at the macro level implies increases in capital stock, improvements in methods of production and economic organization, accretions to knowledge of land and mineral resources, addition to labour force and skil, l etc. Development is often defined as sustained growth with structural change in the composition of output, pattern of employment and use of technology Economic development signifies a qualitative change in the economy accompanied by growth of GNP per capita.

After about four and a half decades of planning, Indian economy has witnessed many changes in circumstances and policies—generous U.S. commodity aid under P.L. 480, sudden decline in foreign aid in 1966-67, foodgrain shortages and subsequent surpluses, rapid industrial growth and then slowdown, oil price upheavals, foreign exchange crisis in early 1990s, and then the process of liberalization continuing up to now. Underlying all these is the story of grim struggle of a resource scarce, heavily populated, extremely poor country, which had just attained political independence, to rapidly develop, become self-reliant and attain the goals to which it had pledged itself. If we make an indepth enquiry into the nature and dimension of emerging socio-economic scenario of this period of planning, two facts stand out: One of great achievements in terms of growth, modernization and technological sophistication, and the other of our great failures in terms of meeting adequately the goals of social justice.

To understand India's development experience, it is necessary to take into account the fact that India decided to opt for a mixed economy in the beginning of her planning process. The choice of a mixed economy framework was natural outcome of the strategy Indian national movement had followed. The leadership which came at the helm of affairs after independence evolved a strategy to steer clear of the evils of both the Laissez faire and regimentation inherent in state socialism. So a great experiment in Democratic planning with mixed economy as the cornerstone was initiated, in which the commanding heights were to be attained by the public sector but the private sector was to be free to operate over a wide field subject to state regulation and control. In pursuit of this model of development, massive investments were made in the public sector, far reaching socio-economic changes introduced and, a comprehensive regulatory mechanism embracing monetary, fiscal and physical controls, was developed.

Basically, the idea had been that through a judicious mixture of plan stimulus and market efficiency, both growth and equity would be promoted. Development process was viewed by the Indian planners as something that would have a built-in bias in favour of equity as investment plans would be progressively socialized and technological skills progressively upgrade. India adopted a specific strategy of planning to overcome what was at that time widely believed to be the principle constraint on its growth process, the shortage of capital stock in relation to the availability of employable persons.

India's Development Experience

India adopted economic planning as an instrument of economic and social transformation of the country soon after independence under the visionary and dynamic leadership of Jawahar Lal Nehru.

Rapid increase in national income, development of basic and heavy industries, expansion of employment and reduction of inequalities in income and wealth were to be the major objectives of India's Five Year Plans.

An examination of certain key indicators of economic performance such as time trend in per capita income, growth of industrial and agricultural output etc. is necessary. The Indian development experience can be conveniently divided into three distinct phases. The period spanning roughly the first three Five Year Plans (1950-51 to 1964-65) may be termed as that of sustained economic growth. A sharp break in the growth process appears to have taken place in the mid-sixties. The period between mid-sixties to early eighties was characterized as slowing down phase. The third phase started in the early 1980s and has continued well into the late 1990s. This has been a phase of rapid economic growth.

The growth rate experienced during the first phase of the planning process is characterized by a fairly sustained growth in the GNP of the country. The development strategy with its emphasis on heavy industries proved to be a great success in the initial phase of development. During this phase both saving and investment rates started picking up.

In terms of aggregate performance, this phase recorded a fairly sustained 8 to 10 per cent compound growth rate of industrial output, 3 to 3.5 per cent compound growth rate in the foodgrains output and around. 3.5 percent growth in GNP. All these growth rates represented a sharp acceleration over the pre- independence period. A diversified industrial structure started taking shape. The question then is what were the ingredients, of this success story. The following four factors may be listed.

(i) In a mixed economy, the credibility of the planning process in general and that of public sector investment in particular acquires crucial importance for the private sector economic activity for two inter- related reasons. Economic planning required an ex-ante coordination and a comprehensive view of the future economic activity. This is expected to bring about a higher level of private investment in an under- developed economy than would be possible in the absence of economic planning. Secondly, the public sector investment performs a threefold function under above mentioned conditions, (a) generating the demand for complementary ir puts produced in the private sector and are required for public sector investment (b) Supplying infrastructural facilities and (c) creating additional purchasing power for the goods produced in the private sector. Public sector investments were contemplated basically for building up infrastructure in areas where private sector was either incapable or unwilling to undertake responsibility.

Secondly, a minimal conflict between the private and the social profitability was implied in the Mahalanobis Strategy. Thirdly, as a result of a large variety of import restrictions, the domestic producers were effectively insulated from the international competition throughout this phase. Finally, the Import substitution led industrialization strategy that involved public sector production of basic and capital goods was done successfully through the apparatus of centralized planning. The two-fold constraints on this process consisted of (a) the availability of foreign exchange and technology and (b) the wage good availability The wage good constraint appears to have been relaxed by a higher than historically experienced growth rates of domestic production and secondly through the P.L. 480 food aid from the U.S.A.

As mentioned earlier, the second phase of development experience between the mid-1960s and the late 1970s was characterized bt a deceleration of tempo of economic growth. There was virtual stagnation in the rates of growth of public sector investments as well as in the rate of growth of industrial output. The overall picture that emerges is one of industrial stagnation in the organized sector after the mid- sixties to the late seventies. Heavy industries, e.g. machinery, transport-equipment and basic metals, suffered a major slowdown in growth, while light industries such as food manufacturing

and textiles never experienced a take off while the rate of growth of agricultural output sustained itself through the second phase, the growth rate of GNP in real terms has alternated between virtual stagnation and sporadic and intermittent growth. The average annual growth rate of real GNP in this phase was around 3 per cent.

The decline of growth momentum in this period has been subject to considerable scrutiny. The mid-sixties saw an erosion of the discipline of planning. There was a substantial decline in targeted levels of investment and the desire to increase savings. Thus, the rate of gross capital formation which reached around 17% in the mid-sixties peaking at 18.4% in 1966-67, declined to around 15% at the end of the sixties and reached 19 per cent again in the mid-seventies. The nation succumbed to the advice of those who advised devaluation of the rupee to bring about rapid opportunities for economic growth through international trade. The additional problems of this period were the energy crisis which hit the economy very hard and rising prices at 20% compound per-annum only in the mid-seventies.

While this phase in India's development experience was marked by near-stagnation in industrial production as well as the over-all GNP there are two brighter aspects of this experience during the phase which need to be mentioned. In the first phase, the mid 1960s marked the beginning of the Green Revolution, which eventually led to self-sufficiency in food production. Secondly, the rate of domestic savings, which had risen in the first phase from about 10% in 1950-51 to 14.5 of the GDP in 1965-66, had tended to stagnate, in the next about one decade. Luckily, the rise in the domestic saving rate was resumed around the mid-1970s and by the beginning of the 1980s, the saving rate had risen to about 21 per cent of GDP.

The loss of development momentum in the mid-sixties and the Fourth Plan, led to some deeper problems. India was pushed back in the rate of technological transformation and in the race between population growth and the growth rate of output. At another level, in spite of gains, poverty, illiteracy, sickness, and premature death, morbidly, hunger and malnutrition, particularly for the female population, continued undiminished. Even though indicators like literacy rates went up, and mortality rates or poverty ratios went down, the absolute magnitude of the problem went on increasing.

By the late 1970s or early 1980s, revival of the growth process had already started. A few sectoral development had contributed to this upturn. The industrial sector, which in the second phase had nearly stagnated started experiencing acceleration of growth rate. Against average annual growth of 5.5% in industrial production during the second phase, in the first five years of the third phase le. between 1980 and 1985) the growth rate had risen to about 10%. In the agricultural sector too, the impact of the Green Revolution was clearly visible at the beginning of the third phase. The index of agricultural production (with triennium ending 1981-82=100) rose by 16 percentage points between 1970-71 and 1980-81. but between 1980-81 and 1990-91, it rose by 46 percentage points. The rate of investment (gross domestic capital formation) remained below 20% till the mid-1970s. Thereafter it was consistently above 20% and was as much as 27.4% in 1995-96.

The annual compound growth rate of real GNP was the maximum at 5% in the Fifth Plan, if the entire preceding period is taken. But in the Sixth and Seventh Plans of the third phase, the growth rate was much higher at 5.5% and 5.8% respectively. It is thus clear that, in the third phase of our development experience the over-all economic performance has been much better than in the preceding periods.

Sectoral Development: A brief idea of major developments in some of the key sectors is discussed below.

Agricultural Sector: Let us begin with agricultural performance. During the past more than four decades of planning, number of changes have taken place in the pattern of agricultural production, and the farm sector has certainly been diversified due to the effects of green revolution. During the late

1960s-and the seventies the government started expanding in a big way construction of irrigation dams and fertilizer capacities, supply of hybrid seeds, and improved agricultural practices were encouraged. Farmers were assured of remunerative prices for their produce, as a result of which, yield in cereals started going up at a steady pace. The index number of yield per hectare of cereals (with triennium ending 1981-82-100), rose by 15 percentage points between 1970-71 and 1980-81, but in the next decade rose by 34 percentage points. Foodgrains have been growing at a faster rate then commercial crops. It has also been noticed that the agricultural production is increasing at a rate faster than population growth.

However, there have arisen problems also in the sector. The 1980s have seen Indian agriculture slide into a profound crisis marked by rising cost of cultivation, increasing dependence on expensive inputs glaring disparities in the regional distribution of agricultural growth giving rise to regional imbalances, increasing discontent of (be middle and small farmers, and erratic crop yields. Therefore, the challenge has been basically to diversify spatial distribution of agricultural growth to more and more areas, to improve delivery system of inputs and marketing and procurement, updating land records and implement action of land reform legislation in the states.

Another worrisome problem in the farm sector which has emerged in the 1990s is certain degree of stagnation emerging in agricultural yields. The index number of yield per hectare (with triennium 1981- 82=100) rose by about 34% in the decade preceding 1990-91, but in the next five years it increased by only about 8.6%. The green revolution may have already lost much of its steam.

Industrial Sector: As a result of the pursuit of the import substitution strategy during the five-year plans, industrial structure has become considerably broad-based. Industrial growth was rapid during the first two decades as noted earlier. Industrial growth slowed down in the third decade of independence i.e. after the Third Plan. Not only did industry stagnate during this period, a blatantly elite-oriented production structure also came into existence. The most damaging aspect of this was a steady decline in per capita domestic availability of key wage goods and an increase in the number of people below the poverty line, As Shetty puts it, "The structural retrogression took place at two stages. First the growth of basic and capital goods industries has been slower than even the meager average growth in industrial output and secondly, where growth has been moderately high, a majority of the industries belonged, either directly or indirectly, to elite oriented consumption goods sector. This phenomenon has emerged at the cost of allocation of investible funds for mass consumption goods. Thus, a imbalance in the industrial structure has taken place."

A number of explanations were offered for slow growth of industries between mid-1960s and late 1970s. At the one end, periodic shocks in the form of wars in 1965 and 1971 are held responsible for the deceleration, while at the other end, it is hypothesized that the crisis in industrial growth was rooted in the path of development that India had adopted and that there was no way out unless the fundamental property relations and structure of income distribution were changed.

According to I. J. Ahluwalia, the available available does not support the above hypotheses. Evidence does not show any worsening of the distribution of income over time, the wage good constraint too does not appear to have been-significant and the evidence on association between slowdown and import substitution is mixed. She identifies four factors which contributed to industrial stagnation:

(a) slow growth of agricultural incomes and their effect on limiting the demand for industrial goods; (b) the slowdown in public investment; (c) poor management of the infrastructure sectors, and (d) industrial policy framework including both domestic industrial policies and trade policies and their effect on creating a lopsided industrial structure in the economy.

The industrial scene underwent a change with the onset of the eighties. For the first time in Indian economy, the manufacturing sector was seen to be asserting itself over others in the contribution to the GDP. Its share has moved up from 24.3% in 1980-81 to 28% in 1994-95.

Besides the quantitative growth, industrial sector has changed qualitatively beyond recognition. It has a much diversified structure. A whole host of goods are produced today which were earlier imported from abroad. There is a strong class of industrial entrepreneurs, managers and skilled workers. A number of new industrial townships have appeared in the map of the country. The share of manufactured exports has risen from 45% in 1960-61 to 80% in 1995-96.

Service Sector: This sector now has nearly a 40% share in the GDP. It means that over the planning period, the sector has grown fairly rapidly. The sector growth over the planning period has been mainly promoted through massive public investments in infrastructure. Of course, a part of the growth of the sector is the result or expansion of the commodity production sectors which buy the tertiary services as inputs.

An analysis of the share of different sectors in the GDP 'during the four and a half decades since independence indicates that in the early '50s, agriculture contributed as much as 60.5 per cent of the national output, industry contributed 24.4 per cent and the share of tertiary sector was a mere 15.1 per cent. In the mid-1990s, the share of industrial production has increased to 28 per cent, the contribution of agriculture has come down to 32 per cent, but the share of services sector has gone up to 40 per cent Some of the growth of this sector, such as in transportation and communications, banking, insurance and construction, has been very welcome, since it contributed to over-all economic growth. Some, however, such as in defense expenditure and public administration, has not directly aided production and welfare.

Evidence indicates that in developed countries, the rising share of tertiary sector in GDP is accompanied by a corresponding rise in "the proportion of the working forces absorbed in such activities but in India less than 20 per cent of the working population is engaged in this sector whereas still two-third lie the early '50's are engaged in agriculture and allied activities.

An Overall Assessment: What are the major conclusions that one can draw from India's experience with development planning? During the fifties, India's development prospects were rated high, inside the country as well as outside. The logic of Indian development although not universally appreciated, did on the whole fit in with what contemporary development economics has held up as a viable and democratic model to follow, especially for a large country. During the sixties, the atmosphere changed drastically. Two successive droughts, the declaration of 'plan holidays' for three years, and large scale import of foodgrains under U.S. Public Law 480 generated a mood of despondency and frustration. Internally, our failures emerged in different forms. The savings rate dropped, excess capacity emerged in 'basic sectors' and there was fear that maintaining-food availability per capita was going to be a great problem ahead However, from the experience of initial feeling of helplessness, new agricultural strategy was forged. The late seventies and the first half of eighties experienced a growth rate in gross national product exceeding 4% per annum on a trend basis along with a single digit inflation. There were two major reasons for this success. One is the ability to maintain a rate of growth of food production of around 3% per annum over the period as a whole. The other is the financial deepening' that was experienced by the country, which allowed domestic savings to go up in monetized form. However, much of the increase in savings has taken place in the household sector resulting into an inter-sectoral mismatch between the increase in savings and the increase in demand for investment. The public sector had to rely on borrowing from households as its saving rate has dropped sharply. But still, the successful story of planning lies in the field of over-all savings which have increased from 10.2 per cent of GDP in 1950-51 to 25 per cent in 1995-96. The nationalization of major commercial banks

and planned expansion of their branches especially in unbanked and underbanked centres increased the opportunities for-safe keeping of incomes saved.

What are then the positive and the negative aspects of the development experience of the country over the last about 45 years? First let us take up the positive aspects. First the national and per capita real incomes have risen over the period, with growth rates in the first three decades being somewhat lacklustre, but picking up quite a bit in the last about fifteen years, and especially in the 1990s. Now, we are being rated among the fastest growing economies of the world and in the last decade and a half the per capita réal income has recorded, for the first time since 1951, an annual average growth rate of over 3 per cent Secondly, we have now a fairly diversified industrial sector, with a variety of new production techniques imbibed and a healthy entrepreneurial and managerial class having emerged. Thirdly, the agricultural-sector, by and large, has recorded, productivity growth which in certain respects in quite impressive. This has resulted from the use of a package of new technology comprising of improved seeds, chemical fertilizers and irrigation water in several crops, and regions. Achievements of self-sufficiency in foodgrains protection over the last two decades and a half has come, as a great relief to the country. a robust growth of the tertiary sector has of course aided the production and marketing of agricultural and industrial goods, but it has above all contributed a great deal in generating employment opportunities because of its labour intensive character. Fifthly, the country has quite impressively pushed up the saving and investment rates from a pathetic low of around 10 per cent in the early 1950s to close to 30 per cent in the late 1990s. Finally, in the, 1990s, we have also marked a sharp break with the past by liberating our legal and administrative framework from the stifling inspector-quota permit Raj of the past, recording impressive accelerations in GNP growth rate, accretions to the foreign exchange reserves and a fairly high growth rate of exports. These achievements of the 1990s will attract applaus only if these can be sustained in the years to come.

The negative aspects of our development experience of the post-independence period are no less glaring and disheartening. In the first place, best as our experience with economic growth, whether measured in terms of growth of GNP or per capita income, has been quite unimpressive for decades, but has lately been fairly encouraging, similarly, the performance on the poverty front has been dismal at times, but quite impressive at other times. Unless poverty is completely eradicated, Indian development experience cannot hope to score full marks. Estimates of extent of absolute poverty started being made in the 1960s, and in the 1970s, there was a plethora of studies on the subject. Proportion of population below the poverty line was placed at between 50 to 60% depending upon the methodology of estimates used. Even Five Year Plans seemed to have made little dent in the poverty problem. Since then, the proportion of population below the poverty line has fallen quite precipitously so that it was estimated to be 19 per cent in 1993-94 according to preliminary data from the N.S.S. This figure was subsequently questioned and the figure seems to have been revised upwards to 36%. However, the absolute number of people suffering from poverty is still large: Secondly, Indian planning and policy have singularly failed on the employment front, because all the estimates made so far have shown an increase in the number of people suffering from unemployment and under-employment. Thirdly, although the saving and investment rates have risen quite impressively over the last four and half decades, except for a brief deceleration after the mid-1960s, yet the growth rate of GNP has not risen commensurately. This has been the result of inefficiencies in the optimum use of capital resources, or in other words, an increase in the capital output ratio, the ratio rose from 3.2 in the First Plan to of 5.7 in the Fourth Plan. That is why, even in spite of increase in saving and investment rates, the GNP growth rate did not accelerate. It was only in the Fifth and subsequent plans that the ratio has fallen and the GDP growth rate has accelerated.

Fourthly, the inequalities of income and wealth have persisted even with the growing role of the public sector which was supposed to be an instrument of redistributive justice. The most glaring failure in this respect has been only a partial implementation of land reforms. Fifthly, no serious effort has

been made to fight the menace of black money. The scourage of black money has bred evils like corruption and unproductive-expenditures. Finally, the fiscal policy of the govt. has been a huge failure with mounting fiscal deficits, rising interest payment and subsidies liabilities of the govt, falling share of capital and developmental expenditures.

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Unit V

Prof: K.K. Kaushik

Lesson-19

AGRARIAN POLICY AND IT'S IMPLICATIONS

Agrarian policy on a world-wide scale, that is to say, in developing as well as in developed countries is confronted with a common problem, namely the promotion of the adjustment process of agriculture in a growing economy. In almost all developing countries, one finds a different from of misallocation of resources in agriculture. In this case, agriculture is incapable of achieving the increase of production necessary to feed a greatly expanded population and to earn the', increasing amount of foreign exchange necessary for the development of the economy as a whole. To find solution of these problems, the integration of agriculture and macro economic system has become an essential element in economic policy in developing economies. There are interdependences between agricultural and-non-agricultural sectors of an economy.

The present lesson deals with the identification of different policies and modalities underlying the process of agrarian transition in India since 1951, and the extent to which these have initiated a process of transition of the institutional and social basis of production in India agriculture.

State policies are required to concentrate on two basis areas: industrialization and the promotion of modem technologies in agriculture. The first is about the expansion of the market for agriculture and productivity in agriculture as well as quickening of the pace of differentiation of occupation structure in rural area.

India has a long tradition of formulation and implementation of agricultural development plans and policies. Features of the formulation of investment strategies for the form sector and of economic policies to warded it are important: (1) given the importance and specificity of resource endowment, it is necessary to examine the full potential of development of this sector. (2) Both an account of resource specificities and socio-economic factors, agricultural policy analysis needs to be region specific. (3) Farm sector investment strategy needs to be formulated to realize the full agricultural potential (4) "The farm sector supports a large question of peasant households and the whole question of economic incentives and economic policy towards it is crucial.

The farm sector is both important and difficult to plan for it in terms of investment and policy strategies. Policy and investment initiatives are required to be taken in a number of areas to operationaliz the development strategy viz, investment (public and private), technological change and institutional reforms etc.

For an agriculture with a high man-land ratio as in India, and with rapidly growing population, and week capital base, investment, technological change and institutional reforms form equally important elements in the strategy for agricultural development In the 1950s, greater attention was given to the structural and institutional aspects of agricultural and rural development This was through land reforms community development, Panchayati Raj and Cooperation, we discuss below the different aspects of agrarian policy in India and examine their implications.

Land Reform : Pre-reform Indian agriculture had a large class of poor peasants and landless labourers while substantial areas were oned by a small percentage of rich peasants and landlord-cum-money lenders. Nearly a fifth of land come under tenancy, and more than a third of this under share

tenancy, most of it being under informal arrangements, which lacked potential for growth. The aim of land reforms was to eliminate or at least diminish the exploitation involved in the system of land tenure and tenancy. The fast Five Year Plan made significant redistribution of land and some degree or change from individual to-co-operative pattern of economic activity was an integral part of the programme of agricultural development measures taken under this head included: (i) Abolition of intermediaries; (ii) Tenancy reform to (a) regulate rents paid by tenants and (b) confer ownership right on tenants; (iii) imposition of ceiling on land holdings in a bid to procure land for distribution among landless labourers and marginal farmers. Thus the attempt was aimed at changing the ..... agrarian structure of the rural areas.

In the 1960s, there was renewed interest in ceiling and redistribution of land. Land reforms became. a part of such radical policies as nationalization of 15 major banks on 19th July 1969, abolition of privy purses, the slogan of Garibi Hatao and rhetoric of land ceiling. As a result of the continuous threat of land ceiling legislation, the land of the very big owners was actually 16.375 million hectares, whereas according to the Sixth Plan document only 1.574 million hectares were declared surplus by different states, as in March 1980. Distribution of such surplus land benefited nearly 1,154 million, landless persons. Though the average size of holdings of the rich peasants increased between 1960-61 to 1965-66, it showed a sharp decline thereafter.

The implementation of the land reform measures left much to be desired. There were widespread reports of land reform legislation being, subverted, through systematic and widespread evasion. In many instances, the tenancy legislation led to dislodging of the tenants by their owners in the form of self-cultivation, a lacuna allowed by the land reform legislation. Despite the ceiling laws, the concentration of ownership of land did not change much. Inequality in distribution of land has continued, leading to inequality in distribution of income and other assets

The land reforms failed to make-up the agrarian structure more equitable and, thereby, more productive. The only redeeming feature of the agrarian scene' was the abolition of zamidari tenure which had consisted of 170 million acres of land in the early fifties. The land reform measures also suffered a setback due to adverse court judgments. It has rightly been said that the success of policy-making lies in its implementation. From that point of view land reforms could hardly be considered a successful example of policy formulation in the field of rural and agricultural development. In the early fixities, with production problem dominating policy, land reforms receded into the background, with the advent of new technology, the proportion of tenants area in the area under cultivation decreased steeply.

Community Development : This was another programme adopted in the 1950s for the revival of the rural economy. The main idea behind Community Development was to motivate the rural masses to undertake community effort, such as road or school building and participation in development activities, like agricultural development, and promote self-governing institutions like co-operative and Panchayats. The Community Development Programme commenced in October 1952, with the establishment of fifty five large sized community projects for units larger than the block and with a large budget. The development projects were community-centerd. They emphasized institutional changes to mobilize local man-power and resources for development and introduce new norms of equality.

The Community Development Programine made rural people aware of Government's concern for their development As India's food problem became more acute in the late fifties and the early sixties, the programme of Community Development was found waning and so, was replaced by a purely agriculture- oriented approach.

Anti-Poverty Programme: The attempt to achieve both economic development and reduction of disparities in the absence of basic institutional changes led to the worst of "both the world i.e. neither

growth nor redistribution. Mrs. Gandhi's slogan "Garibi Hatao" given at the beginning of the seventies was an attempt to break through the impasse.

It is in the context that the new rural development schemes were incorporated in the Fourth Five Year Plan. A number of new central sector schemes were introduced. They included the extension of Small Farmers, Development Agency (SFDA) to 45 selected districts, additional projects for marginal farmers and agricultural labourers (MFAL), the Drought Prone Area Programme (DPAP), and the Crash Scheme for Rural Employment (April 1971). The basic objective of DPAP was to increase the rural employment base and to reduce considerably the incidence of drought and scarcity in the identified drought prone areas over a period of time. The strategy was to improve the economy of the drought prone areas through a package of infrastructural and on-farm development activities with an objective to optimum utilization of land, water, human and livestock resources of the area. The programme was launched in January 1972 and on July 1973, the programme was reoriented by changing its emphasis from creation of employment opportunities to undertaking development works so as to provide permanent solution to" the drought problem.

The Twenty-Point Programme introduced during the Emergency-period was described as a direct assault on poverty. It gave highest priority to rapid implementation of land ceiling laws and abolition of bonded labour. The twenty-point programme provided a new 'thrust in the implementation of land reforms. Programmes like abolition of bonded labour, enforcement of minimum wages, liquidation of debt met with only a partial success due to lack of institutional infrastructure.

In 1978, SFDA, MFAL and DPAP were integrated into what is called the Integrated Rural Development Programme (IRDP). On Oct 2, 1980 it was extended to all the 5011 blocks in the country. The goal of the programme was to lift 15 million families in rural areas above the poverty line by providing them income generating assets. The IRDP involves identification of thousands of families within the target group in each block, preparation of plans for assisting these families and arranging credit support for financing these plans.

Supplementing IRDP are programmes like Training Rural Youth for Self Employment (TRYSEM), Minimum Need Programme (MNP) and the Special Area Development Programme. Under TRYSEM, rural youth belonging to families below the poverty line are trained to acquire new skills to take up self- employment. The MNP covers elementary education, rural health, rural water supply, rural works, rural electrification, nutrition to children and housing assistance to rural landless labourers. National Employment Programme (NREP)-was adopted af major wage employment anti-poverty programme.

Poverty alleviation and employment generation programmes:

The Swarnjayanti Gram Swarozgar Yojana (SGSY) was launched as an integrated programme for self-employment of the rural poor with effect from I April 1999, The objective of the scheme is to bring the assisted poor families above the poverty line by organizing them into' Self Help Groups (SHGs) through the process of social mobilization, their training and capacity building and provision of income generating assets through a mix of bank credit and government subsidy. The scheme adopts a process approach and attempts to build the capacities of the rural poor. The scheme provides for the cost of social intermediation and skill development training based on the local requirement. The focus of the programme is on establishing a large number of micro-enterprises in rural areas based on the ability of the poor and potential of each area, both land-based and otherwise, for sustainable income generation. The subsidy allowed under the SGSY is 30 per cent of the total project cost, subject to a ceiling of Rs 7,500 (for SC/STs and disabled persons subsidy limit is 50 per cent of the project cost subject to a ceiling of Rs 10.000). For Self-Help Groups (SHGs), subsidy would be 50 per cent of the project cost subject to a ceiling of Rs. 1.25 lakh or per capita subsidy of Rs.

10,000, whichever is less. The SGSY seeks to promote multiple credits rather than a one-time credit injection.

The scheme lays special emphasis on development of swarozgaris through well designed training courses tailored to the activities selected and the requirement of each swarozgari. SGSY is being implemented through the District Rural Development Agencies (DRDAs), with active involvement of panchayati raj institutions, banks and NGOs. It is financod on 75.25 cost-sharing basis between the centre and the states.

Since the inception of the programme 22.52 lakh Self-Help Groups (SHGs) have been formed - covering 66.97 lakh swarozgaris. These include 35.54 lakhs members of the SHGs and 31.43 lakh individual Swarozgaris w-ho have been assisted with a total investment of Rs. 14403.73 crore. Out of total Swarozgaris assisted, SCs/ST's were 45.54 per cent and women 47.85 per cent. During 2006-2007 the Central allocation for the schemes Rs. 1200 crore.

The Sampoorna Grameen Rozgar Yojana (SGRY) was launched on 25 September. 2001 by merging the on-going schemes of EAS and the JGSY with the objective of providing additional wage, employment and food security, alongside creation of durable community assets in rural areas. The programme is self-targeting in nature with provisions for special emphasis on women, scheduled castes, scheduled tribes and parents of children withdrawn from hazardous occupations. While preference is given to BPL families for providing wage employment under SGRY, poor families above the poverty line can also be offered employment whenever NREGA has been launched. The annual outlay for the programme is Rs. 10,000 crore which includes 50 lakh tones on food grains. The cash component is shared between the centre and the states in the ratio of 75:25. Foodgrains are provided free of cost to the states/UTs. The programme is implemented by all the three tiers of Panchayat raj Institutions. Each level of Panchayat is an independent unit for formulation of Action Plan and executing the scheme.

Resources are distributed among District Panchayat, Intermediate Panchayats and the Gram Panchayats in the ratio of 20:30:50.

The National Food for Work Programme was launched in November, 2004 in 150 most backward districts of the country, identified by the Planning Commission in consultation with the Ministry of Rural Development and the State governments. The objective of the programme was to provide additional resources apart from the resources available under the Sampoorna Grameen Rozgar Yojana (SGRY) to 150 most backward districts of the country so that generation of spplementary wage employment and providing of food-security through creation of need based economic, social and community assets in these districts are further intensified. The scheme was 100 per cent centrally sponsored. The programme has since been subsumed in National Rural Employment Guarantee Act which has come in force in 200 identified districts of the country including 150 NFFWP districts. The Act provides 100 days of work guarantee to every rural household whose members volunteer to do unskilled manual work.

The "National Rural Employment Guarantee Act (NREGA)" was enacted in September 2005 and brought into force w.e. f2 February in 200 most backward districts with the objective of providing 100 days of guaranteed unskilled wage employment to each rural household opting for it. The NREGA marks a paradigm shift and stands out among the plethora of wage employment programmes, as it bestows a legal right and guarantee to the rural population through an Act of Parliament and is not a scheme unlike the other wage employment programmes. The ongoing programmes of Sampoorna Grameen Rozgar Yojana (SGRY) and National Food for Work Programme (NFFWP) have been subsumed in NREGA. The NREGA would cover all districts of the country within five years. The focus

of the Act is on works relating to water conservation, drought proofing (including afforestation/tree plantation), land development, flood control/protection (including drainage in waterlogged areas) and rural connectivity in terms of all- weather roads.

The foregoing was a brief analysis of the anti-poverty programmes pursued so far in the rural sector. These programmes are a part of the social dimension of agrarian change in the country. Now we turn to a discussion of the policy measures adopted for engendering technological revolution in the farm sector.

Policies for Technological Change

The importance of bringing about a technological revolution has always been recognized. Indian agriculture was said to be backward because of its obsolete technology, hence technological change was. expected to play a major role in transforming traditional agriculture and" the growth process. Two successive droughts in 1965-66 and 1966-67 gave rise to apprehension, within the country and in international circles, about India's capacity to feed her large and growing population. To overcome the 'agricultural stagnation", a new strategy of agricultural development was formulated during the 'Annual Plan period. This strategy carried over into the Fourth Five Year Plan, which was finally adopted 1969 under the intellectual leadership of D.R. Gadgil, an eminent economist with a deep interest in the problem of Indian agriculture.

The new policy marked a notable shift in the perception of what constituted the crucial constraint in the agrarian sector. It has been noted in India that it was basically the absence of knowledge of appropriate agricultural practice, along with the maintenance of an obsolete social structure, which prevented increases in agricultural production. Land reform was considered very important, at least in principle; in practice the issue was largely evaded. The new-strategy seemed to ignore the critical importance of land reform. Instead, emphasis was shifted towards technological modernization.

NEW AGRICULTURE POLICY

Indian agriculture has since Independence, made rapid strides. In taking the annual foodgrains production from 51 million tones in early fifties to 206 million tones at the turn of the century, it has contributed significantly in achieving self-sufficiency in food and in avoiding food shortages. Though green revolution has been widely diffused in irrigated areas throughout the country, the dry land areas have not seen benefit of technological breakthrough as witnessed through green revolution technology. Of late, improved varieties of oilseeds and course cereals have provided some opportunities for productivity growth in dryland areas.

A new phase was started in India's economic policy in 1991 that marked significant departure from the past. Government initiated process of economic reforms in 1991, which involved deregulation, reduced government participation in economic activities, and liberalization. Though much of the reforms were not initiated to directly affect agriculture sector, the sector was affected indirectly by devaluation of exchange rate, liberalization of external trade and disprotection to industry. Then came new international trade accord and WTO, requiring opening up of domestic market.

All these changes raised new challenges and provided new opportunities that required appropriate policy response. Besides, last two decades had witnessed mainly price intervention that had a very limited coverage, and there was a sort of policy vacuum. Because of this, there was a strong pressure on the government to come out with a formal statement of agriculture policy to provide new direction to agriculture in the new and emerging scenario. In response to this, government of India announced New Agricultural Policy in July 2000.

The National Agricultural Policy:

Since the early nineties, successive governments have promised a policy statement on agriculture. Several versions have done the rounds, including the current one under circulation and discussion. It states: "The objectives of the policy will be to accelerate-all-round development and economic viability of agriculture in its comprehensive term. Farmers will be provided the necessary support, encouragement and incentives, so that rural people look to this noble occupation for a future of all round development, well-being and hope. The policy will aim at management and conservation of natural resources base and the orientation of technological and institutional change in such a manner as to ensure the attainment and continued satisfaction of human needs for the present and future generations."

The National Agricultural Policy visualizes technological upgradation of Indian agriculture as a core element of the agricultural development strategy. The goals of sustainable agriculture, food and nutrition security, risk management as well as growth and agricultural trade depend critically on improved R&D processes in the sector. Specifically, it endorses the concept of regionalization of agricultural research based on identified agroeco regions, (location-specificity), use of frontier sciences, participatory and proprietary approaches in R&D, strengthening research-extension linkages, and a "wellorganised, efficient and result-oriented agricultural research and education system to introduce technological change in Indian agriculture."

It calls for a redefinition of the partnership between central and state governments, assigning an upstream role for the centre it also charts a pathway of incentives, support systems, investment imperatives and policy to "actualize the vast untapped potential of Indian agriculture." The National Policy on Agriculture seeks to actualize the vast untapped growth potential of Indian agriculture, strengthen rural infrastructure to support faster agricultural development, promote value addition, accelerate the growth of agro business, create employment in rural areas, secure a fair standard of living for the farmers and agricultural workers and their families, discourage migration to urban areas and face the challenges arising out of economic liberalization and globalization. Over the next two decades, it aims to attain.

The salient features of the National Agricultural Policy are:

1. A growth rate of over 4 per cent per annum in the agricultural sector. Greater private sector participation through contract farming.
2. Growth that is based on rational utilization of resources and conserves our soil, water and bio diversity.
3. Growth with equity i.e., growth which is widespread across regions and farmers.
4. Growth that is demand driven and caters to domestic markets and maximizes benefits from exports of agricultural products in the face of challenges from economic liberalization and globalization.
5. Growth that is sustainable. technologically, environmentally and economically.

National Commission on Farmer

National Commission on Farmers set up in 2004 to suggest an action plan for farmers and farm sector. Report of the Commission covers a wide range of recommendations dealing with integrated lifesaving support programme for farm families facing acute distress; produstivity and livelihood enhancement in rainfed areas; a new deal for women in agriculture, strengthening and expanding the horticulture revolution; enhancing productivity, quality and global competitiveness of cotton; sustaining and expanding trade in farm commodities and its sanitary and phytosanitary dimensions; village

knowledge centres; and nutrition security of livestock and livelihoods. NAP envisages institutional, legal arrangements for leasing of private lands for cultivation and agribusiness, which would presume that holders of uneconomic farms would find it prudent to engage themselves in alternative occupations in the rural sector rather than migrate in large numbers to town and cities. The fashion of the day is a VRS policy for industrial workers and not for the marginal farmer.

Input Policies:

Several issues that have emerged with the spread of new technology and increasing use of modem inputs are increasing use of modern inputs are: unsatisfactory availability of quality seeds and other inputs, increasing input subsidies, decline in input use efficiency in agriculture and environmental impact of excessive and unbalanced use of inputs, in particular fertilizers. The following section contains a brief review of the main agricultural inputs policies and changes therein from time to time.

The National Seeds Policy: is vital instrument in attaining the objectives of doubling food production and making India hunger free. It is expected to provide the impetus for a new revolution in Indian agriculture, based on an efficient system for supply of seeds of the best quality to the cultivator. While the system of seed production and distribution was a major contributor in making India self sufficient in food production, some deficiencies, viz., deterioration of quality seeds due to improper inspection and certification, lack of attention towards non-food crops seeds and freeing of trade in seeds to multinationals resulted in rethinking about seed policy.

The National Seeds Corporation that was set up in 1963 followed by the State Seed Corporation of India and the State farms Corporation of India lately were given a main role in seed production of breeders, foundation and certified/Quality seeds increased from 0.25mn tons in 1981 to 1.38mn in 2004- 05. The area under certified seeds has increased from less than 500 hectares in 1962-63 to over 5 lakh hectares in 1999-2000. The quantum of quality seeds has crossed 100 lakh quintals. The annual rate of growth of certified/quality seeds distribution is targeted to accelerate from 12.1 per cent in 2005-06 to 18.1 per cent in 2006-07. During 2006-07, 69,980 quintal breeder seed is anticipated to be produced by the National Agricultural Research System.

Earlier Seeds Act of 1962 was replaced by The protection of Plant Varieties and farmers' Right (PV&FR) Act, during2003. Some recent developments in the area of biotechnology and trade related issues regarding patenting, necessitating the introduction of comprehensive new seed policy to protect the interest of farmers and to preserve biodiversity. Seed bill of 2004 came under severe criticism as it violated the farmers' fundamental right to produce, use, save, sell or exchange their own seeds.

It has become evident that in order to achieve the food production targets of the future a major effort will be required to enhance the seed replacement rates of various crops. A major increase in the production of quality seeds is required in which the private sector is expected to play a significant role. At the same time, private and Public Sector Seed Organizations at both Central and State levels are expected to adopt economic pricing policies that would seek to realize the true cost of production. The creation of a facilitative climate for growth of a competitive and localized seed industry, encouragement of import of useful germplasm and boosting of exports are the core elements of the agricultural strategy of the new millennium.

Seed is the most important determinant of agricultural production potential on which the efficiency of other agriculture inputs is dependent. Seeds of appropriate characteristics are required to meet the demand of diverse agro-climatic conditions and intensive cropping systems. Sustained increase in agriculture production and productivity is dependent to a large extent on the development of new and improved varieties of crops and an efficient system for timely supply of quality seeds to farmers. The seed sector has made impressive progress over the last three decades.

Globalization and economic liberalization have opened up new opportunities as well as challenges. The main objectives of the National Seeds Policy, therefore, are the provision of an appropriate climate for the seed industry to utilize available and prospective opportunities, safeguarding of the interests of Indian farmers and the conservation of agro-biodiversity. While unnecessary regulation needs to be dismantled, it must be ensured that gullible farmers are not exploited by unscrupulous elements. A regulatory system of a new genre is, therefore, needed, which will encompass quality assurance mechanisms coupled with facilitation of a vibrant and responsible seed industry.

Fertilizer pricing Policy: Retention Price System (RPS) and Subsidy

India is the third largest producer and consumer of fertilizers. The installed capacity of the fertilizer industry as on November 1, 2006 was 123 lakh MT of nitrogen and 57 lakh MT of Phosphatic nutrient. During April-October 2006, total fertilizer production grew by 6% over the corresponding period of the previous year. While phosphatic fertilizer production increased by 13%, urea production grew by 3%. The import of manufactured fertilizers during H 1''07 compared to H1 '06 also surged by about 39%. The, consumption of chemical fertilizers (in terms of nutrients) grew by 10.6 per cent to 20.34 MT during 2005-06. Though the nitrogenous fertilizers account for over 60 per cent of total consumption (in terms of nutrients), the share of potassic fertilizers is increasing in recent years. Compared to a share of 9.6 per cent in 2001-02, the share of pottasic fertilizers increased to 11.8 percent in 2005-06(Economic Survey, 2006-07).

Some of the main issues confronting the fertilizer industry are with respect to pricing and availability of feedstock. With the industry competing with the power sector for gas and the Government favoring conversion of existing Naphtha based units to gas, shortages are expected in future as well. The existing Naphtha based units have been given time till end of FY 2009 for conversion to gas.

Fertilizer pricing Policy attempts to meet two objectives simultaneously viz. continuous supply of fertilizers to farmers at reasonable rates and to protect the fertilizer industry by giving them assured returns. These twin goals can only be met by providing a subsidy to both farmers and to the industry. The prices given to the fertilizer industry and fixed independently by using a normative method called retention price system (RPS). RPS reduces uncertainty of returns on investment and encourages the fertilizer plants to increase capacity utilization and also attract investments by both existing plants and new entrepreneurs. Another important element of fertilizer price policy is to encourage farmers make use of more fertilizers by keeping prices of fertilizers low. The distribution of fertilizer is done through the fertilizer industry and the difference between the retention price and the notified sale price to the farmers (minus distribution margins) is given to the industry as subsidy.

Subsidy outlay for the fertilizer sector has been increased from Rs.17,252 (B.E 2006-07) to Rs.22,452 cr in R.E.2006-07. Department of Fertilizers is to work along with the industry in evolving a mechanism for administering subsides directly to the farmers. A pilot programme for the same is to be implemented in at least one district of each state in FY08. As per industry estimates, the total subsidies for the fertilizer sector in FV07 would be around Rs.34,036cr including an amount of Rs.5,913cr carried over from the previous fiscal. However, the budget estimates for FY'07 were far lower at Rs. 17,252cr. Even after accounting for two supplementary grants, a gap of Rs.11,583cr exists. Inadequate subsidies as well as delays in disbursement of allocated subsidies have added to the problems of the industry.

Irrigation Policy

Bridging the gap between irrigation potential created and utilized, completion of all on-going projects, restoration and modernization of irrigation infrastructure including drainage, evolving and implementing an integrated plan of augmentation and management of national water resources will

receive special attention for augmenting the availability and use of irrigation water. A large number of river valley projects, both multi-purpose and for irrigation, have spilled over from plan to plan, mainly because of financial constraints being faced by the State Governments. There were 171 major, 259 medium and 72 extension, renovation and modernization (ERM) on-going irrigation projects in the country at various stages of construction at the end of the VIII Plan with spillover cost of Rs. 75,690 crore. Government launched the Accelerated Irrigation Benefit Programme (AIBP) during 1996-97 for accelerating implementation of ongoing irrigation/multipurpose projects on which substantial progress has been made and which were beyond the resource capability of the State Governments or at advanced stages of construction and could yield irrigation benefits in the next four agricultural seasons.

The budget lays emphasis on agricultural development with higher allocation under various programmes. The Bharat Nirman programme continues to be the cornerstone of the Government's policy and an additional 24 lakh hectare is to be bought under irrigation under this policy. Budgetary support for the programme has been increased from Rs. 18,600cr in 2006-07 to Rs.24,603cr in 2007-08. I Under the accelerated irrigation development programme, 35 new projects are to be completed and an additional irrigation potential of 9 lakh hectares is to be created. The outlay for the programme has increased from Rs.7,121cr in 2006-07 to Rs. 11,000 crore in 2007-08.

Investments in Agriculture

The agriculture sector has been starved of capital. There has been a decline in the public sector investment in the agriculture sector. Public investment for narrowing regional imbalances, accelerating development of supportive infrastructure for agriculture and rural development particularly rural connectivity will be stepped up. A time-bound strategy for rationalization and transparent pricing of inputs will be formulated to encourage judicious input use and to generate resources for agriculture.

Input subsidy reforms will be pursued as a combination of price and institutional reforms to cut down costs of these inputs for agriculture. Resource allocation regime will be reviewed with a view to rechannelizing the available resources from support measures towards assets formation in rural sector. A conducive climate will be created through a favourable price and trade regime to promote farmers' own investments as also investments by industries producing inputs for agriculture and agro-based industries. Private sector investments in agriculture will also be encouraged more particularly in areas like agricultural research, human resource development, post-harvest management and marketing

Rural electrification will be given a high priority as the prime mover for agricultural development. The quality and availability of electricity supply will be improved and the demand of the agriculture sector will be met adequately in a reliable and cost effective manner. The use of new and renewable sources of energy for irrigation and other agricultural purposes will also be encouraged. Emphasis will be laid on development of marketing infrastructure and techniques of preservation, storage and transportation with a view to reducing post-harvest locses and ensuring a better return to the grower.

Assessment of the New Agricultural Policy

Agricultural policy does talk of growth with equity, but fails to identify states which have lagged behind in the utilization of their agricultural potential. Agricultural policy does not identify the problem of declining total factor productivity nor does it recognize that agricultural growth has deteriorated after the macro reforms. It enumerates many objectives but fails to prioritize them. Although the strategy of technical change is acknowledged, it is narrow in scope. More over, it is mixed up with the liberalization of (domestic) food economy without recognizing that it may merely improve the market structure but not the objectives that need priority. The role of non-price factors and the need to step up public and private investments are stated but subsequent years budget has reduced plan expenditure for agricultural and rural development and over emphasized the role of institutional credit which, as is well known cannot

fructify without such expenditure. New policy relies and perhaps the budget overtly relies on agricultural product price support rather than inputs pricing as an "instrument "for agricultural development. This shows the government's shortsighted view about simplicity of this "instrument". And last but not the least, the new policy disregards formulation of the basic contours of organizational model for implementation.

Policies for Foodgrains Production, Procurement and Imports

In the face of a rising population to be fed and the stagnant agriculture during the sixties, the management of food economy came to be regarded as an essential goal of state-policy in India. The principal objectives of the state policy were:

(i) to avoid localized and wide-spread famine and open under-nutrition; (ii) to maintain remunerative prices to farmers; (iii) to stablise prices due to market distortions; (iv) to supply vulnerable classes with foodgrains at below market prices, (v) to build and maintain a buffer stock of foodgrains to facilitate government operations, (vi) to socialize the gain-trade, and above all, (vji) to boost production and productivity of foodgrains through subsidized supply of inputs, extension services and farm research.

One of the most remarkable successes of govt. policy of the agricultural sector has been the achievement of self-sufficiency in the production of cereals like wheat and rice. From a net importer of foodgrains, India has turned into a net exporter of some foodgrains, except in years of relative scarcity and rising fbodgrain prices.

As noted earlier, the introduction of HYV seeds, especially in. wheat and rice and the accompanying technology, package of irrigation water, fertilizers and insecticides, in the mid 1960s marked thy beginning of what has been termed as the green revolution. This revolution has been the combined result of agricultural research in Farm Universities, agricultural extension service of state agricultural departments, supply of subsidized inputs and growth of area under irrigation. Above all the green revolution has been the result of the hard work put in by fanners in Punjab, Haryana, Western, UJP and some other states.

As a result of the foregoing initiatives, in which policy measures played a major role, the production of cereals (comprised of wheat, rice and course cereals) nearly doubled between late 1960s and early 1990s. To be more precise, the index numbers of cereals production (with triennium ending 1969-70-100) rose to 197.7 in 1990-91. In this growth, major role was played by wheat production, followed by rice and cereals production, in that order. During this period, area under cereals production rose very little. So almost the entire increase in production resulted from productivity growth. Thus, the index number of yield per hectare of cereals (with the same base year as above) rose to 191.6 in 1990-91.

Of course the policy initiative, so far as foodgrains production is concerned, is not without its seamy side. And this has attracted à great deal of criticism against the green revolution in India. The technological revolution brought about through govt. policy was considered rather biased in favour of the big fanners. Besides, it benefited mainly the states which are well-endowed with irrigation facilities, like Punjab, Haryana, Western U.P. The green revolution technology, based primarily on HYV seeds, made visible impact on the wheat crop, and to an extent on rice crop. Coarse grams which are the staple diet of the poorer factions of society benefited the least of all among the cereals. But the greatest failure of the new technology has been the stagnation in the production of pulses another staple diet and the main provider of proteins to the weaker sections of society. The total production of pulses in 1960-61 was 12.7 million tones which had barely crept up to 13.2 million tones 35 years later in 1995-96! Obviously, with population growth, per capita availability of pulses has fallen.

It is thus clear that even though the foodgrains policy of the Govt. did succeed in making the country self-sufficient in it, the green revolution 'remained specific to only some farmers, some crops and some regions.

Procurement of Foodgrains and Public Distribution

Procurement in India is generally undertaken under price support operations. However, when the govemment had difficulties in obtaining adequate quantities for public distribution, compulsory monopoly procurement, levy on farmers, millers and trade, and Pre-emptive purchase were dopted. The volume of procurement of wheat and rice has recorded a substantial increase from 1.43 million tones in 1964 to 22.28 million tones in 1995-96. The two in portant factors contributing to a rise in public procurement of foodgrains have been: (a) considerable regional concentration of output and surpluses, and (b) a favourable price support policy.

Since 1970, India's trade in cereals has shown a trend from net imports to net exports of both wheat and rice a trend that reflects shifts in trade policy, as well as longer term changes in supply and demand Through the 1980s and early 1990s, Indian agriculture had export restrictions and overvalued exchange rates that resulted in net taxation of the farm sector. Exports of agricultural goods, including wheat and rice, were restricted through various regulations to bolster India's domestic food security. For wheat and rice, quantitative controls on imports and exports were administered through the Food Corporation of India (FCI). In the mid-1990s, trade policies were changed when quantitative restrictions on imports were lifted and replaced by tariffs. The wheat tariff was initially set at zero, but was raised to 50 percent in 1999 to curb imports into southern India at a time when surpluses were growing in the north. The rice tariff has remained at 70 percent, a level chat prohibits trade from occurring. Export restrictions on wheat and rice, historically imposed through State trading, quotas, and minimum export prices, have been progressively liberalized In 2000, India began to provide budgetary subsidies to support exports of surplus wheat and rice when the combination of declining world prices and higher domestic prices made Indian wheat and rice, uncompetitive in World market. In 2005, the government halted export subsides because of tightening domestic supplies and reduced Indian competitiveness in international markets, although private traders remain free to export wheat and rice.

Agriculture Prices Policy: Agricultural price policy has moved through two distinct phases during the last four decades. During the first phase, lasting' till 1965, the price policy was largely consumer based. The Third Plan marked the beginning of the producer-bias in the agricultural price, policy. In 1965, the Agricultural Price Commission (APC) was set up. There was a shift from the community approach to entrepreneurial approach with, the submission of, Ford Foundation's Report during 1959 on "India's food crisis and steps to deal with. It." Agricultural policy was reoriented to restore priority for introduction of scientific practices over changes in organization as the foremost instrument for increasing farm production. Other policy measure were: greater investment outlays on agriculture for seeds, fertilizers and insecticides and remunerative prices to provide incentives for private investment in improved inputs. It was recommended that the package of improved practices and services should be extended first to progressive farmers. The services included production, credit, inputs, marketing arrangements, participation of interested cultivators through farm plans, local public works programme etc. This could be described as entrepreneurial approach of an individualistic character as against the community or the co-operative approach emphasized in the fifties.

Under the new policy approach, Panchayat Smitis and Gram Panchayats were given the responsibility of developing agricultural programmes locally, within the framework of state and national, plans. It was recommended that the focus of the agricultural policy should be individual farmer, rather than the village. It would be possible to achieve substantial increase in agricultural production by prodiving price and cost incentives to individual farmers for higher investment in modem inputs.

The APC was charged with the responsibility of evolving a balanced and integrated price structure. "In the perspective of the overall needs of the economy and with due regards to the interests of the producer and the consumer". The terms of reference of the commission refer not only to the need of providing price incentives for promoting agricultural growth but also to the need to ensure national utilization of land and other production resources" and to the "likely effect of the price policy on the rest of the economy, particularly on the cost of living, level of wages, industrial cost structure, etc",

These terms of reference have been modified and expanded in 1980 in response to the changes in the agrarian economy that have taken place during the late sixties and seventies. An important addition is the directive that price fixation should, "take into account the changes in the terms of trade between agricultural and non-agricultural sectors". The original terms of reference did not cover any principle of pricing in relation to costs or parity between sectors, barring a reference to marketing costs and margins. In 1985 the APC was renamed as commission for Agricultural Costs and Prices (CACP). Since 1965, with the establishment of the' CACP, a more stable and meaningful price and distribution policy has been pursued. The policy is aimed at achieving self-reliance by-stepping tip domestic food production ensuring equitable distribution of shortages, reducing, price disparities between the surplus and Jeficit states lo the minimum and stabilizing food prices at reasonable levels.

The main constituents of the price policy are: (i) announcement of minimum support prices for major foodgrains well in advance of the sowing season; (ii) fixation of procurement prices for purchasing a part of the marketable surplus at below market prices (iii) running a public distribution system and.(iv) building up buffer stocks to meet emergency situation to mitigate annual price fluctuations.

A logical corollary to the concept of the minimum support price is that of a maximum or ceiling price the rationale for which lies in two factors. First, protecting farm incomes in years of abundance through purchases by/the government at minimum prices implies building up of stocks; and obviously at least over tie long run, such a policy requires stock depletion as well. Second, a maximum-price would imply protection of consumer interest in the year of crop failure. Without it a support programme undesirable because the farmer and is clearly undesirable because the effects of agricultural output fluctuations in India are not restricted to the farm sector alone but are quickly transmitted to the other sectors of (the economy, especially in periods of scarcity, through high food prices. In a sense, food price acts as a base price in the determination of both agricultural and industrial costs.

The underlying theoretical basis for the guaranteed minimum price policy has several elements such as price stabilization, improvement of agricultural terms of trade, and provision of insurance to the agricultural terms of trade, and provision of insurance to the agricultural producer. As regards the criterion for the fixation of minimum prices, different crops. In fixing the level of minimum support prices, the following factors are taken into account by CACP: (i) the available data on cost of production, (ii) changes in input prices, (iii) changes effected in the administered prices of competing crops and (iv) the need for maintaining overall stability in the general economy

The operation of a support programme is inextricably linked with that of a public distribution system for the supply of grains at subsidized prices. It is clear that a system of subsidies at both ends (production and consumption) can be financially viable only if there are compensatory measures of taxation within the farm sector itself or elsewhere. This leads to the concept of procurement as a tax on surplus producers especially in' years of poor harvest when market prices and hence profit margins are high. By the late sixties, the procurement prices emerged as a guarantee price, announced well ahead of harvest time, at which the government was committed to make purchases.

In the actual fixation of procurement prices from year, to year,, the CACP; has, generally accepted the principle of keeping procurement prices higher than the corresponding minimum support prices, but no fixed formula has been used for determining the level of procurement prices.

Public distribution is another major instrument of price policy. Building up of adequate buffer stock is another' important constituent of price policy for evening out fluctuations in price and availability, over good and bad years. However, although the problem of relative prices and its effects on the composition of production is undoutedly important, even more important is the problem of achieving a rapid rate of increase in aggregate agricultural production.

Implications of Policy Package for Agriculture: Policies on land reforms, taxation, credit and prices have been heavily biased towards big farmers who wield considerable political power at the state level and who influence the formulation as well as implementation of such-policies. Rich farmers display considerable drive for modem farming. Modernization of agriculture by promotion of the new technology has had varied socio-economic implications. The commercial farming, use of HYV, requires more input of energy per units of land. Irrigation requires oil-driven or electric pumps for effective and controlled moisture. The consumption of fertilizers has gone up of course, these materials are to be purchased from the industrial sector. With the use of technological measures the cultivator becomes a market operator for obtaining his inputs. The cost of input becomes a market operator for farming, which can be nullified either through subsidization or by raising the wealth of the peasant. A developing economy tike India may opt for the former due to various considerations other than economics for the time being.

The government price-policy protects the producers by procuremerit prices at which a portion of the marketed surplus is retained for public distribution. The low income rural consumers are badly affected from excessive rise in prices and inefficient public distribution when there is a shortage of foodgrains. A rise in agricultural prices has the immediate effect on transferring income from non-agricultural to the agricultural sector of the economy. The rich peasantry is emerging as an economically dominant class all over the country.

It is clear, from the foregoing that the farm policy regime adopted by the Govt. in post-independence period, which we have discussed in this lesson, has had wide-ranging economic, social and even environmental implication, some good for the society, but others decidedly detrimental. Let us first of all briefly refer to the welcome implications of this agricultural policy package. These are: (i) Attainment of self-sufficiency in the production of foodgrains, except pulses, as well as raw materials like sugarcane, cotton, oil seeds, etc. (ii) Emergence of India as a net exporter of cereals, (iii), Improvement in the agricultural performance being a potent factor in the reduction of rural poverty and unemployment (iv) Development of a new linkage between agriculture and industry, viz. the former emerging as a potent stimulant of demand for industrial products, especially consumer goods, (v) Building up buffer stocks of cereals exerting a healthy influence on the price level as well as a strong instrument of helping the poor and thus redistributing the gains of development. (vii) Extending the technological revolution, to the rural areas which had earlier remained a cesspool of underdevelopment

The Govt. policy package has also had some unhealthy sócio-economic and environmental implications. Briefly stated, these are.: (i) Large farmer bias in govt. policies, thus increasing the economic and technological chasm between petty and large farmers, (ii) Payment of explicit and implicit subsidies to the farmers having become a huge factor lying behind the burgeoning-budgetary deficit, and causing a shift of resources away from fixed investment in rural areas, (iii) Govt. policies creating distortions-in optimal factor combinations of farmers (like encouraging mechanization in a labour abundant country), as well as in the farm product mix (like encouraging production of superior grains, such as wheat and rice, at the cost of coarse grains and pulses which are stapl: diets of the poor), (iv) The encouragement of use of chemical fertilizers, pesticides, weedicides etc. having exerted a very

unhealthy influence on the environment and also on toe physical well being of the farm producers, workers and the consumers, (v) The procurement price policy of the-govt. sometimes having turned into a populist vote-catching device, but decidedly had an undesirable effect on the price situation in the country.

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LESSON-20

INDUSTRIAL POLICY

The first official pronouncement on industrial policy made in 1948 set the tone for the pattern and strategy of India's economic development. It was also the first step towards delineating areas of public and private sector involvement In the industrial policy of 1948, the Government reserved for itself three areas of economic activity, the manufacture of arms and ammunition, the development of atomic energy and the ownership of railways. The policy, of course identified the areas reserved for the Government, but the private sector was to be allowed to come in if it was expedient in the national interest. These areas were: coal, iron and steel, aircraft manufacture, ship building, telephones and allied equipment, oil and electricity- generation and distribution.

The remaining areas were left to private enterprise.

The next landmark in industrial policy was the Industries (Development and Regulation) Act of 1951 (IDR) which among other things, gave birth to the industrial licensing policy.

Industrial Policy Resolution of 1956

On the eve of the Second Plan, the famous Industrial Policy Resolution (IPR) of 1956 was adopted. This was a comprehensive statement which had since become the touchstone of policy and a point of reference for many decisions. Basically, it did two things. First, it defined the areas of public and private sector endeavour in great detail, and secondly, it widened the ambit of the state's direct involvement in industrial activity.

The IPR 1956 laid emphasis on

(i) The development of heavy ar'i machine building industries;

(ii) the expansion of the public sector,

(iii) the establishment of a large and growing cooperative sector; and

(iv) encouragement to the diffusion of ownership and management in the private sector.

The IPR of 1956 classified industries into three categories having regard to the part which the state would play in each of them. These categories would inevitably overlap to some extent and too great a rigidly might defeat the purpose in view. But it was always open to the State to undertake any type of industrial production. The State was free to start any type of industrial production. The State was free to start any industry wherever it deemed it necessary. The above mentioned three-fold classification was as below:

(i) Exclusive responsibility of the State

The first category consisted of industries the future development of which would be the exclusive responsibility of the State. Such industries were 17 in number which bad been listed in schedule A of the Resolution. All new units in these industries, save where their establishment in the private sector had already been approved, would be set up only by the State. This did not preclude the expansion of the existing privately owned units, or the possibility of the State securing the co-operations of private enterprise in the establishment of new units, where the national interests so required. However, four, industries, viz railways, air, transport arms and ammunition and atomic energy were to

be developed as Central Government monopolies. All new units in the remaining 13 industries were to be set up by the State.

Schedule A included the following 17 industries: (1) Arms and ammunition and allied items of defense equipment. (21 Atomic energy, (3) Iron and Steel, (4) Heavy casting and forgings of iron and Steel production, (5) for mining, for machine tool manufacture and for such other basic industries as may be specified by the Central Government, (6) Heavy electrical plant including I hydraulic and steam turbines, (7) Coal and lignite, (8) Mineral oils, (9) Mining of iron ore, manganese ore, chrome ore, gypsum sulphur, gold and diamond, (10) Mining and processing of copper, lead, zinc, tin, molybdenum and wolfram, (11) Minerals specified in the Schedule to the Atomic Energy (Control of Production and use) (12) Aircraft, (13) Air Transport, (14) Railway Transport. (IS) Shipbuilding, (16) Telephones and telephones cables, telegraph and wireless apparatus (excluding radio receiving set) (17) Generation and distribution of electricity.

(ii) Progressively, State owned

Industries in the second category were those listed in Schedule B. Such industries were to be progressively state-owned, but private enterprise was expected to supplement the efforts of the State in these fields. With a view to accelerating the future development of industries included in this category, the State would increasingly establish new undertakings. At the same time private enterprise will also have the opportunity to develop in this field, either on its own or with State participation.

(iii) Industries left To private enterprise

All the remaining industries falling outside the two schedules were included in the third category. Future development of such industries in general was left to the initiative and enterprise of the private sector.

Besides this demarcation of industries between public and private sectors, the IPR of 1956 stressed (1) the role of cottage and village and small scale industries in the development the national economy, (ii) Reduction of disparities in levels of development between different regions, (iii) Maintenance of industrial peace, (iv) Raising the living and working conditions of workers and their standard of efficiency. Enterprises in the public sector were expected to set an example in this respect.

The following were thus the main features of IPR, 1956:

(i) Dominant role of Public Sectors: The IPR of 1956 laid greater comphasis on the expansion of the public sector. State was increasingly to take the initiative in establishing new undertakings. The Resolution declared the adoption of the socialist pattern of society as the national objective.

(ii) No threat of takeover: The IPR of 1956 did not carry the threat of imminent nationalization

(iii) Continuance of mixed economy: To underline the concept of mixed economy, future development of industries falling outside the two Schedules, in general, were left open to private enterprise and initiative, with or without State participation.

The IPR of 1956 made a deep impact on the Second and subsequent Five Year Plans. The pattern and growth of industrial development was primarily governed by this Resolution till 1991.

Looking at the success of industrial policy of 1956, Dr. O.K. Rangnekar had rightly observed that "the basic soundness of India's industrial policy remains unquestioned. Its overall direction, flexibility and thrust would seem to have helped the country to set the industrial development."

But one cannot be blind also to the confusion that has come in its trail. Certain weakness of IPR of 1956 should also be kept in mind. Dr. D.K. Rangnekar has pointed out that there was no time limit stipulated for the fulfillment of the Resolution, which seemed rather odd. It is significant to note that several years after its adoption the Resolution bad not even been fully implemented: Planning and industrial administration tended to be top slow, and as a result the development of State enterprises fell far short of the expansion visualized by Nehru and outlined in the two Industrial Policy Resolutions. The policy and goals had not been strictly adhered to and deviations from the prescribed norms were not very uncommon. Rangenkar has further asserted that "the basic concept of socialism and the underlying goals were glossed over. Licenses were issued to private sector units in areas 'which were exclusively reserved for State ownership and control or where further expansion was intended to be in the public sector. These included coal, oil, fertilizers, chemicals, engineering, etc. Schemes for settings up public sector units in new fields were watered down under pressure for private sector participation, association or continuance".

Although the industrial Policy, 1956 remained the centerpiece of policy in this area till 1991 yet it was frequently tinkered with, especially with changes in the political party in-power at the Centre in 1977 and thereafter. We shall briefly refer to these marginal changes made in the IPR, 1956, before we come to discussion of the latest industrial policy adopted in 1991.

Industrial Policy Declaration of 1977

An industrial policy statement was made in December 1977 when the Janta Party came into power. The Janata Government identified the major shortcomings in the industrial performance of the, country as follows:

(a) increase in unemployment.

(b) widening disparities between rural and urban growth.

(c) severe regional imbalances in industrialization, and

(d) a slackening of industrial output as well as per capita income over the decade prior to their being elected.

The industrial policy enunciated in 1977 was therefore, primarily aimed at removing these distortions and the main objectives of the policy of the Janata Government were the acceleration to pace of industrial growth, rapid increase to the level of employment, productivity and income/of industrial workers and wide dispersal of small tand village industries. The strategy adopted to achieve these objective included the following measures:

(a) The list of in Industries exclusive reserved for small scale sector was expanded from 180 items to over 800-items).

(b) Within the small scale sector, a new segment called the "tiny' sector was created. Tiny units were defined as those with investment in machinery and equipment up to Rs.1 Lakh and situated in towns with a population of less than 50000 according to the 1971 census figures. Special attention was to be paid to the development of the tiny sector.

(c) The focal point of the development null seale and village industries was taken away from urban and metropolitan centres to district headquarters by setting up District Industries Centres which were to provide all the services and support required by small and village entrepreneurs.

(d) The development and application of technology appropriate to the country's socio-economic condition was to receive adequate attention. In affect, this meant that

wherever there was an option, a labour intensive method of production was to be preferred.

(e) Following from the previous measures, the area of operation of large state industries was severely circumscribed. Capacities in several industries such as soaps, textile weaving, matches, etc., were frozen. The areas open for capacity expansion to were : basic industries such as steel and cement, capital goods industries, such as machinery manufacture, and industries using high technology such as petrochemicals, fertilizers, etc. Certain facilities available to them such as permission to produce up to 25 per cent in excess of licensed capacity were withdrawn in respect of items reserved for the small sector. A stringent location policy was introduced under which no new industrial undertaking was to be set up within certain limits of metropolitan and urban areas with a population of over 5 lakhs.

(f) Technological collaboration with foreign firms was not encouraged except in sophisticated and high priority areas. Foreign investment was also to be restricted.

In brief, the Janata Government's policy was weighted in favour of small units and rural areas.

New Industrial Policy of 1980

In 1980 when Congress Party regained power at the Centre, the Government presented to the Parliament a new industrial policy statement which reiterated faith in the principles underlying the industrial Policy Resolution of 1956 in respect of subjects such as the role of the Public sector and the importance of rapid industrialization. The new policy put forward a thesis that industrialization is the sine qua non of economic progress and rapid and balanced industrialization was necessary to improve the lot of the common man in the shape of increasing availability of goods at fair prices. Industrialization was also considered essential to provide support for agriculture and for die development of infrastructural facilities like energy and transport.

The main features of the policy were as given below:

Role of Public Sector: On the role of the Private Sector the statement talked only in broad terms. It restated that the 1956 policy resolution had assigned a role for industrial undertaking in the private sector within the framework of socio-economic policy of the state and subject to certain regulations in terms of relevant legislations.

With regard to large Industrial houses: It stated that it shall not permit the growth of monopolistic tendencies or concentration of economic power and wealth in a few hands. But some, concessions to the large sector were given in the interest of healthy expansion; modernization and exports.

Regularization of Excess Capacity: In many large scale units, installed capacities exceeded licensed capacities at that time. In the interest of maximizing production, particularly in industries which were important from the point of view of the national economy or those engaged in producing articles of mass consumption, it was proposed to regularize such excess capacities on a selective basis.

Provision for Automatic Capacity Expansion:

In 1975 the Government had permitted the facility of automatic expansion in installed capacity in respect of 15 industries. Expansion was permitted at the rate of 5 per cent per year or 25 per cent in a Five Year Plan period. This expansion was in addition to the normal-facility to produce up to 25 per cent in excess of licensed capacity.

The facility of automatic expansion in 1980 was extended to other basic industries such as steel, non-ferrous metals, transport equipment, power plant equipment, cement, chemicals and industrial machinery, etc. included in Appendix I of the Industrial Policy Resolution, 1956.

Revised Definition of Small Scale Units: In the context of the increase in the cost of machinery and plant and in order to boost the development of small scale industries, investment limits were raised for definition purpose as under.

(a) for small scale units from Rs. 10 lakhs to Rs. 20 lakhs;

(b) for 'tiny' units from Rs. 1 lakhs to Rs. 2 lakhs;

(c) for ancillaries from Rs. 15 lakhs to Rs. 25 lakhs.

Village Industries: Village industries were to be encouraged in the interest of generating more employment in villages. Thus handlooms handicrafts, khadi and other village industries were to receive greater attention to achieve a faster rate of growth in villages.

Public Sector: The policy reiterated faith in the public sector and stressed the need to evolve affective operational system of management in the public sector undertaking.

Industrial Sickness: The policy showed concern for the increasing industrial sickness and proposed devising of on early warning system to identify incipient sickness. It proposed to grant income-tax concessions more liberally in the cases of voluntary mergers' of sick units.

Besides the foregoing, the policy statement of 1980 also made provision for (i) setting up nucleus plants in industrially backward districts to generate ancillary and small units, (ii) reviving economic infrastructure such as energy, transport and coal, and (iii) providing special facilities to export-oriented units.

New Industrial Policy (1991)

The new Industrial Policy (NIP) was tabled in Parliament on July 24, 1991. The basic philosophy of the new policy has been summarized as continuity with change. The NIP purports to raise industrial efficiency to the international level and, mainly through it, accelerate industrial growth. India's industrial policy and planning has a mix of economic and social objectives. The economic objective is growth and social objectives are in the spheres of small industry, regional balance, concentration of economic power etc.

Objectives of NIP

The new industrial policy seeks to achieve the following objectives: (i) to consolidated the strengths build up during the last four decades of economic planning and to build on the gains already made; (ii) to correct the distortions that may have crept in the industrial structure as it has developed over the last four decades (iii) to maintain a sustained growth in the productivity and in the gainful employment; and (iv) To address (a) the need to preserver the environment and (b) the need to ensure the efficient of available resources.

The NIP relates to industrial licensing policy, foreign investment, foreign technology agreements: public sector policy and monopolies and Restrictive Trade Practices (MRTP)-Act.

Industrial licensing has been abolished for all industries except for a limited number of industries related to security and strategic concerns, social reasons, hazardous chemicals, environmental reasons and luxury consumption goods. The number of such industries is fifteen. The licensing provisions would not apply to small scale units manufacturing any of the above items reserved for exclusive production in small scale sector.

Automatic clearance will be given to foreign direct investment (FDI) in India in cases where foreign exchange availability is ensured through foreign equity in projects where imported capital goods are required. Majority foreign equity holding up to 51 per cent will be allowed automatically. Higher than 51 per cent equity participation has been allowed in these cases: 100 per cent export oriented units-100 per cent with Govt. approval. Thirty five high-technology and high investment priority industries have been allowed to enter foreign technology agreements. Royalty under these agreements has been allowed up to 5 per cent of domestic sales and 8 per cent of export sales. Besides, lumpsum technology payments of up to Rs. 1 crore have been allowed.

The number of industries reserved for public sector is six. These are atomic energy, coal and lignite, mineral oils, railways, atomic minerals. The focus in the public sector, according to the NIP, will be on strategic, hi-technology and essential infrastructure areas. The Govt. announced its intention to disinfest a part of its shareholding in public sector enterprises. Much greater autonomy was to be given to the enterprises to be retained by the Govt. Thus, through the NIP, Govt. made its intention clear to invite a greater degree of participation by the private sector in important areas of the economy.

The MRTP Act was separately amended and all restrictions on firms with assets about Rs. 100 crores were removed. The NIP recognized the increased competence of Indian private sector firms and gave them the necessary freedom to deal with the emerging challenges.

Through the NIP, the Govt. brought about a substantial structural reform of the Indian industrial policy. The role of the public sector has been de-emphasized, that of private sector industry reemphasized, and multinational corporations and FDI in general have been given a freer role." The policy set in motion a process of modernization and technology up gradation.

Implications of NIP

One of the most striking features of the NIP is the substantive reduction in the role of the public sector in the future industrial development of the country. Over the years, the public sector had come to acquire such commanding heights that it could roughly account for fifty per cent of total industrial activity. Under the NIP, the position will be altogether different as the priority areas for the future growth of the public sector have been confined to mainly essential infrastructural goods and services, exploration and exploitation of mineral resources and manufacturing of products based on strategic considerations.

NIP is once again guided by considerations of promoting an environment of economic efficiency and continuous technological up gradation besides continuing to support the small scale sector.

A number of changes in industrial licensing system, foreign investment, foreign technology agreement and MRTP act are such as do away with the prior clearance of government. This will go a long way in reducing the project launching time and project cost. These measures will definitely help in increasing the productive efficiency resulting into decline in the input cost per unit.

Provisions in the NIP with regard to foreign investment and foreign technology agreements will attract technology, capital and marketing "and managerial expertise from abroad. This will lead to additions of scarce resources in the Indian economy. As a result, industrial production will increase both through their additionality, on the one hand, and higher productive of these resources on the other hand.

Since the number of industries reserved for the public sector has been reduced to 6 from 17 listed in schedule of the IPR 1956, the privatization of 9 industries may make for the improved efficiency of the public sector through its being subjected to the discipline of the market forces.

There will be greater thrust on performance improvement through Memoranda of Understanding (MOU) system. Under MOU and its monitoring professionalization and greater autonomy may be expected to improve the performance of public sector enterprises.

Strengthening of the powers of the MRTP Commission will help in curbing anti-competitive behaviour of firms in the monopolistic and oligopolistic markets and thus promote competition and, through it, efficiency. Thus the logic of NIP along with liberalization in trade, finance and fiscal policy areas, paves the way for increased efficiency and higher-rates of growth, say 10 per cent per annum during the medium term and a 12 per cent plus growth rate in the long run.

The social objectives in the context of the NIP are greater emphasis on public sector, prevention of concentration of economic power in private hands, regional balance and promotion of small industry. NIP has little to subserve these objectives. NIP will go counter to these objectives in the short run as the number of industries has been reduced in the public sector, and close liquidation and proposed privatization of some public sector enterprises has reduced the area of public sector.

J.C. Sandesara, while making a critique of the NIP contrasted the new industry policy with the policy pursued before 1991, especially in the context of the social objectives of Govt. Policy. These objectives earlier were emphasis on public sector vis-a-vis the private sector, faster expansion of basic and key industries, prevention of concentration of economic power in private hands, regional balance in development and promotion of small industry. Sandesara concedes that the NIP does not seek to achieve these social objectives directly and especially in the short run. He, in fact, finds precious little in this regard in the NIP. So the conclusion of this critique of the NIP is that the new policy is heavily biased in favour of growth and efficiency, but has tended to ignore the social objectives sought through govt. policies in the past.

The foregoing discussion shows that in as much as the NIP is growth promoting, even as it contains little to promote social objectives it may be expected eventually to subserve almost all of the social objective as well as the preceding growth promoting policies, expect in regard to the objective of faster expanded the public sector relative to the private sector.

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LESSON-21

POLICIES OF LIBERALISATION AND PRIVATISATION

An important facet of the economic policy shift in the 1980s has been the reduction in the discretionary role of government in industrial planning. Relaxation of government controls or doing away with controls altogether has been an important and integral part of this strategy which came to be epitomized as economic liberalization. Beginning with the devaluation of the rupee in July, 1991, we have had a flurry of changes in credit, foreign trade and exchange, industrial and fiscal policies, all of which have become the subject of wide and often violent debate. These we shall discuss in some detail to this lesson. Over the years, the Indian economy had become saddled with plethora of irrelevant and outmoded controls which, infact, have become pernicious. They help neither the producer generally nor the consumer, and they do not even subserve and broad social purpose. The Indian decision to liberalize its capital market was motivated by the economic slow down in general and. industrial slowdown in particular that occurred in second half of seventies the failure of the economy to adjust to the decline of domestic investment opportunities.

V.M. Dandekar, making a scathing criticism of the earlier policy regime, observes that, "This is the policy syndrome called 'Growth with Social Justice with greater emphasis on Social Justice than on Growth. In the process all elements of growth have been crippled and all motivation for standing on one's own made redundant. As a result, growth has suffered and, in consequence, also social justice."

In the Indian context, it has been argued that the network of government controls under the planning regime and particularly, the selective technology policy with regard to import of foreign capital and foreign technology denied the firms the free access to fast-changing technologies from advanced countries and thereby contributed to their technological stagnation. This necessitated the immediate suspension of medium term planning and a slowing down of public investment.

After going through a period of prolonged stagnation since the mid-sixties Indian industry showed signs of recovery towards the close of the severities and manifested buoyancy in growth in the eighties. This period also coincided with the adoption of the development strategy away in emphasis from economic planning towards economic liberalism. Some economists regard the protectionist regulatory policies under planning regime as the basic cause of industrial stagnation witnessed since the mid-sixties and attribute improvement in industrial growth in the eighties to the liberalization of industrial licensing, import control and some other regulatory policies that helped create a somewhat competitive environment and recommended a further dose of economic liberalism for the future industrial policy so that the fuller play of market forces and external orientation-would ensure a higher rate of growth. This has resulted in several policy measures which can be termed as the process of liberalization, these include privatization, delicenzing, automatic expansion of opacity, relaxation of price and distribution controls, replacement of qualitative import controls by fiscal duties and other non-discretionary measures, reduction in import duties on capital goods and intermediate products, reduction in direct taxes rates, and a host of other economic reforms.

The process of liberalization got a fillip with the announcement of new industrial policy in July 1991. The major provisions relating to industrial linensing in this policy have already been discussed in the preceding lesson. The policy issues described in the proceedings lesson for improving industrial performance involve a considerable measure of deregulation. There are two components of this liberalization process internal and external.

These internal and external components of the policy of liberalization together comprise what is called the new economic policy (NEP) of 1991 and subsequent years. We shall separately but briefly discuss these two major components of the NEP below.

The New Economic Policy (The Liberalization Policy)

We first of all take up the internal component of the NEP. The main sub-components of internal economic liberalization are the following:

(a) The Fiscal Policy

(b) The Industrial Policy Reform

(c) The Financial Sector Reform

Each of these sub-components merits some discussion which follows:

(a) The Budgetary reforms or the Fiscal Correction:- As is well-known, the immediate provocation for the adoption of the NEP was the economic crisis of 1989-90. One of the major factors contributing to this economic crisis was the mounting fiscal-deficit of the 1980s which had become unsustainable and needed an immediate solution as the 1990s approached. Under the NEP it was decided that since the over-all deficit of the public sector, including the Central Govt, and its enterprises had reached a staggering figure of 12.5 per cent of the GDP in 1989-90, it needed to be reduced to a relatively more sustainable level of 7 per cent of the GDP by the mid 1990s. In the main Central Govt. budget, the fiscal deficit was to be brought down to under 4 per cent of the GDP. The budge process was to be so reformed as to raise tax revenues on the one hand, and to reduce, public expenditure. Since 1991 these budgetary or fiscal reforms have been given effect to in all the budgets. One of these was initiated in the budget for 1991-92 itself when some subsidies were sought to be reduced to bring down public expenditure However, further action on this front, both at the. Centre and in the States, has met with resistance from the lobbies enjoying the benefits of these subsidies. Besides, taxation reforms have since been carried out, through the Central budgets. The cornerstone of taxation reforms has been to rationalize taxation rates reducing these rates in general, and making efforts to broad-base the taxation system by roping in more tax payers, etc. On the expenditure side, budgetary support to public sector enterprises is being sought to be withdrawn and these enterprises made financially more autonomous. Similarly, the state governments are being advised to raise electricity tariff's to make the State Electricity Boards more viable. Disinvestment in Central and State public sector enterprises is also a part of these fiscal reforms. However, due to the populist stances of the Govt. resistance of those sections.....

producers, workers etc. who were the beneficiaries of such public expenditure earlier (and are even now), lack of courage on the part of the govt. to speed up these reforms, etc. the pace of the budgetary reforms has been somewhat slow.

(b) The Industrial Policy Reform:- In the preceding lesson, we have dealt with the question of these industrial policy reforms in some detail. Here, we may merely summarize that discussion and recapitulate the broad features of these reforms. Thus, the broad features of Industrial Policy adopted in July, 1991 and marginally amended since men are the following: (i) Abolition of the licensing requirements for industrial enterprises, except for 15 industries. (ii) reduction of the number of industries reserved for the public sector to 6; (ill) more and more private sector initiative encouraged in the development of infrastructure, including power, roadways, telecommunications, shipping and ports, ports and civil aviation; (iv) reduction in the number of items reserved for the small scale sector; (v) phased disinvestment by the central and state governments in public sector enterprises (PSUs) and (vi)

grant of automatic approval to foreign direct investment and equity holding up to 51 per cent, and further liberalization in this respect in several other sectors of the economy.

In this respect too, the pace of policy reforms has been slower than anticipated in 1991. For instance, liberalization in crucial sectors like civil aviation and telecommunications has been halting and mired by controversy. Disincestment in PSUs has met with resistance from within the enterprises and from some political parties.

(c) The Financial Sector Reform:- This covers the policy of liberalization in the banking and insurance sectors. Till the early 1990s, these two sectors were the virtual monopolies of the public sector. The banking sector has been since opened up to foreign as well Indian private sector banks. Several of these private sector banks are now competing with the nationalized banks. Further, a part of the equity of the latter has been sold to the public. Significant liberalization has been made in respect of the interest rate structure and the reserves requirements for the banking sector. Since 1991 the interest rate structure has been gradually and selectively freed fro... the control of the R.B.I. Except a few rates of interest on deposits and advances, the rest now independently determined by the individual hanks. Besides, the reserve requirements of banks have been gradually relaxed through phased reduction in SL.R and CRR. The nationalized banks have also been authorized to access the share market for mobilizing resources to strengthen their financial base. They have even been allowed to invest a small proportion of their total deposits in the secondary share market.

The insurance sector, however, still remains a public sector monopoly. The employees of the sector have so far resisted efforts to open it up for private sector insurance companies, although a limited effort was made in the budget for 1997-98 to throw open the health insurance sub-sector.

Financial sector reforms have primarily aimed at encouraging increased competition in the sector, improving its efficiency and profitability and making it more consumer friendly. The employees unions in the sector are very strong and they have tried to stall these reforms and to slow down their pace.

Now, we take up for discussion below the external component of the NEP. Before coming to the external component proper of the NEP, it needs to be kept in mind that even the internal component which we have discussed above, is not purely 'internal' in the sense that of all the subcomponents of the NEP already discussed, each has an external aspect to it in the sense that some external liberalization, where the foreign trade, foreign capital, enterprise management and technology import, is inevitably involved. For example, budgetary reforms involve changes in customs duties, industrial policy reform has a bearing on the activities of the multinational corporations in India, and the financial sector reforms involve the permission to foreign financial institutions and companies to permission to foreign financial institutions and companies to operate in the country. But the main external component of the NEP which primarily leads to globalization of the Indian economy, consists of the foreign trade policy reforms. These may be discussed now.

Foreign Trade Policy Reforms: These reforms have a bearing on the import and export trade and therefore, on the balance of payments of the country, and on the foreign exchange rate policy.

First of all let us take up the exchange rate policy reform, or the reform of the foreign exchange market. Prior to the NEP India had a tightly regulated foreign exchange market (The market where foreign currencies are purchased and sold). There was no such free market in existence. The govt. through the R.B.I, conducted foreign exchange transactions. All foreign currencies were available only from the R.B.L., which was subject to strict rules regarding who could buy foreign exchange, how much and at what price (i.e. exchange rate). Those who acquired foreign exchange (exporters, industries collaborating with foreign companies. Indians employed abroad and remitting money to their relations,

here, etc.) had to surrender all of it to the R.B.I., of course in return for rupees. Obviously, the exchange, rate (the rate at which each dollar or pound sterling", etc. would exchange for Indian rupees) was also fixed by the R.B.I.

By 1991, need had been for freeing the foreign exchange market from govt. control. In fact, one of the raison d' etre for external reforms was the balance of payments crisis of 1990-91.Since then, however, the foreign exchange market has been gradually freed from Govt. control, although only partially so far (i.e. by mid 1997).

The first step towards ..... the market from the Govt. control was taken in 1991 when a dual exchange rate system was adopted under which partly the currency was traded in the free market at market (supply and demand) determined exchange rate, and partly it was still purchased by and sold to the R.B.I. as before. In March, 1993 the dual exchange rate regime was abolished and an entirely market determined exchange rate system was adopted. Since then there has been no officially fixed exchange rate of the rupee. It is now determined by supply and demand in a free foreign exchange market. The P.B.I of course always keeps ready to intervene in the market, should the exchange rate fluctuate too much or comes under pressure from the speculators. During this period, the rupee is fully convertible into foreign currencies in the free market for purpose of transactions on current account (Le. for purposes of merchandise trade and trade in invisibles.) For purposes of capital account transactions of the balance of payments, the rupee is not fully convertible and purchases and sales of foreign currencies for capital account transaction still take place through the R.B.I. as before.

The L.M.F. has however, been pressing all its member countries to free the foreign exchange market completely from official control. In India's case it means that the rupee has to be made freely convertible on capital account as well. For moving towards capital account convertibility (CAC) Le completely freeing the foreign exchange market from Govt. control, the R.B.I set up a committee, chaired by S.S. Tarapore to make recommendations in this regard. The Committee submitted its report May, 1997 in which it set large for the country to achieve CAC by the year 1999-2000. The targets laid (or the pre-condition necessary) for this purpose" are: total interest rate deregulation, fiscal deficit ratio of 3.5 per cent of the GD.P., three-tear average inflation rate of 3-5 per cent, low cash reserve requirements for banks and a transparent exchange rate policy. Even up to 2008 India has not been able to enforce the capital account convertibility.

Under the new exchange rate policy of the post March, 1993 period, the rupee-dollar exchange rate remained stable at about Rs. 31.4 per dollar for over two years. This stability was achieved through market intervention by the R.B.I. During the period there was a steady inflow of foreign private capital into the country. This would have led to an appreciation in the dollar value of the rupee and this would have hurt the interests of the country's exporters. The R.B.I. sterilized this inflow by purchasing the excess foreign currencies from the market (to build up foreign exchange reserves) and thus ensuring a stable rupee-dollar exchange rate. After August, 1995, the rupee was allowed to depreciate against the dollar. During 1995-96, there were some speculative pressures on the rupee which temporarily soared at one time to a high of. around Rs. 38 per dollar, but later its value has stabilized at between Rs. 35.0 and Rs. 35.9 between May, 1996 and June. 1997.

Another major sub-component of the external aspect of the NEP is the foreign trade policy proper. This policy reform aimsat accelerating India's transition towards a globally oriented economy by stimulating exports and ensuring freer imports. Since 1991, there has been an effort to eliminate quantitative restrictions,- licensing and discretionary controls over imports. Imports of capital goods, raw materials and components have been considerably do licensed, tariffs on such imports have been substantially reduced, and tariff categories have been rationalized. As a result, all goods can now be freely imported and exported, except those belonging to two negative (prohibited) lists. Besides the

above mentioned measures forming part of EXIM Policy 1992-97 measures have been taken for trade promotion and simplification of procedures. The negative list for imports is constantly reviewed and some items are shifted to the list under special import license (SIL) scheme, and to the OGL (open general list) in which case goods can be freely imported. Items are also shifted from SIL to OGL for example, on 10th February, 1997-99 items from SIL were shifted to OGL and another 95 items from the negative list to the SIL list.

It thus clear from this discussion of the NEP that the earlier regulatory regime is gradually being dismantled and is yielding place to a liberalized policy regime. Unnecessary, obstructive and obsolete regulatory measures are being dropped or suitably amended. This gives greater freedom to and encourages initiative in individuals and business organizations. The new policy regime seems to have started yielding tangible results in the form of accelerated growth of GDP, industrial growth rate, exports growth rate arid burgeoning foreign exchange reserves. However, all this would be justifiably adduced to the NEP only if these supposed gains of the policy are sustained over a long period.

PRIVATISATION

Privatization emerged as a major public policy issue in the eighties. In the last 15 years, there has been a burst of interest in the idea of privatization. The broad reason for this burst of interest in privatization is that governments everywhere are searching for new ways to mobilize resources and for ways to use more effectively the resources they have. The privatization response is in a real sense a reaction to the worldwide growth of government. The rapidity with which the public sector in many countries expanded over the last four decades, roughly in the period from 1950 to 1985, is frequently overlooked.

Privatization, in general refers to the transfer of assets or services function from public-to private ownership of control and the opening of hitherto closed areas to private sector entry. Privatization, may be defined, as a process by which individuals and private sector firms participate in the development of their economy and participate in the resultant betterment commensurate with their contribution. It helps in the enlargement of political and economic freedom. Privatization thus, spells economic democracy, Steve H. Hauke summarizes the objectives of privatization as:

(i) improvement of the economic performance of assets or services functions concerned.

(ii) depoliticisation of economic decisions,

(iii) generation of public budget revenues through sale receipts,

(iv) reduction in public outlays, taxes, and borrowing requirements.

(v) Promotion of popular capitalism through wider ownership of assets.

In Indian context, the term privatization is currently being used in the sense of industries and sectors [having developed within the public sector] and throwing open increasing areas of rational economy to the private sector. The former process has been referred to as "Divestment or Disinvestment" in public policy debate and official documents in India. It means divesting a part or whole of the Govt. holding of equity in the public sector undertakings (PSUs)

The privatization process in India in recent years has included the following:

(a) Reduction in the number of industries and sectors reserved earlier for the public sector, under the new industrial policy.

(b) In the Seventh and the Eighth Five Year Plans, the relative share or public sector investment was reduced and that of the private sector raised, compared to what obtained under the earlier Plans.

(c) Increasing areas, earlier being the state monopoly, being opened up for private sector initiative, these being, for example, telecommunications, power, banking, road transportation, civil aviation, etc,

(d) Divestment of govt. equity holding in the PSUs at the centre and, the states, especially that of the former.

The process of privatization in India, which was something unthinkable in the 1950s and the 1960s, has been spurred by primarily three developments in the last about fifteen years:

(i) The government in India would perhaps never have thought of privatization in the abovememioned senses, had written the public sector the PSUs performed efficiently and, secondly and more importantly, had the budgetary resources not been increasingly diverted from developmental to non-developmental activities. The PSUs became a treadmill round the neck of the govt. several of which sustained huge losses and, but for a few, most, of the profit-making ones also yielded very poor returns on investment. Besides, since the 1970s the government has suffered from a resource crunch for developmental activities because of rising budgetary allocations to defence and civil administration (collectively called public consumption). The government, therefore, wanted to come out of tight spot and readily agreed to privatization various forms.

(ii) For about two decades now, the Indian Govt. has been under a great deal of pressure from the aid giving foreign governments as well as the multilateral financial institutions like the World Bank and the LM.F., to partially or wholly agree to some form of privatization, During the past several years, the World Bank I-II.M.F. combine has been pursuing a short-term economic stabilization programme and a long- term economic stabilization programme and a long term structural adjustment programme for its member countries. Both the programmes in effect mean state deregulation' and privatization. These pressures also precipitated the recent privatization process in India.

(iii) In recent decades, the national economies of the world have been swept by a privatization wave. The severity of this wave was strengthened by the failure of the erstwhile socialist economies like Soviet Russia and other East European countries. All this also helped in hastening the privatization process in India.

This process in our country has primarily two objectives: one, to reduce the fiscal deficit of the Central 'and state governments, which has assumed alarming proportions of late and secondly, to improve over-all economic efficiency of the productive enterprises and sectors of the economy by subjecting them to the operation of market forces.

The shift of policy in India from the dominance of the public sector until late 1970s to privatization in its different forms in the 1980s and especially the 1990s has set in motion an intense debate on the subject Some of the left intellectuals are deadset against privatization in any form. But even within the government it has not been easy to privatize. There, the problem is not ideological. It is that of loosening a hold over whole sectors and enterprises which the politicians and the bureaucracy had used (or misused) for their various ends. They do not relish the idea of handing over this public sector empire built up since the 1950s to the private sector.

A more serious debate has arisen over the questions of divestment or disinvestment in PSUs. The issues which have been raised in this connection are: which PSUs should be privatized, what should be the extent of divestment, where should the proceeds of sale of PSU shares go, what should be the modality of sale of these shares, how should be PSU shares be valued, etc.?

You dear students, would be well-advised to look up the suggested readings of this lesson, for a fuller discussion of the above issues involved in the debate on disinvestment questions. Here one may refer to the lastest Govt. moves on these questions, as also the lizziness which prevails on this issue within the govt. itself. Besides, there is a great deal of dithering as well as inter-departmental tug of war going on in official circles in this respect.

Between 1991 and March, 1996 partial disinvestment of varying degrees took place in respect on 40 Central Govt. PSUs. During 1996 the Govt. set up a Disinvestment Commission to go into the question of terms and conditions as well as the modalities of disinvestment of public (i.e. Govt.) equities. The Govt. was contemplating disinvestment in 40 major PSUs. The commission has also been asked to go into the questions of identifying non-core PSUs where the Govt. may even become a minority owner of the undertakings.

The Disinvestment Commission (DC) submitted its first report in February, 1997 and a second one in April of the same year. A third on was also ready by the end of May. 1997, but by then an unseemly controversy had arisen in this context. The two Ministries of the Central Govt. the Finance and Industry, which are directly concerned with the working of the DC started a wrangle over the matter.

Before coming to the contentious issues it may be noted that in the first report the DC had recommended 100 per cent disinvestment in three PSUs, viz. TTDC, Modem Food Industries and Gas Authority of India. In its second report the DC further recommended disinvestment in six more PSUs, including ITI Ltd., Bharat Aluminum BRPL, etc.

Further, it may be added that the DC is a purely advisory body and its reports are to be processed by a Core Group of Secretaries, before sending their recommendations to the cabinet for final decision. The Industry Ministry is the designated administrative ministry for DC, while the financial plan' of disinvestment was to be handled by the Finance Ministry.

By mid 1997 however, he Core Group had not even met to proc. the reports of the DC. Soro action had been taken for disinvestment in PSUs despite these, reports of the DC. In fact, between 1995 and mid-1997, no disinvestment had actually taken place.

The wrangling was going on between the DC and the Industry Ministry on the one hand, and the two Ministries on the other. The former arose on account of the Industry Ministry's, pique over the DC having recommended that the funds generated by sale of shares of PSUs should go to the Finance Ministry. The two Ministries were quarrelling over their jurisdiction over the working of the DC. The DC itself was feeling sore over the Govt. inaction over their reports and accused the latter of reducing its status to that of an "abandoned bady".

All these goings-on in the government are a sad commentary over its working. The serious question of disinvestment, over which hinges the whole question of privatization, has been treated so casually. To this sad drama is added the muscle-flexing of the trade unions of PSU employees, and the opposition of the left academics and communist parties, which are otherwise supporting the Govt. The latter unfortunately have no fully worked-out alternative to the process of privatisation. Status quo, however, is no solution.

SUGGESTED READINGS

1. B.M. Misra "Privatization of Public Enterprises in India", The Indian Economic Journal. Oct-Dee., 1993.
2. Arun Ghosh "Trade Reform for Restructuring the Economy". Economic and Political Weekly. June 15.1991.
3. Una Kapila (Ed.) Indian Economy since Independence. Volumes, 4-6.
4. V. Kanesalingam (Ed.) Privatization-Trends and Experiences in South Asia. Macmillan India, 1991.
5. Govt. of India' Economic Survey (Latest issue)

M.A. Examination

Economics

(Indian Economy)

Paper-ECON 241

Time: 3 Hours **Max. Marks: 100**

The candidates shall limit their answers precisely within the answer-book (40 pages) issued to them and supplementary/continuation sheet will be issued.

Note: Attempt six questions in all. Question No. 1 with 10 parts is compulsory and carry 2 marks each. attempt rest of the five questions choosing one question from each unit and carry 16 marks each.

I. Answer the following in 5 lines (50 words)

a) Conceptualise self sufficiency.

b) Define urban poverty.

c) what is Minimum Support Price (MSP).

d) Give the latest definition of micro enterprise.

e) Conceptralise CRR.

f) What do you mean by inflation targetting.

g) Conceptralise invisibles.

h) Name two Indian M.N.C's.

i) What do understand by inclusive Growth in 11th plan.

j) Differentiate between privatisation & Private sector.

UNIT-I

II. Discuss the trends in the nature and magnitude of unemployment in Indian economy,

III. Make an appraisal of the Demographic trends in India in recent times.

UNIT-II

IV. Make an assessment of the impact of liberalisa.ion on agriculture sector of Indian economy.

V. Justify privatisation of Public Sector units in India.

UNIT-III

VI. Express your understar ding of the problem of inflation in Indian economy.

VII. Discuss the implications of parallel economy in India.

UNIT-IV

VIII. Explain the major causes of disequilibrium in Indian Balance of Payments in recent times. Suggest remedial steps.

IX. Prove the superiority of Export promotion over and above the import substitution for Indian economy.

UNIT-V

X. Comment on the poverty alleviation programmes in rural India under five year plans.

XI. Critically examine the National Agriculture Policy 2000 for India.