

Chapter 6 select aspects of Indian economy

Unit 1 population

Meaning:

In common parlance, population refers to the total number of people residing in a place. Thus, population of India means the total number of people living in India. There was a time when growth in population was considered desirable. **There are still certain countries (example, Australia), which give incentives to people to have large families and hence have big population of the country.** For them, more number of persons is desirable as

It provides work force to produce.

It provides market for the products produced.

It may promote innovative ideas.

It may promote division of labour and specialisation.

However, there are countries (example, India) for whom more number of persons is not desirable as There may not be adequate jobs to absorb all additional people. They put pressure on means of subsistence.

They put pressure on social overheads (hospitals, schools, roads etc.)

They may result in increased consumption and reduced savings and hence slow down capital formation.

They may increase dependency.

Actually, whether a big and growing population is an asset or a liability for the economy depends upon economy to economy.

Demographic trends in India

Size of Population: The size of population is determined in terms of number of persons. Considering the present boundary of India (i.e., except Pakistan and Bangladesh), we can say over a period of 100 years, our population has more than quadrupled. In 2011 the population was more than 121 crores.

As far as the size of India's population is concerned India ranks second in the world after China. India has only about 2.4 per cent of the world's area and less than 1.2 per cent of the world's income but accommodates about 17.5 per cent of the world's population.

At present, a little more than one out of every six persons in the world is from India

Rate of Growth :

Since 1921, population has again started increasing. In fact, year 1921 is known as 'Year of Great Divide' for India's population. The slow or negative growth during 1901-21 was due to rapid and frequent occurrence of epidemics like cholera, plague, influenza and famines.

Amongst the states, **Bihar has the highest growth rate of population, while Kerala has the lowest rate.**

Birth rate and Death rate: Birth rate refers to number of birth **per thousand** of population. Similarly, death rate refers to number of deaths per thousand of population.

Density of population : Density of population refers to the number of persons **per square kilometer.**

Density of the population before Independence was less than 100.

Bihar is the most densely populated state in the country with 1102 persons living per sq. km. followed by West Bengal.

Sex ratio : Sex ratio refers to the number of **females per 1000 males.**

The sex ratio, is highly favourable to males than females. This speaks of a very important characteristic of our society

i.e., our society is male dominated. This is in contrast to what is found in other countries of the world specially the more advanced one. Till late, there was great tendency among people in India to get the sex of the unborn child medically tested and get the pregnancy terminated if it was female. But now these tests have been banned. **The recent census (2011) shows that there has been a marginal increase in sex ratio.**

Life-expectancy at birth : Life expectancy refers to **the mean expectation of life** at birth. If death rate is high and/or death occurs at an early age, life expectancy will be low and, it will be high if death rate is low and/or death occurs at an advanced age.

Life expectancy has improved over the years.

Life expectancy at birth in India compares badly when compared with the life expectancy at birth in developed economies and some of the developing economies such as Sri Lanka and Thailand. India can still improve its life expectancy by increasing moderately the expenditure on public health and medicine.

Literacy ratio : Literacy ratio refers to number of literates **as a percentage of total population.**

Illiteracy is bound to affect the progress of family planning programme. It has been found that literate persons are more responsive to family planning programme than illiterate ones.

Literacy is higher among urban population compared with rural population. This could be because of better facilities of education in urban areas compared to the facilities available in rural areas.

The Eighth Plan aimed at complete eradication of illiteracy among people in the age group of 15 to 35 years by the end of the plan. Seeing the overall progress on literacy front till now, this seems to be a difficult target. According to one estimate, it would take more than 30 years for the Indian population to be fully literate.

Causes of rapid growth of population:

Population generally increases because of

- (i) high birth rate.
- (ii) relatively lower death rate.
- (iii) immigration.

India's population has mainly increased because of high birth rate and relatively low death rate.

Causes of high birth rate

- (1) India is predominantly agrarian economy. In an agrarian economy, children are considered assets and not burdens as they help in agricultural fields. The process of urbanisation is slow in India and it has failed to generate social forces which force people to have small families.
- (2) There is high incidence of poverty in India. Poor people tend to have large families.
- (3) Marriage is both a religious and social necessity in India. Presently in India by the age of 50 only 5 out of 1,000 Indian women remained unmarried.
- (4) Not only marriages are almost compulsory, they take place at quite young age in India.
- (5) Most Indians on account of their religious and social superstitions desire to have more children having no regard to their economic conditions.
- (6) Joint family system in India also encourages people to have large families.
- (7) Lack of education among people especially among women causes people to have irrational attitudes and hence big families.

Causes of fall in the death rate

- (1) Famines which were wide spread before Independence, have not occurred on a large scale since Independence. Whenever droughts occurred, they have been dealt with adequately.
- (2) Cholera and small pox often resulted in epidemics before Independence. Now small pox is completely eradicated and

cholera is very much under control. Similarly there has been decline in the incidence of malaria and tuberculosis. These have resulted in reducing the death rate.

- (3) Other factors which have reduced the death rate are: spread of education, expanded medical facilities, improved supply of potable water, improvement in the nutritional level and so on.

Growth of population in India and its effect on development:

India is passing through the phase of population explosion. **Population explosion is a transitory phase according to the theory of Demographic Transition.** This theory says that every country passes through 3 stages - In the first stage both birth rate and death rate are very high. Hence, population remains stable. In this stage, birth rate is high because people are illiterate, poverty is wide-spread, marriages are conducted at early age and superstitions cause people to have big families. Death rate is high on account of malnutrition, lack of medical facilities, absence of hygienic conditions etc.

In the second stage, birth rate comes down slightly but death rate comes down very heavily. Death rate comes down due to improvement in medical facilities and improved standard of living. Birth rate remains high because of social beliefs and customs do not change overnight. This stage is also called the stage of population explosion as population increases at a very high rate during this stage.

In the third stage, greater education causes people realise the importance of smaller families and better standard of life. Old social customs give place to new ideas. As a result, birth rate is low. Death rate is low because of better hygienic conditions and better medical facilities. The net result is population grows at a very modest rate.

Now we will analyse how growth of population has affected economic growth in India.

Growth of national income : National income rose by nearly 18 times during 1950-51 to 2011-12, but on account of increase in population by more than 2 times, the per capita income rose by less than five times only.

Unproductive consumers : With a rapid increase in population, the ratio of children and old persons in total population has a tendency to increase which leads to higher burden of unproductive consumers on the total population. In India, around 63 per cent of the population is in the age group 15-64 and 37 per cent of the population is under 15 or above 64. That means about **37 percent of the population is dependent** on 63 per cent of the population. An increase in the ratio of unproductive consumers places additional burden on the resources of the family as well as the public utility services like education, health etc. Economists have calculated the burden of dependency in terms of food, education and health. Such dependency load is an important contributing factor to the vicious circle of poverty and under-development in developing countries.

Problem of unemployment : With fast growing population, the labour force increases rapidly and there is a pressure for creating jobs for the growing labour force. In absence of insufficient number of jobs, the number of unemployed people increases.

Capital formation : It is said that a part of capital formation investment normally goes in maintaining the existing standard of living for the additional population. For example, with a population growth of 2 per cent an investment of around 8 per cent (with a capital output ratio of 4 : 1) of national income would just be able to maintain the existing standard for the additional population.

Ecological degradation: A rapid growth population in India, as in many other countries, has somewhat upset the ecological balance. There is a gradual shrinkage of area covered by forests as also open land. **Denudation of forest means serious soil erosion and floods with their adverse consequences on food production.**

Demographic Dividend: In India, **63 per cent population is in the working age group (15-64 years).** Such a big labour force, if properly utilised can yield high production and growth for the economy. **This has come to be known as “demographic dividend”.** For actually tapping this dividend, the Eleventh and Twelfth plans rely upon not only ensuring proper health care but also on putting a major emphasis on skill development and encouragement of labour intensive industries.

Government measures for solving the population problem:

Population growth is not to be left to natural, biological and other forces. Policy intervention is needed to plan and regulate it in tune with the needs of the economy and society.

Family planning which was and is a principal component of the population policy was taken up on a modest scale with emphasis on clinical approach during the first decade of planning. The emphasis was mainly on research in the field of demography, physiology of reproduction, motivation and communication. Since these measures did not yield the expected results, a **full fledged department of family planning was created in 1966. Various contraceptive methods were offered and the acceptors had the freedom to choose any of the methods offered. This has been known as ‘cafeteria approach’.** The allocation towards family planning programmes kept on increasing from plan to plan. There was a significant shift in the strategy of the government towards population under the Fifth Plan. **A new National Population Policy replaced earlier Population Policy of the government.**

Under the policy the marriageable age was **raised to 18 years and 21 years** for girls and boys respectively.

The implementation of parts of this policy during **Emergency (1975-77)** had disastrous consequences since the implementers indulged in all types of high-handed practices.

National Population Policy, 2000

With a view to encourage two-child norm and stabilizing population by 2046 A.D. the Government adopted the National Population Policy (NPP-2000).

Maternal Mortality Ratio and Infant Mortality Rate : Maternal Mortality Ratio (MMR) refers to the number of maternal deaths in a given period **per 1,00,000 live births.** Infant Mortality Rate (IMR) refers to number of babies dying before the age of one, **per 1000 live births.**

Unit 2- poverty

Poverty is a widespread social evil in underdeveloped countries of the world, particularly in Asia and Africa. There is no standard definition of poverty for all the countries of the world. Some countries approach poverty in the absolute terms and some countries approach poverty in relative terms.

When poverty is taken in absolute terms and is not related to the income or consumption expenditure distribution, it is absolute poverty.

On the other hand, when poverty is taken in relative terms and is related to the distribution of income or consumption expenditure, it is relative poverty.

The concept of **absolute poverty is relevant for the less-developed countries.** To measure absolute poverty, absolute norms for living are first laid down. These relate to some minimum standard of living. These may be expressed or measured in terms of income/consumption expenditure. Given this, one classifies all those as poor who fall below the standard. The number or percentage of such poor in the country's population gives the measure of poverty.

The concept of **relative poverty is more relevant for the developed countries.** According to the relative standard, income distribution of the population in different fractile groups is estimated and a comparison of the levels of living of the top 5 to 10 per cent with the bottom 5 to 10 per cent of the population reflects the relative standard of poverty. **Gini co-efficient are often used for measuring poverty in relative sense.**

In India we use the concept of absolute poverty for measuring poverty. For this a minimum level of consumption standard is laid down (known poverty line) and those who fail to reach this minimum consumption level are

regarded as poor.

Poverty in India

It is generally agreed that only those people who fail to reach a certain minimum level of consumption standard should be regarded as poor.

The Planning Commission adopted the definition provided by the 'Task force on Projections of Minimum Needs and Effective Consumption Demand' according to which, a **person is below the poverty line if his daily consumption of calories is less than 2400 in rural areas and 2100 in urban areas**. On the basis of this, the monthly cut-off points turned out to be Rs. 76 for rural areas and Rs. 88 for urban areas at 1979-80 prices.

Poverty Estimates : The **National Sample Survey Office (NSSO)** undertakes surveys from time to time in order to analyse the expenditure pattern of people in rural and urban areas.

It uses two types of recall periods – **uniform recall period (URP)** and **mixed recall period (MRP)**. While the **URP uses 30-day** recall/ reference period **for all items** of consumption, **MRP uses 365 day** recall/reference period **for five infrequently purchased non-food items** namely, clothing, footwear, durable goods, education and institutional medical expenses.

Planning Commission Estimates of Poverty:

The **Planning Commission**, the **nodal agency for estimating the number and proportion of people living below the poverty line** at national and state levels reviews the methodology for estimating poverty from time to time.

The Committee **recommended that poverty estimates should be based on MRP based NSSO data** on private household consumer expenditure and calorie intake norms should be done away with.

While poverty rates have declined, the malnutrition has remained stubbornly high.

The **Human Development Report (HDR) 2010** measures poverty in terms of a new parameter namely **Multidimensional Poverty Index (MPI)**. The MPI shows the share of population which is **multidimensionally poor in terms of living standards, health and education**. According to this parameter, India has a poverty index of 0.283.

Causes of Poverty:

Economic Causes : Various causes of poverty can be classified under economic, political and social heads. Economic backwardness or stagnation is often the characteristic of the countryside of a developing country like India where majority of the population lives. Agriculture is the main occupation of the rural poor and contributes 14 per cent of the GDP. Yet the income it provides to agricultural workers is substantially below average and almost at the subsistence level. There are a number of factors which are responsible for low income in the agricultural sector such as small size of land holdings, inadequate irrigation facilities, lack of enough financial resources needed for investment for ensuring development and raising productivity. Thus, productivity in small farms is generally low resulting in very low levels of returns. The condition of landless agricultural labourer is worse. The economic conditions of persons engaged in non-agricultural activities in the rural sector are equally dismal.

Political and Social Causes : Political vested interests are also equally responsible for widespread poverty in the economy. But whereas these interests can be countered by following the right type of policies, social factors responsible for promoting poverty are more severe and are interwoven in the web of society itself. Inhibitions and handicaps arising from caste and religion are hard to overcome and require considerable effort by way of propaganda and education through mass media, reorientation of education system and so on.

Other Causes : Apart from these, other factors such as family size and family composition, poor levels of education and skills, lack of motivation and will to get out of the rut of poverty and misery, the feudalistic system of bonded labour in some parts of the country and so on, are also responsible for depressed standards of living among people.

Government programme's for poverty alleviation:

Poverty alleviation and raising the average standard of living have always been stated as the central aims of economic planning in India.

The plan strategies to achieve these aims can be broadly divided into three phases.

In the first phase, the prime **emphasis was on growth.** It was expected that growth through improvement in infrastructure and heavy industries will take care of the problem of unemployment and poverty.

In the second phase, beginning with Fifth Plan, **poverty alleviation came to be adopted as an 'explicit objective'** of economic planning.

Several specific programmes for poverty alleviation and employment generation directed towards selected target groups were launched.

In the third and final (present) phase, emphasis shifted to **'growth' and 'poverty alleviation' as two complementary actions.**

The various recent programmes for poverty alleviation are as follows. The earlier such programmes have been streamlined and merged into these programmes. **The Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS):** The MGNREG Act was notified in 2006 in selected districts and was later extended throughout the country in 2008. It **aims at enhancing livelihood security of households in rural areas of the country by providing at least 100 days of guaranteed wage employment in a financial year to every household** whose adult members volunteer to do unskilled manual work.

Swaran Jayanti Gram Swarozgar Yojana (SGSY) : This was introduced in April, 1999 as a result of restructuring and combining the Integrated Rural Development Programme (IRDP) and allied programmes and Million Wells Scheme (MWS). It is the only self-employment programme for the rural poor. It aims at bringing the self employed above the poverty line by providing them income generating assets. *Upto February, 2012, more than 168 lakh swarozgaries have been assisted.* The SGSY had been restructured as the National Rural Livelihoods Mission (NRLM) and now has been renamed as Aajeevika. The NRLM aims at reducing poverty by enabling poor households to access gainful self-employment and skilled wage employment opportunities.

The Swarna Jayanti Shahari Rozgar Yojana (SJSRY) : The SJSRY which came into operation from December '97, sub-summing the earlier urban poverty alleviation programmes viz., Nehru Rozgar Yojana (NRY), Urban Basic Services Programmes (UBSP) and Prime Minister's Integrated Urban Poverty Eradication Programme (PMIUPEP). The scheme which was revamped in 2009, aims to provide gainful employment to the urban unemployed or underemployed poor by encouraging the setting up of self-employment ventures or provision of wage employment. A total of more than 4,00,000 beneficiaries have been assisted in 2012-13.

Unit 3- unemployment

Roughly every sixth person in the world is an Indian and every third poor person in the world is also an Indian. The statistics speak about the gravity of the problems of unemployment and poverty which demand an immediate solution. It has been observed that with the increase in the number of unemployed persons poverty expands. Keeping in view this fact, removal of unemployment has been mentioned as one of the objectives of economic planning in all five year plans, but it has been given serious consideration only after Fifth Plan. Till Fifth Plan, there was no serious concern for solving the unemployment problem.

It was assumed that the gains of economic growth would percolate downwards and thus inequalities would decline and problems of poverty and unemployment and would be automatically solved. The growth of employment and removal of poverty were taken for granted. The connection between economic growth and other objectives as stated above is not as simple as it is often believed in this country. It has been observed in a number of less developed countries that economic growth generally benefits the elite groups and, as a result, economic inequalities grow. India's experience is precisely the same over the period. The growing unemployment over the years is generally attributed to this basic weakness in the approach of the Government.

Meaning & Types of Unemployment:

Generally a person who is not gainfully employed in any productive activity is called unemployed. Unemployment is a complex phenomenon and takes many forms. The important forms are:

- i) **Voluntary unemployment :** In every society, there are some people who are unwilling to work at the prevailing wage rate and there are some people who get a continuous flow of income from their property or other sources and need not work. All such people are voluntarily unemployed. Voluntary employment may be a national waste of human energy, but it is not a serious economic problem.
- ii) **Frictional Unemployment :** Frictional unemployment is a temporary phenomenon. It may result when some workers are temporarily out of work while changing jobs. It may also result when the work is suspended due to strikes or lockouts. To some extent, frictional unemployment is also caused by imperfect mobility of labour. We may also say that frictional unemployment is due to difficulties in getting workers and vacancies together.
- iii) **Casual unemployment :** In industries, such as construction, catering or agriculture, where workers are employed on a day to day basis, there are chances of casual unemployment occurring due to short- term contracts, which are terminable any time.
- iv) **Seasonal unemployment :** There are some industries and occupations such as agriculture, the catering trade in holiday resorts, some agro-based activities like sugar mills and rice mills, in which production activities are seasonal in nature. So they offer employment for only a certain period of time in a year. People engaged in such type of work or activities may remain unemployed during the off-season. We call it seasonal unemployment.
- v) **Structural Unemployment :** Due to structural changes in the economy, structural unemployment may result. It is caused by a decline in demand for production in a particular industry, and consequent disinvestment and reduction in its manpower requirement. In fact, structural unemployment is a natural concomitant of economic progress and innovation in a complex industrial economy of modern times.
- vi) **Technological unemployment :** Due to the introduction of new machinery, improvement in methods of production, labour-saving devices, etc., some workers tend to be replaced by machines. Their unemployment is termed as technological unemployment.
- vii) **Cyclical unemployment :** Capitalist biased, advanced countries are subject to trade cycles. Trade cycles - especially recessionary and depressionary phases cause cyclical unemployment in these countries. During the contraction phase of a trade cycle in an economy, aggregate demand falls and this leads to disinvestment, decline in production and unemployment. The solution for cyclical unemployment lies in measures for increasing total expenditure in the economy, thereby pushing up the level of effective demand. Easy money policy and fiscal measures such as deficit financing may help. Since cyclical phase is temporary, cyclical unemployment remains only a short- term phenomenon.
- viii) **Chronic unemployment :** When unemployment tends to be a long- term feature of a country it is called chronic unemployment. Underdeveloped countries suffer from chronic unemployment on account of the vicious circle of poverty, lack of developed resources and their under utilisation, high population growth, backward, even primitive state of technology, low capital formation, etc.
- ix) **Disguised unemployment :** So far, the types of unemployment which we have discussed above are all related to open unemployment. Apart from open unemployment we have disguised unemployment. Disguised unemployment commonly refers to a situation of employment with surplus manpower in which some workers have zero marginal productivity so that their removal will not affect the volume of total output. Disguised unemployment in the strict sense, implies underemployment of labour. To illustrate, suppose a family farm is properly organized and four persons are working on it. If, however, two more workers are employed on it and there is no change in output, we may say that these two workers are disguisedly unemployed. This kind of unemployment is a common feature of under developed

economies especially of their rural sector. In short, overcrowding in an occupation leads to disguised unemployment. It is a common phenomenon in an over populated country.

Nature of unemployment in India

Most of the unemployment in India is definitely structural, that is, the structure of the economy is such that it does not absorb an increasing number of people coming to labour market in search of jobs. Apart from structural unemployment there is some cyclical unemployment which has resulted from industrial recession in urban areas. If we classify unemployment as rural and urban unemployment, we find total urban unemployment is mainly of industrial unemployment and educated unemployment type and rural unemployment is seasonal and disguised in nature. Industrial unemployment is the one which has resulted from failure of the industrial sector to absorb the increasing labour force and educated unemployment results

when a large number of educated people remain unabsorbed. Seasonal unemployment, generally, results in agricultural sector when a large number of small and marginal farmers and laborers' do not get occupied during the off-season and disguised unemployment results when people appear to be occupied but actually they are not adding to production. This happens because of over-population, which forces people to work on a small piece of land although their services on the land may not be required. It is estimated that over one-third of India's work force is disguisedly unemployed.

Causes of Unemployment in India

The various causes responsible for widespread unemployment in India are as follows :

1. ***Growth without adequate employment opportunities*** : As economy grows usually employment also grows. But in India, most of the time, the economic growth has been inadequate and adequate number of jobs could not be created. In fact, for almost three decade 1950-80, GDP growth rate was as low as 3.5 per cent per annum. Such a low rate of growth did not push many jobs in the market. Since 1980s however, growth has accelerated to around 5-6 per cent but job creating capacity of the economy has not improved much.
2. ***Growing Population*** : Population has increased at a very fast pace since Independence but jobs have failed to keep pace with the population.
3. ***Inappropriate technology*** : India is a labour surplus and capital scarce economy. Under such circumstances, labour-intensive industries should have been given preference. But not only in industry but also in agriculture producers are increasingly substituting capital for labour. This has hindered the growth of job opportunities.
4. ***Inappropriate education system*** : The education provided in India has not much practical utility. The students receiving such education, even very high one, fail to get appropriate jobs.

Extent of unemployment in India:

Before understanding the incidence of unemployment, it is better to understand the meaning of labour force, work force and unemployment rate.

Labour force : Labour force or in other words, the economically active population refers to the population which supplies or seeks to supply labour for production and, therefore, includes both 'employed' and 'unemployed' persons and the labour-force participation rate (LFPR) is defined as the number of persons in the labour force per 1000 persons.

Work-force : Work force is a part of labour force and refers to the population which is employed. Thus work force participation rate (WPR) is defined as the number of persons/ person-days employed per 1000 person/person days.

Unemployed rate : Unemployment rate is defined as the number of persons unemployed per thousand persons in the labour-force.

Measurement of Unemployment: There are three main measures of employment and unemployment.

1. **Usual Status (US) :** This measure estimates the number of persons who may be said to be chronically unemployed. This measure generally gives the lowest estimate of unemployment especially for a poor economy because only a few can afford to remain without work over a long period. **Current Weekly Status (CWS) :** This estimate reduces the reference period i.e. the period for which data is collected to one week. According to this estimate a person is said to be employed for the week even if he is employed only for a day during that week.
2. **Current Daily Status (CDS) :** The reference period here is a day. It counts every half day's activity status of the respondent over the week. For working out the rate of unemployed person-days the aggregated count of unemployed days during the reference weeks constitutes the numerator and the aggregated estimate of the total number of labour force days constitutes the denominator.

The backlog of unemployment at the beginning of the FYP-1 was 3.3 million to which were added 9.0 million new entrants during this period. The Plan provided additional employment to 7.0 million, thus leaving a back log of 5.3 million at the beginning of the FYP-2. In the subsequent plans, the back log has been continuously increasing, since the new jobs created during each plan period invariably fell short of new entrants to the labour force. As per the estimates the backlog of unemployment at the beginning of the FYP-9 was estimated to be of the order 34-35 million. The labour force was projected to increase by about 36 million during 1997-2002. Thus, the total number of persons requiring employment would be 70 million over the period 1997-2002. The Tenth Plan aimed at creating 50 million jobs during the plan. *The result of the 61st round of the NSSO shows that above 47 million persons were provided employment during 2000-2005.* Thus the aggregate employment generation of 47 million work opportunities during 2000-2005 was fairly close to the target of 50 million opportunities.

The Eleventh Plan (2007-12) aimed at generation of 58 million work opportunities. The NSSO survey shows an increase in work opportunities to the tune of that 18 million under the current daily status between 2004-5 and 2009-10. However, the overall labour force expanded by 11.7 million. That means new entrants to job markets were considerably less than the job created during this period leading to a fall in unemployment in absolute terms by 6.3 million. This lower labour force can be attributed to the fact that more youth were busy in education and lower labour force participation among working-age women.

If we compare developments in employment situation over two relatively longer periods i.e. 1983 to 1993-94 (Period I) and 1993-94 to 2004-05 (Period II), we find that :

Population growth decelerated in Period II as compared to Period I. As a result labour force growth also decelerated during over the same period.

Employment grew more slowly than the labour force in Period II. As a result, unemployment rate increased from 6.1% in 1993-94 to 8.3% in 2004-05.

The inadequate increase in employment in Period II is associated with a sharp drop in the pace of creation of work opportunities in agriculture.

Lower absorption in agriculture sector should have been compensated by an expansion in other sectors. But this did not happen. The pace of opening up of employment opportunities for casual wage labour getting released from the agricultural sector has slowed down sharply in Period II.

Although there has been an increase in salaried employment due to expansion of the non-agricultural sectors - manufacturing and services, increase in employment in these sectors was not very encouraging. The largest shortfall in employment generation has been in manufacturing.

NSSO - 66th Round

NSSO - 66th Round the latest round of National Sample Survey on employment was conducted by National Sample Survey Organisation (NSSO) during 2009-10.

	WPR	PU	LFPR	PU/LFPR $\times 100$
US	392	8	400	2.0%
CWS	370	14	384	3.6%
CDS	341	24	365	6.6%

WPR = Work Force Participation Rate
PU = Persons Unemployed
LFPR = Labour Force Participation Rate

The above table shows that in the year 2009-10, out of 1000 persons in the population, 400 persons were in the labour force according to US. Out of 400, 392 were working and 8 were unemployed. In other words, unemployed persons as percentage of labour force were 2 considering US. Similarly according to CWS and CDS, the unemployment rates were 3.6 per cent and 6.6 per cent respectively. The extent of unemployment actually varies considerably depending on the measure chosen. For example, the unemployment rate for the year 2009-10 in India is a low 2% based on US definition but it rises to 6.6% based on the CDS definition.(Table 10).

As per the Survey, the following are the salient features of the trend of employment and unemployment in India: According to the usual status, 40 per cent of population belonged to the labour force. About 98 per cent of the Labour force was employed according to usual status.

The male WPR in both the rural and urban areas was considerably higher than female WPR. Women comprise 48.3% of the population but have only 26% share in persons employed.

The WPRs according to the CDS were the lowest.

At the all India level, unemployment rate was 6.6 per cent in the CDS approach. The unemployment rate stood at 3.6 per cent in CWS approach and 2 per cent in the US approach.

In the rural areas, generally, the female unemployment rate was lower than the male unemployment rate.
In the urban areas, generally, the female unemployment rate was higher than the male unemployment rate.

Recent Approach of government to solve the problem of unemployment.

The Eleventh Plan targeted 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 services sectors such as tourism and construction and village and small scale enterprises.

It underlined the need to have a proper policy on developing skills. Therefore, a National Policy on Skill Development was formulated in 2009 which envisions empowering all individuals through improved skills, knowledge, and nationally and internationally recognized qualification to gain access to decent employment and ensure India's competitiveness in the global market.

Educated youth are expected to join the labour force in increasing numbers during the 12th Plan. The 12th Plan therefore lays great stress on improving job opportunities in manufacturing sector, agro-processing, supply chains, rural infrastructure and services. It lays high stress on skill building as it is critical for achieving faster, sustainable and inclusive growth on the one hand and for providing decent employment opportunities to the growing young population

on the other.

It has identified priority sectors for employment generation and skill development. These include, Textiles and Garments, Leather and Footwear, Gems and Jewellery, Food Processing Industries, Handlooms and Handicrafts, Machine Tools, IT Hardware and Electronics, Telecommunications equipment, Aerospace Shipping, Defense Equipment, etc.

Chapter 4- Infrastructural challenges

Energy is an important input for most of the production processes and consumption activities. It plays a crucial role in the economic development. Economic growth and demand for energy are positively co-related. **A study shows a 3 per cent rise in industrial production in the world is accompanied by a 2 per cent increase in energy consumption.** A similar relation is also observed in India.

India is both a major energy producer and consumer. India currently **ranks as the world's fifth largest energy producer**, accounting for about 4 per cent of the world's total energy production. It is also the **world's fourth largest energy consumer** after U.S.A., China and Russia accounting for about 6 per cent of the world's total energy consumption. However, it is noteworthy that India's **per capita energy consumption is one of the lowest** in the world.

There is a distinction between primary energy resources and final energy resources. When coal is consumed for generating electricity and electricity is consumed by industry, we call coal as primary energy resource and electricity as the final one. Coal, petroleum products and natural gas are both primary resources and final resources as they are consumed directly as well as indirectly, while electricity is, by and large, the only final energy resource.

Electricity: Electricity or power is the most important source of commercial energy. **Over the planning era, the production and consumption of electricity has increased tremendously.**

Sources of Electricity: There are **5 major sources of electricity** (1) water (2) coal (3) oil (4) gas and (5) radio active elements like uranium, thorium and plutonium. Electricity generated from water is known as **hydro-electricity**. Electricity generated from coal, oil and gas is called **thermal electricity** and electricity generated from radio-active elements is called **atomic energy**.

The central government, state governments and private sector all work together in the generation of power. The Central Government operates through **National Thermal Power Corporation (NTPC), National Hydroelectric Power Corporation (NHPC) and Nuclear Power Corporation of India Limited (NPCIL).** State governments have their **State Electricity Boards (SEBs).** There also exist Central Electricity Authority and Central Electric Regulatory Commission.

Difficulties and Problems relating to energy

Demand and Supply imbalances in commercial fuels : The demand for energy, particularly for commercial energy, has been growing rapidly with the growth of the economy, change in the demographic structure, rising urbanisation, social-economic development and desire for attaining and sustaining self reliance in the economy. The supply has not increased concurrently.

Primary commercial energy (oil, natural gas, LNG, coal, hydro etc.)....

Oil prices and inflationary pressure : Since 1973, oil prices have been rising in the international market. During 1973-2013, the **Organisation of Petroleum Exporting Countries (OPEC)** has increased the prices many folds. This has contributed to the inflationary pressure in India. **Mineral oil is presently the major source of energy for transport,**

industry and agriculture. It is also used as household fuel. Therefore, rising oil prices has led to rising general prices in India.

Growing oil imports bill : Since 1973, India's oil imports bill has increased substantially. *A record level of more than Rs. 6,00,000 crore in 2011-12.* **Petroleum, oil and lubricants (POL)** constitute around 35 per cent of our import bill. The oil import bill is also responsible to a great extent for the existing large balance of trade gap.

Transmission and distribution losses: One of the major problems faced by the power companies are **transmission and distribution (T&D)** losses. The T&D losses are very high in many of the SEB systems. These losses include substantial amount of theft of power. National average of this loss is more than 20 per cent while in many states it is more.

Sick SEBs : Many SEBs have become financially sick. A large portion of these losses is accounted for by almost free supply of power to agriculture. Besides, operational inefficiencies, high cost structure, lower power tariffs and large overdues have made SEBs sick.

Operational inefficiency : Most of the thermal power plants are operating inefficiently. **Plant load factor (PLF) measures the operational efficiency of a thermal plant.** If total generating capacity is say 600 billion kilo-watt hours (kwh) and we are producing only 300 billion kwh, plant load factor here is 50.

Inadequate electrification : Till date, many of villages are not electrified. In many villages, there are a very few houses which are lighted. This is sad considering the fact that more than 60 years have passed since we got Independence and still our rural areas are without electricity.

Recent steps taken to meet the above problem

In order to improve production of power, **Electricity Act was passed in 2003** and Electricity Amendment Bills 2005 was passed in 2005. The focus is on improved investment in power sector and fixing of power tariffs on the basis of competition, efficiency, economical use of resources, commercial principles and consumers' interests.

Certain provisions of the Electricity Act 2003 were amended in 2007 by passing of Electricity (Amendment Act) 2007.

To improve generation of power, Ministry of Power has launched the 'Partnership in Excellence' programme. Under the programme, 26 thermal stations with PLF less than 60 per cent have been identified. Steps will be taken to improve their efficiency.

Steps are being taken to improve and add electricity-generating capacity of the plants.

Government is encouraging the use of hydel and wind energy sources which do not rely on fossil fuels and avoid carbon emissions.

Steps have been taken to turn around SEBs. These include, rationalization of tariff structure particularly the prices charged by the SEBs from various categories of consumers, monitoring of cost structure, optimum utilization of existing capacity.

The **greatest weakness in the power sector is on the distribution side.** **Aggregate Technical and Commercial (AT&C)** losses of most **State Power Utilities (SPUs)** remain high. In order to redress the problem the **Accelerated Power Development and Reforms Programme (APDRP) was initiated in 2002-03.** Although at the national level the AT&T losses have not come down much, the losses have come down in towns where APDRP has been implemented. The APDRP has been restructured. The focus of restructured APDRP is reduction in AT & T losses.

In order to reduce transmission losses, distribution reforms have been carried out. **In 2002, power sector was**

privatized in Delhi. The experience of privatization in Delhi has been encouraging. For example, there the quality of power has improved, load shedding has come down and the average response time for attending breakdowns has also come down.

An **All India Power Grid, also called National Grid** has been developed to even out supply-demand mismatches.

Nine sites were identified for the development of Ultra-Mega Power Plants (UMPPs) with capacity of 4000 MW each. Four of the UMPPs are already at different stages of implementation.

Steps are being taken to provide access to electricity to all areas including villages and hamlets. **For this, 'Rajiv Gandhi Grameen Vidhyutikaran' programme was started in 2005.**

The **Scheme provides for free electricity connections** to below poverty line (BPL) households. **Rural Electrification Corporations is the nodal agency for this.** Under the scheme, more than 1,00,000 villages have been electrified and connections to more than 200 lakh BPL households have been released.

Besides the above, certain Steps have been taken to encourage conservation of energy. These include, giving energy conservation awards to deserving industries, encouraging use of **Compact Fluorescent Lamps (CFLs)** and promoting energy efficient equipments etc. The **Bureau of Energy Efficiency (BEE)** has taken initiatives to promote energy efficiency.

Transportation:

Today, **along with energy, transport is the basic infrastructural requirement** for industrialization. Transport provides a useful link between production centers, distribution areas and ultimate consumers. Important means of transport are railways, roads, water transport and air transport.

Railways : Indian Railways, is the **fourth largest railway network** in the world. It has been contributing to the industrial and economic landscape for over 165 years. **There are two main segments of railways - freight and passenger.** The freight segment accounts for about 70 per cent of revenues and passengers thirty per cent of revenues. Railways however, faces the following problems:

The existing technology of both electric and diesel locomotive is very old. The entire system is in urgent need of modernization.

The railway network is smaller and inadequate vis-à-vis the requirements of the economy.

The railways is facing the problem of financial crunch. The conventional methods of increasing the net revenue, like raising of tariffs and expenditure control are inadequate for generating the levels of investment required.

Because of social responsibilities, railways is forced to operate a number of unremunerative lines and suffer heavy losses. Often, essential goods like foodgrains, fruits and vegetables have to be carried at a loss.

Railways also suffers from over crowding and poor passenger services.

There is need to develop safety measures on an extensive scale.

*In order to meet the above challenges, railways is trying to improve resource management. Rational price policy, increased wagon load, faster turnaround time, **Public-Private Partnerships (PPPs)**, double line freight corridor for efficient freight movements are some of the steps taken in recent years to improve railway's performance.*

Road: The Indian road network is **one of the largest networks** in the world. Today, India has a network of 4.69 million kilometre. Out of this, more than half is surfaced. **In order to connect all major cities by four-lane highways, a new scheme called "Pradhanmantri Bharat Jodo Pariyojana" was started.**

Recognising that rural connectivity is a key component of rural development and poverty alleviation in India, the Government of India, undertook the Pradhan Mantri Gram Sadak Yojana (PMGSY).

The Government of India has also identified 'rural roads' as one of the six components of 'Bharat Nirman' with a goal to provide connectivity to all habitations with a population of 1,000 persons and above in plain areas and 500

persons and above in hilly or tribal areas with an all weather road.

Problems of road transport : Following problems are faced in the case of road transport:

The road length is inadequate considering the size of the country.

A number of areas, particularly interior areas and hilly tracts remain to be linked with roads.

Large tracts of rural roads are mud roads which cannot be used for plying heavy traffic.

A number of urban roads are also poorly maintained. This is due to constraints of financial resources, organizational inadequacies, procedural delays, shortage of essential materials etc.

Most of the State Road Transport Corporations are running on heavy losses. This is because of rising cost of operations, inefficiency in operations and corruption.

*In order to overcome the above problems a number of steps have been taken. These include, undertaking the **National Highways Development Project (NHDP)** which involves developing **Golden Quadrilateral (Mumbai, Delhi, Chennai and Kolkata)**, North-South and East-West corridors, Port connectivity and other projects, PPP in roads developments and rationalisation of taxes etc.*

Water transport: Water transport can be **divided into inland water transport and shipping. Shipping can again be divided into coastal shipping and overseas shipping.**

Over the years, the importance of this mode of transport has declined considerably due to expansion of rail and road transport and navigational inadequacies. The government approved the Inland Water Transport Policy which includes a number of incentives to encourage private sector participation in inland water transport.

Currently, there are five waterways which have been declared as **National Waterways (NWs).**

Coastal shipping is very energy efficient and cheapest mode of transport for carrying bulk goods (like iron and steel, iron-ore, coal, timber etc.) over long distances.

Since ports are very important for coastal and overseas shipping, special efforts have been made in the Five Years Plans for the development and modernization of existing ports and establishment of new ports. The total traffic carried by the major ports was about 560 million tonnes during 2011-12. The 12 major ports carry about 64 per cent of the total traffic, with **Kandla as the top traffic handler in each of the last five years.**

Problems faced by Indian ports : The main problems are low productivity and poor competitiveness. Major factors contributing to these are:

Operational constraints such as frequent breakdown of cargo handling equipment due to obsolescence.

Inadequate dredging and container handling facilities.

Inefficient and non optimal deployment of port equipment. Lack of proper coordination in the entire chain.

Indian containers are costlier than other ports in the region for handling containers. The additional cost burden due to use of second and third generation vessels has been estimated at U.S. \$ 250 million a year. Container delays at Indian ports cost U. S. \$ 70 million a year.

Air transport: Air transports is the **preferred mode of transport especially for long distance travel**, business travel, accessing difficult terrains and for transporting high value and perishable commodities. **In the civil aviation sector, there are three parts – operational, infrastructural and developmental. The first is the operational.**

There are **10 scheduled passenger operators** (three in public sector - Air India Ltd., Air India Charters Ltd. and Air Lines Allied services and seven in private sector) and **three cargo operators** in the country. **Indian Airlines and Air India were amalgamated with National Aviation Company Ltd. (NACIL) With effect from November 2010, the name of National Aviation Company Ltd., has been changed to Air India Ltd.**

Regarding infrastructural facilities, **Airport Authority of India (AAI) is the main organization managing 125 airports across the country.** The Private sector by way of participating in public– private partnership (PPP) has also

been playing an important role in developing airport infrastructure in India.

The **Airport Economic Regulatory Authority (AERA)** was established in the Eleventh Plan to safeguard the interests of users and service providers at Indian airports.

The key development during 2006 -11 have been:

India has become the ninth largest civil aviation market in the world;
Connectivity to North Eastern region has risen.

Other Recent important developments in the airline and airport sector included: (i) liberalization of FDI limit upto 100% through automatic route for setting up Greenfield airports; (ii) A Civil Aviation Economic Advisory Council (CAEAC) was set up to look into the economic issues facing the civil aviation sector. (iii) adoption of trade facilitation measures in custom procedures to facilitate speedy clearance of air cargo. (iv) For seamless navigation of civil aircrafts, a GPS-aided GEO augmented Navigation (GAGAN) project is being implemented. (v) The Domestic Air Transport Policy approved by the government provides for foreign equity participation up to 49 per cent and investment by non-resident Indians (NRIs) up to 100 per cent in the domestic air transport services. With a view to attracting new technology and management expertise, government has permitted up to 49 per cent Foreign Direct Investment (FDI) by foreign airlines in Indian airline companies.

Communication:

Communication means transmission of information. For the development of industries, commerce and trade in the country, communication is very necessary. The important means of communications are the postal services, telephone services, tele printers, radio and television etc. Telephone, tele-fax and e-mail have been gradually evolving and telex and telegraph are getting out of fashion.

Postal services: India's postal system dates back to 1837 and today our postal network is the **largest network in the world**. Postal services suffer from many weaknesses such as inadequate number of post offices, use of outdated techniques, delays in reaching of posted material etc. A number of steps have been taken for resolving these problems. Such as speed post, business post, express parcel post, media post, speed post passport etc. services have been introduced. With a view to improve the speed and volume of transactions, a range of e-enabled services such as **electronic money order (eMO), e-payment and Instant Money Order (IMO) have been started**. To provide better services, mechanization and computerization of postal operations is being progressively introduced. **Automatic mail processing centers (AMPC)** have been set up at various places for faster processing of mails. **E-post services were started in 2001** in some states. Under e-bill post, customers are able to pay multiple utility bills at post office counters. They are now being upgraded for multiple messaging to make them useful for corporate houses. This is a major initiative to provide user-friendly services to its vast customer base. 'Logistics Posts', 'Retail Post Services' are other new services which are now being provided. Post offices are also providing a number of financial products such as saving bank and saving certificate, postal life insurance, non life insurance products, mutual funds etc.

Besides the above, the **Department of Posts launched a pilot project "Project Arrow" with the aim of providing fast and reliable postal services to the consumers.**

Telecommunications: Communications all over the world has progressed rapidly and the most important factor accounting for increased communication has been the development of telecommunications which include (i) the telephone service, and (ii) the telex service.

India's telephone network is the **second largest** in the world (after China) with a tele density (number of phones **per 100 persons**) of 76.75 per cent.

Regulatory framework and functions are carried out by Telecom Regulatory Authority of India (TRAI) and now the National Internet Exchange of India (NIXI) has been set up to ensure that internet traffic originated and

destined for India, is routed within India.

In view of the fact that telecommunication has emerged as a key driver of economic and social development in the global scenario, a National Telecom Policy (NTP) was announced in 2012. NTP -2012 endeavors to create an investor friendly environment for attracting additional investments in the sector apart from generating manifold employment opportunities in various segments of the sector. Availability of affordable and effective communications for the citizens is the main aim of the Policy.

Health:

For good health, two things are essential: (1) balanced and nutritional diet and (2) medical care.

The **general health standard in India is quite low.** This is quite inevitable as nearly 30% of the population lives below the poverty line. These people do not have nutritional diet, adequate medical care and hygienic conditions. As a result, the overall health conditions are poor in India. Prevalence of child under weight and child malnutrition is widespread across states. It is not that nothing has been done on the health front but they are far from satisfactory. The following table shows trends in health care in India since Independence.

Under the various plans, health development programmes have been integrated with family welfare and nutritional programmes for vulnerable sections – children, pregnant women and nursing women. These programmes focussed on increasing health services in rural areas, intensification of the control of communicable diseases like small pox, malaria and leprosy, improvement in education and training of health personnel etc. **Since sixth plan there has been a change in the whole approach towards health services. Under the new approach, the focus is not on providing hospitals but on providing better health and medical care services to the poor people.** A community based programme on health care and medical services in rural areas was launched. Apart from developing rural health services, the control of communicable diseases is now being given the highest priority. Since diseases like, T.B., malaria, gastrointestinal infections are related with unhygienic sanitation, efforts have been intensified in providing hygienic conditions and opening new hospitals and strengthening existing hospitals especially in rural areas. In order to bridge the gap between existing health infrastructure and to provide affordable and equitable health care, a large number of schemes have been started in India. Important among them are:

The National Rural Health Mission was started in 2005 to provide accessible, affordable, and quality health services to rural areas. Seeing its success in the rural areas, the government aims to extend it to towns also by converting it in National Health Mission.

Accredited Social Health Activists (ASHAs) have been selected and trained in health care for various villages.

Janani Suraksha Yojana was started to bring down maternal mortality rate in India.

Pradhan Mantri Swasthya Yojana was launched with the objectives of correcting regional imbalances in the availability of reliable health care services in the country.

Janani Shishu Karyakaram (JSSK) is a new initiative launched in 2011 for mother and child care. Under the programme, free entitlements are given to pregnant women and sick new borns for cashless delivery, drugs and consumables, diet etc.

National Vector borne Disease control Programme is being implemented for prevention and control of vector borne diseases such as malaria, filariasis, kala-azar, dengue, etc.

As a result of these efforts, there has been a fall in the incidence of certain diseases like T.B, leprosy and polio. **But a rise in the incidence of certain diseases like AIDS, blindness, cancer etc. has also been noticed.** These require immediate attention, care and action.

Education:

Education plays an important role in the overall development of a human being and a society. It is the **single most important instrument for social and economic transformation.** Therefore, stress on imparting education has been given in our Constitution which says education should be free for children below 14 years of age. Under the various plans, education facilities have been expanded at all levels in India and as a result, not only the literacy rate has risen but

the percentage of children availing school education has also increased. *India, now, has the one of the largest education systems in the world. Eighty four per cent of rural habitation in India now have a primary school located within a distance of 1 kilometre.* The National Policy on Education (NPE) was made in 1986 and further modified in 1992. It emphasized on: universal access and enrolment; universal retention of children up to 14 years of age and a substantial improvement in the quality of education.

Right of Children to Free and Compulsory Education Act (RTE Act) 2009, has made free education for all children between the age of 6 and 14 years, a fundamental right.

Gross Enrolment Ratio (GER), which shows the proportion of children in the 6-14 years age group actually enrolled in elementary schools, has increased.

The main vehicle for providing elementary education to all children is the ongoing comprehensive programme called Sarva Shiksha Abhiyan (SSA) launched in 2001-02. Programme for Education of Girls at Elementary Level (NPEGEL) is an important component of SSA. This programme concentrates on education of girl child.

Another important component of SSA is the Education Guarantee Scheme and Alternative and Innovative Education (EGS + AIE). This is specially designed to provide access to elementary education to children in school-less habitations and out of school children. Apart from the above, Mid-day meal scheme, Kasturba Gandhi Balika Vidyalaya (KGBV), Parambhik Shiksha Kosh (PSK) are other schemes for encouraging people for elementary education.

In order to enhance access to secondary education and improve its quality, Rashtriya Madhyamik Shiksha Abhiyan (RMSA) was launched in 2009 with the objective of enhancing access to secondary education and improving its quality.

Apart from RMSA, there were other schemes undertaken during Eleventh Plan are setting up of model schools, National Scheme of Incentive to Girls for Secondary Education (NSIGSE) and Inclusive Education for the Disabled at the Secondary Stage (IEDSS).

For adult education, the National Literacy Mission (NLM) was launched in 1998 as a Technology Mission. It aimed at imparting functional literacy to non-literates in the country in the age group of 15-35 in a time-bound manner. Its objective was to attain a sustainable threshold literacy rate of 75 per cent by 2007. The Total Literacy Campaign (TLC) has been the principal strategy of NLM. NLM has accorded priority for the promotion of female literacy. NLM was recast into Saakshar Bharat (SB) in 2009. SB as a flagship scheme of adult education would be continued in Twelfth Plan as well.

Unit 5- Inflation

Inflation refers to a persistent upward movement in the general price level. It results in a decline of the purchasing power.

According to most economists inflation does not occur until price increase averages less than 5% per year for a sustained period. Inflation can broadly be of the following types:

- (i) **Demand-pull inflation** : In a market there is interaction between the flow of money and flow of goods and services. When more money chases relatively less quantity of goods and services the excess of demand relative to supply pushes up the prices of goods and services. Such inflation, as a result of increased money expenditure, is called demand-pull inflation. In other words, when demand for goods and services is more than their supply, their prices rise. Such price rise is called demand pull inflation.
- (ii) **Cost-push inflation**: Cost push inflation refers to a situation where prices persistently rise because of growing factor costs. Cost-push inflation results when factors of production especially wage earners try to increase their share of the total product by raising their prices. A rise in factor prices leads to a rise in the total cost of production and consequently a rise in the price level. This may result in an inflationary spiral. Inflation once set in motion due to phenomenon of cost push in one industry or sector spreads throughout the economy. For example, due to rise in wages in the steel industry, prices of steel may rise and this will raise the prices of vehicles, machines, etc., using steel as input. The rise in prices of vehicles may in turn raise the cost of transport and manufactured goods. The cost of agriculture may also rise due to high

prices of tractors. Ultimately, food and raw material prices will also go up leading to higher cost of living. Higher cost of living will further push wage rates. Cost push inflation is much more difficult to control than demand pull inflation. This is because cost push inflation is not susceptible to direct control. Often the demand pull inflation precedes the cost push inflation. When the former sets in, there is an increasing demand for factors of production; the prices of these also rise, leading to rise in general prices.

(iii) **Stagflation** : The **combined phenomenon of demand-pull and cost-push inflation** is found in many countries, both the developed and the developing. One of these situations is in the form of stagflation under which economic stagnation, in the form of a low rate of growth, combines with the rise in general price level. In the developing countries, this happens when aggregate demand increases at a fast rate due to high public expenditure and expansion of credit money, aggregate cost increases due to higher wages resulting from pressure from labour organisations thus combining cost-push effect with the demand pull inflation.

Such inflationary situations when unchecked by appropriate monetary and fiscal measures, may lead to galloping or hyper-inflation leading to price increase of even 40% to 100% every year.

Stagflation in India has been interpreted to mean that the economy is growing slowly or stagnating (i.e. GNP is either increasing slowly or remaining constant or even declining) and at the same time experiencing a high rate of inflation.

In India during 1991, partly as a result of large budget deficits resulting in rapid expansion in money supply and partly due to supply shocks delivered by Gulf war in 1990-91 and sharp increase in the procurement prices of foodgrains the high rate of inflation emerged in the economy. Along with high inflation rate, rate of industrial and economic growth, was very low. Thus, **during the period 1991-94 high inflation occurred in India while the economy was stagnating. Therefore, it is correct to say that India was experiencing stagflation during the period.**

Deflation: Deflation is a state in which the prices are falling and thus the purchasing power of money is increasing. Deflation is just the opposite of inflation.

Price trend in India

In India, the **variation in prices are measured in terms of Wholesale Price Index (WPI)** . They can also be measured in terms of Consumer Price Index (CPI).

Wholesale Price Index (WPI) : The Wholesale Price Index (WPI) is the **price of a representative basket of wholesale goods**. The WPI focuses on the price of goods in the wholesale market. The Indian WPI is **updated on a monthly basis**. This **basket comprises 676 items** which carry different weights. WPI measures headline inflation i.e. it includes the entire set of commodities. This is different from core inflation in which the commodities which have volatile prices (like food and fuel) are not considered. WPI, however, does not include services and non-tradable commodities. Currently, in India WPI series with base 2004-05 is being used to assess price changes.

Consumer Price Index (CPI) : A consumer price index (CPI) measures **changes in the price level of consumer goods and services purchased by households**. It reflects the cost of living for a homogeneous group of consumers. There are **4 CPI indices in India. These are CPI for industrial workers, CPI for agricultural labour, CPI for rural labour and CPI for urban non-manual employees.**

Since **CPI measures changes in the price level of goods purchased by the ultimate consumers, it shows the real inflationary pressure on consumers and is, thus a more realistic measure** than WPI. However, in India the main focus is on WPI. Moreover, there is no single CPI but four CPIs as stated above.

There has been a significant variation in inflation rate in terms of WPI and the Consumer Price Indices (CPIs). For example, for the year 2009-10, whereas the average WPI was 3.8 per cent, the average CPI for Industrial Workers was 12.4 per cent. This was **mainly due to food inflation, which forms a significant proportion of CPI as compared to WPI and which was very high during 2009-10**. In the financial year 2011-12, the gap between WPI (9.14 per cent) and CPI (8.4 per cent) has significantly narrowed down due to a fall in food inflation.

The Central Statistics Office (CSO) has come out with a new series on CPI with base 2010 = 100. This series intends to reflect the actual movement of prices at the micro-level.

Causes of Inflation in India

A general price rise can take place either as a result of rise in aggregate demand or a failure of aggregate supply or both. Increase in public expenditure, deficit financing, and rapid growth of population can be mentioned as demand factors and erratic agricultural growth, agriculture price policy, inadequate rise in industrial production and upward revision of administered prices etc. can be mentioned as supply factors which have led to inflationary price rise in India.

(i) **Increase in public expenditure:** Public expenditure has risen at great pace. With a rise in national income and also rapid growth of population an increase in public expenditure is unavoidable. But the spectacular rise in the public expenditure is not justifiable. **Approximately 40 per cent of the government expenditure in India is on non-developmental activities.** No doubt, **defence and maintenance of law and order are essential for the stability of the society.** At the same time, it must not be forgotten that due to their unproductive nature, expenditure on these activities results in inflationary price rise. The government expenditure on non-developmental activities, by putting purchasing power into the hand of its employees, creates demand for goods and services, but it does nothing whereby their supply could increase. Under these circumstances the general price level shows an inevitable tendency to rise.

(ii) **Deficit financing:** Deficit financing means financing of budget deficits (shortages) by borrowing from the banks or printing of more currency. The Government of India has frequently resorted to deficit financing in order to meet its developmental expenditure. A small dose of deficit financing is helpful in tiding over the gap between public revenue and public expenditure and making available funds for the growth of the economy but a large dose and that too in a period of relatively slow growth turns out to be inflationary. This happens because by financing the deficit the government puts purchasing power in the hands of people but it does nothing for creating real resources for the economy at least in near future. In India from plan to plan, the recourse to deficit financing has been increasing which has led to inflationary trends in the country.

(iii) **Erratic agricultural growth:** The Indian agriculture largely depends on monsoons and thus crop failures due to drought have been regular feature of agriculture in this country. **In the years of scarcity of foodgrain, not only price of food articles increases but the general price level also rises.**

(iv) **Agricultural price policy of the Government:** The government has been pursuing a policy of price support to the agriculturists. For this, it announces the price at which it would be buying agricultural products. This ensures certain minimum price to the farmers. This policy benefited farmers in India but this has been a major contributory factor to the inflationary price rise in the country.

(v) **Inadequate rise in industrial production :** Performance of the industrial sector, particularly in the period 1965 to 1985, has been rather disappointing. Over the 20 years period, industrial production increased at a modest rate of 4.7% per annum. The performance of essential consumer goods sector which includes industries like oil, food manufacturing, textiles, weaving, apparel and footwear was particularly disappointing.

(vi) **Upward revision of administered prices :** There are a number of important commodities for which price level is administered by the government. Many of these commodities are produced in the public sector. The government keeps on raising prices from time to time in order to cover the losses in the public sector which often arise due to inefficiency and unimaginative planning. This policy results in cost push inflation.

Measures to check inflation:

Since **inflation is a phenomenon where money income is rising faster than the real goods and services**, the measures to check inflation should either be of a check on the increase in money incomes or making available more of real goods and services.

The various measures can be studied under three main heads – monetary and fiscal measures, control over investment and other measures.

(iv) **Monetary measures** : Monetary measures are **applied to check the supply of currency and credit**. These measures consist of quantitative measures (open market operations, statutory reserve requirements and Bank Rate) and qualitative measures (margin requirements, moral suasion etc.). When the Reserve Bank of India wants to control inflation it uses any one or more of the above measures. Thus, it may sell government securities in the open market. By issuing (i.e. by selling) government securities, the government takes away liquidity (i.e. cash etc.) from the people. This lowers the balances with the banks; which in turn will reduce their capacity to create credit or lend money for investment purposes. This will reduce liquidity in the economy and bring the prices under control. Similarly, by raising Bank Rate or statutory reserve rates the RBI controls liquidity and credit and ultimately prices. The extent to which these will be effective will depend on the intensity of the investment demand. The raising of the statutory reserve ratio is very widely used measure in India but the effect of this measure also depends on the banking habits of the people. However in those countries where banking is not fully spread and all money is not quickly banked, the effect will be much smaller. There are several selective measures of credit, such as variable interest rates, variable margin requirement, ceiling on certain types of loans, minimum and maximum rates of interest etc. There is need for selective control of credit when the rise in prices is confined to some commodities only e.g. necessities of life.

Fiscal measures : These are the measures taken by the government with regard to taxation, expenditure and public borrowings. Taxes determine the size of the disposable income in the hands of the public. In the case of inflation, a proper tax policy will be to avoid tax cuts, or to introduce some increase in the existing rates so as to reduce the purchasing power in the hands of the people and thus reduce the pressure of demand on prices. The fiscal tools have been extensively used as tools to control inflation in India. The progressive income tax system, control over public expenditure, introduction of new types of taxes, improving profits of public sector units, etc. are all meant to control inflation in the country.

Control over investment : Controlling investments is also considered necessary because, due to the multiplier effect, the initial investment leads to large increase in income and expenditure and the demand for both the consumer and capital goods goes up speedily. Therefore, it is necessary that the resources of the community should be employed for investment which does not have the effect of increasing inflation.

Other measures : These measures can be divided broadly into short term and long term measures. **Short term measures can be in regard to public distribution of scarce essential commodities through fair price shops.** There may also be control over movement of commodities from one state to another. **In India whenever shortage of basic goods has been felt, the government has resorted to imports so that inflation may not get triggered.** It has also resorted to rationing of essential goods in times of shortages. The **long term measures will require accelerating economic growth** especially of the wage goods which have a direct bearing on the general price and the cost of living. Some restrictions on present consumption may help in improving saving and investment which may be necessary for accelerating the rate of economic growth in the long run.

Unit 6 Budget and fiscal deficits in India

The Government of India, every year prepares budget which shows the expected receipts and expenditures of the government in the coming financial year. Receipts of the government come from taxes (both direct and indirect), profits from various financial institutions, government commercial undertakings, interest from loans given to other governments, local bodies, etc. and expenditure of the government are on developmental projects such as construction of roads, railways, production of energy and non-developmental expenditure on a large number of activities such as defence, subsidies, police, law and order, etc. If receipts are equal to expenditure, the budget is said to be balanced one. If receipts are higher than the expenditure, the budget is said to be surplus one and if receipts are lower than the expenditure, the budget is said to be deficit one.

Budget deficit is thus the difference between total receipts and total expenditure (revenue plus capital). If borrowings and other liabilities are added to the budget deficit, we get fiscal deficit. Fiscal deficit, thus measures that part of

government expenditure which is financed by borrowings.
Consider the following example to understand both the concepts:

Calculation of Budget Deficit and Fiscal Deficit

	1990-91 Rs. (crore)	2009-10 Rs. (crore)
Revenue Receipts	54,950	5,72,811
Capital Receipts of which	39,010	4,51,676
(a) Loan recoveries + other receipts	5,710	33,194
(b) Borrowings & other liabilities	33,300	4,18,482
Total Receipts (1+2)	93,960	10,24,487
Revenue expenditure	73,510	9,11,809
Capital expenditure	31,800	1,12,678
Total expenditure (4+5)	1,05,310	10,24,487
Budgetary Deficit (3-6)	11,350	Nil
Fiscal deficit	44,650	4,18,482
[1 + 2(a) - 6 = 7 + 2(b)]		

Fiscal deficit is

- (a) the difference between total expenditure and total revenue receipts and capital receipts but excluding borrowings and other liabilities. **or**
- (b) it is the sum of budget deficit plus borrowings and other liabilities.

Trends in India's budget and fiscal deficit

Budgetary deficit which shows the difference between total revenue and total expenditure **does not give a true picture of the financial health of the economy. It treats government borrowing** from the market or raising the funds from the public such as national savings schemes, post office saving deposits, provident fund collections etc. **as receipts. Originally, budget deficit was calculated to show RBI lending to the government. In 1997, the practice of RBI lending to government through ad hoc Treasury Bills was given up.** Thus the concept lost its relevance and now it is no longer shown in the budgetary statement. The government now taps 91 days treasury bills from the market and shows it as part of the capital receipts under the heading "borrowings and other liabilities".

Fiscal deficit is a more comprehensive measure of the imbalances. It focuses on/measures the total resource gap and as such fully reflects the impact of the fiscal operations of the indebtedness of government. It is the measure of excess expenditure over the government's own income.

To restore fiscal discipline, the Fiscal Responsibility and Budget Management (FRBM) Bill was introduced in 2000 and FRBM Act was passed in 2003.

Worldwide financial crisis affected Indian economy also. The extraordinary situation that emerged due to crisis had led to a sharp shrinkage in the demand for exports. Domestic demand also shrank leading to a downturn in industry and services sectors. **The situation demanded a fiscal response.**

Unit 7- balance of payment

The Balance of Payments (BOP) is one of the oldest and most important statistical statements for any country. It is a systematic record of all economic transactions between the residents of one country and the residents of the rest of the world in a year. Since we merely record all receipts and payments in international transactions using double entry system, the balance of payments always balance in an accounting sense.

Balance of Trade : Balance of Trade may be defined as the difference between the value of goods sold to foreigners by the residents and firms of the home country and the value of goods purchased by them from foreigners. If value of exports of goods is equal to the value of imports of goods, we say that there is balance of trade equilibrium and if the latter exceeds the former, then we say that there is balance of trade deficit. But if the former exceeds the latter, i.e., if value of exports of goods is more than the value of imports of goods, we say there is surplus balance of trade.

Balance of Current Account : Balance of current account is a broader concept than the balance of trade. It includes balance of services and balance of unilateral transfers (i.e., unrequited transfers) besides including balance of trade. Balance of services records all the services exported and imported by a country in a year. Unlike goods which are visible and tangible, services are invisible and are not tangible. Thus, while all earnings and expenditure by way of exports and imports of goods and services and transfers like remittances, donations etc. form a part of the current account, foreign investments (direct and portfolio), commercial borrowings, external assistance, NRI deposits etc. form a part of the capital account.

Balance of Payment on capital account : Balance of payments on capital account includes balances of private direct investments, private portfolio investments and government loans to foreign governments. Balance of capital account basically deals with debts and claims of the country in question or we say it deals with borrowings or lending of the country in question.

Balance of Payments: Overall balance of payments is the sum of balance of current account and balance of capital account. It includes all international monetary transactions of the reporting country vis-à-vis the rest of the world. The balance of payments must always balance in a book-keeping sense. This is because for any surplus (or deficit) in the overall balance of payments there must be a corresponding debit (or credit) entry in the net changes in external reserves. In other words, if there is a surplus it adds to external reserves of the country and if there is a deficit, it reduces down the external reserves of the country.

Trends in BOP of India

A country, like India, which is on the path of development generally, experiences a deficit in balance of payments situation. This is because such a country requires imported machines, technology and capital equipments in order to successfully launch and carry out the programme of industrialisation. Also, since initially it has only primary goods to offer as exports, it generally has an unfavourable balance of payments position. As pace of development picks up it has to have 'maintenance imports' although it has now more sophisticated goods to offer for exports. But the situation remains the same i.e., deficit balance of payments.

The Sixth Plan characterised the balance of payments position as 'acute'. The balance of payments continued to be under strain during the Seventh Plan. In early 1990-91, the already poor BOP position worsened because of Gulf war and further deterioration in invisible remittances. An immediate response to the BOP crisis was introduction of several restrictions on import in 1990-91. In 1992-93, many important changes such as a new system of exchange rate management, liberalization of import licensing and tariff reductions were introduced.

India saw a remarkable turnaround from a foreign exchange constrained control regime to a more open, market driven and liberalized economy. The trade liberalization and a shift to a market-determined exchange rate regime have had a significant positive impact on the country's balance of payments.

There has been a significant improvement in the structure of India's balance of payments since the economic crisis of 1991.

Since 2003-04 trade deficit has widened sharply, particularly in 2004-06, because of higher outgo on import of petroleum, oil and lubricants. As a result, current account surpluses have once again turned into deficits inspite of the fact that invisibles flows have continued to swell.

The high growth rate of imports was mainly due to increase in the growth of Petroleum, Oil and Lubricants (POL), gold and silver imports.

In 2011-12, the net FDI recovered and reached the level of US \$22 billion. India's foreign exchange reserves comprise foreign exchange assets (FCA), gold, special drawing rights (SDRs) and reserve tranche position (RTP) in the International Monetary Fund (IMF). When there is volatility in exchange rate, the Reserve Bank of India (RBI) intervenes to smoothen it. This results in increase or decrease in the level of foreign exchange reserves depending upon the type of intervention. Exchange Market Intervention' by RBI means the sale or purchase of currencies by the RBI with the aim of changing the exchange rate of rupee vis-a- vis on or more currencies. If there is too much demand for foreign currency (say dollar), it will appreciate too much and Indian rupee will depreciate. At this point, the RBI intervenes by releasing the dollars (from its reserves) in the market to stabilize the exchange rate. Similarly, if there is too less demand for foreign currency (say dollar), it will depreciate and the rupee will appreciate too much. At this point, the central bank will intervene by purchasing dollars from the market to stabilize exchange rate.

Special Drawing Rights: The **Special Drawing Rights (SDRs)** were created in 1969 by the IMF, to supplement a shortfall of preferred foreign exchange reserve assets, namely gold and the US dollar. **SDR is neither a currency, nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies** of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs in two ways: first, through the arrangement of voluntary exchanges between members; and second, by the IMF designating members with strong external positions to purchase SDRs from members with weak external positions. In addition to its role as a supplementary reserve asset, the SDR serves as the unit of account of the IMF and some other international organizations. The SDR today is redefined as a basket of currencies, consisting of the euro, Japanese yen, pound sterling, and U.S. dollar. The basket composition is reviewed every five years. Special drawing rights are allocated to member countries by the IMF. A country's IMF quota, the maximum amount of financial resources that it is obligated to contribute to the fund, determines its allotment of SDRs.

The primary means of financing the International Monetary Fund is through members' quotas. Each member of the IMF is assigned a quota, part of which is payable in SDRs or specified usable currencies and part in the member's own currency. **The difference between a member's quota and the IMF's holdings of its currency is a country's Reserve Tranche Position (RTP).** RTP is accounted among a country's foreign-exchange reserves.

Unit 8 extrenal debt

Since no country is self-sufficient, it has to rely on other countries and international organizations for financial assistance. This is especially true for a developing country which is on the path of development. It needs funds for its various developmental projects. India is no exception. Ever since Independence it has relied on other countries for external assistance. **External assistance to India has been in two forms – grants and loans.** While grants do not involve any repayment obligation, loans carry an obligation to pay interest and repay the principal. About 90 per cent of the external assistance received by India has been in the form of loans. These loans have been from different sources like World Bank, **International Monetary Fund (IMF)**, International Development Association, U.S.A., U.K., Japan, etc.

India's external debt amounted to Rs. 17,50,000 crore at end March, 2012.

As per the world Bank, India was the fourth most indebted country in 2011.

It needs to be also recognized that the **debt service ratio (ratio of principal and interest to total exports)** for India remains high by international standards. **Besides, India's exports of goods as a percentage of GDP (2011-12) works out to be around 16.5 per cent.** This ratio which represents the potential capacity of the nation to service external debt, being relatively low, makes India vulnerable to external shocks. This, therefore, underscores the need for sustaining the growth in exports and invisibles.

Chapter 7- Unit 1- Economic Reforms in India

After Independence, India **followed the policy of planned growth** and for this it pursued conservative policies. The **public sector was given dominant position** and was made the main instrument of growth.

The fiscal policy was framed in a way that it mobilized resources from the private sector to finance development programme and public investment in infrastructure.

Similarly, **monetary policy sought to regulate financial flows** in accordance with the needs of the industrial sector and to keep the inflation under control.

Foreign trade policy was formulated to protect domestic industry and keep trade balance in manageable limits.

Economic reforms were set in motion though on a modest scale in 1985. However, measures undertaken were ad-hoc, half-hearted and non serious. As a result, **sign of crisis began to manifest themselves in 1991. These were:**

Low foreign exchange reserves: The available foreign exchange reserves were just sufficient to finance imports of three weeks.

Burden of National Debt: National Debt constituted 60 percent of the GNP in 1991.

Inflation: Gulf war, hike in the administrative prices of many essential items and excess liquidity in the economy led to very high rate of inflation in the country.

The government responded to the crisis by introducing economic reforms in the country. Reforms were introduced in all major sectors of the economy namely: Industrial sector Financial sector External sector Taxation

Industrial Sector:

In the industrial sector, following reforms were undertaken:

1. **Industrial licensing was abolished for all projects except for 18 industries** related to strategic and security concerns, social reasons, hazardous chemicals and over-riding environmental reasons and items of elitist consumption. **At present there are only 6 industries which relate to health, strategic and security considerations remain under the purview of industrial licensing.**

These are:

Distillation and brewing of alcoholic drinks.

Cigars and Cigarettes of tobacco and manufactured tobacco substitutes.

Electronic Aerospace and Defence equipment: all types.

Industrial explosives including detonating fuses, safely fuses, gun powder, nitrocellulose and matches.

Hazardous chemicals.

Drugs and Pharmaceuticals.

2. **Only 8 industries groups** where security and strategic concerns pre-dominate would be **reserved exclusively for the public sector. At present, there are only 3 industries which are reserved for the public sector.** They are (i) atomic energy, (ii) the substances specified in the schedule to the notification of the Government of India in the Department of Atomic Energy, and (iii) rail transport.

3. **In 2001, defense production was dereserved and opened up to private participation through licensing. Foreign investment up to 26% is being allowed.**

Recently (July 2013), the government allowed increase in FDI in defense beyond 26 percent, but this will be on a case-to-case basis, and after clearance from the Cabinet Committee on Security headed by prime minister.

4. In projects where **imported capital goods** are required **automatic clearance** would be given where foreign exchange availability is ensured through foreign equity and if the **value of imported capital goods required is less than 25% of the total value of plant and machinery up to maximum of Rs. 2 crore.**

5. In locations other than cities of more than 1 million population, there would be **no requirement of obtaining industrial approvals from the Central Government** except for industries subject to compulsory licensing.

MRTP Act

In the pre-reform period, under **Monopolistic and Restrictive Trade Practice (MRTP) Act, 1969**, companies with **more than defined investment in assets** were **required to take prior approval of central government** for establishment of new undertakings, expansion of existing undertakings, merger, amalgamation and take over and appointment of directors (under certain circumstances). **Under the new Industrial Policy of 1991, this requirement was abolished.**

In 2002, the Competition Act, 2002 was enacted to replace MRTP Act.

Under this Competition Commission of India was established to prevent activities that have an adverse impact on competition in India.

Financial Sectors:

Financial sector reforms mainly relate to three categories as (a) banking sector reforms (b) capital reforms (c) Insurance sector reforms. Here, we will discuss banking sector reforms only.

Banking Sector Reforms

In the pre-reform period the banking system functioned in a highly regulated environment characterised by:

- ✓ Administered interest rate structure.
- ✓ Quantitative restrictions on credit flows.
- ✓ High reserves requirements under Cash Reserve Ratio (CRR).

These restrictions resulted in inefficiency of the banks which in turn led to low or negative profits. As a result, measures were taken to reform banks. The important ones are:

1. **CRR was gradually lowered from its peak at 15 per cent during pre-reforms year.** Since then it has been increased or decreased depending upon the requirements of the country. At present (July 2013) it is 4 per cent. **SLR was reduced from its peak of 38.5% during 1990-1992 .** At present it is 23 per cent.

2. **Prime lending rates of banks for commercial credit** are now entirely within the purview of the banks and **not set by the RBI. The rate of saving accounts and rates of interest on export credit are still subject to regulations.** Bank Rate at present is 10.25 per cent.

3. **The RBI issued comprehensive guidelines for new bank licenses in 2013. The new guidelines allow corporates and public sector entities with sound credentials and a minimum track record of 10 years to enter the banking business.** However, RBI's permission would be required for setting up the bank.

4. Derivative products such as **Forward Rate Agreement (FRAs)** and interest rate swaps were introduced.

5. **The Basel II framework, which lays down norms to be followed by banks to ensure financial stability has been operationalised by banks since March, 2008.**

6. **Basel III is supposed to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage. It has been introduced in 2013 and banks are required to implement it by 2019.**

7. **The financial crisis that surfaced around August 2007** affected economies world wide. India could not insulate itself from the adverse developments in the international financial markets. There was extreme volatility in stock

markets, exchange rates and inflation levels during a short duration necessitating reversal of policy to deal with emergent situations.

External Sector:

The **foreign trade policy in India was made very restrictive** after initiation of the programme of industrialisation in the Second Plan. **Only import of capital equipment, machinery, components, spare parts, industrial raw material was allowed.**

Import of all inessential items was strictly controlled.

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 eighties however, special arrangements were made to liberalise imports in a big way. This was done in order to promote exports and increase competitive skills of the exports. Many fiscal and monetary concessions were granted to exporters. Many schemes such as duty draw back scheme, cash compensatory scheme, **100 per cent Export Oriented Units (EOUs) and Export Processing Zones (EPZs)** were started to promote exports.

A number of organizations such as The Export Promotion Council, Commodity Boards, The Federation of Indian Export Organisations, The Trade Fair Authority, The Indian Institute of Foreign Trade etc. were geared up to promote exports.

However, India continued to face deteriorating balance of payments situation in late 80's and early 90's. In order to rectify the situation, devaluation was carried out. It was followed by announcement of new foreign trade policy and foreign trade reforms.

Following are the major measures which have been undertaken to reform the external sector of the country:

Exchange Rate Stabilisation: The rupee was overvalued for most of the period prior to 1991 thus adversely affecting exports. **The rupee was devalued twice in July, 1991** amounting to a **cumulative devaluation of about 19 per cent.** **Devaluation means lowering the external value of the country's currency undertaken by the Government.** This is different from depreciation of currency. Currency depreciation is the loss of value of a country's currency with respect to one or more foreign reference currencies due to market forces. This happens typically in a floating exchange rate system.

Foreign Investment: Foreign investment may take the form of direct investment or portfolio investment. Broadly speaking, FDI refers to **investment made** by the residents of one country in an enterprise of another country with the aim of gaining an effective voice in the management of the enterprise. It may take many forms, such as a direct takeover of a local firm by a foreign firm, mergers and acquisitions, construction of a new facility, entering into a joint venture or strategic alliance or acquiring shares in an associated firm. It usually involves transfer of technology and expertise.

When **residents of a country acquire securities** in a foreign country's stock and bond market **it is called Foreign Portfolio Investment (FPI).** **FPI is usually a short term investment (sometimes less than a year), as opposed to the FDI which is usually a long term investment.**

The most important characteristic of FDI, which distinguishes it from foreign portfolio investment, is that it is undertaken with the intention of exercising control over an enterprise. For example, if an American buys shares worth US \$1000 of an Indian company in Bombay Stock Exchange, it is FPI. But if an American company (example, Coca Cola) establishes a plant in India, it is FDI.

Foreign Portfolio investments may be made directly or through Foreign Institutional Investors (FIIs). FIIs are entities established or incorporated outside India which invest in India. These investments by the FIIs are made on behalf of sub accounts, which may include foreign corporates, individuals, funds like hedge fund, pension fund, mutual fund, banks, insurance companies, etc. For example, if a corporation or mutual fund from the United States or Europe puts money into the Indian markets for the purpose of making a profit, it is FII.

The nodal agency for registration of FIIs is the Securities and Exchange Board of India (SEBI).

Till now, In India, there was no clear cut distinguishing factor between FDI and FII. In order to remove the ambiguity, **Union Budget 2013-14, proposed to follow the international practice and lay down a broad principle that, where an investor has a stake of 10 percent or less in a company, it will be treated as FII and, where an investor has a stake of more than 10 percent, it will be treated as FDI.**

At present, in India, FDI is allowed fully or partially in most of the sectors.

For example, 100 per cent FDI is now allowed in drugs and pharmaceuticals, hotels and tourism etc.

Apart from this, 100(49+51) per cent FDI is now allowed in asset reconstruction companies, single brand retail trading, and basic and cellular services. But in these, while up to 49 % FDI is allowed through automatic route, FDI above this is allowed through government approval route i.e. after getting permission from **Foreign Investment Promotion Board (FIPB).**

Similarly, **74 per cent FDI is allowed in private sector banking** (up to 49 per cent through automatic route, above that after getting FIPB permission), telecom sector in certain services, service providers like **Direct to Home (DTH)** in broadcasting sector (increased from 49 per cent) and credit Information companies.

Import Licensing: India's foreign trade policy was quite complex before economic reforms. There were various categories of import licenses and ways of importing. The process of liberalisation was given a push with the **announcement of EXIM Policy in 1992. The policy allowed free trade of all items except a negative list of imports and exports.** The number of import licenses has also been reduced.

Quantitative Restrictions: Quantitative Restrictions (QRs) were removed on 714 items in EXIM Policy of 2000-01 and on remaining 715 items in EXIM Policy of 2001-02. **Thus except defence goods, environmentally hazardous goods and some other sensitive goods, gates of domestic markets have been opened to all kinds of imported consumer goods.**

Tariff: Prior to 1991, Indian import tariff structure was among the highest in the world. India has lowered its average tariff rate from 125 per cent in 1990-91 to 10 per cent.

Export Subsidies: Direct subsidies are not provided to exporters in India. These are generally provided indirectly through duty and tax concessions, export finance, export insurance and guarantee and export promotion marketing assistance.

Export subsidies were thought to be important to boost exports. However, they involved considerable transaction costs, delays and corruption. Since 1991, the emphasis of the export incentive system has considerably changed and modified. **The Cash Compensatory Scheme was abolished in July 1991. A special scheme known as Export Promotion Capital Goods (EPCG) scheme introduced in 1990 to encourage imports of capital goods.**

Special Economic Zones (SEZs): Export Processing zone model for promoting exports was not much a successful instrument for export promotion. Therefore, a new policy called **Special Economic Zones (SEZs) Policy was announced in 2000.** SEZ Act, supported by SEZ Rules, **came into effect in 2006.** The main objectives of the Act are generation of additional economic activity, promotion of exports of goods and services, promotion of investment, creation of employment opportunities and development of infrastructure facilities.

From FERA to FEMA: Due to acute shortage of foreign exchange in the country, the Government of India had **enacted the Foreign Exchange Regulation Act (FERA) in 1973.** FERA remained a nightmare for 27 years for the Indian corporate world. It, instead of facilitating external trade, discouraged it. As a result, Foreign Exchange Management Act (FEMA) was made. FEMA sets out its objective as "facilitating external trade and payment" and "promoting the orderly development and maintenance of foreign exchange market in India."

Other measures: Special schemes were started to promote their growth. For example, **'Vishesh Krishi Upaj Yojana' was started to promote agricultural exports.** Similarly, to accelerate growth in exports of services so as to create a unique 'Served from India' brand, the earlier **Duty Free Export Credit (DFEC)** scheme was revamped and recast into

the 'Served from India' scheme.

The Foreign Trade policy of 2009-14 aims at reviving exports and to double India's share in global trade by 2020. Many new schemes have been started under the Policy. These include, Focus Market Scheme, Focus Product Scheme, Market Linked Focus Product Scheme and EPCG Scheme at Zero Duty etc. Many relaxations and benefits to exporters have been given under the existing schemes.

Tax Reforms:

Fiscal Policy means policy relating to public revenue and public expenditure and allied matters thereof.

The unsustainable levels of government expenditures, insufficient revenues combined with poor returns on government investments led to fiscal excesses in 1980s. Fiscal reforms were therefore undertaken to deal with the crisis. **They aimed at reducing expenditure, increasing revenues and earning positive economic returns on the investments.** Following measures have been undertaken to bring fiscal discipline in the economy.

Tax Reforms

In **August 1991, the Government of India constituted a Tax Reforms Committee (TRC)** to recommend a comprehensive reform of both direct and indirect tax laws.

Income Tax Reforms: Following measures were taken to increase collection of income tax.

Historically, rates of income tax in India have been quite high, almost punitive. For example, the **maximum marginal rate of individual income tax was as high as 97.7%. This proved to be counter productive.** Consequent upon the recommendations of the TRC, the income tax slabs were reduced and the rates were scaled down.

The **tax rate for domestic companies has been reduced from 40 per cent to 30 per cent now.** The **tax rate on foreign companies is 40% on incomes other than royalties.**

Dematerialisation of TDS certificates was made effective from 1.4.2008.

Indirect Tax Reforms: Following are the main measures with regard to indirect taxes:

Reducing the peak rate of customs duties.

Rationalising excise duties with a movement towards a median **CENVAT (Central Value Added Tax).**

Introduction of **state-level VAT (Value-Added Tax)** for achieving a non-cascading, self-enforcing and harmonised commodity taxation regime.

The **Fiscal Responsibility and Budget Management Act (FRBMA), 2003** is in place and emphasizes on revenue-led fiscal consolidation, better expenditure outcomes and rationalisation of tax regime to remove distortions and improve competitiveness of domestic goods and services in a globalised economic environment.

Plan to introduce **Goods and Service Tax (GST)** in the coming years.

In order to further reform the taxation system in India, a **Direct Tax Code (DTC)** is being introduced. The DTC will consolidate and amend laws relating to direct taxes i.e. income tax, dividend distribution tax and wealth tax. The aim is to establish an economically efficient, effective and equitable direct tax system which will facilitate voluntary compliance and help increase the tax to GDP ratio.

Impact of economic reforms on Indian economy

There are certain hurdles which are to be cleared first for development of Indian economy. These are:

1. Failure to achieve fiscal discipline to the targetted level: Fiscal deficits are still very high and we need to reduce them. This requires

(i) Improving tax administration to raise larger revenues.

(ii) Reducing subsidies.

2. **Failure to implement fully industrial deregulation:** Dismantling of industrial licensing and opening of industry to foreign investment was an important part of first generation reforms.

3. **Not fully opening the economy to trade:**

4. **Ad hoc and unplanned disinvestment:** The programme of privatisation and disinvestment has been carried out in an unplanned manner.

5. **Financing of infrastructure:** Achieving rapid growth of the economy requires a very high quality of infrastructure. Unfortunately, our infrastructure consisting of roads, power, ports, telecommunications, etc. is inadequate.

Chapter 7-Unit 2- Liberalization, Privatization & Disinvestment

Meaning:

Due to the inability of the Indian public sector enterprises in generating adequate resources for sustaining the growth process and due to other weaknesses, there had been an increasing demand for their liberalisation, privatisation and disinvestment.

Liberalisation: In general, liberalisation refers to **relaxation of previous government restrictions** usually in areas of social and economic policies. Thus, when government liberalises trade it means it has removed the tariff, subsidies and other restrictions on the flow of goods and services between countries.

Privatisation: Privatisation, in general, refers to the **transfer of assets or service functions from public to private ownership or control** and the opening of hitherto closed areas to private sector entry. **Privatisation can be achieved in many ways-franchising, leasing, contracting and divesture.** Of the many forms privatisation could take, **divesture through equity sale is the most significant, since ownership is transferred to public/corporate entities.**

Liberalisation and de-regulation of the economy is an essential pre-requisite if privatisation is to take off and help realise higher productivity and profits.

Arguments in favour of privatisation: Privatisation is favoured on the following grounds:

- (i) **Privatisation helps reducing the burden on exchequer** which results from the public subsidising of chronically loss making public sector units.
- (ii) It helps the **profit making public sector units to modernise** and diversify their business.
- (iii) It helps in making **public sector units more competitive.**
- (iv) Privatisation may **help in reviving sick units** which have become a liability on the public sector.

Arguments against Privatisation: Privatisation is opposed on the following grounds:

- (i) Privatisation will **encourage growth of monopoly power** in the hands of big business houses. It will result in greater disparities in income and wealth.
- (ii) Private enterprises may not show any interest in buying shares of loss-making and sick enterprises.
- (iii) Privatisation may result in lop-sided development of industries in the country. Private entrepreneurs will not be interested in long-gestation projects, infrastructure investments and risky projects. It may retard growth of capital good industries and other industries where the profit margin is less.
- (iv) The limited resources of the private individuals cannot meet some of the vital tasks which alter the very character of the economy. Private individuals prefer to invest money in trade, real estate and other services areas which allow small investments and where capital obtains quick returns. But for changing the very structure of the economy, the investment should go to strategic sectors of economy.
- (v) The private sector may not uphold the principles of social justice and public welfare. They may look for maximising their short run profits ignoring the needs of the economy.
- (vi) Given its commitments to W.T.O., the government of India cannot avoid foreign competition nor can it favour particular firms in the private sector. Under such circumstances, some of our public sector giants are best bets for becoming globally competitive firms.
- (vii) It is contended that liberalisation and deregulation are very important if any firm is to deliver higher profits. Since

public sector enterprises exist in a regulatory framework, they are not able to deliver higher productivity and profits. Had they been given unbridled freedom to decide prices, product-mix etc. they would have behaved like private sector and showed higher efficiency and higher returns. It is not the ownership which is important but the competitive environment. Thus, the belief that privatisation *per se* leads to better results itself is questionable.

Privatisation offers both opportunities and threats to the economy. We have to privatise in such a manner that we make the maximum of opportunities while at the same time minimising the threats to the economy.

Disinvestment: Disinvestment means disposal of public sector's unit's equity in the market or in other words selling of a public investment to a private entrepreneur.

Privatization & Disinvestment in India:

Privatisation in India generally is in the form of disinvestment of equity. There are mainly three different approaches to disinvestments :

Minority Disinvestment : A minority disinvestment is one in which at the end of it, the government **retains** a majority stake in the company, typically **greater than 51%**, thus **ensuring management control**. The present government has made a policy statement that all disinvestments would only be minority disinvestments via Public Offers. i.e. the Government would retain at least 51% and management control of the Public Sector Undertakings. Minority sale could be through auction or through an offer for sale. Examples of minority sales in India are National Thermal Power Corporation (NTPC) Ltd., National Hydroelectric Power (NHPC) Ltd. etc.

In 2005, a 'National Investment Fund' (NIF) was constituted into which the realization from sale of minority shareholding of the Government in profitable CPSEs would be channelised. The income from the Fund would be used for :

- (a) Investment in social sector projects which promote education, health care and employment;
- b) Capital investment in selected profitable and revivable Public Sector Enterprises to improve the overall capital base of Public Sector in India.

Majority Disinvestment: A majority disinvestment is one in which the government, post disinvestment, retains a minority stake in the company i.e. it sells off a majority stake. Historically, majority disinvestments have been typically made to strategic partners. These partners could be other Central Public Sector Enterprises (CPSEs) themselves, a few examples being Madras Refineries Limited (MRL) and Bongaigaon Refinery and Petrochemicals (BRPL) to Indian Oil Corporation (IOC), and Kochi Refinery Limited (KRL) to Bharat Petroleum Corporation (BPCL). Alternatively, these can be private entities, like the sale of Modern Foods to Hindustan Lever, Bharat Aluminium Company (BALCO) to Sterlite, Computer Maintenance Corporation (CMC) to Tata Consultancy Services (TCS) etc.

Complete Privatisation : Complete privatisation is a form of majority disinvestment wherein 100% control of the company is passed on to a buyer. **Examples of this include 18 hotel properties of India Tourism Development Corporation (ITDC) and 3 hotel properties of Hotel Corporation of India Limited (HCI).**

Progress of Disinvestment:

The **disinvestment programme was started in 1991-92** but the disinvestment carried out so far has been half-hearted. By the year end 2011-12, the Government could auction off very small portion of its investment in the public sector.

The procedures adopted for disinvestment have suffered from ad hocism in the absence of a long-term policy of disinvestment. It narrowly focused only on disinvestment of shareholdings without taking into consideration other important issues such as the initial price offers, involvement of strategic partners, setting up of a trust, employees stock ownership and participation, handing over the enterprises to workers' unions/cooperatives and management buy-outs etc.

The process of disinvestment has been referred privatisation of the profits of the profit-making enterprises and the nationalisation of losses of the loss-making enterprises.

Many reasons may be ascribed for this failure, but the most important is the non-acceptability of the shares of PSUs in the capital market.

Unit 3- globalization

Globalisation means integrating the domestic economy with the world economy. It is a process which draws countries out of their insulation and makes them join rest of the world in its march towards a new world economic order. It involves increasing interaction among national economic systems, more integrated financial markets, economies of trade, higher factor mobility, free flow of technology and spread of knowledge throughout the world.

In the Indian context, it implies **opening up of the economy to foreign direct investment** by providing requisites facilities, removing administrative and other constraints, allowing Indian companies to enter into joint ventures and foreign collaborations, bringing down quantitative and non-quantitative restrictions to trade, diluting the role of public sector and encouraging privatisation and so on. **Globalisation got the real thrust from the new economic policy of 1991 and it was further pushed forward by the coming up of the World Trade Organisation (WTO).** Globalisation would eventually mean being able to manufacture in the most cost effective way anywhere in the world. It aims at integrating the world into one global village. As a result of globalisation efforts taken by India we find all types of goods available here. For example, Lee Cooper Shoes, Reebok-T shirts, Rayban sunglasses, Coca-Cola and Pepsi, Armani's shirt, INTEL's Pentium etc. have flooded the Indian market.

Cases in favour globalization

- (iv) It is argued that globalisation of under developed countries **will improve the allocative efficiency of resources, reduce the capital output ratio and increase labour productivity**, help to develop the export spheres and export culture, increase the inflow of capital and updated technology into the country, increase the degree of competition, and give a boost to the average growth rate of the economy.
- (v) It will help to restructure the production and trade pattern in a capital-scarce, labour-abundant economy in favour of labour-intensive goods and techniques.
- (vi) Foreign capital will be attracted and with its entry, updated technology will also enter the country.
- (vii) With the entry of foreign competition and the *removal of import tariff barriers*, domestic industry will be subject to price reducing and quality improving effects in the domestic economy. It is believed that the main effect of integration will be felt in the industrial and related sectors. At result cheaper and high quality consumer goods will be manufactured at home. Besides, employment opportunities would also go up.
- (v) It is also believed that the efficiency of banking and financial sectors will improve, as there will be competition from foreign capital and foreign banks.

Cases against

- (vii) The globalisation process is in essence a tremendous **redistribution of economic power** at the world level which **will increasingly translate into a redistribution of political power.**
- (viii) One study reveals that in the globalising world the **economies of the world are ironically moving away from one another** more than coming together.
- (ix) It is becoming hard for the countries to ask their public to go through the pains and uncertainties of structural adjustment for the sake of benefits yet to come.
- (x) Globalisation is **helping more the developed economies than the developing economies.** Like in India, it is argued that it is true that letting in Cokes and Pepsis have led to opening doors for INTEL, AMD and CISCO, but the sum total of their investment has been very less in relation to their investment abroad.

Measures:

To pursue the objective of globalisation, the following measures have been taken:

Convertibility of Rupee: The most important measure for integrating the economy of any country is to make its currency fully convertible i.e., allow it to determine its own exchange rate in the international market without any official intervention. **As a first step towards full convertibility of rupee, rupee was devalued against major currencies in 1991. This was followed by introduction of dual exchange rate system in 1992-93 and full convertibility of the rupee on trade account in 1993-94.**

India achieved full convertibility on current account in August, 1994. Current account convertibility means freedom to buy or sell foreign exchange for the following transactions (i) all payments due in connection with foreign trade, other current account business, including services and normal short term banking and credit facilities, (ii) payment due as interest on loans and as net income from other investments (iii) payments of moderate amount of amortisation of loans or for depreciation of direct investment and (iv) moderate remittances for family living expenses. The next step for India is to go for full convertibility on the capital account also. Under **Capital Account Convertibility (CAC)**, any Indian or Indian company is entitled to move freely from the Rupee to another currency, to convert Indian financial assets into foreign financial assets and back, at an **exchange rate fixed by the foreign exchange market and not by RBI.**

A committee (Tarapore Committee) was set up which recommended full CAC by the year 2000. ***Committee on fuller capital Account convertibility (Tarapore Committee II) chalked out a road map for capital account convertibility. Strong macro economic framework, strong financial systems and prudent regulatory framework are the preconditions for capital convertibility. A Five year time framework (2007-2011) was given for full convertibility on capital account. Since these conditions are still not met, move towards CAC has been slow in India.***

Import liberalisation: As per the recommendation of the World Bank, free trade of all items except negative list of imports and exports has been allowed. In addition, import duties on a wide range of capital commodities have been drastically cut down. The peak rate of custom duty (on non-agricultural goods) has been brought down **from 150 per cent** in early 90's to just **10 per cent in recent years. Tariffs on imports of raw materials and manufactured intermediates have also been reduced. In addition to the phased reduction of import duties, India, being member of World Trade Organization (WTO) has since April 2001, totally removed the quantitative restrictions on foreign trade.**

Opening the economy to foreign capital: The government has taken a number of measures to encourage foreign capital in India. Many facilities and incentives have been offered to the foreign investors and Non-Resident Indians in the new economic policy. The Foreign Direct Investment floodgates have been opened.

Exports now finance more than 80 per cent of imports of goods and services.

At the time of crisis, our external debt was rising at the rate of \$8 billion a year. At March 2012 end, external debt amounted to Rs. 17,50,000 crore.

Contrary to what many feared, the exchange rate for the rupee has not been as volatile as was feared despite the introduction of full convertibility of rupee.

It is also pointed out that globalisation policy is not a free lunch. Globalised economies or outwardly oriented economies tend to perform well during a period of dynamism and high growth in the world economy whereas they are prone to severe dislocation and collapse during a downturn in international economic activity. On the contrary, internal oriented economies are likely to be less damaged by the slow down in world trade.

Organizations facilitating globalization:

There are many international organisations which have facilitated the process of Globalisation. We shall study three main organisations here. These are International Monetary Fund (IMF), the World Bank and the World Trade Organisation (WTO).

The International Monetary Fund

The **International Monetary Fund (IMF)** was organised in 1946 and **commenced its operation in March, 1947.** It was

set up with the following main objectives:

- (i) the elimination or reduction of existing exchange controls;
- (ii) the establishment and maintenance of currency convertibility with stable exchange rate;
- (iii) the widest extension of multilateral trade and payments.
- (iv) the solving of short-term balance of payments problems faced by its member nations.

The Fund is an autonomous organisation affiliated to the UNO. The Fund now has a membership of 188 countries. It is financed by the participating countries, with each country's contribution fixed in terms of quotas according to the relative importance of its prevailing national income and international trade. The quotas of all the countries taken together constitute the total financial resources of the Fund. Moreover, the contributed quota of a country determines its borrowing rights and voting strength.

Functions of the IMF: The following are major functions of the IMF:

- (i) It functions as a short-term credit institution.
- (ii) It provides machinery for the orderly adjustment of exchange rates.
- (iii) It is a reservoir of the currencies of all the member nations who can borrow the currency of other nations.
- (iv) It is a sort of lending institution in foreign exchange. However, it grants loans for financing current transactions only and not capital transactions.
- (v) It also provides machinery for altering sometimes the par value of currency of a member country.
- (vi) It also provides machinery for international consultations.
- (vii) *It monitors economic and financial developments of its members and provides policy advice aimed at crisis preventions.*

The World Bank

The **International Bank for Reconstruction and Development (IBRD)** more popularly known as the **World Bank** was formed as a part of the deliberations at Bretton Woods in 1945. The World Bank was floated in order to give loan to members' countries, initially for the reconstruction of their (world) war-ravaged economies, and later for the development of the economies of the poorer member countries. The World Bank provides its member countries (188 in numbers) long term investment loan on reasonable terms. By far the bulk of the World Bank loans have been for financing specific projects. In recent years, it has also been engaged in giving structural adjustment loans to the heavily indebted countries. The World Bank is an inter-governmental institution, corporate in form, whose capital stock is entirely owned by its member governments. The World Bank Group consists of, apart from the World Bank itself, the International Development Association (IDA), the International Finance Corporation (IFC), and the Multi-lateral Investment Guarantee Agency (MIGA) and the International Centre for Settlement of Investment Disputes (ICSID).

The International Development Association (IDA) is the part of the World Bank that helps the world's poorest countries. Established in 1960, IDA aims to reduce poverty by providing interest-free credits and grants for programs that boost economic growth, reduce inequalities and improve people's living conditions. IDA is also called soft lending arm of the World Bank since it gives interest free loans to the poor countries.

IDA complements the World Bank's other lending arm—the International Bank for Reconstruction and Development (IBRD)—which serves middle-income countries with capital investment and advisory services.

IFC provides investments and advisory services to build the private sector in developing countries.

Created in 1988, MIGA helps encourage foreign investment in developing countries by providing guarantees to foreign investors against loss caused by non commercial risks.

ICSID was founded in 1966. It is an autonomous body which facilitates the settlement of disputes between foreign investors and their host countries.

Objectives of the World Bank

The World Bank **works in 188 countries** with the primary focus of helping the poorest people and the poorest countries. It emphasises the need for -

Investing in the people, particularly through basic health and education. Focusing on social development.

Protecting the environment.

Supporting and encouraging private business development.

Promoting reforms to create a stable macro-economic environment, conducive to investment and long-term planning.

Functions of the World Bank: The main functions of the World Bank are:

- (i) To help its member countries in the reconstruction and developmental of their territories by facilitating the investment of capital for productive purposes.
- (ii) To encourage private foreign investment and credit by providing guarantee of repayment of the private investors. If private capital is not forthcoming at reasonable terms, to make loans for productive purposes out of its own resources or funds borrowed by it.
- (iii) To promote the long-term balanced growth of international trade and the maintenance of equilibrium in balance of payments of its member countries.

The World Trade Organisation

As told before, it was the World Trade Organisation which gave a real push to the process of globalisation. The World Trade Organisation (WTO) came into existence on 1st January, 1995. The WTO is a powerful body which broadly aims at making the whole world a big village where there is free flow of goods and services and where there are no barriers to trade. It is the only global international organisation which deals with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments.

Features of WTO

The WTO is the main organ of implementing the Multilateral Trade Agreements.

The WTO is global in its membership. Its present membership is 159 countries and with many other considering accession.

It is the forum for negotiations among its member. In this forum, the member-nations discuss issues related to the Multilateral Trade Agreements (MTAs) and associated legal instruments. It is also the forum for negotiations on terms of the Plurilateral Trade Agreements (PTAs). In fact, it is the third economic pillar of world-wide dimensions along with the IMF and the World Bank.

It has a far wider scope than its predecessor GATT, bringing into the multilateral trade system, for the first time, trade in service, intellectual property protection and investment.

It is a full-fledged international organisation in its own right.

It administers a unified package of agreements to which all members are committed.

The decision-making under the WTO is carried out by consensus. Where a consensus is not arrived at the issue shall be decided by voting. Each member has one vote.

The WTO has legal personality. Members shall endow it with such legal capacity, privileges and immunities as are necessary for the exercise of its functions.

The representatives of the members and all officials of the WTO enjoy International privileges and immunities.

Functions of WTO: The WTO has the following functions:

- 1. The WTO facilitates the implementation, administration and operation of world trade agreements.
- 2. The WTO provides the forum for trade negotiations among its member countries.

3. The WTO handles trade disputes.
4. The WTO monitors national trade policies.
5. It provides technical assistance and training to developing countries.
6. With a view to achieving greater coherence in global economic policy making, the WTO co-operates, as appropriate, with the IMF and IBRD and its affiliated agencies.

Chapter 8- Unit 1-Money

Meaning: Money is an important and indispensable element of modern civilization.

To a layman, thus, in India, the rupee is the money, in England the pound is the money while in America the dollar is the money.

Definition of Money : It is **very difficult to define** money in exact sense.

This is because, there are various categories of assets which possess the attributes of money. **Many things** such as clay, cowry shells, tortoise shells, cattle, slaves, rice, wool, salt, porcelain, stone, gold, iron, brass, silver, paper and leather etc. **have been used as money.**

Traditionally, money has been defined on the basis of its general acceptability and its functional aspects. Thus, anything which performed the following three functions (i) served as medium of exchange (ii) served as a common measure of value and (iii) served as a store of values, was termed as money.

To modern economists or empiricists, however, the crucial function of money is that it serves as a store of value. It thus includes, not only currencies and demand deposits of banks, but **also includes a host of financial assets such as bonds, government securities, time deposits** with banks and equity shares which serve as a store of value.

Some economists **categorise these financial assets as near money**, distinct from pure money which refers to cash and chequable deposits with commercial banks.

Functions of Money:

In a *static sense*, money serves :

(viii) As a medium of exchange : The fundamental role of money in an economic system is to **serve as a medium of exchange** or as a means of payment.

(vi) As a unit of account : Money is a **common measure or common denominator of value.** The value in exchange of all goods and services can be expressed in terms of money.

It would be possible to use any good as a unit of account (say) mobile phones. This would mean that the prices of tables, chairs, books and groceries would all be quoted in terms of the number of mobile phones required to buy them.

In theory it sounds possible, but in practice who would want to carry around mobile phones to pay for everything they buy? Since we are generally not willing to accept commodities such as gold or phones as units of accounts, we require another alternative. This alternative is Fiat money.

Fiat Money : Fiat money exists where **paper with no intrinsic value itself fulfils the functions of money**, and government legislation ensures that it must be accepted for transaction. For example **in India, rupee is the fiat money.** A hundred rupee note is capable of buying goods and services worth 100 rupees, although as such the note of hundred rupees is nothing but a piece of paper.

In fact, it acts as a means of calculating the relative prices of goods and services.

(vii) As standard of deferred payments : Money is a unit in terms of which debts and future transactions can be settled. Thus loans are made and future contracts are settled in terms of money.

(viii) As store of value : Money is a convenient means of keeping any income which is surplus to immediate spending

needs and it can be exchanged for the required goods and services at any time. Thus it acts as a store of value.

In **dynamic sense**, money serves the following functions:

Directs economic trends : Money **directs idle resources into productive channels** and there by affects output, employment, consumption and consequently economic welfare of the community at large.

As encouragement to division of labour : In a money economy, **different people tend to specialise in the different goods** and through the marketing process, these goods are bought and sold for the satisfaction of multiple wants. In this way, occupational specialisation and division of labour are encouraged by the use of money.

Smoothens transformation of savings into investments : In a modern economy, **savings and investments are done by two different sets of people - households and firms**. Households save and firms invest. Households can lend their savings to firms. The mobilisation of savings can be done through the working of various financial institutions such as banks. Money so borrowed by the investors when used for buying raw materials, labour, factory plant etc. becomes investment. Saved money thus can be channelised into any productive investment.

Money Stock in India

In 1979 the RBI classified money stock in India in the following four categories.

M_1	Currency with the public i.e., coins and currency notes + Demand deposits of the public known as narrow money.
M_2	M_1 + Post office saving deposits.
M_3	M_1 + Time deposits of the public with banks called broad money.
M_4	M_3 + Total post office deposits. (excluding National Saving Certificates)

The basic distinction between **narrow money (M_1)** and **broad money (M_3)** is in the treatment of time deposits with banks. Narrow money excludes time deposits of the public with the banking system while broad money includes it.

The third RBI working group (1998) redefined its parameters for measuring money supply and introduced new monetary aggregates (NM).

NM_1 = Currency + Demand deposits + Other deposits with RBI.

NM_2 = NM_1 + Time liabilities portion of saving deposits with banks + Certificates of deposits issued by banks + Term deposits maturing within a year excluding FCNR (B) (Foreign Currency now Residential Bank) Deposits.

NM_3 = NM_2 + Term deposits with banks with maturity over one year + Call / term borrowings of the banking system.

NM_4 has been excluded from the scheme of new monetary aggregates.

Three liquidity aggregates L_1 , L_2 and L_3 have also been introduced.

It may, however be noted that the measures M_1 , and M_3 are still used as measures of money supply in India.

Chapter 8-unit 2 Commercial Banks

A modern industrial society cannot be run by self-financing of entrepreneurs. Some institutional assistance is necessary to mobilize the savings of the community and to make them available to the entrepreneurs. The people, a large majority of who save in small odd lots, also want an institution which can ensure safety of their funds together with liquidity. Banks assure this with a further facility - that the funds can be drawn back in case of need.

From a broader social angle, **banks act as a bridge between the users of capital and those who save but cannot use the funds themselves.** The idle resources of the community are thus activated and brought to productive use.

Besides, the banking system has capacity to add to the total supply of money by means of credit creation. **The bank is a dealer in credit - its own and other people's.**

Role of Commercial Bank:

Banks play a very useful and dynamic role in the economic life of every modern state.

Their economic importance may be viewed in the followed points :

- (2) A developing economy needs a high rate of capital formation to accelerate the tempo of economic development. But the economic development depends upon the rate of savings. **Banks offer facilities for keeping savings** and thus encourage the habits of thrift in the society.
- (3) Not only do the banks encourage savings but they **also mobilise savings done** by several households and make them available for production and investment to the entrepreneurs in various sectors of the economy. Without banks these savings would have remained idle and would not have been utilised for productive and investment purposes.
- (4) **Allocation of funds or economic surplus** among different sectors, users or producers so as to make maximum social return and thus to ensure optimum utilization of savings is another important function performed by the banks. However **commercial banks do not always work and allocate resources** in the way that maximises production or social welfare. For example, *before nationalisation in 1969, the commercial banks in India neglected socially highly desirable sectors such as agriculture, small scale industries and weaker sections of the society.* Therefore, it was thought necessary to nationalise them so that they should allocate resources in socially desirable directions.

Functions of a Bank:

The functions of a bank can be summarised as follows :

- (4) **Receipt of deposits** : A bank receives deposits from individuals, firms, and other institutions. **Deposits constitute the main resources of a bank.** Such deposits may be of different types. Deposits which are withdrawable on demand are called **demand or current deposits**, others are called **time deposits**.
Savings deposits are those from which withdrawals are not restricted as regards the amount and the period. Deposits withdrawable after the expiry of an agreed period are known as **fixed deposits**. Interest paid by banks is different for each kind of deposit - highest for fixed deposits and lowest or even nil for current deposits.
- (5) **Lending of money** : *Banks lend money mainly for industrial and commercial purposes.*
- (6) **Agency services** : A bank renders various services to consumers, such as : (i) collection of bills, promissory notes and cheques; (ii) collection of dividends, interests, premiums, etc.; (iii) purchase and sale of shares and securities; (iv) acting as trustee or executor when so nominated; and (v) making regular payments such as insurance premiums.
- (7) **General services** : A modern bank performs many services of general nature to the public, e.g. (i) issue of letters of credit, travellers cheques, bank drafts, circular notes; etc. (ii) safe keeping of valuables in safe deposit vaults; (iii) supplying trade information and statistics; conducting economic surveys; and (iv) preparation of feasibility studies, project reports, etc.

With development in technology, new methods of banking have been evolved. Now people have the benefit of banking anytime and anywhere. **Important tools of modern banking are Automatic Telling Machine (ATM), Real Time Gross Settlement (RTGS) and the National Electronic Funds Transfer (NEFT).**

An **automated or automatic teller machine (ATM)** also known as an **automated banking machine (ABM)** is a computerized telecommunications device that enables the clients of a financial institution to perform financial transactions without the need for a cashier, human clerk or bank teller. Banks issue ATM card to its customers which, generally, is a plastic card with magnetic strip. Using ATM and ATM card, customers can access their bank accounts in order to make cash withdrawals and check their account balances.

Nowadays, transactions which are bulk and repetitive in nature are routed through electronic clearing service (ECS). India has two main electronic funds settlement systems for one to one transactions: the Real Time Gross Settlement (RTGS) and the National Electronic Funds Transfer (NEFT) systems.

Real Time Gross Settlement (RTGS): RTGS system is a funds transfer mechanism where transfer of money takes place from one bank to another on a 'real time' and on 'gross' basis. **This is the fastest possible money transfer system through the banking channel.** Settlement in 'real time' means payment transaction is not subjected to any waiting period. The transactions are settled as soon as they are processed.

In India, the Reserve Bank of India (India's Central Bank) maintains this payment network.

Core Banking enabled banks and branches are assigned an Indian Financial System Code (IFSC) for RTGS and NEFT purposes. **This is an eleven digit alphanumeric code and unique to each branch of bank.** The first four letters indicate the identity of the bank and remaining seven numerals indicate a single branch. This code is provided on the cheque books, which are required for transactions along with recipient's account number.

National Electronic Fund Transfer (NEFT): The National Electronic Fund Transfer (NEFT) system is a nation-wide system that facilitates individuals, firms and corporates to electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country. NEFT requires Indian financial system code (IFSC) to perform a transaction.

Commercial Banking in India:

At the time of Independence Government announced the nationalisation of 14 major commercial banks with effect from July, 1969.

The objectives of nationalisation were to bring in financial discipline and to meet progressively the needs of development of the economy, in conformity with national policy and objectives.

Six more banks were nationalised in 1980. (Two banks were merged, so at present there are 19 nationalised banks).

Commercial banks in India include Scheduled banks(banks which have been included in the Second Schedule of RBI Act 1934) and Non Scheduled banks (banks which are not included in the Second Schedule of RBI Act 1934, e.g. some local area banks).

Scheduled banks are further divided into public sector banks (banks in which majority of stake is held by the government, e.g. State Bank of India, Union Bank, etc), **private sector banks** (banks in which majority of stake is held by private individuals, e.g. ICICI, HDFC, etc. **and foreign banks** (banks with head office outside the country in which they are located, e.g. Citi Bank, Bank of America).

Most of the public sector banks are nationalized banks (e.g. Bank of India, Punjab National Bank). But State Bank of India and its associates are public sector banks but they are not nationalized.

Nationalization of commercial bank:

The following factors were responsible for nationalization of commercial banks in 1969.

(i) **Private ownership of commercial banks and concentration of economic power** : Until nationalisation, all major banks were controlled by one or more business houses. These business houses used the resources contributed by the mass of the people for their own personal benefits. They financed those projects which ultimately enhanced their own financial resources. Thus, private ownership of banks resulted in concentration of income and wealth in few hands.

(ii) **Urban-bias** : Prior to nationalization, commercial banks had shown no interest in establishing offices in semi-urban and rural areas. More and more branches were opened in cities resulting in concentration of banking facilities in urban areas. For example, **five major cities (Ahmedabad, Bombay, Calcutta, Delhi and Madras) together had one-seventh share in the number of bank offices and about fifty percent share of bank deposits and bank credit.** *This urban biased nature of commercial banks led to slow rate of growth in the rural areas.*

- (iii) **Neglect of agricultural sector** : There was a total neglect of the agricultural sector and its finance prior to nationalisation of banks. The banks increasingly advanced finances to commerce and industry.
- (iv) **Violation of norms** : Commercial banks often violated the norms and priorities laid down in the plans and granted loans to even those industries which figured nowhere in the priority list.
- (v) **Speculative activities** : Private commercial banks earned large profits and indulged in speculative activities. They even extended advances to hoarders and black marketers against high rates of interest.
- (vi) **Neglect of priority sectors** : Not only there was a complete neglect of agricultural sector, other sectors such as export, small-scale industries etc. were also completely neglected.

In order to discipline the commercial banks so that they do not overlook the national priorities, nationalisation of banks was undertaken first in 1969 and then in 1980.

Objectives of nationalisation : Nationalisation was meant for an early realisation of the objectives of social control which were as follows :

- (v) removal of control by a few;
- (vi) provision of adequate credit for agriculture and small industry and export;
- (vii) giving a professional bent to management;
- (viii) encouragement of a new class of entrepreneurs; and
- (ix) the provision of adequate training as well as terms of services for bank staff.

After the nationalisation of banks in 1969, commercial banking operations have become an integral part of India's economic policy. **Following development have taken place since nationalisation in 1969 :**

- (viii) **Expansion of branches** : There has been an unprecedented growth in the branch network since nationalisation. Number of branch office of scheduled commercial banks in 2012 has increased to 98,591 indicating a greater access to banking facilities to the common man.

As a result, the population per bank office is 12,500 in 2012.

- (ix) **Branch opening in rural and unbanked areas** : There has been a qualitative change in branch expansion programme ever since the nationalisation of banks. Before nationalisation, there was a clear urban bias in the operations of banks. But after nationalisation they have started moving towards rural and less developed areas.

- (x) **Deposit mobilisation** : There has been a substantial rise in the rate of deposit mobilisation since nationalisation. The aggregate deposits of scheduled commercial banks is Rs. 60,00,000 crore in 2012. Considering state-wise deposit mobilisation, we find Maharashtra leads all other states and accounts for 23 per cent of the aggregate deposits received by the banks.

- (xi) **Bank lending** : There has been a spectacular rise in the Scheduled commercial banks lending since nationalisation of banks in 1969. It has gone upto Rs. 50,00,000 crore in *December, 2012.* \

Shortcomings of commercial banks in India:

- (i) Although the commercial banks have spread their wings to every corner of the country, but considering the huge population of India, their growth in numerical terms is insufficient.
- (ii) There are regional imbalances in the coverage of bank offices. Only few states have well developed banking facilities:
- (iii) As a result of increasing advances and loans to unemployed and weaker sections the commercial banks are facing the problem of bad debts, doubtful debts and over dues.

*This seriously affects the process of recycling of funds by the commercial banks. **Bad and doubtful debts of scheduled***

commercial banks, called non-performing assets (NPAs) have swelled over a period of time.

- (iv) There is a problem of effective management and control especially over the branches which are located in remote areas. This has hampered the overall efficiency of the commercial banks.
- (v) The absolute profits of the banks are rising but the profitability ratio (in terms of return on investment, return on equity) has *not improved much*.

Concerned with the problem of declining profitability and high incidence of non performing assets (NPA), the RBI has started fine-tuning its regulatory and supervisory mechanism. Measures have been taken to reduce NPAs. These include, reschedulement, restructuring at the bank level, corporate debt restructuring and recovery through Lok Adalats, civil courts and debt recovery tribunals.

Chapter 8- Unit 3- Reserve Bank of India

Meaning & Functions of Central Bank:

A Central Bank is one which constitutes the **apex of the monetary and banking structure** of a country and which **performs, in the national economic interest**, the following functions :

1. The regulation of currency in accordance with the requirements of business and the general public.
2. The performance of general banking and agency services for the State.
3. The custody of cash reserve of the commercial banks.
4. The custody and management of the nation's reserves of international currency.
5. The granting of accommodation, in the form of rediscounting or collateral advances to commercial banks, bill brokers and dealers.
6. The clearance arrangements among banks; and
7. The control of credit in accordance with the needs of business with a view to carrying out broad monetary policy adopted by the State.

The above is quite comprehensive but, in addition, central banks perform additional functions to meet the specific requirements of the country. **Broadly speaking, a central bank has three objectives, namely a) monetary stability, including stability of domestic price levels,**

- b) maintenance of the international value of the nation's currency and**
c) issue of currency.

Central Bank v/s Commercial Bank

Whereas other banks are largely profit seeking institutions, the central bank is not so. Although, it makes huge contribution to be general revenues, its objective is not to make profit. **It does not allow interest on deposits.** Its profits are mainly through its dealings in Government securities which it holds in reserve against note issue and interest on advances and loans which it grants to State Governments and other financial institutions, including commercial banks.

The Central Bank acts as the organ of the State. *The ultimate responsibility of framing and executing economic policies is that of the State* and, therefore, the Central Bank has to advance the policies of the State.

Whereas other banks have largely public dealings, the Central Bank's dealings are with Governments, Central and State banks and other financial institutions.

Whereas other banks mobilise savings and channelise them into proper use, the Central Bank's role is to ensure that the other banks conduct their business with safety, security and in pursuance of the national plan priorities and objectives of economic and social development.

Role of Reserve Bank of India

The Reserve Bank of India (RBI) is the Central Bank of India and occupies a pivotal position in the Indian economy. Its role is summarised in the following points:

The RBI is the apex monetary institution of the highest authority in India. Consequently, it plays an important role in strengthening, developing and diversifying the country's economic and financial structure.

It is responsible **for the maintenance of economic stability** and assisting the growth of the economy.

It is India's eminent public financial institution given the responsibility for controlling the country's monetary policy.

It **acts as an advisor to the government** in its economic and financial policies, and it also represents the country in the international economic forums.

It also **acts as a friend, philosopher and guide to commercial banks**. In fact, it is responsible for the development of an adequate and sound banking system in the country and for the growth of organised money and capital markets.

India being a developing country, the RBI has to keep inflationary trends under control and to see that main priority sectors like agriculture, exports and small scale industry get credit at cheap rates.

It has also to protect the market for government securities and channelise credit in desired directions.

Functions of Reserve Bank of India:

The Reserve Bank of India being the Central Bank of India **performs all the central banking functions**. These are :

(i) **Issue of currency** : The RBI is the sole authority for the issue of currency in India **other than one rupee coins and notes and subsidiary coins**.

(ii) **Banker to the government**.

5. **Banker's Bank** : The RBI has been vested with extensive power to control and supervise commercial banking system under the **Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949**.

All the scheduled banks are required to maintain a certain minimum of cash reserve ratio with the RBI against their demand and time liabilities. This provision enables the RBI to control the credit position of the country.

The RBI provides financial assistance to scheduled banks and state cooperative banks in the form of discounting of eligible bills and loans and advances against approved securities.

The RBI also conducts inspection of the commercial banks and calls for returns and other necessary information from banks.

6. **Custodian of Foreign Exchange Reserves**: The RBI is required to maintain the external value of the rupee. For this purpose it functions as the custodian of nation's foreign exchange reserves. It has to ensure that normal short-term fluctuations in trade do not affect the exchange rate. When foreign exchange reserves are inadequate for meeting balance of payments problem, it borrows from the IMF(International Monetary Fund)

7. **Controller of Credit**: Credit plays an important role in the settlement of business transactions and affects the purchasing power of people. The social and economic consequences of changes in the purchasing power are serious, therefore, it is necessary to control credit. Controlling credit operations of banks is generally considered to be the principal function of a central bank. The RBI, like any other Central Bank, possesses power to use almost all qualitative and quantitative methods of credit controls.

8. **Promotional Functions**: Apart from the traditional functions of a Central Bank, the RBI also performs a variety of developmental and promotional functions. It is responsible for promoting banking habits among people and mobilising

savings from every corner of the country. It has also taken up the responsibility of extending the banking system territorially and functionally.

Initially, it had also taken up the responsibility for the provision of finance for agriculture, trade and small industries. But now these functions have been handed over to NABARD, EXIM Bank and SIDBI respectively.

(viii) **Collection and publication of Data** : It has also been entrusted with the task of collection and compilation of statistical information relating to banking and other financial sectors of the economy.

Indian Monetary Policy

Monetary Policy is usually **defined as the Central Bank's policy** pertaining to

- the control of the availability, cost and use of money and credit
- with the help of monetary measures in order to achieve specific goals.

In the Indian context, **monetary policy comprises those decisions** of the government and the Reserve Bank of India **which directly influence the volume and composition of** money supply, the size and distribution of credit, the level and structure of interest rates, and the effects of these monetary variables upon related factors such as savings and investment and determination of output, income and price.

Monetary policy is **implemented by the RBI through the instruments of credit control.**

Generally two types of instruments are used to control credit.

These are (i) quantitative or general measures and (ii) qualitative or selective measures.

The quantitative measures are **directed towards influencing the total volume of credit** in the banking system without special regard for the use to which it is put.

Selective or qualitative instruments of credit control, on the other hand, are **directed towards the particular use of credit and not its total volume.**

I. **Quantitative or General Measures:** Quantitative weapons have a general effect on credit regulation. They are used for changing the total volume of credit in the economy.

(a) **Bank Rate Policy:** It is the **traditional weapon** of credit control used by a Central Bank. The Bank Rate is the rate at which the Central Bank discounts the bills of commercial banks. When the Central Bank wishes to control credit and inflation in the economy, it raises the Bank Rate. **Increased Bank Rate** increases the cost of borrowings of the commercial banks who in turn charge a higher rate of interest from their borrowers. This means the price of credit will increase. This will affect the profits of the business community who will feel discouraged to borrow. As a result, the demand for credit will go down. Decreased demand for credit will slow down investment activities which in turn will affect production and employment. Consequently, income in general will fall, people's purchasing power will decrease and aggregate demand will fall and prices will fall down. **This in turn will lead to a cumulative downward movement in the economy.**

On the other hand, if the Central Bank wishes to boost production and investment activities in the economy, it will decrease the Bank Rate.

Bank rate in 2013 was 10.25%

(b) **Open market operations:** Open market operations imply deliberate **direct sales and purchases of securities and bills in the market** by the Central Bank on its own initiative to control the volume of credit.

When the Central Bank sells securities in the open market, other things being equal, the cash reserves of the commercial banks decrease to the extent that they purchase these securities. In effect, the credit-creating base of commercial banks is reduced and hence credit contracts. On the other hand, open market purchases of securities by the Central Bank lead to an expansion of credit made possible by strengthening the cash reserves of the banks. Thus, on account of open market

operations, the quantity of money in circulation changes.

This tends to bring about changes in money rates. An increase in the supply of money through open market operations causes a down ward movement in the interest rates, while a decrease of money supply raises interest rates. Change in the rate of interest in turn tends to bring about the desired adjustments in the domestic level of prices, costs, production and trade.

- (ii) **Variable reserve requirements:** The Central Bank also uses the method of variable reserve requirements to control credit. There are two types of reserves which the commercial banks are generally required to maintain (i) Cash Reserve Ratio (ii) Statutory Liquidity Ratio (SLR).

Cash reserve ratio refers to that portion of total deposits which a commercial bank has to keep with the Central Bank in the form of cash reserves.

Statutory liquidity ratio refers to that portion of total deposits which a commercial bank has to keep with itself in the form of liquid assets viz - cash, gold or approved government securities.

By changing these ratios, the Central Bank controls credit in the economy. If it wants to discourage credit in the economy, it increases these ratios and if it wants to encourage credit in the economy, it decreases these ratios. Raising of the reserve rates will reduce the surplus cash reserves of the banks which can be offered for credit. This will tend to contract credit in the system. Reverse will be effects of reduction in the reserve ratio requirements reflected in the expansion of the bank credit.

At present, (July 2013) cash reserve ratio is 4 per cent and statutory liquidity ratio is 23 per cent for entire net demand and time liabilities of the scheduled commercial banks.

(c) **Repo Rate and Reverse Rate:**

Repo rate is the rate at which our banks borrow rupees from RBI. Whenever the banks have any shortage of funds they can borrow it from RBI. RBI lends money to bankers against approved securities **for meeting their day to day requirements or to fill short term gap.** A reduction in the repo rate will help banks to get money at a cheaper rate. When the repo rate increases borrowing from RBI becomes more expensive. **At present, Repo rate is 7.25 per cent.**

Reverse Repo rate is the rate at which Reserve Bank of India (RBI) borrows money from banks. *An increase in Reverse repo rate can cause the banks to transfer more funds to RBI due to this attractive interest rates.* It can cause the money to be drawn out of the banking system. **At present Reverse Repo rate is 6.25 per cent.**

II. Qualitative or Selective Measures: Qualitative or selective measures are generally meant to regulate credit for specific purposes. The Central Bank generally uses the following forms of credit control -

- (a) **Securing loan regulation by fixation of margin requirements :** The Central Bank is empowered to fix the margin and thereby fix the maximum amount which the purchaser of securities may borrow against those securities. Raising of margin curbs the borrowing capacity of the security holder. This is a **very effective selective control device to control credit in the speculative sphere.** This device is also **useful to check inflation** in certain sensitive spots of the economy without influencing the other sectors.

- (b) **Consumer credit regulation:** The regulation of consumer credit consists of **laying down rules** regarding down payments and maximum maturities of installment credit **for the purchase of specified durable consumer goods.** Raising the required down payment limits and shortening of maximum period tend to reduce the demand for such loans and thereby check consumer credit.

- (c) **Issue of directives:** The Central Bank also uses directives to various commercial banks. These directives are **usually in the form of oral or written statements, appeals, or warnings,** particularly to curb individual credit structure and to restrain the aggregate volume of loans.

- (d) **Rationing of credit :** Rationing of credit is a selective method adopted by the Central Bank for **controlling and regulating the purpose for which credit is granted** or allocated by commercial banks.

- (e) **Moral suasion** : Moral suasion implies persuasion and **request made by the Central Bank to the commercial banks to co-operate** with the general monetary policy of the former. The Central Bank may also persuade or request commercial banks not to apply for further accommodation from it or not to finance speculative or non-essential activities. **Moral suasion is a psychological means of controlling credit; it is a purely informal** and milder form of selective credit control.
- (f) **Direct Action** : The Central Bank may take direct action against the erring commercial banks. It may **refuse to rediscount their papers, and give excess credit, or it may charge a penal rate of interest over and above the Bank Rate**, for the credit demanded beyond a prescribed limit.

By making frequent changes in monetary policy, it ensures that the monetary system in the economy functions according to the nation's needs and goals.

