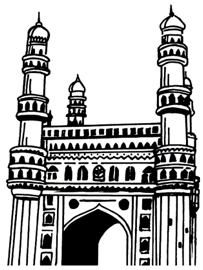
Rahul's ✔

Topper's Voice



M.Com.

II Semester

(Osmania University)

LATEST EDITION
2019

BUSINESS ENVIRONMENT AND POLICY

- STUDY MANUAL
- UNITWISE SHORT NOTES
- OBJECTIVE TYPE
- SOLVED QUESTION PAPERS

Price ` .169/-

- by -

WELL EXPERIENCED LECTURER

Rahul Publications™

Hyderabad. Ph : 66550071, 9391018098

M.Com.

II Semester

BUSINESS ENVIRONMENT AND POLICY

Inspite of many efforts taken to present this book without errors, some errors might have crept in. Therefore we do not take any legal responsibility for such errors and omissions. However, if they are brought to our notice, they will be corrected in the next edition.

Price ` 169-00

Sole Distributors : ☎ : **66550071, Cell : 9391018098**

VASU BOOK CENTRE

Maternity Hospital Opp. Lane, Narayan Naik Complex, Koti, Hyderabad.
Near Andhra Bank, Subway, Sultan Bazar, Koti, Hyderabad -195.

CONTENTS

BUSINESS ENVIRONMENT AND POLICY

STUDY MANUAL

SOLVED PREVIOUS QUESTION PAPERS

SYLLABUS

UNIT - I

INTRODUCTION:

Business environment: micro-environment - macro environment – environmental scanning. Policy environment: Industrial Policy - Industrial Policy Resolution 1956 – New Industrial Policy 1991 – Fiscal policy – Monetary policy.

UNIT - II

LIBERALIZATION AND GLOBALIZATION:

New economic policy: economic reforms - liberalization. Globalization: meaning - stages - factors facilitating and impeding globalization in India - consequences of globalization for India.

UNIT - III

PUBLIC SECTOR AND PRIVATIZATION:

Public sector: changing role of public sector - relevance of public sector – public Sector reforms. Privatization: concepts – nature – objectives – forms - regulatory framework with reference to insurance, power and telecom sectors.

UNIT - IV

FOREIGN CAPITAL:

Foreign direct investment: policy - trends -problems - consequences – FEMA- objectives - provisions - multinational corporations - entry strategies - role - growth – problems - consequences. Mergers and acquisitions: reasons - trends - advantages and disadvantages - competition law.

UNIT - V

WTO AND TRADE POLICY:

WTO agreements - Agreement on Agriculture (AOA) - Multi-fibre Agreement (MFA) - Trade Related Intellectual Property Rights (TRIPS) - Trade Related Investment Measures (TRIMS) - General Agreement on Trade in Services (GATS) - Barriers to trade. Trade policy changes consequent to WTO - Recent EXIM policy - Consequences of WTO for India.

Contents

Topic		**Page No.**

Frequently asked and Important Questions

UNIT - I

Q1. Explain the external factors that influence business environment.

Ans :

May-2017, May/June-2016,

May/June-2014, May/June-2012,

Refer to Unit-I, Page No. 8 - 19, Topic : 1.6.2.

Q2. Explain the sailent features of industrial policy resolutions 1991.

Ans :

May-2017, April/May-2014,

April/May-2013

Refer to Unit-I, Page No. 25, Topic 1.12.

Q3. Explain in detail about the fiscal policy of India.

Ans :

May/June-2016

Refer to Unit-I, Page No. 28, Topic 1.13.

Q4. Explain the sailent features of Industrial policy resolutions.

Ans :

Apil/May-2016

Refer to Unit-I, Page No. 23, Topic 1.11-1.12.

Q5. Explain detail about monetary policy in the 21st century.

Ans :

Refer to Unit-I, Page No. 51, Topic 1.14.7.

UNIT - II

Q1. Discuss the improvement and achievements of the liberalization programm launched by the government of India.

Ans : **May-2017, May/June-2012**

Refer to Unit-II, Page No. 68, Topic 2.2.3.

Q2. What is globalization? Describe the entry strategies available to enter global market.

Ans : **May-2017, May/June-2016, May/June-2015**

Refer to Unit-II, Page No. 70, 73-76, Topic 2.3, 2.3.3.

Q3. Critically evaluate the impact of economic reforms on business.

Ans : **May/June-2015, April/May-2014**

Refer to Unit-II, Page No. 57, Topic 2.1.

Q4. Define globalisation and explain its merits and demerits.

Ans : **May/June-2012**

Refer to Unit-II, Page No. 77 - 79, Topic 2.3.5.

Q5. Evaluate the impact on FMCY industry.

Ans :

Refer to Unit-II, Page No. 81, Topic 2.3.6.

UNIT - III

Q1. Examine the need and importance of public sector in India.

Ans : **May-2017, May-2016, May/June-2015**

Refer to Unit-III, Page No. 86-87, Topic 3.1.3.

Q2. What is private sector? Discuss the role of private sector in India economy.

Ans : **May-2017**

Refer to Unit-III, Page No. 106-108, Topic 3.2.7.

Q3. What is privatization? and Explain the regulatory frame work with reference to insurance and power sectors.

Ans : **May/June-2015**

Refer to Unit-III, Page No. 97-98, 109-110, 113-114, Topic 3.2, 3.3.1, 3.3.2.

Q4. Elucidate different methods of disinvestment in public sector enterprises giving adventages associated with each of them.

Ans :

Refer to April-May-2013, Q.No. 8(b)

Q5. Examine the role of various regulatory agencies in India.

Ans :

Refer to May/June-2012, Q.No. 8(b)

UNIT - IV

Q1. Discuss the rationale for encouraging foreign direct investment.

Ans :

Refer to May-2017, Q.No. 9(a)

Q2. Evaluate the impact of MNCs on India Economy?

Ans : **May-2017**

Refer to Unit-IV, Page No. 166. Topic : 4.3.10.

Q3. Give an overview on recent trends in FDI policy.

Ans : **May-2017**

Refer to Unit-IV, Page No. 138, Topic 4.1.6.1.

Q4. Out line the merits and demerits of MNCs.

Ans : **May-2016**

Refer to Unit-IV, Page No. 160, Topic 4.3.6.

Q5. What do you understand by Mergers? Explain the salient features of competition law.

Ans :

Refer to May/June-2015, Q.No. 9(b)

Q6. Define FDI and FDI policy in Indai.

Ans :

Refer to Unit-IV, Page No. 125, 136, 151, Topic 4.1.1, 4.14.

Q7. Write advantages of disadvantages of FDI.

Ans :

Refer to Unit-IV, Page No. 132 - 137, Topic 4.1.5, 4.1.5.1, 4.1.5.2.

UNIT - V

Q1. Briefly explain about trade related intellectual property right (tirps).

Ans : **May/June-2016, May/June-2015**

Refer to Unit-V, Page No. 200, Topic 5.2.3.

Q2. Explain the consequences of who to Indian Economy?

Ans : **May-2017, May/June-2016, April/May-2014**

Refer to Unit-V, Page No. 227, Topic 5.7.

Q3. Discuss the various agreements under to.

Ans : **May/June-2015, April/May-2013,**

April/May-2014, May/June-2012

Refer to Unit-V, Page No. 195 - 204, Topic 5.2, 5.6.

Q4. Presnet the changes introduced in the export import policy of 2015 - 2020 and their impact on India's export import business.

Ans :

Refer to Unit-V, Page 224, Topic 5.6.

Q5. Explain how quantity influencing non-tariff barriers.

Ans :

Refer to Unit-V, Page No. 211, Topic 5.3.4.2.

UNIT I	**INTRODUCTION : Business environment**: Micro - Environment - Macro Environment – Environmental Scanning. **Policy Environment**: Industrial Policy - Industrial Policy Resolution 1956 – New Industrial Policy 1991 – Fiscal policy – Monetary policy.

1.1 Business Environment

1.1.1 Introduction

Business and society have a symbolic relationship with one another. Each derives from the other some form of benefit. The purpose of business is to earn money (profit). It also helps in the creation of employment which in turn raises the standard of living while, at the same time contributing to the economic growth and development of the country. Society needs business only for its survival.

Success of a business is dependent upon its interaction with the environment around it environmental factors have a bearing on the business not the other way round. A business therefore should operate its activities as per the environment in which it exists.

Environment refers to the surrounding conditions of any particular object or business environment refers to the external conditions or factors affecting the business.

"Business Environment is aggregate of all conditions, events and influences that surround and affect it. External factors or conditions are limitations which may be internal or external depending upon whether they are controllable or not. These environmental factors could be social economic, cultural, geographical, technological or legal factors.

1.1.2 Meaning and Definition of Business Environment

Business environment means all internal and external factors that affect how the company functions including employees, customers, management, supply and demand and business regulations. Business environment refers to those aspects of the surroundings of business enterprise, which affect or influence its operations and determine its effectiveness.

Definitions of Business Environment

According to Keith Davis, "Business environment is the aggregate of all conditions, events and influence that surrounds and affect it".

According to Andrews, "The environment of a company as the pattern of all external influences that affect its life and development".

According to W.F. Glueck and Lawrence R. Jauch, "The environment includes factors outside the firm, which can lead to opportunities or threats to the firm. Although there are many factors, the most important of these factors are socio-economic, technological, supplier, competitors and government".

1.2 Nature/Characteristics of Business Environment

The nature of business environment is as follows :

1. Complex

Business environment is compound in nature. Environment consists of a number of factors, events, conditions and influences arising from different sources which impact business thus making the business complex.

2. Interdependence

The environment of the business is made of social, economic, legal, cultural, technological and political factors. These factors of the environment are inter-dependable. The economic status of a country affects the development of technology.

3. Dynamic

Business environment is constantly changing process. Business environment is dynamic as it keeps on changing in terms of technological improvement, shifts in consumer preferences or entry of new competition in the market. The various forces in the environment keeps on changing from time to time thus making business dynamic and not static.

4. Inter-Relatedness

The different factors of business environment are co-related. For example, let us suppose that there is a change in the import-export policy with the coming of a new government. In this case, the coming of new government to power and change in the import-export policy are political and economic changes respectively. Thus, a change in one factor affects the other factor.

5. Impact

Business environment has both long-term and short-term impact. Environment therefore has different effects on different firms in the same industry, e.g., Drugs.

6. Uncertainty

Business environment is largely uncertain as it is very difficult to predict future happenings, especially when environment changes are taking place too frequently as in the case of information technology or fashion industries.

7. Relativity

Business environment is a relative concept since it differs from country to country and even region to region. Political conditions in the U.S.A., e.g., differ from those in China or Pakistan. Similarly, demand for sarees may be fairly high in India whereas it may be almost non-existent in France.

8. Specific and General Forces

Business environment includes both specific and general forces. Specific forces affect individual enterprises directly and immediately in their day-to-day working. General forces have impact on all business enterprises and thus may affect an individual firm only indirectly.

9. Totality of External Factors

Business environment is the sum total of all those factors/forces which are available outside the business and over which the business has no control. It is the group of many such forces that is why its nature is of totality. It covers factors and forces like customers, competitors, suppliers, government, and the social, cultural, political, technological and legal conditions.

10. Environment is Multi-Faceted

The same environmental trend can have different effects on different industries. For example, GATS that is an opportunity for some companies but a threat for others.

11. Forecasting is not Possible for All Developments

Macroeconomic developments such as interest rate fluctuations, the rate of inflation and exchange rate variations are extremely difficult to predict on long-term basis. On the other hand, some trends such as demographic and income levels can be easy to forecast.

1.3 Importance of Business Environment

The competent and successful management must be capable of adapting to the environment. The knowledge of the environment helps in :

1. Capitalizing emerging opportunities
2. Activating management

3. Image building
4. Basis of strategy
5. Intellectual stimulation
6. Continuous learning

1. Capitalizing emerging opportunities

Environment friendly enterprise are the first movers to avail of the existing opportunities of resources to grab the market. These enterprises do not loose emerging opportunities to their competitors.

2. Activating management to changing needs

The knowledge of environmental changes sensitizes the management to make strategy to cope with the emerging problems. For example: The turmoil in the USSR resulted in the loss of market to many companies like Hoechst. In order to meet the situation Hoechst divested its manufacturing facility in favors of IPCA Laboratories Ltd.

3. Image building

Environmental understanding by the management builds image of the company in the minds of the people. They feel that the company is sensitive and responsive to their needs and problems. For example: G. E is said to be image conscious. It divested its computer and air-conditioning business because they could not attain 1st or 2nd position in the business as per their policy. Now they are snickering to out sourcing in India, aircraft engineering, plastic etc.

4. Basis of strategy

Strategists can gather qualitative information regarding business environment and utilizing them in formulating effective plants. For example: ITC Hotels foresaw bright opportunities in the travel and tourism industry and started building hotels in India and abroad.

5. Intellectual stimulation

Knowledge of environment changes provides intellectual stimulation to planners and decision-making authorities. They can do it by paying more attention to people by listening to their problems and suggestion. They can also eliminate procedure complexities in a visible way. The drastic and dynamic steps will definitely keep the company better placed.

6. Continuous learning

Environmental scanning provides continuing broad based learning to is executives. Reliance adopted the policy of decentralization and empowered their managers to close the deal themselves even regarding price. In 1993 managers were require to chat with the proprietors on alternate days for 15 minutes.

The process made them so competent that now the managers are required to chat only three times in a month. It shows that continuous learning made the managers competent to take independent decision.

1.4 Dimensions of Business Environment

The following are the key components of general environment of a business.

1. **Economic environment.** Economic environment consists of economic factors that influence the business in a country. These factors include gross national product, corporate profits, inflation rate, employment, balance of payments, interest rates consumer income etc.
2. **Social environment.** It describes the characteristics of the society in which the organization exists. Literacy rate, customs, values, beliefs, lifestyle, demographic features and mobility of population are part of the social environment. It is important for managers to notice the direction in which the society is moving and formulate progressive policies according to the changing social scenario.
3. **Political environment.** It comprises political stability and the policies of the government. Ideological inclination of political parties, personal interest on politicians, influence of party forums etc. create political environment. For example, Bangalore established itself as the most important IT centre of India mainly because of political support.
4. **Legal environment.** This consists of legislation that is passed by the parliament and state legislatures. Examples of such legislation specifically aimed at business operations include the Trade mark Act 1969, Essential Commodities Act 1955, Standards of Weights and Measures Act 1969 and Consumer Protection Act 1986.
5. **Technological environment.** It includes the level of technology available in a country. It also indicates the pace of research and development and progress made in introducing modern technology in production. Technology provides capital intensive but cost effective alternative to traditional labour intensive methods. In a competitive business environment technology is the key to development.

1.5 Scope of Business Environment

The scope of business environment is described below :

1. **Strategies and Policies.** Strategy describes how a particular business intends to succeed in its chosen marketplace against its competitors, as compared to policies of business, strategy is comparatively short- term. Business policies are sets of rules followed by a business that defines business processes, industry practices, and the scope and characteristics of a business. Therefore the study of business environment helps an organisation to formulate its broad strategies and long-term policies.
2. **Competitors Analysis.** The study of business environment helps an organisation to analysis its competitor's strategy and thereby formulate effective competitive strategies. This is usually done by conducting the SWOT analysis of one's own corporate and thereby formulating the effective strategies in order to combat competition.
3. **Dynamism.** The study of business environment helps in attaining the knowledge about the continuous changing environment and thus keeping the organisation dynamic in its approach.
4. **Impact.** The study of business environment enables the organisations to foresee the impact of socio-economic changes at the national and international level on its stability.
5. **Adjustment.** As a result of study, business executives are able to adjust to the prevailing conditions and thus influence the environment to make it congenial to do business.

1.6 Composition of Business Environment

Factors Affecting Business Environment

Business Environment refers to all external and internal factors which have a direct or indirect bearing on the activities of business. However some economists use it in a narrow sense and refer business environment only to the external factors which effect business.

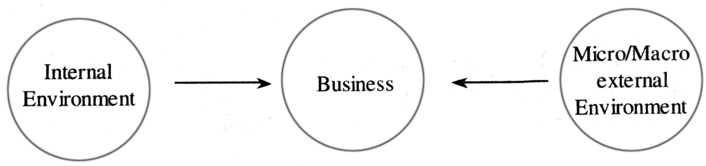


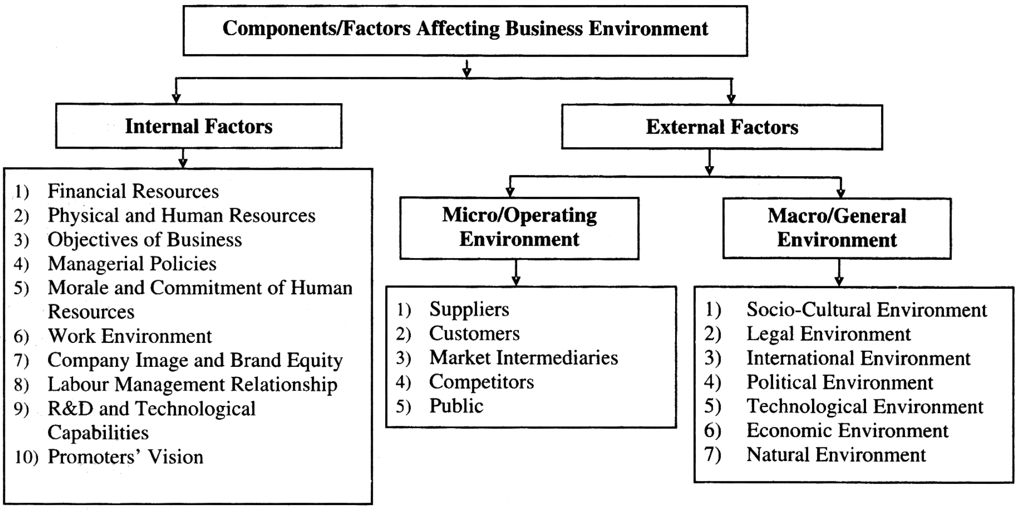
Fig.: Environment of Business

Both internal factors and external factors together effect the environment of business. The external environment of business can be further divided into micro environment and macro environment.

There are two broad components of business environment:

a) Internal Factors, and

b) External Factors.



1.6.1 Internal Factors Influencing Business Environment

Internal environment refers to factors existing within a business firm. The internal factors are generally regarded as controllable factors because the company has control over these factors; it can alter or modify such factors as its personnel, physical facilities, organisation and functional means such as marketing mix, to suit the environment.

There are a number of internal factors which influence the business decisions are as follows:

1. **Financial Factors :** Factors like financial policies, financial position and capital structure are also important internal environment affecting business performances, strategies and decisions.

2. **Physical and Human Resources :** The characteristics of the human resources like skill, quality, moral, commitment, attitude, etc., could contribute to the strength and weakness of an organisation. The involvement, initiative, etc., of people at different levels may vary from organisation to organisation.

3. **Objectives of Business :** The business domains of the company, priorities, direction of development, business philosophy, business policy, etc., are guided by the mission and objectives of the company.
4. **Managerial Policies :** The managerial policy determines the business capacity ranges, the company targets and the behaviour principles in relation to the relevant groups of requirements. It regulates handling interest conflicts inside and outside. It serves the consent identification in the value conceptions and interests of all relations with these groups, load-carrying to the enterprises took part or of its actions groups concerned and the permanent care.
5. **Morale and Commitment of Human Resources :** Quality of human resources, a component of internal environment is largely responsible for success or failure of business unit. For example, if employees of an organisation are skilful and committed towards the organisation, then it can take the business to big heights.
6. **Work Environment :** The organisational structure, the composition of the Board of Directors, extent of professionalisation of management, etc., are important factors influencing business decisions.
7. **Company Image and Brand Equity :** The image of the company matters while raiding finance, forming joint ventures or other alliances, soliciting marketing intermediaries, entering purchase or sale contracts, launching new products, etc. Brand equity is also relevant in several of these cases.
8. **Labour Management Relationship :** Factors like the amount of support, the top management enjoys from different levels of employees, shareholders and Board of Directors have important influence on the decisions and their implementation.
9. **R & D and Technological Capabilities :** It determines a company's ability to innovate and compete.
10. **Promoter's Vision :** The extent to which the value system is shared by all, in the organisation is an important factor contributing to success. The value system of the founders and those at the helm of affairs has important bearing on the choice of business, the mission and objectives of the organisation, business policies and practices.

1.6.2 External Factors Influencing Business Environment

The external environment refers to the factors existing outside the business firm. The external factors are by and large, beyond the control of a company. The external or environmental factors such as the economic factors, socio-cultural factors, government and legal factors, demographic factors, geo-physical factors, etc. are therefore generally regarded as uncontrollable factors.

As the environmental factors (external) are beyond the control of a firm, its success will depend to a very large extent on its adaptability to the environment, i.e., its ability to properly design and adjust the internal (the controllable) variables to take advantage of the opportunities and to combat the threats in the environment.

Although the term business environment is often used to refer to the external environment of business, the management of an enterprise confronts two kinds of environment, viz., the internal environment and external environment. A business decision, therefore, is often influenced by both the internal and external environment. The various elements of external environment consist of the following:

1. Micro Environment, and
2. Macro Environment.

1.7 Micro Environment

Micro environment or the Competitive environment refers to the environment which an organization faces in its specific area. This area may be an industry, or it may be what is referred to as a strategic group.

Besides looking at primary demand and supply factors, firms examine the state of competition they face because that determines whether they will remain in the same industry or start a new one. All the business decisions - what business, pricing, distribution channel, promotion strategy, product portfolio, etc. - depends on the competitive position of a firm.

For instance, a new entrant in the glucose biscuit segment will have to study and consider the marketing mix as well as strategy of existing players like Britannia, Parle, Priyagold, etc., before deciding its marketing mix. Following are the key Micro Environment factors:

The Five Forces of Competition

Professor Michael Porter of the Harvard Business School has demonstrated the state of competition in an industry as a composite of five competitive forces. According to Michael Porter, the five forces of any competition are :

1. **Threat of Competitors:** The rivalry among sellers in the industry.
2. **Threat of New Entrants:** The potential entry of new competitors.
3. **Threat of Substitutes:** Market attempts of companies in other industries to win customers over to their own substitute products.

4. **Bargaining Power of Suppliers:** The competitive pressure stemming from the supplier-seller collaboration and resultant bargaining.

5. **Bargaining Power of Buyers:** The competitive pressure stemming from seller-buyer collaboration and bargaining.

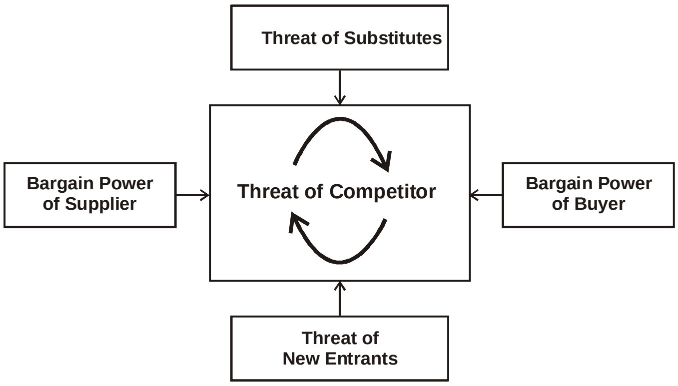


Figure.: Michael Porter's Five Forces Model

Rivalry Among Competing Sellers (Threat of Competitions)

When rivals compete to win over customers to improve market share or profitability, the situation is termed as rivalry among competing sellers.

The intensity of rivalry among competing sellers is a function of how vigorously they employ tactics such as lower prices, snazzier features, expanded customer service, longer warranties, special promotional offers, and introduction of new product. All these lead to adverse impact on the profits of the firm. Rivalry intensifies as the number of competitors increases and as competitors become equal in size and capability.

Rivalry becomes **stronger** when the demand for a product grows, and industry conditions tempt competitors to cut prices or use other competitive weapons to boost unit volume. Rivalry is also intensified when one or more competitors are dissatisfied with their market position and launch moves to bolster their standing at the expense of rivals, or when exit barriers are very high and it costs more to get out of business than to stay on.

Sometimes, stronger companies outside the industry acquire weak firms in the industry and launch aggressive, well-funded moves to transform their newly acquired company into major market contender.

Rivalry is **weak** when most competitors in the industry are relatively well-satisfied with their sales growth and market shares. Such companies rarely make concerted attempts to steal customers away from one another, and have comparatively attractive earnings and returns on investment.

The Threat of New Entrants

A new entrant in an industry represents a competitive threat to established firms, sometimes called the incumbents. The entrant adds new production capacity and brings substantial resources that were not previously required for success in the industry But there are various barriers to entry that the new player has to face. These barriers are a challenge for the new entrant and a protective shield for the established player and include :

1. **Economies of Scale:** Existing large firms enjoy lower costs per unit. They have enough room to reduce prices as they may enjoy higher profits. Also, they could be selling products at such a low price that new player may not able to produce the same output.
2. **Cost Disadvantage Independent of Scale:** Besides economies of scale, existing firms have many other cost advantages such as proprietary product knowledge, patents, favorable access to raw material, favorable location, lower borrowing cost and government subsidies.
3. **Learning and Experience Curve:** Established companies have the advantage of learning curve. Because of this learning curve, established firms are in a better position as they have skilled and trained human resources.
4. **Product Differentiation:** Differences in physical or perceived characteristics make an incumbent's product unique in the eyes of consumer.
5. **Capital Requirement:** It is said that the offender must have three times the power than that of the defender. Thus, an offender requires capital not only to establish a new business but also to compete with established firms. Even the cost of capital is higher for a new firm as lenders hesitate to provide capital to new entrant.
6. **Switching Costs:** Sometimes, the costs (physical, psychological and financial) incurred in switching from one supplier to another also resists the customer from going for a new vendor.
7. **Access to Distribution:** The middlemen are reluctant to deal with a product that is new to the market. This situation becomes more critical in industrial and international markets as there are few middlemen because they usually prefer established products.
8. **Government and Regulatory Environment:** Government policies like licensing, permits, broadcasting regulations, liquor policies, anti-monopoly policies like the MRTP in India and the Anti-Trust Law in America also work as a barrier for the new entrants.

Threat of Substitutes

This refers to the market attempts of companies in other industries to win customers over to their own substitutes products. For instance, a producer of scooters will compete with motorcycle makers, newspapers compete with television operators, tea competes with coffee, CD players compete with DVD players, Aspirin manufacturers compete with the makers of Acetaminophen, Ibrufen and other pain relievers, makers of eyeglasses compete with the makers of contact lenses, road transport services compete with the railways, and so on. Strong competitive pressure from substitute products depends upon the following three factors :

1. Whether attractively priced substitutes are available.
2. Whether the buyers view the substitutes as being satisfactory in terms of quality, performance, and other relevant attributes.
3. Whether buyers can switch to substitutes easily.

The Bargaining Power of Suppliers

Suppliers have little or no bargaining power when there are many suppliers and supply exceeds demand. Suppliers compete with each other to grab orders. On the other hand, bargaining power is high when it comes to high technology and the supplier has an expertise, or if the supplier is working at economies of scale. The supplier has high bargaining power if he has significant cost advantage or constantly improves the product in the interest of the consumer, or finances the buyer.

The Bargaining Power of Buyers

Today we are living in a market-oriented economy, where consumer is king. The buyer enjoys significant bargaining power when there are many sellers and few buyers or when production capacity exceeds the demand.

The buyer can bargain for reduction of prices, quantity discount, better quality at same price, better after-sales service, or even credit or finance facility. Being, for instance, arranges finances for its buyers. Today, the consumer durables industry and the two-wheelers and automobile industry arranges finances for customers in collaboration with banks.

The Sixth Force

Andrew Grove, the former CEO of Intel, has argued that Porter's five forces model ignores a **sixth force**

The power, vigor and competence of complementors. Complementary products are those products that add value to some other product. They are consumed with some other product. Because they are used together, the demand of one product depends upon the demand and availability of another product. Like the demand of personal vehicles in a country depends upon the availability and price of fuel.

Demand for personal computers depends upon the availability and affordability of user-friendly software. In fact, the business of accessories like car and motorcycle accessories, computer accessories, etc., depends upon the key product. In fact, both substitutes and complementary products influence the demand for a product. So while studying the environment, one should not forget complementary products because at some point in time, they can be the decisive factor for sales and profits. Following are some other factors :

1. Marketing Intermediaries

These are firms and persons that help in distribution, promotion, selling, and provides services like consultancy. Almost every business has to take the help of these intermediaries. Sometimes they play a decisive role. Like in the FMCG business, distribution is of critical importance and there is an intense competition to acquire the support of a strong distributor.

The primary reason Coca-Cola acquired Parle was to gain access to the distribution network of Parle, which was wide and penetrated. Besides this, there are brokers, agents, logistics companies, private transporters, etc., which play an important role.

There are incidences of retailers boycotting the product of particular companies because of low margins. Companies also spend a significant amount on promotion and advertising firms. For instance, companies like HLL spend as much as 800 crores on advertising as part of their marketing strategy.

2. Financial Institutions (FIs)

For any business, FIs play a critical role. FIs not only make available the finance but also create an environment for investment. They also give expert opinion and consultancy to the corporate. Every corporate is dependent on FIs — whether it is banks or consultancies or NBFCs - for its financial needs. They also facilitate the mode of payment. For the industrial development of any country, a well-established financial institutions is a prerequisite.

These FIs mobilize the savings of the public to the corporate world. An organization that has a good rapport with FIs usually gets finance easily and at easy terms, which makes a lot of difference in this competitive environment.

3. Strategic Group

Strategic groups are conceptually defined as clusters of competitors that share similar strategies, and therefore, compete more directly with one another than with other firms in the same industry. A strategic group is to identify a more defined set of organizations so that each grouping represents those with similar strategic characteristics. They are not a formal group or an association, in fact, they are conceptual clusters in the sense that they are grouped together for the purpose of improving analysis and understanding of competition within their industry. Strategic groupings look for these similarities :

1. Extent of product diversity.
2. Extent of geographic coverage.
3. Number of market segment served.
4. Distribution channel used.
5. Extent of branding.
6. Marketing effort.
7. Extent of vertical integration.
8. Pricing, etc.

Coca Cola and Pepsi will be considered a strategic group because both have similar products and both follow similar strategies. P&G, HLL and NIRMA can also be considered to be the same strategic group. This sort of grouping in order to analyse and understand competition is very useful. It also helps in tracing close competitors and in formatting counter strategies.

4. Critical Success Factors (CSFs)

Many industries have small but extremely important set of factors that are essential for successfully gaining and maintaining a competitive advantage. Critical success factors are those areas in which good results will help to ensure an organization's success against competition and where poor results usually lead to declining performance.

CSFs which are relevant to any company are determined by a variety of environmental and firm-specific considerations. During environmental analysis, one should find out what are the critical factors for the firm. For an FMCG, distribution network is a critical success factor; for pharmaceutical companies, R&D is a factor, and for a generic product company like steel, or aluminium manufacturing firms, cost is a CSF. For a food chain organization like McDonalds, logistics and supply chain management is a CSF.

5. Driving Force

Behind every change in environment there is some driving force and these driving forces lead to a sequential change in environment. To understand and forecast future trends, it is essential to understand the driving force behind them. In fact, sometimes changes in segment A can be the result of changes in segment B and on the other hand, to influence B, one has to influence A.

For instance, if there is a sudden rise in the sale of a certain product of an organisation, it may pressure this to be a result of the hard work of tis sales force, whereas it may actually because its competitor's product is in short supply.

1.8 Macro Environment

The Macro/General environment consists of factors external to the industry that may have a significant impact on a firm's strategies. Here we will look at six broad dimensions—demographic, socio-cultural, political/legal, technological, economic and global.

All these dimensions of general environment are interrelated. These dimensions not only influence businesses, but also influence each other. After a political change in 1991, when Congress government came to power, major economic change took place in the form of LPG, i.e., Liberalization, Privatization, and Globalization. This led to an enhancement in the technological environment of the country. This technological and economical change has transformed the socio-cultural environment of the country.

Globalization has also enabled India to become the software superpower of the world. All global organizations now have a new and vast market, as well as cheap manufacturing hub, which has compelled them to change their global marketing and manufacturing strategies.

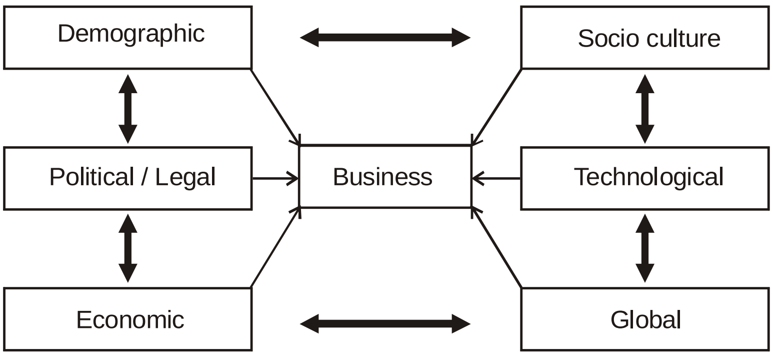


Figure : Dimensions in General Environment

With this, over the last ten years, there has been a drastic change in India's demography as per capita income has risen. The number of young achievers and high earners has increased drastically, which changed the entire demand schedule of products.

This shows that a single political change in 1991 has changed all the components of the macro environment. So, while studying macro environment, one should not only concentrate on how this factor will influence business but also on how this will influence other components of the environment and what will be the impact of these changes in the business. Only then can one design long-term strategies.

1. **Political Environment: I**t is the political environment of a country that decides the fortune of businesses in the country. After the 1917 revolution in Russia, a sudden political change transformed the equation of doing business. After the change of regime in the USSR, in late 1980s and early 1990s, business equations changed once again in Russia.

   In India, in 1977, the Janata government came to power because of which Coca Cola and IBM had to leave the country. All liquor companies had to close their operations. When P.V. Narsimha Rao came to power and a new economic policy was put in, it presented new opportunities for businesses, but at the same time brought a threat for inefficient organizations.

   Not only political philosophy but political stability too has a significance for businesses. The more stable the political environment of a country, the more conducive will be the environment for business. The consensus among various political parties on key issues are also relevant in this case.

2. **Regulatory and Legal Environment:** The political environment governs the legal and regulatory environment of a country. The regulatory environment plays a vital role by dictating the dos and don'ts of a business. Every country has a different legal environment.

   In India, we have the Companies Act that governs companies, the MRTP Act which restricts monopoly, various laws regarding shares, the Consumer Protection Act, environmental laws, etc.

   The implementation of GATS has resulted in the implementation of international laws regarding patents. There are also laws for import and export, licensing, etc. that have a drastic impact on the business and future of organizations.

   When a British citizen and also an NRI, Lord Swaraj Paul, tried to take over Escorts, its owners, the Nandas approached the government to save their company. A law restricting any NRI from purchasing shares of an Indian company came into force, and Escorts was saved.

3. Demographic: It is the demographic environment which decides the marketing mix for an organization. It decides the type of product the organization comes out with. In India, a lot of research and efforts are undertaken to reduce the cost of products and to launch products at the cheapest possible rates. A one rupee sachet of shampoo or a five rupee ice-cream cone are some examples. It is the demography that decides the pricing, promotion and distribution strategies. 70% of India's population lives in villages and of this, 70% are youth which is why every business house is launching new products, specifically for the rural market. For example, ITC launched its unique and ambitious programme called chaupal, targeted at the rural market.

4. Socio-Cultural: Socio-cultural variables like the beliefs, value system, attitudes of people and their demographic composition have a major impact on the personality of people and their behavior style. The consumers' preferences have undergone a drastic change since 1990s. This has led to an increase in the production of cars, refrigerators, air conditioners and other articles that were at one time considered as ostentatious and luxurious.

Not only this, socio-culture paradigms also dictates the preference of consumer in different regions. For instance, companies launch different products in the south and north because of differing preferences. Companies have to change their product portfolio because of cultural preferences as McDonalds and KFC did when they launched their restaurant chain in India.

5. Technological: Technological forces present a wide range of opportunities and threats that have to be accounted for in the process of business strategy formulation. Technological advancement may dramatically affect an organization's products, services, markets, suppliers, distributors, competitors, customers, manufacturing process, marketing practices, financial composition, and competitive position. Some of the important factors that influence the technological environment are :

i) Sources of technology like company sources, external sources and foreign sources, cost of technology acquisition, collaboration and transfer of technology.

ii) Rate of change in technology, rate of obsolesce.

iii) Impact of technology on human being, the man-machine system, and the environmental effect of technology.

iv) Communication and infrastructure technology in management.

Today, technology is a decisive factor. From FMCGs to the microprocessor industry, everybody is investing heavily in technology. The technological knowledge of a consumer also influences the decisions. Organizations have to modify its products according to the level of technological knowledge of the target costumer, because in developing nations, complex household machines that need programming will not work. So they have to be technologically more and more focused.

6. **Global Environment:** The international environment consists of all factors that operate at the transnational, cross-cultural level and across the border. The world is a global village today and it is getting closer and closer as far as business is concerned.

For the sake of business, countries are burying their grievances and forging economic relationships. Erstwhile adversaries like America and Russia are today goods friends and China and India are coming closer.

India has also signed a bilateral treaty with Sri Lanka. It is developing close economic relationship with South Africa and Brazil, and is planning to develop a road network in South East Asia. India is also a close ally of ASEAN, and is also a signatory of WTO which has a multilateral trade agreement among more than 100 nations.

India is in the process of laying down a gas pipeline from Iran via Pakistan. All this is just a glimpse of the present international environment. Every new bilateral/multilateral agreement opens new vistas for business and also brings a new threat in the form of global competition.

7. **Economic Environment:** The economic environment consists of macro level factors related to the means of production and distribution of wealth, which have an impact on the business of an organization.

The economic structure of a country, whether it is socialist, mixed or capitalist, has a drastic impact on the economy. Economic policies such as foreign trade policy, industrial policy, fiscal policy, GDP growth rate, policy of licensing, monetary policy, development of financial institutions, development of money and stock market, and the extent of globalization are some of the aspects of an economy that reflect on business in an economy. A slight change in monetary policy can release crores of rupees into the economy that may result in a decrease in interest rate, which further increases investment as well as inflation.

Also, banks' lending rates decide the level of investment in any country. The higher the interest rate, the lower the level of investment. In most industrialised nations, like the US, this interest rate is between 4% to 6%. In India, in 1991, the PLR (Prime Lending Rate) was 17% to 18%, which was reduced to 8% to 10% by 2000 because of a change in the country's economic policy.

8. **National Competitive Advantage:** Despite globalisation, industrialisation is clustered in a small and specific number of countries. Most successful computer and biotechnology firms are based in the US, the successful chemical and engineering industry is based in Germany, and the cream of the electronics industry is based in Japan.

Similarly, the successful call centers are clustered in India as are many of the customised software companies. This suggests that the nation and its environment in which a company is based may have an important bearing on the competitive position of that company in the global marketplace.

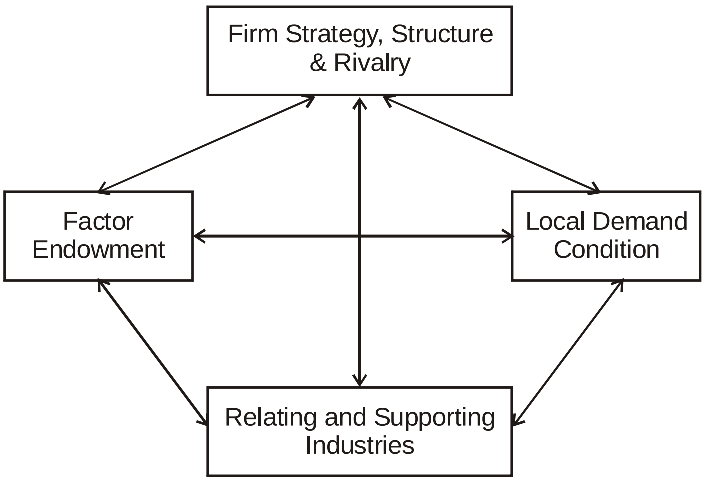


Figure : Michael Porter's International Competitiveness Model

In a study of national competitive advantage, Michael Porter identified four attributes of a national or country-specific environment that have an important impact on the global competitiveness of companies located within that nation.

1. **Factor Endowments:** A nation's position in the factors of production such as skilled labour, capital, technology or the infrastructure necessary to compete in a given industry.

2. **Demand Condition:** The nature of home demand for the industry's products and services.
3. **Relating and Supporting Industry:** The presence and absence of supplier industries and related industries in a nation that are internationally competitive.
4. **Firm Strategy, Structure and Rivalry:** The conditions in a nation that govern how companies are created, organised and managed and the nature of domestic rivalry.

1.9 Environmental Scanning

The process by which organisations monitors their environment to identify opportunities and threats affecting their business, is known as environmental scanning. The following factors are considered for environmental scannings :

1. **Events :** Important and specific occurrences that take place in a certain sector.
2. **Trends :** The general tendencies or courses of action along which these events take place.
3. **Issues :** The current concerns that arise in response to events and trends.
4. **Expectations :** The demands made by interested groups in the light of their concern for issues.

1.10 Policy Environment : Industrial Policy

Introduction

Industrial development plays a significant role in the economic development of any nation. Industrial development of a country calls for an appropriate and progressive industrial policy To regulate the industry in the desired direction, Government of India has been issuing guidelines from time-to-time in the form of Industrial Policy. Before independence, policy of the government was characterised by laissez-faire, i.e., non-interference policy in the affairs of industries.

Industrial development was left to the exclusive care of private sector. However, in the post-independence era, government has been taking an active interest in the development of industries in India. Through industrial policy, industrial development has been fully controlled and regulated by the government.

Meaning of Industrial Policy

Industrial policy means those principles and activities which are pursued and performed to help industrialise a country. Industrial policy includes rules, regulations, principles and procedures to regulate the industrial undertakings of a country in the desired direction, so as to achieve broader objectives like industrial development, economic development, balanced regional development, increase in employment, etc. Industrial policy includes policy regarding labour and capital, cottage and small industries, foreign capital and protection, etc. It is, therefore, aptly said, “Industrial policy is an instrument with the help of which the state participates in the growth process.”

Definition of Industrial Policy

According to World Bank, “Industrial policy comprises government efforts to alter industrial structure to promote productivity based growth”.

According to Rodrik, Naude, “Industrial policy is the process whereby governments aim to deliberately affect the structural characteristics of their economies”.

According to UNCTAD, “Industrial policy as a “concerted, focused, conscious effort on the part of government to encourage and promote a specific industry or sector with an array of policy tools”.

According to Akkemik, “Industrial policy is a set of policies designed for the development of selected industries to increase the welfare of the country and to achieve dynamic comparative advantages for these industries by use of state apparatus in resource allocation”.

1.10.1 Objectives of Industrial Policy

Some of the important objectives can be identified as follows :

1. **Correcting Imbalances:** Correct the imbalances in the development of industries and helps in bringing about a desirable balance and diversification in them.
2. **Directing Resource Flow:** Direct the flow of scarce resources in the most desirable areas of investment in accordance with national priorities.
3. **Optimum Utilisation of Resource:** Prevent the wasteful use of scarce resources and ensure their conservation and judicious utilisation.
4. **Control over Private Industry:** Empower the government to regulate the establishment and expansion of private industry in accordance with the planned objectives.
5. **Demarcating Industrial Areas:** Demarcate areas among the public, private and joint sectors of the economy, as well as large, medium and small-scale industries.
6. **Proper Distribution of Wealth:** Prevent the formation of monopolies and concentration of wealth in a few hands through fiscal and monetary policies. So that the evils associated with monopolies can be effectively curbed.

7. **Control Over Foreign Capital:** Give guidelines for importing foreign capital and the conditions on which such capital should be permitted to operate.

8. **Other Objectives:** Other objectives or the rationale of industrial policy includes:

    i) Achieving a socialistic pattern of society,

    ii) Preventing undue concentration of economic power,

    iii) Achieving industrial development,

    iv) Achieving economic growth,

    v) Reducing disparities in regional development,

    vi) Developing heavy and capital goods industry,

    vii) Proving opportunities for gainful employment,

    viii) Expanding the public sector for achieving socialism,

    ix) Achieving faster economic growth,

    x) Achieving a self-sustained economy,

1.10.2 Importance of Industrial Policy

Importance of industrial policy to an underdeveloped country is evident from the following facts :

(i) Limited Capacity of Private Sector : Private sector has limited resources and is not in a position to undertake risky ventures in underdeveloped countries. It therefore, becomes imperative that government itself should take active part in industrial development. Industries of public interest and involving huge capital investment and risk are set up by the government in public sector. Government develop roads, establishes power stations, heavy and basic industries, etc. As a result, private sector also receives stimulus. Private sector as a subsidiary to public sector develops various industries. Some industries are developed jointly by public and private sector.

(ii) Regulation of Private Sector : To regulate private sector in the desired direction appropriate industrial policy is required. Resources of underdeveloped countries being limited, the same should be utilized according to the priorities of the plans. Government, therefore, controls and regulates private sector to work in accordance with the priorities determined by the plans. Thus, proper industrial policy is very essential to control the private sector.

(iii) Regulation of Foreign Sector : In the initial stages of economic development, a country has to depend on foreign capital, foreign assistance and foreign trade, etc. Proper policies in this respect are of utmost significance. It therefore, becomes imperative for the government to formulate appropriate policies; so that foreign sector does not go against the national interest and helps to promote economic development. Public, private and foreign sectors make great contribution to industrial development. A firm and clear industrial policy is, therefore, very necessary to coordinate and demarcate these sectors.

Industrial Policy in Free India

Need for a new, well-planned and clear industrial policy was felt in independent India. To meet this need, five industrial policies at different time intervals have so far been formulated in India, i.e., Industrial Policy, 1948, 1956, 1977, 1980 and 1991 respectively.

1.11 Industrial Policy Resolution 1956

A new and comprehensive Industrial Policy was announced in 1956. Main objectives of the new Industrial Policy were acceleration of the rate of industrial and economic development, development of basic industries, machine-building industries, reduction of income and wealth inequalities and checking of concentration of monopoly and economic power. Second five year plan to fifth five year plan were based on this industrial policy.

Main Features of Industrial Policy of 1956

(a) Classification of Industries

Large-scale industries have been divided into three categories:

(i) Public Sector

Under Schedule A', 17 industries were enlisted for public sector. These industries included such industries as arms and ammunition, atomic energy, iron and steel, heavy machinery, heavy electrical parts, mineral oil, coal, air transport, railway transport, shipping, telephones, wireless apparatus, copper, lead and zinc mines, generation of electricity, etc.

(ii) Public-cum-Private Sector

Under Schedule 'B', 12 industries were included. These industries were to be progressively state owned and in the setting up of new undertakings normally government was to take the initiative. However, private enterprise would also be given opportunities to develop in this sector. It is hoped that the private enterprises would serve as supplementary to state enterprises. In this schedule industries included are- aluminium, machine tools, drugs, chemical fertilizers, road and sea transport, minerals, etc.

(iii) Private Sector

Under Schedule 'C' all the remaining industries not included in the above two categories are included. Their establishment and development were both left to the private sector, but it will have to operate in conformity with the economic and social policies of the state.

(b) Fair Treatment to Public Sector

Provision has been made under this policy to promote private sector industries by giving them facilities of power, transport and finance. Government will not adopt any discriminating policy against private sector and it will be given fair and equal treatment.

(c) Cottage and Small-Scale Industries

An important role has been assigned to cottage and small-scale industries as these industries have potential to generate more and quick employment, remove the inequalities in the distribution of wealth and make proper use of the local capital. Government will make all efforts to promote the-development of these industries.

(d) Balanced Regional Growth

In order to check unbalanced growth of industries in different parts of the country, special provisions have been made in this policy. Those regions which are industrially backward will receive priority in the establishment of new industries. More and more facilities will be provided for the development of industries in these regions.

(e) Technical and Managerial Personnel

Arrangements will be made to impart technical and managerial training to the personnel of both private and public sectors. Special training institutions, business management courses will be started in universities to meet the requirement of managerial personnel.

(f) Proper Amenities for Labourers

Under this policy, arrangements will be made to provide proper amenities for labourers like, social security measures, pension-benefits, etc. Special efforts will be made to raise the standard of living of labourers and improve their working conditions. It was resolved to give opportunities to the labourers to participate in management.

(g) Proper Management of Public Enterprises

In this policy emphasis was placed on the importance of need for efficient management of public enterprises. It was hoped that these public enterprises would be a source of adequate revenue to the state and make proper use of country's resources.

(h) Foreign Capital

Several modifications were introduced in the policy concerning foreign capital. To make use of foreign capital on a large-scale, many concessions were offered to foreign capital.

(i) Flexible

Under the policy, the government was empowered to go in for any kind of industrial production. The division of the industries into three categories, under this policy, was not rigid. It was flexible and can be changed by the government, if so needed. Industries of one sector may be allowed to be developed by the other sector.

1.12 New Industrial Policy 1991

On July 24,1991, Government of India announced its new industrial policy. The main objective of this policy is to the liberalise the Indian industrial economy from administrative and legal controls. Its main aim is to raise industrial efficiency to the international level and accelerate industrial growth.

Main Features of New Industrial Policy

1. Contraction of Public Sector

Under the new industrial policy number of industries reserved for public sector was reduced from 17 to 8. These 8 industries were: (i) Arms and Ammunition, (ii) Atomic Energy, (iii) Coal, (iv) Mineral Oil, (v) Mining of Iron Ore, Manganese Ore, Gold, Silver, (vi) Mining of Copper, Lead, Zinc, (vii) Atomic Minerals, (viii) Railways. In 2004-05, this number was reduced to 3 only, i.e., now only three industries are exclusively reserved for public sector, namely atomic mineral, atomic energy and railways. All other areas are thrown open to the private sector.

Recently government is thinking of opening atomic energy sector for private sector. Industries reserved for public sector are gradually opened to private sector. In order to increase competition in public sector, provisions have been made to offer a part of government share holding in the public sector to mutual funds, financial institutions, workers and the general public. Public sector will continue to occupy an important place in the economy of the country, but government will ensure that it functions on business lines. Public sector will be permitted to set up even those industries which are not reserved for it.

2. Delicensing

In new industrial policy, it was necessary to obtain industrial licence only in case of 18 industries. Rest all other industries were exempted from industrial licensing. In the wake of liberalisation, in 1999, the industries requiring compulsory licence were reduced to 6. In 2006, number of industries which are required to obtain compulsory industrial licence has been further reduced to 5. The specified industries where compulsory licensing will continue include alcoholic products, tobacco products, aerospace and defence equipments, industrial explosives, hazardous chemicals. Except these industries all other industries are exempted from the industrial licensing. So area of industrial licensing has been reduced and its scope has been made very limited.

3. Abolition of Registration

All existing registration schemes related to industries have been abolished. Now the entrepreneurs will have to give only a memorandum of information for new projects and substantial expansion of existing industrial units.

4. Foreign Capital

Foreign capital investment limit has been raised from 40 per cent to 51 per cent equity. In 47 high priority industries foreign equity upto 51 per cent will be permitted without any bottlenecks and red tapism. Foreign capital investment upto 74 per cent has been permitted in 9 industries. Foreign equity holding upto 74 per cent equity has been allowed for trading houses primarily engaged in export activities. In the year 1999, Foreign Exchange Regulation Act (FERA) was replaced with new Foreign Exchange Management Act, 1999 (FEMA). In the new Act, foreign equity upto 100 per cent has been allowed in many areas. Now our government welcomes foreign investment.

5. Setting up Foreign Investment Promotion Based

A special empowered board has been constituted to negotiate with international firms and approve foreign direct investment in selected areas.

This would be a special programme to attract substantial foreign investment and to provide access to high technology and world markets.

6. Technical Experts

Hiring foreign technicians or foreign testing of indigenously developed products will need no permission. For these payments, foreign exchange can be easily purchased from Reserve Bank of India without any restrictions.

7. Public Enterprises Incurring Losses

Public enterprises incurring losses persistently will be investigated by the Board for Industrial and Financial Reconstruction (BIFR). Government will formulate revival or rehabilitation schemes for chronically sick public sector units. Interest of the workers affected by these schemes will be protected.

8. Facilities to Labourers

In order to rehabilitate retrenched employees and workers of public sector units the policy provides for social security mechanism. With a view to providing social security to the workers, National Renewal Fund is set up. The fund provides relief to the workers affected by technological changes, privatisation of public sector units and closure of public sector units.

9. Location of Industries

In cities with population of less than 10 lakh, location clearance will not be required (except for those industries where licensing is compulsory). In case of cities with population of 10 lakh and above, except electronics and other non-pollutant industries, all other units will be set up at a distance of 25 kms from the city municipal limits. It means non-pollutant industries like printing, computer, electronics etc. can be set up within city also.

10. Encouragement to Industries in Backward Areas

Special incentives will be offered by the government to industries in the backward regions with a view to reducing regional disparities.

11. Freedom from Administrative Controls

Expansion programmes of new units will be exempted from administrative controls. Existing units will be free to produce any commodity on the basis of the licence already issued.

12. Concessions from Monopolies Act

Companies under MRTP Act have been given concessions Monopolies and Restrictive Trade Practices Act have been amended to remove the limits of assets in respect of MRTP companies. Now companies will not have to take permission from MRTP Commission, for setting up of new units, mergers, expansion, diversification, etc. In the new industrial policy 1991 working of MRTP Act is restricted to prevent restrictive and unfair trade practices. In the year 2002, government abolished MRTP Act and in its place framed much liberal Competition Act, 2002.

13. New Definition of Micro, Small and Medium Enterprises

In year 2006, a new definition of micro, small and medium enterprises was given. In this definition both manufacturing and service enterprises are covered in the meaning of micro, small and medium enterprises. Following investment limits have been fixed:

(i) Manufacturing Enterprises - based on investment in plant and machinery

  (a) Micro enterprise - upto Rs 25 lakh

  (b) Small enterprise - above Rs 25 lakh and upto Rs 5 crore

  (c) Medium enterprise - above Rs 5 crore and upto Rs 10 crore

(ii) Service Enterprises - based on investment in equipments

  (a) Micro enterprise - upto Rs 10 lakh

  (b) Small enterprise - above Rs 10 lakh and upto Rs 2 crore

  (c) Medium enterprise - above Rs 2 crore and upto Rs 5 crore

14. Reservation for Small-Scale Industries

In year 2006, small-scale industry has been defined as a unit having investment upto Rs 5 crore in plant and machinery. Special provisions have been made for promotion of small-scale industries. In October 2008, production of 21 items was reserved for exclusive manufacture in small-scale industries. Large industries and medium enterprises will not be allowed to go in for their production.

15. Facilities of Import

The policy provides for automatic approval for the import of capital goods whose value is less than 25 per cent of the total value of plant and machinery subject to a maximum limit of Rs 2 crore. In other matters relating to the import of capital goods, raw materials, technology, etc. Ministry of Industries will give necessary permission keeping in view foreign exchange position.

1.13 Fiscal Policy

Introduction

Fiscal Policy is a part of economic policy of the government which is related to government income and expenditure. It includes public expenditure policy, taxation policy, public debt policy and deficit financing. it is aimed at achieving certain objectives like – rapid economic development, reduction in economic inequalities, promoting capital formation, etc.

Meaning of Fiscal Policy

The term, fiscal policy, embraces the tax and expenditure policies of the government. Fiscal policy may be defined as that part of governmental economic policy which deals with taxation, expenditure, borrowing and the management of public debt in an economy. It is an instrument of modern public finance.

Thus, fiscal policy operates through the control of government expenditures and tax receipts. It encompasses two separate but related decisions; public expenditures, and the level and structure of taxes. The amount of public outlay, the incidence and effects of taxation, and the relation between expenditure and revenue exert a significant impact upon the free enterprise economy.

Definition of Fiscal Policy

According to Buehler, "fiscal policy is meant the use of public finance or expenditure, taxes, borrowing and financial administration to further our national economic objective".

According to Arthur Smithies, "Fiscal policy is a policy under which government uses its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on the national income, production, and employment".

1.13.1 Objectives of Fiscal Policy

1. To mobile resources for rapid economic development of the country.
2. To increase the rate of saving in the country so that sufficient financial resources can be obtained from within the economy.
3. To increase the rate of investment in the economy, so as to promote capital formation.
4. To remove poverty and unemployment
5. To reduce economic' inequality
6. To reduce regional disparities
7. To achieve economic stability
8. To ensure optimum utilisation of resources
9. To support private sector
10. To achieve favourable balance of payments.

1.13.2 Tools & Techniques of Fiscal Policy

Fiscal policy has four techniques as under:

1. Public Expenditure Policy
2. Taxation Policy
3. Public Debt Policy
4. Deficit Financing

Fiscal Policy of the government is reflected in its annual budget. To have knowledge of fiscal policy, it is essential to study its different techniques.

1. Public Expenditure Policy

Public expenditure influences the economic activities of a country very much. In 2008-09, share of public expenditure in national income was 16.93 per cent. Public expenditure may be of two kinds i.e, developmental and non-developmental. Developmental expenditure is of great importance to the economic growth of the country. Expenditure on developmental activities requires huge amount of capital. So much capital cannot be made available by private sector alone. It requires substantial increase in public expenditure.

Development of means of transport, extension of means of irrigation, completion of power projects and expansion of educational and health facilities are possible only with the help of public expenditure. Public expenditure may be made in many ways, *viz.,* (i) Development of state enterprises, (ii) Support to private sector (iii) Development of infrastructure i.e., railways, roads, power projects, bridges, hospitals, etc. (iv) Social welfare. Main features of government's policy regarding public expenditure are as follows:

(i) Development of Public Enterprises: Underdeveloped countries lack in basic and heavy industries. Establishment of these industries requires huge capital investment. They involve great deal of risk. Ordinarily, private sector cannot set up these industries because of more risk and huge capital investment. Since Industrial Policy 1956, government of India has been developing these industries.

(ii) Support to Private Sector: In order to accelerate the rate of economic growth in the country, government should encourage private sector. For this, government gives various subsidies, concessional loans, tax concessions, etc. to the private sector.

(iii) Development of Infrastructure: Government spends huge amount for development of infrastructure, which is must for economic development of any nation. Infrastructure of an economy includes development of railways, power projects, roads, air ports, ports, hospitals, bridges, tunnels, dams, etc.

(iv) Social Welfare: Government spends huge amount on public health, education, safe drinking water, sanitation, welfare of weaker sections of society, etc.

2. Taxation Policy

Taxes are the main source of revenue of government. Government levies both direct and indirect taxes in India. Direct taxes are those taxes which are paid directly by the assessee to the government e.g. income tax, wealth tax, etc. Indirect taxes are paid indirectly by the public to the government, i.e., these taxes are charged by trader/manufacturer from the public and then paid to government e.g., excise duty, custom duty, value added tax (VAT), service tax, etc.

Direct taxes are progressive in nature, i.e., the rate of tax increases with the increase in level of income/wealth, so people with low income pay tax at lower rates and people with higher income pay tax at higher rates. Indirect taxes are not progressive. These are charged from all segments of the society at the same rate, i.e., both rich and poor have to pay indirect taxes at the same rate. In India, in the year 2009-10, direct taxes constituted 58 per cent of the total tax collection and indirect taxes constituted 42 per cent of total tax. Main objectives of taxation policy in India are as follows:

(i) Mobilisation of Resources: Taxes are the major sources of government revenue. Tax revenue in India has been rising every year. Government mobilizes resources through taxation for economic development. In year 2009-10, about 56 per cent of revenue of central and state governments of India came from tax revenue. Rate of taxes have come down but the collection of tax has increased.

(ii) To Promote Saving: One of the important objectives of taxation policy is to promote savings. For this purpose various tax concessions, tax deductions are given on savings e.g., savings in provident fund, savings in national saving certificate, saving through life insurance policies, saving through government bonds, mutual funds, etc.

(iii) To Promote Investment: To promote investment in remote and backward areas, rural areas, various tax rebates, tax concessions and tax holiday benefits are given for investment in these areas. Similarly, tax rebates and concessions are given to export-oriented units, so as to encourage investment in these industries.

(iv) To Bring Equality of Income and Wealth: To achieve this objective, different kinds of progressive direct taxes are levied e.g. income tax, wealth tax, etc. i.e., rate of tax is increased with the increase in income. Similarly, excise duties are levied at higher rate on luxury goods and at lower rates on necessary goods.

3. Public Debt Policy

Government needs lot of funds for the economic development of the country. No government can mobilise so much funds by way of taxes alone. There are many reasons for it, viz., (i) most of the population is poor; (ii) adverse effect of more taxes on saving and investment; (iii) taxes are levied only upto taxable capacity of the people. It therefore, becomes inevitable for the government to mobilise resources for economic development by resorting to public debt. Public debt is obtained from two kinds of sources:

(i) Internal Debt: Internal debt should be mobilised in a manner that it has no adverse effect on private investment. It is more beneficial to collect small savings as it encourages the people to save more. Special efforts should be made to mobilise rural small savings. In India, small savings are being collected from large number of people through commercial banks and post offices. Internal debt constituted 96.1 per cent of total public debt in the year 2009-10.

(ii) External Debt: India cannot meet its financial requirements from internal debt alone. It has to borrow from abroad as well. The main advantage of foreign loans is that these loans are received in foreign currency. External debt constituted 3.9 per cent of the total public debt in the year 2009-10.

4. Deficit Financing

Deficit financing refers to financing the budgetary deficit. Budgetary deficit here means excess of government expenditure over government income (including borrowings). Deficit financing in India means, "Taking loan from the Reserve Bank of India by the government to meet the budgetary deficit." Reserve Bank gives this loan by issuing new currency notes. Consequently, money supply increases. Increase in money supply leads to fall in the value of money. Fall in value of money in turn leads to increase in price level.

So deficit financing should be kept low as it leads to price rise in the economy. But in underdeveloped countries like India, level of income is low. As a result, capacity to save in these countries is low and so also their taxable capacity is also low. Due to low saving, there is low rate of capital formation and low rate of capital formation causes low rate of economic growth.

Hence, to accelerate the rate of economic growth, it becomes inevitable to increase saving and investment. Deficit financing is a kind of forced saving. On account of deficit financing, price level rises and people get less number of goods in exchange for the same amount of money than before. Government of India has also been taking resort to deficit financing since the beginning of the plans. Thus, due to deficit financing, on the one hand, necessary funds are made available for economic growth and on the other, inflation in the country increases. It is, therefore, essential that deficit financing be kept within safe limits. Presently, our government is not using deficit financing for meeting its financial requirements.

1.13.3 Evaluation of Fiscal Policy

Since independence, government of India has been making use of fiscal policy to mobilise resources for economic development. Industries of India have witnessed rapid development. Considerable expansion of means of communication and transport, roads, railways, canals, power projects, etc. has taken place. However, due to increasing burden of taxation, people's capacity to save and produce has been adversely affected. Fiscal policy has failed to check economic inequality and solve the problem of unemployment in an effective manner. Instead of checking rise in prices, fiscal policy has fuelled inflation.

Contribution / Advantages of Fiscal Policy

The main advantages of fiscal policy are as follows:

1. Capital Formation

Fiscal policy has played a significant role in the capital formation of public and private sectors. It leads to further economic development of the nation. Consequently, gross domestic capital formation increased to 34.9 per cent in 2008-09.

2. Inducement to Private Sector

Fiscal policy of India has provided incentives to private sector for investment and production by several measures. To set up industries in backward areas, several tax concessions have been given.

3. Mobilisation of Resources

Fiscal policy has also helped mobilisation of resources. To execute the plans, resources have mainly been provided by internal resources. By making use of measures like taxes, savings, public debt, etc. government has mobilised sufficient resources for the projects necessary for economic development. In third five year plan 72 per cent resources were mobilised for plan through internal resources. In eleventh five year plan percentage of internal resources to finance the plan rose to 100 per cent.

4. Incentives for Savings

Fiscal policy has provided several incentives for savings to household and corporate sectors. To encourage savings in the household sector, several concessions are tax exemptions have been given on life insurance, NSCs, Kisan Vikas Patra, Provident Fund, Infrastructure Bonds, etc. Tax concessions have also been allowed to corporate sector to enable them to save more and to replough their profits. It is due to different measures of fiscal policy that the saving rate in the country increased to 32.5 per cent in 2008-09.

5. Development of Public Enterprises

Fiscal policy has been providing finance for development of public enterprises. These public enterprises have been set up in the area of basic and heavy industries. Establishment of basic and heavy industries involves great deal of risk and huge capital investment. So private sector hesitates in setting up these industries. These industries have played significant role in the industrial development of our nation. Public enterprises have promoted infrastructure like railways, power, ports, roads, dams, etc.

6. Social Welfare

Through fiscal policy government spends huge amount on public health, education, safe drinking water, welfare of weaker sections of society, child welfare, woman welfare, welfare of aged persons, etc. All this has promoted social welfare in the economy.

7. Alleviation of Poverty and Generation of Employment Opportunities

Fiscal policy has been endeavouring to alleviate poverty. With a view to providing employment to the poor people of the country and to enhancing their level of income, considerable public expenditure was incurred on several programmes initiated in this respect e.g. 20-point programme, Integrated Rural Development Programme, Jawahar Rozgar Yojana, Prime Minister Rozgar Yojana, National Rural Employment Guarantee Act, etc. Public expenditure on these programmes has directly influenced the living standard of the poor population. Subsidy given by the government on food, kerosene oil, LPG, etc. has also benefitted the poor people.

8. Reduction in Inequality of Income and Wealth

Fiscal policy has also endeavoured to reduce inequality of wealth and income. By way of progressive income tax, high rates of taxes on luxuries, wealth tax, etc. government has mobilized resources from the rich class and has utilized the same on the welfare schemes meant for the poor. The poor are exempted from the payment of income tax if their income is upto a certain limit. Besides, several fiscal concessions like exemption from taxes, grant of subsidies, etc., have been given for the industrial development of backward areas. The objective is to reduce regional disparities.

9. Export Promotion

Government has made use of fiscal policy for promoting export. The exporters of certain categories have been exempted from income tax. Certain exports enjoy several concessions and cash subsidies. Rate of import duty on raw materials and capital goods used for the production of export goods has been reduced. As a result of all these measures, growth rate of export that stood at 4.5 per cent in 1960-61 rose to 28.9 per cent in 2007-08.However due to economic slowdown of global economy the export growth rate has come down to 13.6 per cent in 2008-09. Likewise, subsidies and tax concessions have also been given to encourage import substitution.

10. A Tool to Control Economic Recession

Fiscal policy is a significant tool to counter the negative impact of economic recession. By providing tax reliefs and by increasing public expenditure fiscal policy helps to increase demand in the economy. To control recent economic recession, government adopted various fiscal measures in the year 2008-09 and 2009-10. Various tax concessions and reliefs in the form of reduction in excise duty, service tax, central sales tax, commodity transaction tax, removal of surcharge on individuals; increase in public expenditure on infrastructure projects, have helped in controlling economic recession. In the budget of 2008-09 and 2009-10, fiscal deficit was 5.9% and 6.5% of GDP respectively. Such fiscal measures have promoted demand and thereby production.

1.13.4 Short Comings / Drawbacks of Fiscal Policy

Main shortcomings of fiscal policy of India are as follows:

1. Inflation

Deficit financing has proved inflationary. Deficit financing results in increase in money supply, which results in fall in the value of money and in turn leads to rise in prices.

2. Defective Tax Structure

In India share of direct taxes is less than the share of indirect taxes. Such tax structure proves burdensome for the poor. Indirect taxes like excise duty, value added tax, service tax, etc. are charged at the same rate from rich as well as poor sections of society. It badly affects the poor section of our society. Moreover, agriculture income is still tax free, although some of the big farmers are earning the huge income. Salaried class bears the huge burden of tax.

3. Poor Tax Administration

Indian tax administration has been very poor. Because of poor administration, there is enormous tax-evasion. There are various loopholes in our taxation policy, because of which business class can evade tax. Poor tax administration has failed to check black money.

4. Inequality of Income

Fiscal policy has failed to check inequality of income. Because of defective indirect tax system, the poor class has to bear the burden of indirect taxes like the rich class. It has adversely affected the poor segment. On the other hand, direct taxes like gift tax, death duty which have no effect on poor have been withdrawn. Upper limit of wealth tax has been raised. All this has resulted in increasing the wealth and income inequality.

5. Failure of Public Sector

Various public sector units are running at losses. Huge investment in public enterprises has failed to generate adequate return on this investment. Some public sector undertakings have failed to pay even interest on the capital invested therein.

6. Increase in Non-development Expenditure

In fiscal policy government is spending huge amount on non-development expenses like -— defence expenses, election expenses, subsidies, foreign travels, interest payments, grants to states/UTs, etc. These expenses are of unproductive nature and put undue burden on government exchequer. Fiscal policy has failed to control non-development expenditure.

7. Failed to Check Regional Disparities

Regional disparity refers to unequal development of different regions/states. Fiscal policy has failed in reducing regional disparities. Although some tax rebates and tax concessions are offered for investment in backward or rural areas but still a lot is yet to be done.

8. Increasing Interest Burden

Under fiscal policy government has taken huge public debt both from internal and external sources. This has resulted into undue interest burden on government exchequer.

9. Failure in Eradicating Poverty and Unemployment

Despite the working of more than five decades of fiscal policy, it has not been much successful in eradicating poverty and unemployment problem. Fiscal policy has failed to provide productive employment. Even now 21.8% of our population is living below poverty line.

1.13.5 Suggestions for Reforms in Fiscal Policy of India

Following suggestions are offered to bring about reforms in fiscal policy:

1. Reduction in Non-developmental Expenditure

Non-developmental expenditure should be scaled down through appropriate fiscal policy. The objective of the fiscal policy should be to accord importance to rapid growth rate of the economy. If non-development expenditure is brought down then growth rate of economy will improve and inflation will come down.

2. Reduction in Public Debt

Government should reduce its dependence on public debt as it imposes interest burden on government exchequer. 13th finance commission also suggested in year 2010 to reduce public debt of the centre and states.

3. Agricultural Taxation

Agricultural sector should be brought under tax net. Consequently, revenue of the government will increase and there will be no need on the part of the government either to resort to deficit financing or to depend on public debts.

4. Increase in Profitability of Public Sector Enterprises

Efficiency of public sector enterprises must be improved. As a result, fair return on capital worth billions of rupees invested in these enterprises would be generated.

Government will no longer depend on deficit financing or public debt for its expenditure. To make these enterprises profitable, these should be managed on commercial lines and more autonomy should be given to the managers of public sector units. These should be managed by professionals and not by bureaucrats.

5. Wide Scope of Taxes

Taxation system should be broad-based so that large population is brought under tax net. It will not only increase government revenue but also enable it to increase expenditure on social welfare.

6. More Direct Taxes

More importance should be given to direct taxes than indirect taxes. Government should expand the scope of direct taxes. As direct taxes have no effect on poor population, so a larger revenue should be collected through direct taxes instead of indirect taxes.

7. Reduction in Tax Evasion

Strict measures should be taken to check tax evasion in the country. For this : (i) Tax administration machinery should be made more efficient and strict. Those found evading the tax should be prosecuted, (ii) As suggested by Kelkar Committee, maximum rate of tax should be reduced so that people will not have much benefit in evading the tax. Thus, there will be very little tax evasion. Checking tax evasion will also help us to solve the problem of black money. Moreover, corruption and political immorality should also be curbed.

8. Progressive Tax Structure

The tax structure should be made more progressive so that their burden may fall more heavily on the rich than on the poor. Higher tax rates should be charged from rich class and lower tax rates should be charged from middle class. Luxury goods be taxed at higher rates while necessary goods should be taxed at still lower rates.

9. Simple Taxation System

Taxation system of the country must be simple. It will check tax evasion and tax payers will have no inconvenience in paying the taxes.

10. Disinvestment of Loss Making PSUs

Loss making public sector units should be privatised. It will reduce the financial burden of government.

11. Reducing the Problem of Overstaffing in Government Departments

Some government departments are over-staffed. It is unnecessary financial burden on the government. So surplus staff should be downsized.

12. Reduction in Subsidies

Various subsidies are being given by the government viz., food subsidy, fertilizer subsidy, petroleum subsidy, export subsidy, etc. These subsidies should be reduced as these put undue burden on government exchequer.

13. Encouragement to Saving and Investment

Although in the past few years the saving and investment rates have increased, but still there is wide scope for its further improvement. More incentives should be given to promote savings and investments.

14. Strict Implementation of Various Projects

Implementation of various projects should be strictly monitored so as to check leakage of funds and ensure control over government expense.

1.13.6 Critical Analysis of Recent Fiscal Policy of Government of India

The critical evaluation for the current fiscal policy is as follows :

1. Tax Revenues

Government of India has forecast that its gross tax revenues will expand by 19% in 2013-14, primarily reflecting an increase in surcharges for direct taxes; and factoring in GOI' expectation that nominal economic growth would be 13.4%. ICRA expects real economic growth of 5.8-6.0% in 2013-14. Corporation tax collections are estimated to expand by 17% in 2013-14 considerably higher than the 11% growth in 2012-13 BE, benefiting from an expected recovery of corporate profitability.

2. Non-Tax Revenue and Disinvestment Proceeds

The Budget Estimate (BE) for 2013-14 forecast inflows from telecom to double to Rs. 400 billion from Rs. 200 billion in FY 13, the achievement of which would depend on market conditions and the outcome of ongoing legislation regarding one-time spectrum fee from private GSM players, GOI has assumed a sharp up tick in dividends and profits to Rs. 740 billion in FY14 from Rs. 555 billion in FY13. The target for disinvestment has been set at Rs. 558 billion.

3. Revenue Expenditure

It is budgeted to increase by 14% in 2013 14 relative to 10% in 2012-13 RE. Non-plan revenue expenditure is expected to rise by a modest 8% in 2013-14 BE, lower than the 13% growth in 2012-13 RE. However, plan revenue expenditure is expected to expand by a healthy 29% in FY14, following the low 3% growth in 2012-13 RE. In particular, grants for capital assets are estimated to grow by 41% in FY 14 after contracting by 6% in FY13.

4. Capital Expenditure

Capital expenditure and gross lending is budgeted to rise by a sharp 37% in 2013-14 relative to the modest 6% in 2012-13 RE. Capital expenditure on defence is expected to rise by 25% in 2013-14 BE, following the low 2% growth in 2012 13 RE. Non-defence capital outlay and gross loans and advances are estimated to expand by a sharp 45% in the coming fiscal (8% in 2012-13RE).

This includes an allocation of Rs.155 billion for capitalisation of public sector banks, regional rural banks, etc.

5. Fiscal Balances

The revenue deficit and effective revenue deficit are estimated to decline in 2013-14 as compared to 2012-13 RE even as the fiscal deficit is estimated to widen to Rs.5.4 trillion from Rs.5.2 trillion, respectively. In particular, the effective revenue deficit is estimated to decline appreciably to Rs.2.1 trillion in 2013- 14 from Rs.2.7 trillion in the ongoing fiscal. Moreover, the targeted fiscal deficit of 4.8% of GDP is in line with the target set in October 2012.

6. Borrowings

Government of India has indicated a net long-term borrowing programme of Rs.4.84 trillion in 2013-14, marginally higher than the borrowings of Rs.4.67 trillion in 2012-13. However, the gross borrowings to be undertaken by Government of India in 2013-14 exceeded market expectations (Rs.5.8-6.0 trillion), causing long-term bond yields to harden. This was on account of the decision to introduce a buy-back/swapping of government securities of Rs.500 billion in 2013-14, to reduce redemption pressure from 2014- 15 to 2018-19.

The fiscal policy for 2013-14, as enunciated in the union budget, has been designed to meet the macroeconomic challenges faced by India in an uncertain global environment :

1. Revival of Investment Patterns

The reduction in the GFD-GDP ratio in 2013-14 (BE) is based on higher mobilisation of disinvestment proceeds, tax revenues, telecommunication receipts and reduction in expenditure on subsidies. As the budget relies largely on revenue-led fiscal consolidation, its success would depend on the revival of investment climate and growth.

2. Reduction in Revenue Deficit

The reduction in revenue deficit by 0.6% of GDP during 2013-14 critically hinges upon the success in meeting the projected tax and non-tax revenues. The government would have to continue with its efforts towards rationalising and reducing subsidies in order to create space for meeting future commitments under the proposed Food Security Act.

3. Prioritisation of Capital Expenditure

The re-prioritisation of expenditure in favour of capital expenditure would increase capital outlay-GFD ratio from 28.1% in 2012-13 to 38.5% in 2013-14. It may be noted that during the fiscal consolidation phase the capital outlay-GFD ratio, on an average, was as high as 51.4%.

4. Fiscal Consolidation Measures

Overall, the fiscal consolidation measures announced in the budget will lay the foundation for a sustainable re-balancing of government finances. Fiscal prudence would impart confidence in the economy and support domestic and foreign investments.

5. Growth in Capital Formation

The envisaged elimination of effective revenue deficit by 2015-16 would make available additional resources for financing investment and capital expenditure (including grants for creation of capital assets), ensure the use of government borrowing primarily for capital formation and aid the growth process.

1.14 Monetary Policy

Monetary policy refers to the measures which the central bank of the country takes in controlling the money and credit supply in the country with a view to achieving certain specific economic objectives.

Objectives of Monetary Policy

The objectives of monetary policy differ from country to country according to their economic conditions. In the less developing countries like India or Pakistan its objective may be the maintenance of monetary stability and help in the process of economic development. In the developed countries its objective may be to achieve full employment, without inflation. Following are the main objectives of the monetary policy.

1. Control of Inflation and Deflation

Inflation and deflation both are not suitable for the economy. If the price level is reasonable and there is an adjustment between the price and cost, rate of out put can increase. Monetary policy is used to coordinate the cost and price. So price stability is achieved through the monetary policy.

2. Exchange Stability

Monetary policy second objective is to achieve the stable foreign exchange rate. If the rate of exchange is stable it shows that economic condition of the country is stable.

3. Economic Development

Monetary policy plays very effective role in promoting economic growth by providing adequate credit to productive sectors.

4. Increase in the Rate of Employment

Monetary policy another objective is to achieve full employment but without inflation.

5. Equal Distribution of Credit

Monetary policy should also ensure that distribution of credit should be equitable and purposeful. The credit priority should be given to backward areas.

6. Improvement in Standard of Living

It is also the major objective of the monetary policy that it should improve the quality of life in the country.

1.14.1 Features of the Monetary Policy of the Reserve Bank of India

The main features of the monetary policy of the Reserve Bank of India are given below:

1. Active Policy

Before the advent of planning in India in 1951, the monetary policy of the Reserve Bank was a passive, cheap and easy policy. It means that Reserve Bank did not use the measures of monetary policy to regulate the economy.

For example from 1935 to 1951, the bank rate remained stable at 3%. But since 1951, the Reserve Bank has been following an active monetary policy. It has been using all the measures of credit control.

2. Overall Expansion

An important feature of Reserve Bank's monetary policy is that of overall expansion of money supply. In the words of S.L.N. Sinha ' The Reserve Bank's responsibility is not merely one of credit restriction.

In a growing economy there has to be continuous expansion of money supply and bank credit and the central bank has the duty to see that legitimate credit requirements are met'. In fact, the overall, trend of money supply has been one of the expansions along with an almost continuous rise in price level.

3. Seasonal Variations

The monetary policy is characterised by the changing behaviour of busy and slack seasons. These seasons are tied to the agricultural seasons. In the busy season there is an expansion of funds on account of the seasonal needs of financing production, and inventory building of agricultural commodities.

On the other hand, the slack season is characterised by the contraction of funds due to the return flow. It may be pointed out that aggregate contraction of funds during the slack season has tended to fall far short of expansion in the preceding busy season.

The main reason behind this changing pattern is the requirement of additional funds by the industrial sector. Thus, during busy season the Reserve Bank adopts an expansionary credit policy and tightens the liquidity pressures during the slack season.

4. Tight and Dear Monetary Policy

In order to restrain inflation the Reserve Bank has often adopted a tight and dear monetary policy. A tight monetary policy implies that the rate of growth of money supply is lowered. A dear money policy refers to increase in bank rate. This increase in bank rate leads to an increase in the interest rates charged by the banks.

5. Investment and Saving Oriented

The monetary policy adopted by the Reserve Bank is both investment and saving oriented. To encourage investment, adequate funds were made available for productive purposes at reasonable rates of interest. The Reserve Bank has also kept the interest on deposits at a reasonable rate to attract savings.

6. Imbalance in Credit Allocation

The monetary policy is biased towards industrial sector. Agriculture does not get the required institutional finances. Consequently, it has to depend upon money lenders to a considerable extent for its credit needs.

The agricultural sector has to pay high rate of interest and even then does not get required amount of capital. A large part of funds flows to large industries. Even small scale industries suffer from the inadequacy of finances. Thus monetary policy has resulted in imbalances in credit allocation.

7. Wide Range of Methods of Credit Control

The Reserve Bank has used a wide range of instruments of credit control. It has adopted all the measures of quantitative and qualitative credit controls to meet the needs of a complex and varying economic situation.

Since the objective has been to achieve economic growth with stability, the policy of monetary management has gone beyond the traditional regulatory function. It has adopted a more positive role of channeling credit to desired sectors.

8. **Guiding Factors**

According to Shri. C. Rangarajan the following three factors have essentially guided the conduct of monetary policy:

(i) Monetary policy measures have generally been a response to fiscal policy.

(ii) While monetary policy has been primarily acting through availability of credit, the cost of credit has also been adjusted upwards sometimes very sharply to meet effectively the inflationary situations.

(iii) The areas of operation of monetary policy did not remain confined to those related to regulation of monetary authority in the allocation of credit to the non-Government sector because of an important element of national economic policy, specially after the nationalisation of banks.

1.14.2 Methods of Monetary Policy of RBI

The Monetary Policy of RBI is not merely one of credit restriction, but it has also the duty to see that legitimate credit requirements are met and at the same time credit is not used for unproductive and speculative purposes RBI has various weapons of monetary control and by using them, it hopes to achieve its monetary policy.

I) Quantitative Credit Control Methods

In India, the legal framework of RBI's control over the credit structure has been provided

Under Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949. Quantitative credit controls are used to maintain proper quantity of credit of money supply in market. Some of the important general credit control methods are:-

1. **Bank Rate Policy**

Bank rate is the rate at which the Central bank lends money to the commercial banks for their liquidity requirements. Bank rate is also called discount rate. In other words bank rate is the rate at which the central bank rediscounts eligible papers (like approved securities, bills of exchange, commercial papers etc.) held by commercial banks.

Bank rate is important because its is the pace setter to other market rates of interest. Bank rates have been changed several times by RBI to control inflation and recession. By 2003, the bank rate has been reduced to 6% p.a.

2. Open market operations

It refers to buying and selling of government securities in open market in order to expand or contract the amount of money in the banking system. This technique is superior to bank rate policy. Purchases inject money into the banking system while sale of securities do the opposite. During last two decades the RBI has been undertaking switch operations. These involve the purchase of one loan against the sale of another or, vice-versa. This policy aims at preventing unrestricted increase in liquidity.

3. Cash Reserve Ratio (CRR)

The Cash Reserve Ratio (CRR) is an effective instrument of credit control. Under the RBI Act of, l934 every commercial bank has to keep certain minimum cash reserves with RBI. The RBI is empowered to vary the CRR between 3% and 15%. A high CRR reduces the cash for lending and a low CRR increases the cash for lending. The CRR has been brought down from 15% in 1991 to 7.5% in May 2001. It further reduced to 5.5% in December 2001. It stood at 5% on January 2009. In January 2010, RBI increased the CRR from 5% to 5.75%. It further increased in April 2010 to 6% as inflationary pressures had started building up in the economy. As of March 2011, CRR is 6%.

4. Statutory Liquidity Ratio (SLR)

Under SLR, the government has imposed an obligation on the banks to, maintain a certain ratio to its total deposits with RBI in the form of liquid assets like cash, gold and other securities. The RBI has power to fix SLR in the range of 25% and 40% between 1990 and 1992 SLR was as high as 38.5%. Narasimham Committee did not favour maintenance of high SLR. The SLR was lowered down to 25% from 10th October 1997. It was further reduced to 24% on November 2008. At present it is 25%.

5. Repo And Reverse Repo Rates

In determining interest rate trends, the repo and reverse repo rates are becoming important. Repo means Sale and Repurchase Agreement. Repo is a swap deal involving the immediate Sale of Securities and simultaneous purchase of those securities at a future date, at a predetermined price. Repo rate helps commercial banks to acquire funds from RBI by selling securities and also agreeing to repurchase at a later date.

Reverse repo rate is the rate that banks get from RBI for parking their short term excess funds with RBI. Repo and reverse repo operations are used by RBI in its Liquidity Adjustment Facility. RBI contracts credit by increasing the repo and reverse repo rates and by decreasing them it expands credit. Repo rate was 6.75% in March 2011 and Reverse repo rate was 5.75% for the same period. On May 2011 RBI announced Monetary Policy for 2011-12. To reduce inflation it hiked repo rate to, 7.25% and Reverse repo to 6.25%.

II) Selective / Qualitative Credit Control Methods

Under Selective Credit Control, credit is provided to selected borrowers for selected purpose, depending upon the use to which the control try to regulate the quality of credit - the direction towards the credit flows. The Selective Controls are :-

1. Ceiling On Credit

The Ceiling on level of credit restricts the lending capacity of a bank to grant advances against certain controlled securities.

2. Margin Requirements

A loan is sanctioned against Collateral Security. Margin means that proportion of the value of security against which loan is not given. Margin against a particular security is reduced or increased in order to encourage or to discourage the flow of credit to a particular sector. It varies from 20% to 80%. For agricultural commodities it is as high as 75%. Higher the margin lesser will be the loan sanctioned.

3. Discriminatory Interest Rate (DIR)

Through DIR, RBI makes credit flow to certain priority or weaker sectors by charging concessional rates of interest. RBI issues supplementary instructions regarding granting of additional credit against sensitive commodities, issue of guarantees, making advances etc.

4. Directives

The RBI issues directives to banks regarding advances. Directives are regarding the purpose for which loans may or may not be given.

5. Direct Action

It is too severe and is therefore rarely followed. It may involve refusal by RBI to rediscount bills or cancellation of license, if the bank has failed to comply with the directives of RBI.

6. Moral Suasion

Under Moral Suasion, RBI issues periodical letters to bank to exercise control over credit in general or advances against particular commodities. Periodic discussions are held with authorities of commercial banks in this respect.

1.14.3 Recent Changes In RBI's Monetary Policy

Since 1991 RBI's monetary management has undergone some major changes.

1. **Multiple Indicator Approach**

   Upto late 1990s, RBI used the 'Monetary targeting approach' to its monetary policy. Monetary targeting refers to a monetary policy strategy aimed at maintaining price stability by focusing on changes in growth of money supply. After 1991 reforms this approach became difficult to follow. So RBI adopted Multiple indicator Approach in which it looks at a variety of economic indicators and monitor their impact on inflation and economic growth.

2. **Selective Methods Being Phased Out**

   With rapid progress in financial markets, the selective methods of credit control are being slowly phased out. Quantitative methods are becoming more important.

3. **Reduction In Reserve Requirements**

   In post-reform period the CRR and SLR have been progressively lowered. This has been done as a part of financial sector reforms. As a result, more bank funds have been released for lending. This has led to the growth of economy.

4. **Deregulation Of Administered Interest Rate System**

   Earlier lending rate of banks was determined by RBI. Since 1990s this system has changed and lending rates are determined by commercial banks on the basis of market forces.

5. **Delinking Of Monetary Policy From Budget Deficit**

   In 1994 government phased out the use of adhoc treasury Bills. These bills were used by government to borrow from RBI to finance fiscal deficit. With phasing out of Bills, RBI would no longer lend to government to meet fiscal deficit.

6. **Liquidity Adjustment Facility (LAF)**

   LAF allows banks to borrow money through repurchase agreement LAF was introduced by RBI during June, 2000, in phases. The funds under LAF are used by banks to meet day-to-day mismatches in liquidity.

7. **Provision Of Micro Finance**

   By linking the banking system with Self Help Groups, RBI has introduced the scheme of micro finance for rural poor. Along with NABARD, RBI is promoting various other microfinance institutions.

8. **External Sector**

   With globalisation large amount of foreign capital is attracted. To provide stability in financial markets, RBI uses sterilization and LAF to absorb the excess liquidity that comes in with huge inflow of foreign capital.

9. **Expectation As A Channel Of Monetary Transmission**

   Traditionally, there were four key channels of monetary policy transmission:- Interest rate, credit availability, asset prices and exchange rate channels. Interest rate is the most dominant transmission channel as any change in monetary policy has immediate effect on it. In recent years fifth channel, Expectation has been added. Future expectations about asset prices, general price and Income levels influence the four traditional channels.

1.14.4 Evaluation of Monetary Policy

The RBI aims at one time was controlled expansion. On one hand it was taking steps to expand bank credit. On other hand RBI uses quantitative and qualitative methods to control credit. These two contradictory objectives limited the success of monetary policy. The performance of monetary policy can be seen from its achievements and failures, let us discuss.

Positive Aspects of Monetary Policy

1. **Short Term Liquidity Management**

   RBI has developed various methods to maintain stability in interest rate and exchange rate like LAF, OMO and MSS. RBI has also managed its sterlization operations very well.

2. **Financial Stability**

   With the help of controls, regulation and supervision mechanism, RBI has been successful in maintaining financial stability. During the period of global crisis it has also been able to maintain macro economic stability.

3. **Financial Inclusion**

   Along with NABARD, RBI has made a great impact in the growth of microfinance. RBI has supported Self Help Group Model and promoted other microfinance institutions.

4. **Adaptability**

   In India monetary policy is flexible, as it changes with time. RBI has developed new methods of credit control and shifted from monetary targeting to multiple indicator approach.

5. Increase In Growth

To maintain the growth of economy RBI has used its instruments' effectively. At present India has the second highest rate of GDP growth after China. Thus monetary policy has played an important role.

6. Increase In Bank Deposits

The increase in bank deposits over the years indicates trust and confidence of people in banking sector. Effective supervision of RBI over banks and financial institutions is largely responsible for trust and confidence of public in banking sector.

1.14.5 Tools of Monetary Policy

1. Monetary Base

Monetary Policy can be implemented by changing the size of the monetary base. This directly changes the total amount of money circulating in the economy. A central bank can use open market operations to change the monetary base. The central bank would buy/sell bonds in exchange for hard currency. When the central bank disburses/collects this hard currency payment, it alters the amount of currency in the economy, thus altering the monetary base.

2. Reserve Requirements

The monetary authority exerts regulatory control over banks. Monetary Policy can be implemented by changing the proportion of total assets that banks must hold in reserve with the central bank. Banks only maintain a small portion of their assets as cash available for immediate withdrawal; the rest is invested in illiquid assets like mortgages and loans. By changing the proportion of total assets to be held as liquid cash, the Federal Reserve changes the availability of loanable funds. This acts as a change in the money supply.

3. Discount Window Lending

Many central banks or finance ministries have the authority to lend funds to financial institutions within their country. By calling in existing loans or extending new loans, the monetary authority can directly change the size of the money supply.

4. Interest Rates

The contraction of the monetary supply can be achieved indirectly by increasing the nominal interest rates. Monetary authorities in different nations have differing levels of control of economy-wide interest rates. In the United States, the Federal Reserve can set the discount rate, as well as achieve the desired Federal funds rate by open market operations. This rate has significant effect on other market interest rates, but there is no perfect relationship. In the United States open market operations are a relatively small part of the total volume in the bond market.

1.14.6 Limitations of Monetary Policy

1. Huge Budgetary Deficits

RBI makes every possible attempt to control inflation and to balance money supply in the market. However Central Government's huge budgetary deficits have made monetary policy ineffective. Huge budgetary deficits have resulted in excessive monetary growth.

2. Coverage of Only Commercial Banks

Instruments of monetary policy cover only commercial banks so inflationary pressures caused by banking finance can be controlled by RBI, but in India, inflation also results from deficit financing and scarcity of goods on which RBI may not have any control.

3. Problem of Management of Banks And Financial Institutions

The monetary policy can succeed to control inflation and to bring overall development only when the management of banks and Financial institutions are efficient and dedicated. Many officials of banks and financial institutions are corrupt and inefficient which leads to financial scams in this way overall economy is affected.

4. Unorganised Money Market

Presence of unorganised sector of money market is one of the main obstacle in effective working of the monetary policy. As RBI has no power over the unorganised sector of money market, its monetary policy becomes less effective.

5. Less Accountability

At present time, the goals of monetary policy in India, are not set out in specific terms and there is insufficient freedom in the use of instruments. In such a setting, accountability tends to be weak as there is lack of clarity in the responsibility of governments and RBI.

6. Black Money

There is a growing presence of black money in the economy. Black money falls beyond the purview of banking control of RBI. It means large proposition of total money Supply in a country remains outside the purview of RBI's monetary management.

7. Increase Volatility

The integration of domestic and foreign exchange markets could lead to increased volatility in the domestic market as the impact of exogenous factors could be transmitted to domestic market. The widening of foreign exchange market and development of rupee - foreign exchange swap would reduce risks and volatility.

8. Lack of Transparency

According to S. S. Tarapore, the monetary policy formulation, in its present form in India, cannot be continued indefinitely. For a more effective policy, it would be necessary to have greater transparency in the policy formulation and transmission process and the RBI would need to be clearly demarcated.

1.14.7 Monetary Policy in the 21st Century

One of the most obvious trends over the last two decades has been the gradual erosion of central bank power by market forces. Central banks are operating under tighter constraints as financial markets become more integrated and efficient, and as capital itself becomes more mobile and currencies more volatile. Now, more than ever, central banks need to ensure that they carry the markets with them if their policies are to have any chance of success.

1. Monetary Policy in Operation

Monetary policy sometimes works under conflicting goals, e.g. the desire to avoid inflation versus the desire to boost output and employment. It is necessary to establish what it can and can't do. For example, the central bank can fix the reserves or it can set the interest rates on any one class of debt instruments. It can also set the foreign exchange rate of its currency. But a central bank trading only in the securities market and making or taking payment by adjusting the supply of reserves can't directly set the volume of bank lending. It can only exert influence on these economic processes.

2. Use of Money as an 'Intermediate' Target

The central bank can decide on the amount of 'money supply' in a given year, but cannot directly set the amount of money in the financial system; besides, it can't directly control the volume of bank credit. It tries to use money as an intermediate target by conducting monetary policy.

3. E-money and Falling Demand for Central Bank Money

Central banks face a new threat. Long-run factors, technological ones in particular, reduce the effectiveness of monetary policy. These new developments threaten to reduce the demand for central bank money (the monetary base) to a level where the central bank's leverage over the monetary system—its ability to influence interest rates, exchange rates, and the money supply—effectively disappears. As electronic substitutes for cash become more widely available.

4. Implications of a Declining Demand for Base Money

The declining demand for base money causes major problems for central bankers. First, as base money becomes less significant, it will gradually lose its effectiveness as a channel through which the central bank can influence the broader monetary system.

Secondly, the decline in the demand for base money would make prices and interest rates more vulnerable to external shocks and, in particular, to changes in the technological and other factors that influence the demand for currency.

5. Globalisation and the Monetary Policy

With the deregulation of financial markets and globalisation, the process of monetary policy formulation has acquired a much greater market orientation than ever before. This has been accompanied by several institutional changes in the monetary-fiscal interface to ensure that central banks possess autonomy.

The process of globalisation and liberalisation has necessitated widening of the mandate of central banks. For their policies to be effective, monetary authorities are required to modify the way in which they conduct monetary policy. Central banks in emerging markets also face similar issues. A special challenge in their case has been the need to calibrate the changes in the operating procedures of monetary policy with the pace of transition from an administered regime of interest rates to a market- based process.

6. Monetary Policy and Inflation

One of the most significant developments in the theory and practice of monetary policy in recent years has been inflation targeting. The rationale for inflation targeting emerges as the joint consequence of two tools of monetary policy. It can be either open market operations or the interest rate the bank charges on advances. It is possible to express the policy chosen at any time in terms of the intended outcome of any single economic magnitude that monetary policy affects: inflation, output, employment or the economy's foreign balance. Maintaining price stability fosters greater output and employment in the long run. And in the short run, there is nothing monetary policy can do about either output or employment.

7. Central Bank Independence

Central bank independence relates to three areas viz. personnel matters; financial aspects; and conduct of policy. Personnel independence refers to the extent to which the government distances itself from appointment and dismissal procedures of top central bank officials and the governing board. Financial independence relates to the freedom of the central bank to decide the extent to which government expenditure is either directly or indirectly financed via central bank credits. Policy independence is related to the flexibility given to the central bank in the formulation and execution of monetary policy.

8. Central Bank (Reserve Bank) Autonomy Over the Years

The Reserve Bank of India (RBI) was set up in March 1934, with the stated objective of monetary stability and operations on currency and credit system in India.

Shortly after Independence, the RBI was nationalised. The early years, RBI was involved in promoting credit to agriculture and industry in pursuant to the overall objectives of the Five-Year Plans. An example of differences between the Government and RBI was the resignation of Governor Rama Rao in 1957.

During 1948 to 1969, the RBI matured into a full-fledged professionally managed central bank. The mid-fifties saw the beginning of serious erosion of autonomy in the monetary policy function due to the emergence of the system of ad hoc treasury bills and automatic monetisation of fiscal deficit.

The third phase started with the nationalisation of major banks in 1969. Government became the owner of a number of banks, but the supervision of these banks was conducted by the RBI. High fiscal deficits persisted, which posed serious problems for prudent monetary management.

The interest rates were administered and the Statutory Liquidity Ratio (SLR) requirements of the banking sector were periodically hiked. Recourse to the RBI credit was high, thus leading to high levels of monetisation. To neutralise the effect of monetisation on the price level, the RBI had to increase the Cash Reserve Ratio (CRR) requirements of the banking sector.

1.14.8 Monetary Policy in India

The conduct of monetary policy was guided by the objective of provision of adequate liquidity to meet credit growth and support investment demand in the economy while continuing a vigil on the movements in the price level. Ensuring macroeconomic stability was a concurrent objective with intensified monitoring of price movements, in view of the hardening of international commodity prices, especially crude oil. Strong capital inflows posed a challenge for monetary management.

The Reserve Bank responded with a policy mix of prepayment of external debt and liberalisation of foreign exchange transactions to maintain monetary conditions in line with the overall objectives. The monetary management with additional instruments in the context of the large volume of capital inflows led to the institution of a Market Stabilisation Scheme (MSS). Interest rates on nonresident deposits were gradually aligned with those prevailing in the international markets in view of the rapid expansion in banks' external liabilities.

These measures were reinforced by refinements in the Liquidity Adjustment Facility (LAF) scheme to strengthen the operating procedure of monetary policy. The Reserve Bank undertook parallel initiatives to improve the credit delivery system, especially in respect of agriculture and small and medium enterprises (SMEs). Let us understand the meanings of some of the tools used by the RBI.

1. Bank Rate

The **bank rate** is the rate at which banks borrow from the RBI. (See Reserve Bank Monthly Bulletin or website to check the current Bank Rate.) It is also defined as the rate of which Reserve Bank gives loans to banks by discounting bills. Any revision in bank rate by the RBI is a signal to banks to revise deposit rates as well as Prime Lending Rate (PLR).

2. Repo Rate

The **repo rate** is the rate at which the RBI borrows from the banks. This is also the floor rate at which overnight deals are struck. Besides lowering the cost of the funds, a lower repo rate will see the emergence of a short-term yield curve, since yields on a 91-day Treasury bill and repo rate will be the same. (Refer Reserve Bank website for updated rate.)

3. CRR and SLR

CRR is the cash reserve ratio, which is the percentage of net funds that commercial banks have to park fortnightly with the RBI to do business. Lowering of CRR means that more money comes into circulation.

In addition to the CRR requirement banks are supposed to maintain a certain percent of net deposits in government securities and similar instruments specified. This is known as Statutory Liquidity Ratio (SLR) which is 25% at present.

1.14.9 Monetary Policy Operations

1. Liquidity Management

The Reserve Bank modulates market liquidity through a mix of repo operations. As capital flows persisted, the Reserve Bank's portfolio necessitated a switch from outright OMO to repo operations. In this context, the Reserve Bank appointed two groups, viz., a working group on instruments of sterilisation and an internal group on Liquidity Adjustment Facility to search for alter-native instruments of sterilisation.

On the basis of the recommendations of the Working Group on the Instruments of Sterilisation, the MSS was instituted in April 2004. The MSS, operationalised in April 2004, has emerged as a key instrument of liquidity management.

2. Interest Rate Policy

The Reserve Bank continued to take policy initiatives to impart a greater degree of flexibility to the interest rate structure. In order to enhance transparency in pricing of loan products by banks, April 2003 Monetary and Credit Policy Statement advised banks to announce their Benchmark Prime Lending Rates (BPLRs), taking into account the actual cost of funds, operating expenses and a minimum margin to cover the regulatory requirement of provisioning/capital charge and a profit margin. By 2004, almost all commercial banks had adopted the new system of BPLR.

SMEs and infrastructure, is critical to sustain growth. In these sectors, the issue of availability of credit is often as important as the cost of credit, especially as the rates of interest on alternative sources of finance from the informal sector are prohibitively high. It is in this context that the Reserve Bank take initiatives to ensure flow of adequate bank credit at reasonable rates of interest.

UNIT II	**LIBERALIZATION AND GLOBALIZATION : New economic policy :** economic reforms - liberalization. **Globalization:** meaning - stages - factors facilitating and impeding globalization in India - consequences of globalization for India.

2.1 New Economic Policy : Economic Reforms

Introduction

The process of economic reforms was started by the government of India in 1991 for taking the country out of economic difficulty and speeding up the development of the country. Indian economic policy plays a major role in determining various government actions on the economic field. Depending on the Indian economic policy, the government of India initiates various actions including preparing budget, setting interest rates, etc. The economic policy also influences the national ownership, labour market, and several other economic areas where government intervention is required.

There are a number of internal factors like political beliefs and policies of the parties, etc., that play vital roles in determining the economic policy of India. Besides these, like all other countries, Indian economic policy also gets influenced by various international institutions like the World Bank and the International Monetary Fund (IMF), etc. India embarked on economic reforms in 1991, in the wake of a balance of payments crisis. Issues concerning economic policy, impact of the reforms on poverty, sectorial issues relating to agriculture, industry, and infrastructure. To become a major player in world economy, a comprehensive approach was taken through Indian economic policy.

After the liberalisation of Indian economy in the early 1990s, the Indian economy scenario witnessed a paradigm shift of stance. Indian economic policy has cast-off its protectionism image and became more liberal. Foreign investors were allowed to invest in Indian business and as a result of which huge foreign direct investments or FDI flowed into the Indian market. Rationality and consistency among trade and other economic policies were taken into account for maximising the contribution of such policies. And, while implementing the Indian economic policy, previous economic policies of India were also refered, to allow developmental scope of Indian economic policy.

2.1.1 Origin of New Economic Policy 1991

In early 1991, a major economic crisis occurred in the country the likes of which people had never experienced since Independence. The problems of the economy which assumed crisis proportions did not develop suddenly but had accumulated over several years.

The cavalier macro-management of the economy during 1980s led to large and persistent macroeconomic imbalances; the widening gap between the revenue and expenditure of the government resulting in growing fiscal deficits had to be met by heavy internal borrowing. Further, the large and steadily growing deficits in the balance of payments had to be financed by borrowing from abroad. As a result of this attempt to live beyond means, the economy was pushed a deep economic crisis.

The crisis made economic reforms absolutely necessary. The country was on the verge of defaulting on international financial obligations and the situation warranted immediate policy action to save the situation. In response to the crisis situation of 1990-91, the government decided to introduce economic policy reforms founded on macroeconomic stabilisation and structural reforms. While stabilisation deals with demand management (control of inflation, fiscal adjustment, balance of payments adjustment), structural reforms deal with sectorial adjustments designed to back the problems on the supply side of the economy - trade and capital flows reforms, industrial deregulation, disinvestment and public enterprise reforms and financial sector reforms.

2.1.2 Major Steps in New Economic Policy

The immediate priority of the government was to stabilise the economy, bring its growth to its normal track and to win back the confidence of masses in the country and the international financial community. This required a number of hard decisions to be taken by the government. Most of the crisis management effort was indicated in the Union Budget 1991-92, presented in July 1991 which is regarded as a landmark budget. The crisis management measures focused largely on fiscal correction, industrial decontrol and balance of payments and laid the foundation for the subsequent reform process.

Some of the early major steps taken to manage the crisis were the following :

1. Fiscal correction aimed at reducing fiscal deficit by about `77.00 billion in 1991-92 (compared to 1990-91).
2. Announcement of the new industrial policy in July 1991 seeking to deregulate the industry with the view to promoting the growth of a more efficient and competitive industrial economy.

3. Abolition of industrial licensing for all the industrial projects except 18 industries of high strategic and environmental importance and with high import content. About 80% of the industries were delicensed.
4. MRTP Act amended to eliminate the need for prior approval by large companies for capacity expansion and diversification.
5. Nine areas in basic and core industries earlier reserved for public sector were opened to private sector.
6. Limit of foreign equity holding raised from 40% to 51% in a wide range of priority industries.
7. Foreign Investment Promotion Board (FIPB) established to negotiate proposals from large international firms and expedite clearances of the investment proposals.
8. Rupee devaluation by 18% during 13 July, 1991 supported by a standby credit of U.S. $2.3 billion from the International Monetary Fund (IMF) over a 20 months period, negotiated in October 1991.
9. Negotiation of structural adjustment loan of U.S. $500 million from the World Bank in April 1992 and a loan totalling Special Drawing Rights (SDR) of 1.3 billion from the IMF between January- September, 1991.
10. Introduction of India Development Bond Scheme and Immunity Scheme for repatriation of funds held abroad in October 1991, under which more than U.S. $2 billion was mobilised during 1991-92.
11. Bringing back of gold earlier pledged to the Bank of England and Bank of Japan.
12. Continuance of the measures of import control and credit squeeze.
13. Administered licensing of imports replaced by freely tradable import entitlements (called Eximscrips) linked to export earnings. The measure was expected to introduce self-balancing mechanism in India's foreign trade.
14. Introduction of Liberalised Exchange Rate Management System (LERMS) under which a dual exchange rate system was established, one rate being effectively floated in the market.
15. Import licensing in most capital goods, raw materials, intermediates and components eliminated. Advance licensing system considerably simplified.

2.1.3 Economic Reforms of New Economic Policy 1991

Since 1991, following economic reforms concerning liberalisation, privatisation, and globalisation have also been undertaken:

1. Fiscal Reforms

Fiscal reforms mean increasing the revenue receipts and reducing the public expenditure of the government in a manner that production and economic welfare are not adversely affected. Its main objective was to reduce fiscal deficit that stood at 8.5% of GDP in 1990-91, to 3%. Several reforms were undertaken to achieve this objective, e.g., control over public expenditure, increase in taxes, sale of share of public sector enterprises, and increased price of public sector products. On the basis of the recommendations of Raja J. Chelliah Committee Report, long-term fiscal policy was announced. This fiscal policy initiated many reforms. The main fiscal reforms are as follows:

i) Taxation system was made more scientific and rational. The maximum limit of income-tax was reduced from 50% to 30%.

ii) Taxation system has been simplified.

iii) Custom duties were brought down from 250% to 10%.

iv) Excise duty on several commodities was reduced.

v) Subsidies were cut down, and

vi) Special efforts are being made by the government to cut public expenditure.

2. Financial/Monetary Reforms

These reforms refer to reforms in country's monetary and banking policies. Government had appointed Narasimham Committee to introduce financial reforms. On the basis of recommendations of this committee, government has introduced the following significant financial/monetary reforms:

i) Reduction in Liquidity Ratio. Statutory Liquidity Ratio (SLR) has been lowered from 38.5% to 25%. Likewise Cash Reserve Ratio (CRR) has been brought down from 12% to 5%.

ii) Reduction in Bank Rate. Bank rate has been brought down to 6%.

iii) Free Determination of Interest Rates. Rates of interest should not be determined by the Reserve Bank rather the same be allowed to be determined by the banks independently within some limits.

iv) **More Freedom to Banks.** Different banks should be given freedom to recruit their own officials. Inspection of the banks should be based on internal inspection reports.

3. International Trade and Investment Reforms

India's trade policy prior to the 1991 reforms was characterised by high tariffs and import restrictions. Foreign manufactured consumer goods were entirely banned, and capital goods, raw materials, and intermediate goods for which domestic substitutes existed were importable only through a bureaucratic licensing process. Illustrative of the severity of the situation, Infosys executives described how the founders had to visit Delhi nine times to obtain a license to import just one personal computer.

Although foreign ownership in some Indian companies was permitted, investors faced complications that included a subjective licensing process, high regulation upon approval, and equity- holding caps. In fact, until recently Indians had only one television program and had to settle for locally produced Thumbs Up instead of Coca-Cola.

India has come a long way toward opening its borders to trade - exports and imports grew at 19% and 30% in 2004 and 2005 respectively - and both Congress and the BJP are committed to increasing free trade. India should continue to take advantage of the WTO as a cover against domestic backlash to further tariff reductions. Concessions like temporary subsidies may be necessary to placate short-term losers in non-competitive industries. Investment has increased throughout the past decade and a number of important industries like aviation and construction have raised or eliminated caps on foreign investment.

Despite the benefits of outside technical expertise, many fears that increased foreign investment will lead to lost jobs and threaten domestic businesses, especially businesses like the mom-and-pop shops of the retail sector. The Communist Party and many labour unions are vocal supporters of such small-scale industries and fight against liberalising foreign investment. Tariffs also remain among the highest of the developing world. This further confirms that, with a 2003 trade deficit of around $17 billion, India's exports are not yet competitive on global markets.

4. Industrial Sector Reforms

India's industrial policy was one of the areas most changed by the economic liberalisation of the 1990s. The early reforms crystallised a trend that had been building since the national government moved toward a pro-business approach to industrial policy during the 1980s. During the following decade, India transitioned from a centrally planned and operated economy to a market-driven economy, reflecting a global trend toward less regulated economies. Most government-operated industries in India are now privatised, though some political contention still exists over the removal of reservation schemes.

5. Infrastructure Reforms

A short drive through any Indian city reveals some of the serious deficiencies of India's infrastructure - roads full of potholes, relentless traffic, suffocating pollution. Although an efficient infrastructure is in the national interest, state governments control many infrastructure projects. Large private sector organisations are taking care of their own infrastructure needs in response to state governments' neglect. Infosys, e.g., maintains a fleet of nearly 600 buses to transport its 12,000 employees to work. Prime Minister Singh has declared that India must raise levels of investment in infrastructure to enable the nation to reach its goal of 8% growth. Unfortunately, due to India's large deficit, the nation often skimps on infrastructure spending. Additionally, improvements in centre-state cooperation are greatly needed.

6. Labour Reforms

While less than 10% of the 500 million person labourforce is "organised" or has regular contractual employment, 12 labour regulations have made unions a powerful force in Indian politics. The tide is beginning to change, however. There are fewer labour strikes today, labour agreements now generally include clauses on productivity, and court judgments are no longer reflexively in favour of labour. While Rao recognises the need for labour reform, he had hesitated to implement reforms like laying-off public sector workers or closing down or privatising inefficient factories.

Additionally, it remains difficult to fire workers and employers are hesitant to hire new ones. A 1947 Act mandates state governments to require manufacturing firms with over 100 workers to gain governmental approval before firing workers. According to Nandan Nilekani, CEO of Infosys, the lack of a flexible labour policy is an important impediment to India's growth.

7. Agricultural Reforms

Prime Minister Manmohan Singh maintains that India must improve conditions for farmers and invest more in education and healthcare to reach its goal of 8% growth. He aims to modernise agriculture and increase manufacturing by expanding agribusiness and food processing. Yet any change to the agricultural sector faces intense political opposition. Despite the fact that it contributes only 20% of India's GDP, the agricultural sector has always been politically influential. Interest group politics often hinder government attempts to cut costs in its agricultural spending.

8. Privatisation Reforms

The Government of India runs coal mines as well as discotheques. Public enterprises account for nearly half of India's capital stock and enjoy commanding market shares in industries like mining, smelting, banking, and railways. Most, however, exhibit poor productivity of labour and capital. Many public enterprises were created and kept alive for political reasons. For example, a fertilizer factory in Haldia, West Bengal, kept thousands of workers on its payroll for years without ever commencing production.

2.1.4 Importance of New Economic Policy 1991

Following points discuss the importance of Economic Policy

1. Increase in Rate of Economic Growth

Despite huge investments during first fifty years of planning, growth rate of domestic product oscillated around 3.6% and of per capita income around 1.4% per annum. However, in the period of 1981 and 2002, these rates have risen to 6.5% and 4.3% respectively. Growth rate of per capita income as lower compared to most developing nations of the world. All this called for drastic economic reforms as a result of which growth rate of per capita income could be increased as much as in the other developing countries. The growth rate in GDP in 2004-05 was 13.1%.

2. Reduction in Poverty and Inequality

Plans in India have thus far failed to reduce poverty or inequality in the distribution of wealth and income. New policy aims at developing human resources. As a result of the policy of liberalisation, people will get more opportunities of self-employment. It will help to reduce poverty and inequality of income.

3. Increase in Efficiency of Public Sector

Plans in India have been giving special status to the public sector. Unfortunately however, this sector piled up only inefficiency and losses. An investment of nearly

30 thousand crore of rupees in this sector yields on average just 3% of profit, which is hopelessly low. New Economic Policy will remove defects of public sector and improve its efficiency.

4. Fall in Fiscal Deficit

Because of several factors, fiscal deficit and budgetary deficit of the government had been consistently rising. In 1990-91, it was 8.5% of GDP. To meet this deficit, the government has been raising various loans both from within and outside the nations. These loans involve heavy interest burden. The bulk of government revenue is spent by way of interest payment; little is left for investment purposes. Invariably the government has to resort to deficit financing, thus adding to inflationary pressures on the economy. New policy hopes to prevent such tendencies.

5. Control on Prices

Consequent upon new economic policy, there will be less deficit financing, rates of taxation will be slashed, supply of money contracted, public expenditure cut and production increased. All these will keep the prices under control.

6. Decline in Deficit of Balance of Payments

Deficit on the balance of payments on current accounts has almost touched unmanageable limits. New measures claim to boost exports and discourage imports. These measures should also raise global confidence in the Indian economic system. Foreign exchange reserves would increase.

7. Increase in Efficiency

Public sector in India has tended to breed inefficiency resulting in low level of productivity. New Economic Policy will add to the efficiency of the economy in many ways, viz., closure of inefficient units, scientific management, improvement in technology, competition, foreign cooperation, freedom from controls, etc.

8. Development of Small-Scale Industries

Significance of small- scale industries has substantially increased in India. But owing to the constraints of licensing and other controls, this sector has failed to make any progress to extent desired. New policies are expected to offer conducive environment to the small-scale sector allowing it to progress rapidly. Development of this sector will promote employment, reduce poverty and minimise inequalities of income.

2.2 Liberalisation

Introduction

Liberalisation is a very broad term that usually refers to fewer government regulations and restrictions in the "economy in exchange for greater participation of private entities.

Liberalisation refers to the relaxation of the previous government restriction usually in area of social and economic policies. When government liberalised trade, it means it has removed the tariff, subsidies and other restriction on the flow of goods and services between the countries. Economic liberalisation, in its modern form, usually describes internal economic reform such as deregulation and privatisation and the removal of barriers to trade in services as well as the more conventional view of free trade as the removal of tariffs on physical imports.

Meaning and Definition of Liberalisation

Liberalisation does not mean simply inviting a number of foreign companies or Multinational Corporations (MNCs) on whatever terms with whatever objectives in mind and in whatever sector, indiscriminately. By implication, economic liberalisation suggests that the entire opening up of the economy should ultimately be for building up strength of its own. Hence, inviting foreign companies/MNCs should be a means and not an end. Liberalisation means removal of control and not of regulations. Liberalisation does not imply any secret deals behind the curtain. On the contrary, it does mean the elements of transparency and accountability in the functioning and procedures relating to the various sectors of the economy.

According to M. Dhanuja, liberalisation is related to that state of economic conditions in which rules, regulations and controls are eliminated to promote competition.

2.2.1 Nature of Liberalisation

The nature of liberalisation is as follows:

1. **Freedom in Fixing Prices:** Liberalisation involves freedom in deciding the scale of business activities and fixing prices of goods and services.

2. **Reduction in Restrictions:** It includes reduction in physical restrictions on imports and also in the rate of import duties. There is also reduction in controls on foreign exchange both current and capital account and in different tax rates of different industry.

3. **Increase Competitiveness:** Due to liberalisation, various sectors of the Indian economy are made competitive on the global economic platform by making them produce quality goods in a cost-effective manner.

4. **Reform of the Banking System:** Banking sector reforms were kicked off in 1992 and have been continuing since then. Private banks, including foreign banks, have been allowed to operate and their reach is now extensive.

5. **Increase of Foreign Investment:** Liberalisation simplified the policies to attract foreign capital and technology to India.

2.2.2 Factors Favouring Liberalisation in India

While it can be argued that Indian liberalisation began before the 1990s, most will agree that it was in 1991 that the Indian government first began in earnest to adopt policies of liberalisation. However, the reason for which these policies of liberalisation were embraced is not always clear. There were, in fact, three distinct forces which guided India to this watershed moment in its history, two of which were external forces, and one which was an internal force. These are described below:

1. **Severe Economic Situation**

   The internal factor which directed India toward liberalisation was the severe economic situation it was faced with at the time. The central problems were soaring inflation, a rising fiscal deficit, a widening trade deficit, and an enormous foreign debt. In fact, India was "on the verge of defaulting on its foreign loan," but was saved from that humiliation by the IMF. Now, these economic problems were all rooted in one fundamental problem, namely, inefficiency. India was inefficient because of such things as "inadequate infrastructure, various bottlenecks, misallocation of resources, unbalanced regional development, the presence of parallel economy, the urban-rural development gap, and the demand-supply gap". India's economic situation forced its government to accept the fact that major structural changes were needed in India.

2. **Success of Export-Promotion (EP) Industrialisation and Failure of Import-Substitution (IS) Industrialisation**

   One of the external factors was "the success of Export-Promotion (EP) industrialisation along with the failure of Import-Substitution (IS) Industrialisation". EP industrialisation is an economic path to development which came to prominence in the ’70s and ’80s, largely through the stunning performance of those countries which embraced such a policy. The greatest success stories were Southeast Asia’s Newly Industrialised Countries (NICs), many of which have averaged growth rates of more than 8% a year for the past thirty years. Alongwith increasing acceptance of EP industrialisation came the gradual deterioration of IS industrialisation. This began with the fall of the Soviet Union in 1991, which signalled the end of the Soviet Union as a “beacon for centralisation”, and quickly resulted in “the global retreat of socialism”.

The impact this had on India was huge. Since 1947, when India gained its independence, Indian government policy had been one of strong socialism (often modelled, in fact, after the U.S.S.R.), and central to this policy was IS industrialisation. Thus, the collapse of the U.S.S.R. caused India to re-think its well- entrenched socialist policies. The combined evidence of the success of the Asian NICs and the failure of Soviet socialism forced India to reluctantly conclude that EP was better than IS industrialisation.

3. Globalisation

Another external force which was challenging India’s tradition of “centralised and inward- directed business policy” is what is termed globalisation, i.e., the “internationalisation of the world economy”. It became clear to developing countries (LDCs), such as India that, “with the world economy becoming increasingly interdependent”, it was vital that they “devote greater efforts to linking their economies and development strategies to the world economy”.

Now, at the heart of globalisation are the MNCs, which have brought about “global diffusion of production technology and worldwide homogenisation of markets”. In fact, it can be argued that, “with the worldwide resources at their command”, it is the MNCs which “have spawned an integrated international economic system”. Consequently, India realised that, in order to link itself with the world economy, it was essential that it first link itself to the driving force behind globalisation, namely, the multinationals.

Advantages and Disadvantages of Liberalisation

Merits

1. Liberalisation helped in removal of unnecessary restrictions such as licensing, controls, and regulation. This, in turn, Hill help to make Indian economy more efficient and competitive.

2. The policy of liberalisation allows a greater participation of foreign investment.

   This, in turn, increased the flow of foreign investment. Foreign investment has two components: Foreign direct investment and Portfolio investment. This would help in the industrial growth of India.

3. Liberalisation helped in improvements in innovation and productivity of domestic firms due to external competition.

4. Liberalisation helped in improvement of financial sector.

Demerits

1. It neglects die social welfare.

2. Due to removal of import restrictions, domestic industries will have to face the competition from by MNC's. This may affect the growth of domestic industry.

3. There is possibility of monopolies and concentration of economic power in few hands.

2.2.3 Impact of Liberalisation in India

The main aim of liberalisation was to dismantle the excessive regulatory framework which acted as a barrier for industries growth. Over the years the country had developed a system of “LICENCE PERMIT-RAJ”. Major purpose of liberalisation was to free the large private sector from the bureaucratic control if therefore started dismantling the industrial licensing and controls.

The positive and negative impact of liberalisation in India is as follows:

1. Positive Impact of Liberalisation in India

The positive impact of liberalisation in India can be seen in following areas:

i) **Improvement in Healthcare:** Liberalisation has also positively affected the overall healthcare situation in the country. More and more medical innovations are coming which are improving the health situation in India. The infant mortality rate and the malnutrition rate have significantly come down since the last decade. All these factors clearly prove that the globalisation helped to reduce the India’s poverty level.

ii) **Growth of Agriculture:** A major portion of the poverty level in India is from the rural areas whose staple form of income is agriculture and farming. Due to the globalisation, Indian agriculture has improved to some extent which has helped to reduce the poverty problems of the rural masses.

iii) **Liberalisation and Employment:** Liberalisation has also put a favourable effect on the employment scenario of the country. Over the years, due to the liberalisation policies, India has become a consumer oriented market where the changes are brought by the demand and supply forces. Due to the high demand and the supply chains, there has been significant growth in the market. As such, more and more job opportunities are being created in different sectors. This has increased the per capita income considerably which has improved the poverty level to a great extent.

iv) **Liberalisation and Economic Growth:** It was in the 1990s that the first economic liberalisation policies were initiated by the then Finance Minister Dr. Manmohan Singh to encourage the wake of globalisation in India. Since then, the economic condition of India has significantly increased. Over the years, India has gradually become one of the fastest growing economies in the world. It has become the 4^{th} largest economy in the world in terms of the Purchasing Power Parity (PPP). It has been expected that the average yearly economic growth will range between 6 per cent and 7 per cent.

v) **Liberalisation and Mergers in India:** The extents to which cross-border mergers and acquisitions are growing are all due to the globalisation process. It has been observed of late that there are several sectors of the economy that are heating up with a number of cross-border mergers and global alliances. This is only to improve the economic state of the country.

2. Negative Impact of Liberalisation in India

The negative impact of liberalisation in India is as follows:

i) **Reduced Profits:** Liberalisation is often opposed by domestic industries that would have their profits and market share reduced by lower prices for imported goods.

ii) **Exploitation of Workers:** Socialists frequently oppose liberalisation on the ground that it allows maximum exploitation of workers by capital.

iii) **Reduces Economic Freedom:** Liberalisation is opposed by many anti-globalisation groups, based on their assertion that free trade agreements generally do not increase the economic freedom of the poor or the working class, and frequently make them poorer.

iv) Short-Term Adjustments: Even though an economy is likely to benefit from the process of economic liberalisation over time, certain short-term adjustments may not be so positive. If availability of imports causes a local company to lose its market share, there could be a short-term impact in terms of layoffs of workers.

v) Effect on Capital: Liberalisation makes it easier to move capital from one country to another. Global institutions such as the World Trade Organisation exist to make this movement easier by "encouraging" member states to change laws and regulations that eliminate barriers to capital flow. However, rapid inflow or outflow of capital can impact national economies negatively. For example, the sudden withdrawal of capital from East-Asian countries in the late 1990s precipitated a financial crisis.

2.3 Globalisation

Introduction

Globalisation is a powerful real aspect of the new world system, and it represents one of the most influential forces in determining the future course of the planet. It has manifold dimensions - economic, political, security, environmental, health, social, cultural, and others. The focus here is on the concept of "globalisation" as applied to the world economy.

The term was coined in the 1980s, but the concept is an old one that has different interpretations to different people. Partly as a result of these different interpretations, there are very different reactions to "globalisation," with some policymakers, scholars, and activists seeing it as a force for advancing the world economy while others, again all three, seeing it as a serious danger to the world economic system.

Meaning and Definition of Globalisation

Globalisation is also responsible for the major increases in worldwide trade and exchanges in an increasingly open, integrated, and borderless international economy. There has been remarkable growth in such trade and exchanges, not only in traditional international trade in goods and services, but also in exchanges of currencies, in capital movements, in technology transfer, in people moving through international travel and migration, and in international flows of information and ideas.

According to International Monetary Fund (IMF), "Globalisation is the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows and also through the more rapid and widespread diffusion of technology".

According to Charles Hill, "Globalisation is the shift towards a more integrated and interdependent world economy. Globalisation has two main components - the globalisation of markets and the globalisation of production".

Globalisation has significant impact on all economies of the world, with manifold effects. It affects the production of goods and services. It also affects the employment of labour and other inputs into the production process. In addition, it affects investment, both in physical capital and in human capital. It affects technology and results in the diffusion of technology from initiating nations to other nations. It also has major effects on efficiency, productivity and competitiveness.

2.3.1 Nature of Globalisation

The idea of globalisation may be simplified by identifying several key features which are as follows:

1. **Improved Technology in Transportation and Telecommunications:**

   What makes the rest of this list possible is the ever-increasing capacity for and efficiency of how people and things move and communicate. In past years, people across the globe did not have the ability to communicate and could not interact without difficulty. Nowadays, a phone, instant message, fax, or video conference call can easily be used to connect people.

2. **Movement of People and Capital**

   A general increase in awareness, opportunity, and transportation technology has allowed for people to move about the world in search of a new home, a new job, or to flee a place of danger. Most migration takes place within or between developing countries, possibly because lower standards of living and lower wages push individuals to places with a greater chance for economic success.

3. **Diffusion of Knowledge**

   The word 'diffusion' simply means to spread-out, and that is exactly what any new found knowledge does. When a new invention or way of doing something pops-up, it does not stay secret for long. A good example of this is the appearance of automotive farming machines in Southeast Asia, an area long home to manual agricultural labour.

4. Non-Governmental Organisations (NGOs) and Multinational Corporations

As global awareness of certain issues has risen, so too has the number of organisations that aim to deal with them. So called non-governmental organisations bring together people unaffiliated with the government and can be nationally or globally focused.

5. Growing Worldwide Interconnections

This is one characteristic of globalisation. Some interconnections can be predicted, others cannot. Moreover, factors other than globalisation also shape events.

6. Rapid, Discontinuous Change

Another characteristic of globalisation is that this process has occurred rapidly but not at a steady pace. In other words, a chart of global interconnections would follow an upward slope, but the regression line would not be a smooth one.

7. Increased Number and Diversity of Participants

This characteristic of globalisation is growth in the numbers and diversity of actors involved in global activities. For example, participants in global business activities now include many Small to Medium Sized Enterprises (SMEs) as well as large ones..

8. Growing Complexity

Finally, the "one world" characterisation of globalisation exposes most of us. To many more people and ideas whose perspectives on globalisation differ. Domestic questions that once seemed to have simple answers become more complex when one realises that others worldwide have different "simple" answers to the same questions.

2.3.2 Essentials of Globalisation

There are, some essential conditions to be satisfied on the part of the domes economy as well as the firm for successful globalisation of the business. They are :

1. **Business Freedom.** There should not be unnecessary government restrictions which come the way of globalisation, like import restriction, restrictions on sourcing finance or other factors from abroad, foreign investments etc. That is why the economic liberalisation is regarded as a i step towards facilitating globalisation.

2. **Facilities.** The extent to which an enterprise can develop globally from home country base depends on the facilities available like the infrastructural facilities.

3. **Government Support.** Although unnecessary government interference is a hindrance to globalisation, government support can encourage Globalisation. Government support may take the form of policy and procedural reforms, development of common facilities like infrastructural facilities, R and D support, financial market reforms and so on.

4. **Resources.** Resources is one of the important factors which often decides the ability of a firm to globalise. Resourceful companies may find it easier to thrust ahead in the global market. Resources include finance, technology, R & D capabilities, managerial expertise, company and brand image, human resource etc. It should, however, be noted that many small firms have been very successful in international business because of one or other advantage they possess.

5. **Competitiveness.** The competitive advantage of the company is a very important determinant of success in global business. A firm may derive competitive advantage from any one or more of the factors such as 'low costs and price, product quality, product differentiation, technological superiority, after sales service, marketing strength etc. Sometimes small firms may have an edge over others in certain aspects or times of business.

6. **Orientation.** A global orientation on the part of the business firms and suitable globalisation strategies are essential for globalisation.

2.3.3 Stages of Globalsiation

A firm passes through different steps of development before it becomes truly global corporation.

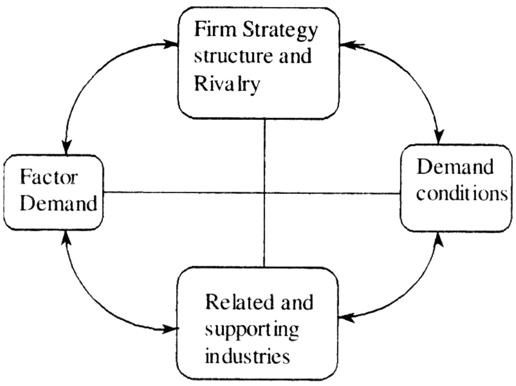
Initiatives for the Corporate Sector

1. **Need for Corporate Sector to go Global**

   In bringing about globalisation of the economy, the Indian corporate sector has to take lead and initiative.

2. **Need to Promote Competitiveness of Indian Producers**

   Competitiveness of Indian producers has to be improved to succeed in global markets. The various determinants of competitiveness can be summarised as follows.



Figure

For bringing the art technology and to reduce costs which improves efficiency and penetrate the global markets with joint efforts, which is required to enter into strategic agreement.

3. Need to Adopt New Strategies

The changing global environment orders that the Indian firms must adopt in order to continue.

The following are the suggestions for corporate restructuring,

1. The same management does not have to manage a variety of unrelated business. Its possible by focusing on core competence.
2. Introduce training to the employees about company to update skills within an organisation.
3. Introduce high-cost debt into the company and increase the ratio of equity to debt.
4. See the total involvement of all employees by providing communication among them, objective performance evaluation, rewards, accountability, etc.
5. Allowing new information technologies into the company which affect the whole organisation.
6. The whole organisation should always focus on customers and their satisfaction.

4. Need for Alliances with MNCs

With the entering of MNCs, India will be developing their global networks to Indian markets. In order to continue, the Indian companies will have to acquire organisational skills which match with those of their competitors.

Choosing the right partner could make all the differences in the race for globalisation. In a successful agreement between the companies, both companies achieve their strategic objective, the agreement continue for a longer period. Partner skills, business contribution, financial strength and cultural compatibility are the major consideration in choosing a suitable partner.

5. Need for Self-Reliance in Technology

For achieving competitive advantages, the major determinants are demand conditions, supplier industries, domestic competition and supporting infrastructure. Global competitiveness can be continuing for a long time only through the development of human skills.

6. Identification of Focus Areas

In identifying countries, which should focus on globalisation. The Indian companies will have to be highly selective. In this activity they need to be guided by three considerations,

1. On which country the Indian country will have a relative advantage, they should focus on that countries.
2. Where markets are growing at high rates, Indian companies should try to enter the economy.
3. In which country the quality standards are not very high, the Indian companies should focus on those countries.

7. Need to Create Favourable Environment

To create overnight world-class companies we need to take some steps to make it a reality with in a ten years period.

1. To enable Indian companies to think and act globally, market conditions have to be transformed.
2. As a partnership between government and business a series of institutions must come up.

8. Need to Setup New Institutions

For improving a high range of human skills, need to setup new institutions to computer software to aircraft maintenance. Need to increase the number of skilled people largely to manage with demand in coming years.

9. Need for New Rules and Regulations

To make our companies world-class, we have to' follow some rules and regulations with global corporate and financial norms.

Established by laws and institutions the software of the state and society. Their reform and effective operation will be very important for successful performance of economics in new millennium.

2.3.4 Factors Facilitating and Impeding Globalisation in India

1. Human Resources

Apart from the low cost of labour, there are several other aspects of human resources to India's favour. India has one of the largest pools of scientific and technical manpower. Cheap labour has particular attraction for several industries.

2. Wide Base

India has a very broad resource and industrial base, which can support a variety of business.

3. Growing Entrepreneurship

Many of the established industries are planning to go international in a big way. Added to this is the considerable growth of new and dynamic entrepreneurs who could make a significant contribution to the globalisation of Indian business.

4. Growing Domestic Market

The growing domestic market enables the Indian companies to consolidate their position and to gain more strength to make into the foreign market or to expand their foreign business.

5. Niche Markets

The growing population and disposable income and the resultant expanding internal market provide enormous business opportunities.

6. Trans-nationalisation of World Economy

Trans-nationalisation of the world economy, i.e., the integration of the national economies into a single world economy as evinced by the growing interdependence and globalisation of markets is an external factor encouraging globalisation of India business.

7. NRIs

The large number of non-resident Indians who are resourceful - in terms of capital, skill, experience, exposure, ideas etc. - is an asset, which can contribute to the globalisation of Indian business. The contribution of the overseas Chinese to the recent impressive industrial development of China may be noted here.

8. Expanding Markets

The growing population and expandable income and the resultant expanding Internal market provides enormous opportunity

9. Economic Liberalisation

The economic liberalisation in India is an encouraging factor of globalisation. The delicensing of industries, removal of restrictions on growth, opening up of industries earlier reserved for the public sector, import liberalisation, liberalisation of policy towards foreign capital and technology etc., could encourage globalisation of Indian business.

10. Competition

The growing competition, both from within the country and abroad, provokes many Indian companies to look to foreign markets seriously to improve their competitive position and to increase the business.

2.3.5 Consequences of Globalisation for India

India's economic integration with the rest of the world was very limited because of the restrictive economic policies followed until 1991. Indian firms confined themselves, by and large, to the home market. Foreign investment by Indian firms was very insignificant. With the new economic policy ushered in 1991, there was, however, been a change. Globalisation has in fact become a buzzword with Indian firms now, and many are expanding their overseas business by different strategies.

The positive and negative impact of globalisation in India is as follows:

1. Positive Impact of Globalisation in India

The positive impact of globalisation in India is discussed below:

i) **Huge Amounts of Foreign Investments :** It brought in huge amounts of foreign investments into the industry especially in the BPO, pharmaceutical, petroleum, and manufacturing industries. As huge amounts of foreign direct investments were coming to the Indian industry, they boosted the Indian economy quite significantly.

ii) **Provides Employment :** The benefits of the effects of globalisation in the Indian industry are that many foreign companies set-up industries in India, especially in the pharmaceutical, BPO, petroleum, manufacturing, and chemical sectors, and this helped to provide employment to many people in the country. This helped to reduce the level of unemployment and poverty in the country.

iii) **Updated Technology :** Also the benefit of the effects of globalisation on Indian industry are that the foreign companies brought in highly advanced technology with them, and this helped to make the Indian industry more technologically advanced.

iv) **Goods and Services :** As markets become global, more goods and services are made available at lower cost to a wider group of people. More access leads to rising consumer demand and improved standards of living. In addition, global competition and cheap imports keep a lid on prices, so that inflation is less likely to derail economic growth.

v) **Free Flow of Capital :** Globalisation helps for free flow of capital from one country to the other. It helps the investors to get a fair interest rate or dividend and the global companies to acquire finance at lower cost of capital. Further, globalisation increases capital flows from surplus countries to the needy countries, which in turn increases the global investment.

vi) **Increase in Industrialisation :** Free flow of capital, along with the technology enable the developing countries to boost-up industrialisation in their countries. This ultimately increases global industrialisation.

vii) **Balanced Development of World Economies :** With the flow of capital, technology, and locating manufacturing facilities in developing countries, the developing countries industrialise their economies. This in turn leads to the balanced development of all the countries.

viii) **Lower Prices with High Quality :** Indian consumers have already been getting the products of high quality at lower prices. Increased industrialisation, spread up of technology, increased production and consumption level enable the companies to produce and sell the products of high quality at lower prices.

ix) **Cultural Exchange and Demand for a Variety of Products :** Globalisation reduces the physical distance among the countries and enables people of different countries to acquire the culture of other countries. The cultural exchange, in turn, makes the people to demand for a variety of products which are being consumed in other countries. For example, demand for American pizza' in India and demand for .'Masala dosa' and 'Hyderabadi biryani' and Indian styled garments in USA and Europe.

x) **Balanced Human Development :** Increase in industrialisation on balanced lines in the globe improves the skills of the people of developing countries. Further, the increased economic development of the country enable the government to provide welfare facilities like hospital: educational institutes etc., which in turn contributes for the balanced human development across the globe.

2. Negative Impact of Globalisation in India

The various negative implications of globalisation on Indian industry are as follows:

i) **Reduced Jobs and Incomes :** The negative effects of globalisation on Indian industry are that with the coming of technology the number of labour required decreased and this resulted in many people being removed from their jobs. This happened mainly in the pharmaceutical, chemical, manufacturing, and cement industries.

ii) **Poor Labour Practices and Environmental Policies :** One of the criticisms against globalisation is that free trade encourages developed nations to move manufacturing facilities off-shore to less developed countries that lack adequate regulations to protect labour and the environment. They feel that free trade can lead to an increase in pollution and exploitation of labour of less developed nations.

iii) **Globalisation and the World's Poor :** Critics of globalisation argue that despite the supposed benefits associated with free trade and investment, over the last hundred years or so the gap between the rich and poor nations of the world has gotten wider. A quarter of the countries with a GDP per capita of less than $1,000 in 1960 had growth rates of less than zero from 1960 to 1995, and a third had growth rates of less than 0.05 per cent.

iv) **Heterogeneity of Problems :** A major hurdle in the path of globalisation is the absence of a universally accepted set of solutions of the problems which have to be tackled. Some of these problems happen to be political and social ones, but even their solutions have economic implications. Frequently, the proposed solutions are such that some countries view them as more harmful than beneficial.

v) **Reluctance of Developed Countries :** Though advocating the advantages of a free market mechanism and competitive markets, rich economies of the world are themselves riddled with all sorts of distortions on account of monopoly forces, huge subsidies, and a variety of vested interests. They are not ready to accommodate the poorer countries of the world on criteria of economic fairness.

vi) **Reluctance of Developing Countries :** The developing countries, on their part, have the bitter experience of being forced into giving trade and non- trade concessions to the developed countries at the cost of their own interests. They realise that, with them, the developed countries want to have 'free trade' and not 'fair trade'. The developed countries keep finding fresh 'reasons' for adding to the trade disadvantages of the developing countries.

vii) **Short Term Gains :** Though several economists from the developed countries have been arguing that long run sustainable growth and prosperity of the developed countries can be ensured only by the growing prosperity of the developing countries, the former are not ready to adopt and pursue this approach.

viii) **Factor Mobility :** Globalisation necessitates unhindered international factor mobility. Developing countries feel that unrestricted mobility of capital and finance can be damaging for them; while developed countries are apprehensive about the effects of unrestricted immigration of low-wage labour.

ix) **Social Security :** With globalisation, it becomes increasingly difficult for a government (particularly of a developing country) to create and finance a social security system. Such like provisions tend to lose their priority in a market-oriented globalisation.

x) **Risks and Uncertainties :** Progress towards globalisation is also hindered by uncertainties relating to a possible shift in political and economic philosophy of some member countries; the fear of nationalisation by the MNCs, the resistance to cultural invasion associated with unrestricted inflow of foreign capital and enterprise, and so on.

2.3.6 Impact on FMCG Industry

Globalisation is having both positive and negative effects on In-dian brands.

Positives

- Globalisation helps Indian entrepreneur to known about the competitors, recent trends, quality of products.
- Helps in sourcing new technology for improving their brand quality.
- Helps in sourcing economical RM/PM from other countries resulting cost effectiveness.
- Hiring competent person irrespective of the nationality.
- Good exposure of Indian brands to overseas market.
- Due to increase in healthy competition with other brands, Indian brands will be forced to improve their quality and services to the customer.

Negatives

- It may be difficult to survive for SSI and other industries which
- are unable to cope up with the changes due to insufficient funds.
- Due to the difference of USD, GBP, Euro and other currencies are more stronger than Indian rupees. Other countries expending less amount in India to promote their brand whereas it is very expensive for Indian brand to promote.
- Indian Talent is being attracted towards other country due to higher salary and emoluments.
- Due to heavy taxation and levies in India, end products is being costly as compared to imported brands.

Most of FMCG brands popular in India have been owned by large multinationals, even before globalisation set in, through subsidiaries of MNC companies in India. Some brands are, Fiat, Ceat, Colgate, Bata, Surf, Pepsi, Coke, Dunlop, Goodyear, Suzuki, Palmolive, Brooke Bond, Lipton, Old Spice, Nescafe, Poison, Cadbury, etc. This list is inclusive, many more brands are there.

Whereas a lot many brands of Indian origin, like Tata, Vimal, Reliance, Birla, Godrej, Dalmiya and hundreds of them have strong footing. These brands may flourish or dye due to their strength and weaknesses, irrespective of globalisation. However, some is not true for technology driven industries brands. Automobiles, White goods and electronic industry will see demise of Indian brands for most companies are not financially strong to upgrade technolog.

We have seen Ambassador cars losing ground to a lot many state of art brands invading Indian markets. Indian brands of Televisions, Refrigerators are loosing battle to LG and Samsung etc. All weton, texla etc., have vanished from TV scene

Two wheeler brands are riding on famous brands like Honda

In FMCG, most Indian brands will hold their ground. Even new brands will emerge to cater to different market segments. Tata tea and Amul are classic examples. Indian brands having mass acceptance like Nirma is not effected by Ariel etc. Promise tooth paste is holding its share.

Thums up share is intact in spite of Pepsi and Coca Cola.

Amul chocolate is fighting fit against Nestle and Cadbury. In cosmetic and toiletries also Indian brands are very stable even after globalisation.

Domestic FMCG majors have started approaching international Markets in a bid to globalise their brands. Though this is a small trend right now, it’s beginning to gain ground.

In an effort to globalise its homegrown brand Good Knight (mosquito repellent), Godrej Sara Lee is test-marketing the product in Pakistan. Parle Bisleri is typing up with retailers to market its brand Bisleri in the United States. Likewise, Marico Ltd., and Dabur India are extending the reach of their flagship brands Parachute and Vatika to global Markets.

Clearly, the focus seems to be on ‘globalisation of homegrown brands’ in the Rs 69,000 crore Indian FMCG industry.

After acquiring Keyline brands (UK) and Rapidol (South Africa), Godrej Consumer Products Ltd., is now getting ready to launch its homegrown brands Fairglow and Cinthol in South Africa and the UK.

“Indian FMCG majors are keenly eying global Markets for additional revenues.

To conclude here I must say that Indian government should give proper support and provides necessary infrastructure and necessary relaxation in Taxes to facilitate Indian Brands to compete with global brands.

UNIT III	**PUBLIC SECTOR AND PRIVATIZATION : Public sector**: changing role of public sector - relevance of public sector – public Sector reforms. **Privatization**: concepts – nature – objectives – forms - regulatory framework with reference to insurance, power and telecom sectors.

3.1 Public Sector : Changing Role of Public Sector

Introduction

Indian economy is a mixed economy. In a mixed economy both public as well as private sectors have their distinct significance. The industrial policy of government of India aims at establishing socialistic pattern of the society. With a view to achieve this objective and to accelerate the process of growth, Government of India has recognized the strategic significance of the public sector. Public enterprise refers to that industrial institution which is owned, managed and controlled by the government.

Definition of Public Sector / Enterprise

According to **A. H. Hanson,** "Public enterprise means state ownership and operation of industrial, financial and commercial undertakings."

According to **S.H. Khera,** "Public enterprises are industrial, commercial and economic activities carried on by the central government or by the state government or jointly by the central and the state government."

Thus, public sector includes all state owned enterprises. These are owned and managed by the government. Government has full control over these enterprises. The objective of these enterprises is to promote social welfare along with earning profits.

3.1.1 Characteristics of Public Sector

1. State Ownership

The enterprise ownership has to be vested with the State. It could be in the nature of Central, State or local government ownership or any instrumentality of the state too can have the ownership of public enterprise.

2. State Control

Public Enterprise is controlled by the Government both in its management and functioning. The Government has the direct responsibility to manage the affairs of the enterprise through various devices and exercises control over it by means of a number of agencies and techniques.

3. Public Accountability

Public Enterprises are accountability to people as they are funded through public money. This accountability is realised through legislature and its committees, ministers, audit institutions and other specialised agencies.

4. Autonomy

Public Enterprises function with utmost autonomy under given situations. They are free from day to day interference in their affairs and management.

5. Coverage

The public enterprise traverses all areas and activities. There is hardly any field of activity, which is not covered by the operations of public enterprises.

3.1.2 Objectives of Public Enterprises / Public Sector

1) To Increase Capital Formation

Savings that constitute an important component of capital formation are' generally low in less developed countries. This retards the rate of economic growth. Thus, to accelerate rate of economic growth, such industries are set up by the government as may stimulate production, encourage other industries, increase savings and promote investment.

2) To Set up Heavy Industry

Heavy and key industries need substantial amount of capital which is beyond the capacity of private entrepreneurs. To fulfil this requirement the government has to set up public enterprises.

3) To Promote Economic Equality

With a view to avoid concentration of economic power, it is essential that key industries in the economy are run by the state; as private sector enterprises may result in concentration of economic power. Thus, public sector enterprises help to achieve economic equality.

4) To Check Evils of Monopoly

Public enterprises are useful with a view to checking the evils of monopoly growth in private enterprises.

5) To Perform Welfare Activities

It has become almost essential for the welfare state to increasingly participate in industrial and trading activities of the economy in order to fulfil its growing commitments of welfare of the citizens.

6) To Set up Defence Industries

The state depends upon public sector enterprises for defence needs of the country. Defence industries cannot be left to uncertainties of the private enterprises.

7) To Promote Regional Equality

From the viewpoint of industrial development, there are lots of regional inequalities in India. On the one hand, there are industrially developed regions like Maharashtra, Gujarat, Tamil Nadu and West Bengal. On the other hand, regions like Orissa, Bihar, Jharkhand, Rajasthan are relatively backward. Public enterprises can be established in these industrially backward regions. As a result of it, regional equality can be promoted.

8) To Increase Income of the Government: Public enterprises are expected to generate income for the government. The government may utilise this income for development programmes of nation.

9) To Promote Self-Reliance: Self-reliance in the field of capital goods and in technical know-how is another objective of public sector enterprises.

10) To Increase Employment: Public sector enterprises are also expected to generate employment opportunities in the economy. In these enterprises, job security is more, so people prefer employment in public enterprises.

3.1.3 Role or Significance of Public Enterprises / Public Sector in Indian Economy

Public enterprises play a significant role in the economic development of our country. Following points may be noted to explain the increasing role of public enterprises in the Indian economy :

(i) Capital Formation

According to Prof. Nurkse capital formation plays a significant role in the economic development of an underdeveloped country. In underdeveloped countries savings rate is very low. Low savings lead to low capital formation. This problem can be overcome through public enterprises. The following table shows the relative contribution of public and private sectors in capital formation in India.

Plan	Public Sector (in per cent)	Private Sector (in per cent)
First Plan	46	54
Second Plan	54	46
Third Plan	63	37
Fourth Plan	61	39
Fifth Plan	58	42
Sixth Plan	53	47
Seventh Plan	48	52
Eighth Plan	45	55
Ninth Plan	33	67
Tenth Plan	24	76
Eleventh Plan	219	78.1

Table : Percentage Share of Public and Private Sector in Capital Formation

(ii) Contribution to Net Domestic Product: Share of public sector in net domestic product has tended to increase overtime. It was just 11 percent in 1992-93 while in 2007-08 it was 20.5 per cent.

(iii) Basic Industries: It is only through public enterprises that we can lay strong foundation for basic industries in India. Large-scale industries like iron and steel, heavy machines, fertilizers, atomic energy, arms and ammunition, etc. could be established only under public sector. This sector has given new life to sick unitsof textile industry. The contribution of public sector in developing basic industries and in attaining self-sustained growth is remarkable.

(iv) Development of Infrastructure: Development of infrastructure comprising of transport, power, communication, basic industries, etc. is a precondition of growth. Expenditure on the development of infrastructure is known as social overhead costs. Pace of industrial development cannot be accelerated without their establishment. Their development requires huge capital investment, which cannot be mobilised by the private sector. Moreover these projects do not promise high profits. The private entrepreneurs would therefore be reluctant to undertake them. Their development is possible only in the public sector.

(v) Import Substitution: For a favourable balance of trade, it is essential that goods imported from other countries are produced within the country or their indigenous substitutes are developed. Public enterprises are playing an appreciable role in the field of import substitution. This sector is producing various kinds of medicines, electronic goods, watches, petroleum products, and railway equipments. Thus public enterprises save sizeable amount of foreign exchange.

(vi) Export Promotion: Public sector in India has promoted exports of the country. Public sector exports consist of railway engines, steel, machinery etc. The State Trading Corporation (STC) and the Minerals and Metals Trading Corporation (MMTC) have done a wonderful job in the area of export promotion. Thus, public sector has made significant contribution in the field of export promotion. In year 2008-09, export earnings of public enterprises were Rs. 74,184 crore.

(vii) Less Regional Disparities: There are notable regional disparities in the country. While on the one hand Punjab, Gujarat and Maharashtra are industrially developed regions, on the other hand, Orissa, Bihar and Madhya Pradesh are equally backward. Expansion of the public sector enterprises has played a significant role in reducing these disparities. For example, three big steel plants in the public sector have been established in the backward regions only. For the sake of economic development of backward regions, public enterprises are being set up there.

(viii) Socialistic Pattern of Society: Industrial Policy of India aims at establishing socialistic pattern of society. In such a society inequality of distribution is kept within the warranted limits and public enterprises are expected to generate the much needed surplus for growth. Investment in public sector serves as a check on the concentration of economic power in the private sector. Adopting the policy of price discrimination the Government sells essential goods to the poorer sections of the society at reduced rates. Wages of low-paid employees are raised to reasonable standard. Public sector enterprises thus set a trend for the socialistic pattern of the society.

(ix) Resources for Economic Development: Less developed countries like India need lot of resources for economic development. Only a small percentage of profit in the private sector is reinvested, the rest is distributed as dividend among the shareholders. But the surplus generated in the public sector enterprises is largely reinvested on development of those very enterprises or on the economic progress of the country. Moreover, the dividend received by government from public enterprises in reinvested in development works like infrastructure development. The Government can thus generate resources for its development plans through public sector enterprises. In year 2008-09, the public sector enterprises earned a profit of Rs 84,228 crore.

(x) Promote Employment: Public enterprises are generating more and more employment opportunities. As on March 2007, public sector enterprises offered employment to 180 lakh people. Public sector employs 66 per cent of total workers employed in organised sector in India.

(xi) Growth of Ancillary Industries: Public enterprises are very large in size. These enterprises purchase various intermediate products from small and ancillary units. Public enterprises have helped in growth of ancillary industries in the country, offering more and more employment opportunities.

(xii) Rehabilitation of Sick Mills: Public sector has rendered notable service in re-habilitating sick industrial units. Many public enterprises were set up to take over sick private sector units. Government has taken over sick private sector units on the ground of employment and continuation of production.

3.1.4 Reforms in Public Sector

With a view to making public enterprises more efficient and raising their profitability, the government set up various Committees from time-to-time. Chagla Commission (1958), Krishna Menon Committee (1959), Administrative Reforms Committee, F Mohammad Committee 1980 and Arjunsen Gupta Committee (1998) are some of the important ones. The annual evaluation of public enterprises is done by the Standing Conference of Public Enterprises (SCOPE). Some of the important suggestions offered by various committees are as under :

1. Sector Corporations

Administrative Reforms Committee is of the opinion that all public enterprises should be put directly under some sector corporations. All engineering enterprises should be brought under one corporation. Likewise, all fertiliser enterprises should be brought under a separate corporation and so on. This policy is expected to be useful in the following way:

(a) Economies of large-scale production will be available,

(b) More research can be conducted for the growth of enterprises,

(c) Training centres may be opened to train managers and

(d) It would become convenient for the government to manage public enterprises.

2. Reforms in the Board of Directors

It is advised that various Boards of Management for the public enterprises should be suitably reformed. These Boards should have professionals, representatives of workers and financial experts. Politicians should not be appointed as directors of these Boards.

3. Efficient Management and Able Employees

Efficient managers should be appointed to manage public enterprises. These appointments should be based on merit. Management training facilities should be spread in the country. Every employee in the public enterprises should have accountability. Promotions should be determined by performance, and not simply on the basis of seniority. Efficient employees should be suitably awarded. Corrupt personnel should be punished. Such managers should be appointed as are committed to the objective of economic growth and social justice.

4. Inspection of Public Enterprises

Public enterprises are inspected by Public Accounts Committee and Estimates Committee. The government has also set up Parliamentary Committee of Public Undertakings for inspection of public enterprises. Public enterprises are thoroughly controlled by these committees. Bureau of Public Enterprises has been established for annual inspection of public enterprises. The Bureau should prepare a model report offering guidelines to public enterprises for preparing their annual progress reports. Every enterprise should publish a comprehensive report of its functioning, so that people may come to know about their performance.

5. Autonomy to Public Enterprises

Complete autonomy should be granted to public enterprises in their day-to-day work. There should be minimum possible government interference. Politicians should not be appointed to control these enterprises. However, if competent and able politicians are available, they should better be appointed as honorary consultants. In no case they should be directly involved in the control and management of the enterprises.

6. Proper Auditing

Accounts of public enterprises should be properly audited. According to Administrative Reforms Committee, three or four Audit Boards should be established under the direct control of Comptroller and Auditor General.

7. Full Utilization of Productive Capacity

Public enterprises should be toned up to fully utilize their productive capacity. New industries should be established only after complete utilization of the existing productive capacity. Productive capacity of the existing enterprises should be raised only if at least 85 per cent of the existing capacity is being utilized.

8. Commercial Outlook

Public enterprises must adopt commercial outlook. There should be a coordination between national interest and profitability. Government has realised that price policy of public enterprises should be based on the market forces i.e., the prices of products of public enterprises be fixed on the basis of prevailing market prices. And in case of government monopolies, prices should be determined with a view to raising the level of profitability.

9. Increase in Efficiency

Public enterprises should raise their efficiency level. In this context it may be suggested that: (i) There should be a proper research department of these enterprises, (ii) there should be proper incentives for raising the level of production, reducing expenses and improving the quality of product, (iii) appointments must be based on ability, expertise and administrative capabilities, (iv) there should be no red tapism in decision making, (v) unwarranted recruitment in the enterprises must be stopped and (vi) efficiency of the enterprises must be annually assessed. Corrupt officials must be punished and able ones must be awarded.

10. Reforms in Labour Policy

Labour policy of public enterprises should also be suitably designed. Efficient workers must be suitably awarded. Appointments should be based not on pulls and pressures but ability and expertise. There should be cordial relationship between the workers and the management. To the extent possible, compensation to employees should be linked with their productivity. There should be only one Trade Union in an industry. Union leaders should be the workers themselves.

Workers must have sense of belongingness to their organisation. Industrial Public Service Commission should be set up for the recruitment of efficient and able workers.

11. Voluntary Retirement Scheme (VRS)

To check the problem of overstaffing in public enterprises government launched voluntary retirement scheme in 1988 and a new VRS scheme in 2001. More than 6 lakh employees have opted for voluntary retirement from central public sector enterprises since October 1988 to March 2009.

12. Revival of Sick Public Sector Enterprises

It is the constant endeavour of the government to revive the sick PSEs in order to improve their performance, productivity and profitability. The sick PSEs which are capable of being revived are referred to Board for Industrial and Financial Reconstruction (BIFR), for formulating appropriate revival/rehabilitation packages. As on 30th September, 2009, 58 sick PSEs were registered with BIFR, out of these government has approved revival package in respect of 36 PSEs and closure of 2 PSEs.

13. Check on Extravagance

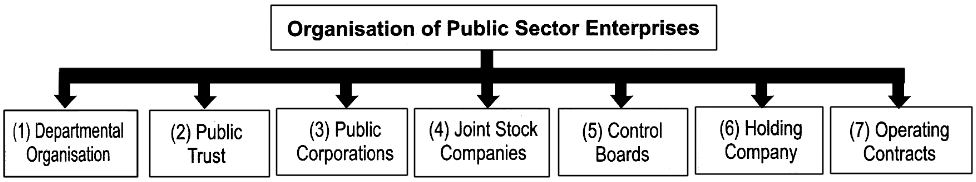
Growing extravagance in public sector enterprises must be checked. Expenditures on foreign trips, entertainments, meetings and symposiums must be severely curtailed. There should be strict parliamentary control over public sector enterprises.

14. Memorandum of Understanding (MoU): On the recommendations of Arjunsen Gupta Committee the government has introduced the concept of Memorandum of Understanding (MoU) in 1988. The main objective of MoU is to reduce the government control and increase accountability of employees of PSUs. The number of public enterprises signing MoUs went up from 4 in 1987-88 to 197 in 2009-10. More such MoUs should be signed so as to give freedom to public enterprises in their working.

The Department of Public Enterprises evaluates the working of public enterprises every year. In 2008-09, 125 public enterprises were rated. 47 enterprises were evaluated as excellent, while 35 PSEs were evaluated as very good, 25 good, 18 fair and none PSE was rated poor..

3.1.5 Organisation of Public Sector Enterprises

Organisation of public enterprises refers to the method of their direction and control. These enterprises are organised in different ways. Following is the detailed description of forms of organisation of public enterprises.



1. **Departmental Organisation :** It is a kind of organisation under which a public enterprise is established, directed, financially managed and controlled by the government department. In India, railways, post and telegraph, Chittranjan Locomotive workshop are examples of departmental organisation.

2. **Public Trust** : This form of organisation has not been made use of, so far, in industrial sector. But it is being increasingly used in service-sector or the sector influencing and controlling social activities. Port Trust or Investment Trust are its examples. This organisation is directed by an autonomous authority. It is established according to constitutional provisions, which spell out the authority and jurisdiction of the Trust. Chairman of the Trust is appointed by the government and he alone is fully responsible for the functioning of the Trust. Members of the Trust ordinarily function in the capacity of advisors. Trust as a form of organisation is quite popular in foreign countries but not so in India.

3. **Public Corporations :** In most of the countries in the world Public Corporation is the most popular form of organisation of public enterprises. It is a combination of both government control and professional adaptability. In the words of Earnest Davies, "Public Corporation is a corporate body created by public authority, with defined powers and functions and is financially independent. It is administered by a board appointed by public authority to which it is answerable." Finance Corporation, Life Insurance Corporation are examples of public corporation.

4. **Joint Stock Companies :** Fourth form of organisation of public enterprises is Joint Stock Companies. These companies come into existence

by virtue of Companies Act. These companies are owned, managed and financed by the shareholders. But the shareholders may be (i) Central government as in case of Nangal Fertilizer Factory, (ii) Central and State Governments as in case of Hindustan Tyre Craft Ltd., (iii) Government and private individuals, as in case of Nepal Mills and Eastern Shipping Corporation. Joint Stock Companies are more independent and flexible than public corporations.

5. **Control Boards:** With a view to organising public sector projects like Multipurpose River Valley Projects, Power Projects etc., Control Boards have been established. These Control Boards have been set-up under **River Board Act, 1956.** According to this Act, a Board is set up by the government for River and Power Projects. These Boards control the concerned project and settle the disputes related to them. Their main objective is to develop inter-state rivers and river valleys and settle mutual disputes among the states on this count. In India as many as 14 Control Boards are in operation, such as, Bhakra Management Board, Hirakud Control Board, Chambal Valley Control Board, etc.

6. **Holding Company :** To organise public enterprise a new system has been adopted recently. It is called Holding Company. A holding company is one that holds 51 per cent or more capital of other companies. In other words, it owns more than half of capital to other companies. Such other companies are called subsidiary companies. Holding company frames policy for the subsidiary companies, administers them and also controls their functioning. Government of India has set up a holding company for its steel plants in the public sector. It is known as **Steel Authority of India Limited. (SAIL)**. Its chairman is appointed by the government of India. Its Board of Directors are appointed with the approval of the government, but its officers are appointed by the Chairman who is also authorised to take all decisions relating to its working.

7. **Operating Contracts :** Under this form of organisation, government enters into contract with an old and experienced private company for managing an enterprise in the public sector. In other words, management of a public sector enterprise is entrusted to a private company by way of a contract. For instance, government has given management contract of a public sector cement factory at Churk (U.P) to a private company.

3.1.6 Causes for the Expansion of Public Enterprise

At the time of independence, India was backward and underdeveloped – basically an agrarian economy with weak industrial base, high rate of unemployment, low level of savings and investment and near absence of infrastructural facilities. Indian economy needed a big push. This push could not come from the private sector because of the lack of funds and their inability to take risk with large long-gestation investments. As such, government intervention through public sector was necessary for self-reliant economic growth, to diversify the economy and to overcome economic and social backwardness.

Let us discuss the rationale or causes for the expansion of public sector enterprises in India.

1. **Rate of Economic Development and Public Enterprises.** The justification for public enterprises in India was based on the fact that the targeted rate of economic growth planned by the government was much higher than could be achieved by the private sector alone. In other words, the public sector was essential to realize the target of high growth rate deliberately fixed by the government.

2. **Pattern of Resource Allocation and Public Enterprises.** Another reason for the expansion of the public sector lies in the pattern of resources allocation decided upon under the plans. In the Second Plan the emphasis was shifted to industries and mining, mainly basic capital goods industries to be developed under the aegis of the public sector. Thus more resources for industrialization were funneled through the public sector.

3. **Removal of Regional Disparities through Public Enterprises.** Another important reason for the expansion of the public sector was the need for balanced development in different parts of the country and to see that there were no serious regional disparities. Public enterprises were set up in those regions which were underdeveloped and where local resources were not adequate. Good examples are the setting up of the three steel plants of Bhillai, Rourkela and Durgapur and the Neyveli Project in Madras which were meant to help the industrialise regions surrounding the projects.

4. **Sources of Funds for Economic Development.** Initially, state was an important source of funds for development. The surplus of government enterprises could be re-invested in the same industries or used for the establishment and expansion of other industries. Profits of public sector industries can be directly used for capital formation which is necessary for the rapid development of the country.

5. **Socialistic Pattern of Society.** The socialistic pattern of society envisaged in the Constitution calls for expansion of public sector. For one thing, production will have to be centrally planned as regards the type of goods to be produced, the volume of output and the timing of their production. Besides, one of the objectives of the directive principles of the Indian Constitution is to bring about reduction of the inequalities of income and wealth and to establish an egalitarian society.

   The Five Year Plans have taken this up as a major objective of planning. The public enterprises were used as major instruments for the reduction of inequalities of income and to bring about a more equitable distribution of income in several ways.

6. **Limitations and Abuses of the Private Sector.** The behaviour and attitude of the private sector itself was an important factor responsible for the expansion of the public sector in the country. In many cases the private sector could not take initiatives because of the lack of funds and their inability to take risk with large long-gestation investments.

   In a number of cases, the government was forced to take over a private sector industry or industrial units either in the interest of workers or to prevent excessive exploitation of consumers. Very often the private sector did not function as it should and did not carry out its social responsibilities. Accordingly, the government was forced to take over or nationalize the private sector units.

3.1.7 Defects/Limitations of Public Sector Enterprises

1. Lack of Efficiency

Efficiency of public enterprises is generally lower than private enterprises. This is because of several reasons such as, managers and organisers of public enterprises seldom commit themselves to the growth and welfare of these enterprises. Generally, they evade from their responsibilities. Moreover these enterprises suffer from red tapism. Decisions and their implementation invariably take long time. This adversely affects the efficiency. Late Prime Minister Rajiv Gandhi held that inefficient management is the fundamental weakness of public enterprises.

2. Lack of Good Management

Lack of good management is yet another drawback of public enterprises. Politicians or retired bureaucrats are appointed on the managerial posts of these enterprises. These politicians use public enterprises as a means to promote their political interest. Lacking good management, public enterprises fail to achieve their objectives. The government has failed to adopt a suitable policy that attracts good management in the public sector enterprises.

3. **Social Objectives:** Public enterprises do not have profit maximization as their sole objective but social welfare is also considered as the objective of public enterprises. Sometimes public enterprises sell their products at reduced prices with a view to strengthening the structure of the economy and to help the poorer section of the society. Price policy of the public sector is not based upon the objective of profit maximization. Low price fixation leads to low profitability of these enterprises.

4. **Long Gestation Period:** Most of the public sector enterprises are large-scale and capital- intensive. These enterprises have long gestation period. There is a long time lag between the establishment of these enterprises and start of production. Longer this gestation gap, higher the cost and lower the profits.

5. **More Construction Expenditure:** Public enterprises are largely established outside the city limits, and at new places. Bhilai, Rourkela, Durgapur and Pinjore were the newly established industrial towns. Lot of expenditure has been incurred on the construction of residential houses for the workers and managers. Such huge investments causes low profits.

6. **Industrial Disputes:** Public sector workers often indulge in industrial disputes. Disputes between workers and management are almost a regular feature. This badly affects production efficiency resulting in low output and high cost. Rate of profit consequently remains low.

7. **Effect of Location:** A private enterprise is located at place that suits the objective of profit maximization. Public enterprises, on the other hand, are located in backward areas with a view to promoting balanced regional development. These places fail to offer developed and economically viable environment. As a result, cost factor is pushed up and profitability reduced. Sometimes location of PSUs is influenced by political considerations like a PSU is set up in the constituency of the minister, but that location may not be economically viable.

8. **Lack of Competition:** Lack of competition is an important obstacle in the way of progress of public sector enterprises. Healthy competition is almost a pre-condition for improving the quality of the products and stability of prices. Because of monopolistic tendencies of public enterprises, not much attention is paid to the cost factor. On the other hand, these enterprises, unlike the private enterprises,

cannot charge high prices for their products. So, while prices remain low, cost of production tends to increase, resulting in huge losses.

9. **Irresponsible Staff:** In public sector workers are generally indisciplined and corrupt. They are hardly conscious of their responsibilities. The security of job makes them irresponsible. Their promotion is determined not by their efficiency but simply by their seniority. Trade unions are also responsible for the indifferent attitude of public sector workers. This results in low productivity.

10. **Under-utilization of Production Capacity:** Public enterprises are known for under- utilization of their production capacity. This is because of several reasons, such as lack of raw material and trained personnel, lack of demand, lack of proper planning in respect of production capacity, and inefficiency of management. In 2008-09, in terms of capacity utilization, 58 per cent of all public enterpirses operated at 75 per cent or higher; 20 per cent operated between 50 to 75 per cent and the remaining 22 per cent operated at even less than 50 per cent of their installed capacity. Because of underutilization of their capacity, these enterprises fail to get high return on their investment.

11. **High Capital Output Ratio:** Output of public enterprises is much lower compared to their capital investment. That is, capital output ratio is very high. On one hand, there is low production in these enterprises, and on the other, productivity of capital remains low. This adversely affects public enterprises.

12. **Over Staffing:** Overstaffing is a well known feature of public enterprises. This results in low productivity and high wage bill. Marginal productivity of the workers is zero or even negative in some of these enterprises.

13. **Over Capitalisation:** In many enterprises, such as Heavy Engineering Corporation and Hindustan Aeronautics there is lot of over capitalization. This involves huge liability of interest payments without corresponding returns. Machines also remain idle. This results in low profitability.

3.2 Privatization Concepts

Introduction

Privatisation is part of the process of rethinking the welfare state. Society is searching for new ways of delivering services because of our collective sense of efficiency. The entrepreneur, not the bureaucrat, is the hero of society. While we cannot be sure how it will all turn out, privatisation will be part of the emerging post- welfare state. “Privatisation where applied has achieved some measures of success in the local government”.

3.2.1 History and Privatisaion

The word 'privatisation' has been receiving much attention in business, government and academic circles all over the world. In fact, the language and programmes of privatisation have disseminated so rapidly throughout the world that the phenomenon can be likened to a revolution or a boon.

Privatisation techniques have already been tried in countries like Great Britain, China, the U.S., Turkey, Brazil, Mexico and Japan. In our country too, a beginning towards privatisation has been made with the sale upto 20 per cent of the equity capital of 30 plus select public sector units (PSU's), first to mutual funds and financial institutions, and later to investing public. While the experience of disinvestment of PSU's has been a mix of encouragement and dis-heartenment, it is advisable to go slow in the direction.

History

The history of privatisation is very short-just 10 to 15 years old, to be precise. Though real disinvestment started only in 1980's, the word 'privatisation' first made its appearance way back in the late 60s. The credit for inventing, the word goes to Peter F. Drucker who used the term first in his famous book, The Age of Discontinuity in 1969. Ten years later, Margarat Thatcher became Prime Minister of Great Britain and it was she who gave practical shape to privatisation. Later, country after country fell in line with Great Britain in the move towards disinvestment.

Meaning and Definition of Privatisation

Privatisation is the process of involving the private sector in the ownership or operation of a state-owned or public sector undertaking. In a broader sense, it connotes private ownership. In other words privatisation means transfer of ownership and/or management of an enterprise from the public sector to the private sector. It also means the withdrawal of the State from an industry or sector, partially or fully. Another dimension of privatisation is opening-up of an industry that has been reserved for the public sector to the private sector.

According to Stuart M. Butler, Privatisation is "the transfer of government assets or functions to the private sector".

According to D. R. Pendse, Privatisation is "any process which reduces the involvement of the state or the government sector in the nation's economic affairs is a privatisation process".

3.2.2 Reasons for Privatisation

The reasons of privatisation could be the main factor to trigger the privatisation process. These include some of the following reasons,

i) To Reduce the Burden on Government

The fiscal deficit and balance of payment become burden for the economy then, the government has to think about alternative sources of funds.

The alternative sources of option are, To Raise Taxes

However the public are unable to pay for these taxes.

ii) To Strengthen Competition

The main reason of privatisation is increased efficiency through the competition. This is more beneficial to the customer not only for cheaper products but also for greater choice and better services and products.

iii) To Fund Infrastructure Growth

In the process of privatisation, upgrading and expanding infrastructure has greatly benefited in both developed and developing countries. In India private capital is used to telecom networks, build new schools and create new transport networks. But, in some countries investors provide services to build port, bridges etc., under private - public partnership.

iv) Accountability to Shareholders

After privatisation process, companies encouraged to act for the interest of shareholders. Privatisation say several times of the fact that privatisation increases shareholder's accountability for looking at the earnings-per-share of the various PUSs.

v) More Disciplined Labour Force

In privatised Industries unions have less power than public. In private companies, there are fewer strikes and it includes both implict and financial cost. The private companies are financially sound because they always try to improve the efficiency and get's profit maximisation for PSU's.

3.2.3 Nature of Privatisation

The various nature of privatisation is as follows:

1. **Transfer of Ownership :** Privatisation of State-Owned Enterprises (SOEs), i.e., the transfer of firm ownership from governments to private investors has become an important tool of economic policy, especially in less-developed and former communist countries.

2. **Increased Competition :** One of the prominent feature of privatisation is the enhanced competitive characteristics it provides to the enterprises which prove to be fruitful for the business as well as the country.

3. **Increased Efficiency :** Competitive environments and capital-market discipline increase the efficiency of privatised SOEs. The result is a lack of specific guidelines for shaping deal conditions given the characteristics of the firm and country.

4. **Increased Opportunities :** The worldwide privatisation wave creates opportunities for international diversification.

5. **Effectiveness of Deal Depends on Host Country :** The effectiveness of the deals depends, on the conditions of the privatisation process and the host country.

3.2.4 Objectives of Privatisation

The basic objective of privatisation everywhere is to improve the performance of CPSUs so as to lessen the financial burden on taxpayers. The other objectives aim at increasing the size and dynamism of the private sector, distributing ownership more widely in the population at large; encouraging and facilitating private sector investments, from both domestic and foreign sources; generating revenues for the State; reducing the administrative burden on the State; and in the case of the former socialist countries — launching and sustaining the transformation of the economy from a command to a market model. Popularisation of the private sector too is an objective of privatisation.

1. **One of the main goals of privatization is to create higher levels of efficiency throughout the economy.** It seeks to either establish or support what is referred to as a "market economy." This type of economy is driven by the notion of free enterprise. Individuals and businesses exchange goods and services voluntarily, largely without any type of government or political intervention. Prices for goods and services are determined by supply and demand and competition among suppliers is encouraged. The United States is an example of a market economy.

2. **Service Development and Efficiency**

   A second aim of privatization is to improve the economic efficiency and development of the service in question. For example, some states allow for the deregulation of utilities. By allowing more than one utility company to provide electricity or gas, customers are able to possibly reap the benefits of lower prices through competition. It is thought that privately-owned companies operate more efficiently than government entities. Efficiency is higher in the private sector due to a stronger connection between the business owners and its executive operators.

3. Budget Improvement

When services are provided by the private sector, a public entity such as a federal government is no longer financially responsible. Transferring the responsibility allows a public entity to gain income from the sale of the business or service in question and reduce its financial burden. The additional income gained from transfer of ownership might be used to reduce citizen tax rates, pay down debts or go toward other expenses.

4. Income Distribution and Political Influence

Privatization seeks to return the ownership of the economy to its citizens. Rather than placing full responsibility with a centralized government, businesses owned and operated by private members of society help contribute to their own well-being. Entrepreneurship is thought to be encouraged and able to flourish under privatization. In addition, political parties and lead figures use privatization to gain influence in political campaigns and push certain political agendas.

Other Objectives are as follows :

1. Greater efficiency
2. Revealing the true and full cost of the service provided
3. Promotion of technological advancement
4. Development of capital markets
5. Broadening the wealth and achieving widespread private ownerships in society
6. Curbing inflation
7. Raising extra-revenues for the government
8. Eliminating hidden unemployment and reducing the power of public employee unions.

3.2.5 Forms of Privatisation

Privatisation is sought to be achieved through any or more of the six important routes: sale to public, management-employee buyout, equal-access voucher privatisation, spontaneous privatisation, cross holding, and strategic sale.

1. **Sale to Public:** This route was mostly used in the early 1990s. As in a private sector enterprise, shares of CPSUs are offered to retail investors through public issues domestically and GDRs in the overseas markets. This route helps broadbase ownership, there is greater fairness and the wealth generated by the CPSUs will be shared with general public.

   Several CPSUs followed this route. A few of them are NTPC, Power Grid Corporation, REC, Oil India, and Shipping Corporation of India.

   Lack of adequate domestic capital, resistance from employees and difficulty of evaluating and negotiating deals make this route less attractive.

2. **Management-Employee Buyout:** Management-employee buyout is a widely used alternative to sale, notably in Croatia, Poland, Romania, and Slovenia. Buyout is relatively fast and easy to implement, both politically and technically. The route may lead to better corporate governance as insiders have better access than outsiders to information needed to monitor managers.

   There are disadvantages however. One disadvantage is that the benefits are unevenly distributed: employees in good firms get valuable assets while those in money-losers get little or nothing of value. Another disadvantage is that the governments typically charge low prices to insiders and thus realise little revenue. Insiders do not bring in new skills and new capital. There could be managerial and worker entrenchment that might block further reforms.

3. **Equal-access Voucher Privatisation:** A third form of privatisation distributes vouchers across the population and attempts to allocate assets approximately evenly among voucher holders. Such programmes excel in speed and fairness. But they raise no revenue for government and they have unclear implications for corporate governance. Mongolia, Lithuania and the former Czechoslovakia were the first to implement this route to privatisation.

4. **Spontaneous Privatisation:** This route to privatisation is easy, obstacle-free, with no revenue generation for the government and has doubtful impact on corporate governance. Small firms lend themselves to this type of privatisation. Russia has divested most of its small units through this route. So is the case with Czechoslovakia, Hungary and Poland.

Method	*Objectives*				
	Better corporate governance	*Speed and feasibility*	*Better access to capital and skills*	*More government revenue*	*Greater fairness*
Sale to public	+	¾	+	+	¾
Management employee Buyout	¾	+	¾	¾	¾
Equal-access voucher privatisation	?	+	?	¾	+
Spontaneous privatisation	?	?	¾	¾	+

Table : Brings out the comparative picture of the four routes of privatisation.

5. Cross Holdings: Yet one more route of disinvestment relates to Cross Holdings, also called the Golden Share Warehousing. This method involves the sale of shares to other CPSUs. In the early 2006, a select group of investors — eight government banks and institutions — were invited to make bids for shares in Maruti Udyog.

- Under the warehousing model, Government owned financial institutions will be invited to buy and keep in store shares of CPSUs until third parties emerge to buy.
- Golden share concept seeks to protect the interests of Government in the CPSUs. Under this model, Government would retain 26 per cent of shares which guaranteed the status of majority shareholders.

6. Strategic Sale: This method of disinvestment is being currently pursued by the Government but was first initiated in 2000. Strategic sale involves inviting expression of intent from individual parties, followed by short-listing based on certain eligibility criteria and invitation of bids from the short-listed firms. The highest bidder wins provided his offer price is higher than a reserve price set by the Government, which is not made known to bidders.

Strategic sale also involves that the Government offers majority stake in the CPSUs to the buyer, as much as 74 per cent of the equity. 26 per cent of equity is retained by the Government, but the lesser stake does not make it a minority shareholder. Instead, this 26 per cent stake will continue to give the Government the status of a majority shareholder.

Strategic sale route was followed in the disinvestment of Modern Foods, BALCO, VSNL, HCI, CMC, ITDC (19 Hotels), IBP PPL and Jessop, among others.

3.2.6 Advantages and Disadvantages of Privatisation

Advantages of Privatisation

1. Improved Efficiency

The main argument for privatisation is that private companies have a profit incentive to cut costs and be more efficient. If you work for a government run industry, managers do not usually share in any profits. However, a private firm is interested in making profit and so it is more likely to cut costs and be efficient. Since privatisation, companies such as BT, and British Airways have shown degrees of improved efficiency and higher profitability.

2. Lack of Political Interference

It is argued governments make poor economic managers. They are motivated by political pressures rather than sound economic and business sense. For example a state enterprise may employ surplus workers which is inefficient. The government may be reluctant to get rid of the workers because of the negative publicity involved in job losses. Therefore, state owned enterprises often employ too many workers increasing inefficiency.

3. Short Term view

A government many think only in terms of next election. Therefore, they may be unwilling to invest in infrastructure improvements which will benefit the firm in the long term because they are more concerned about projects that give a benefit before the election.

4. Shareholders

It is argued that a private firm has pressure from shareholders to perform efficiently. If the firm is inefficient then the firm could be subject to a takeover. A state owned firm doesn't have this pressure and so it is easier for them to be inefficient.

5. Increased Competition.

Often privatisation of state owned monopolies occurs alongside deregulation – i.e. policies to allow more firms to enter the industry and increase the competitiveness of the market. It is this increase in competition that can be the greatest spur to improvements in efficiency. For example, there is now more competition in telecoms and distribution of gas and electricity.

However, privatisation doesn't necessarily increase competition, it depends on the nature of the market. E.g. there is no competition in tap water. There is very little competition within the rail industry.

6. Government will raise revenue from the sale

Selling state owned assets to the private sector raised significant sums for the UK government in the 1980s. However, this is a one off benefit. It also means we lose out on future dividends from the profits of public companies.

Disadvantages of Privatisation

1. Natural Monopoly

A natural monopoly occurs when the most efficient number of firms in an industry is one. For example tap water has very significant fixed costs, therefore there is no scope for having competition amongst several firms. Therefore, in this case, privatisation would just create a private monopoly which might seek to set higher prices which exploit consumers. Therefore it is better to have a public monopoly rather than a private monopoly which can exploit the consumer.

2. Public Interest

There are many industries which perform an important public service, e.g health care, education and public transport. In these industries, the profit motive shouldn't be the primary objective of firms and the industry. For example, in the case of health care, it is feared privatising health care would mean a greater priority is given to profit rather than patient care. Also, in an industry like health care, arguably we don't need a profit motive to improve standards. When doctors treat patients they are unlikely to try harder if they get a bonus.

3. Government loses out on potential dividends.

Many of the privatised companies in the UK are quite profitable. This means the government misses out on their dividends, instead going to wealthy shareholders.

4. Problem of regulating private monopolies.

Privatisation creates private monopolies, such as the water companies and rail companies. These need regulating to prevent abuse of monopoly power. Therefore, there is still need for government regulation, similar to under state ownership.

5. Fragmentation of industries

In the UK, rail privatisation led to breaking up the rail network into infrastructure and train operating companies. This led to areas where it was unclear who had responsibility. For example, the Hatfield rail crash was blamed on no one taking responsibility for safety. Different rail companies has increased the complexity of rail tickets.

6. Short-Termism of Firms.

As well as the government being motivated by short term pressures, this is something private firms may do as well. To please shareholders they may seek to increase short term profits and avoid investing in long term projects. For example, the UK is suffering from a lack of investment in new energy sources; the privatised companies are trying to make use of existing plants rather than invest in new ones.

3.2.7 Impact of Privatisation in India

Privatisation in India is still at a minimalist level. Privatisation by way of sale of public sector enterprises is almost negligible while divestment is also existent by way of selling of a portion of shares of the 31 public sector enterprises. Privatisation got tremendous boost by the introduction of new economic policy in 1991 that allowed delicensing, relaxing entry restrictions and equity funding. Few examples of privatisation in India are Lagan Jute Machinery Company Limited, Modern Food Industries Limited, BALCO, Hotel Corporation of India Limited, Hindustan Zinc Limited, Paradeep Phosphates Limited, BSNL, etc.

The positive and negative impact of privatisation in India is as follows;

1. Positive Impact of Privatisation in India

The positive impact of privatisation in India can be seen in following areas:

i) **Provide the Necessary Impetus to the Underperforming PSUs:** State-owned enterprises usually are outdone by the private enterprises competitively. When compared the latter show better results in terms of revenues and efficiency and productivity. Hence, privatisation can provide the necessary impetus to the underperforming PSUs.

ii) **Provides Momentum in the Competitive Sectors:** Privatisation brings about radical structural changes providing momentum in the competitive sectors.

iii) **Fosters Sustainable Competitive Advantage:** Privatisation leads to adoption of the global best practices alongwith management and motivation of the best human talent to foster sustainable competitive advantage and improvised management of resources.

iv) **Improves Financial Health:** Privatisation has a positive impact on the financial health of the sector which was previously state dominated by way of reducing the deficits and debts.

v) **Lowers Net Transfer to the State-Owned Enterprises:** The net transfer to the state-owned enterprises is lowered through privatisation.

vi) **Escalates the Performance Benchmarks of the Industry:** Helps in escalating the performance benchmarks of the industry in general.

vii) **Beneficial for the Growth of Employees:** It can initially have an undesirable impact on the employees but gradually in the long-term, shall prove beneficial for the growth and prosperity of the employees.

viii) **Better Services to the Customers:** Privatised enterprises provide better and prompt services to the customers and help in improving the overall infrastructure of the country.

2. Negative Impact of Privatisation in India

There are several disadvantages or the problems faced by privatisation which are as follows:

i) **Ignores Social Objectives :** Private sector focuses more on profit maximisation and less on social objective unlike public sector that initiates socially viable adjustments in case of emergencies and criticalities.

ii) **Lack of Transparency :** There is lack of transparency in private sector and stakeholders do not get the complete information about the functionality of the enterprise.

iii) **Support to Unfair Practices :** Privatisation has provided the unnecessary support to the corruption and illegitimate ways of accomplishments of licenses and business deals amongst the government and private bidders. Lobbying and bribery are the common issues tarnishing the practical applicability of privatisation.

iv) **Loses the Mission :** Privatisation loses the mission with which the enterprise was established and profit maximisation agenda encourages malpractices like production of lower quality products, elevating the hidden indirect costs, price escalation, etc.

v) **High Employee Turnover :** Privatisation results in high employee turnover and a lot of investment is required to train the lesser-qualified staff and even making the existing manpower of PSU abreast with the latest business practices.

vi) **Conflict of Interest :** There can be a conflict of interest amongst stakeholders and the management of the buyer private company and initial resistance to change can hamper the performance of the enterprise.

vii) **Escalates Price Inflation :** Privatisation escalates price inflation in general as privatised enterprises do not enjoy government subsidies after the deal and the burden of this inflation affects the common man.

3.2.8 SINS and Pitfalls of Privatisation

Privatisation does not guarantee unconditional success. Privatisation in many countries has been found to be often fraught with many sins and pitfalls.

The commonly observed flaws of privatisation are the following :

1. **Lack of Proper Strategy:** An important reason for failure of privatisation is absence of a proper strategy or norms regarding the industries/units to be privatised, the method of privatisation, extent of divestment, selection of buyer/investor etc.
2. **Ambiguity of Objectives:** The real objective of privatisation is another problem. Is it for raising revenue? Is it for making the enterprise competitive? If there are multiple objectives, what is the priority list?
3. **Connivance:** Some times politicians have hidden objective behind privatisation. The UNDP Report cited above points out that in too many cases it has taken place for the wrong reason, under the wrong conditions and in the wrong way.
4. **Wrong Timing:** Many privatisation schemes could not get a good price because of the wrong timing. A good price can be obtained if privatisation is done when the performance, market capitalisation and the industry prospects are good. It is pointed out the Maruti could have got a good price had it been privatised when the goings were good.
5. **Lack of Political Consensus:** Privatisation is a political process too. As there are opposing views regarding privatisation, there are likely to have some opposition to privatisation. The privatisation BALCO is a case in point. The government shall try to make clear the need for and objectives of privatisation and shall bring about as broad a consensus is possible.

6. **Wrong Labour Strategies:** Most public enterprise have surplus labour, getting rid of which is essential for success of the enterprise. But, to overcome labour resistance to privatisation, often unrealistic promises are given that the labour will not be affected by privatisation. A more open and realistic handling of the labour is needed for making privatisation meaningful. Prospects of retraining and redeployment of the labour are yet to be properly explored in countries like India.

7. **Lack of Political Will:** Privatisation is not carried out in real earnest and properly because of lack of political will and/or vested interests. For example, some ministers oppose privatisation of enterprises under their ministry and some politicians oppose privatisation of undertakings in their Constituencies or States.

8. **Poor Financial Strategies:** Many privatisations are carried out with out a good financial strategy.

9. **Wrong Environment:** Mere transfer of ownership does not help improve the performance of an enterprise. Where the market functions poorly and enterprises are still vulnerable to arbitrary government edicts, transferring ownership to the private sector is unlikely to achieve much.

10. **Prevalence of Monopoly Elements:** If privatisation results in the conversion of a public sector monopoly to a private sector monopoly, privatisation may not produce much beneficial effects, it could even worsen the situation.

11. **Problem of Cultural Change:** Improvement of performance of an enterprise after the privatisation will depend, inter alia, on bringing about a change in the work culture and the total enterprise culture. This is no easy task.

3.3 Regulatory Framework

3.3.1 Insurance Sector

IRDA - Insurance Regulatory Development and Authority is the statutory, independent and apex body that governs and supervise the Insurance Industry in India.

It was constituted by Parliament of India Act called Insurance Regulatory and Development Authority of India (IRDA of India) after the formal declaration of Insurance Laws (Amendment) Ordinance 2014, by the President of India Pranab Mukherjee on December 26,2014.

Establishment :

- IRDA Act was passed upon the recommendations of Malhotra Committee report (7 Jan,1994), headed by Mr R.N. Malhotra (Retired Governor, RBI)
- *Main Recommendations* - Entrance of Private Sector Companies and Foreign promoters & An independent regulatory authority for Insurance Sector in India
- In April,2000, it was set up as statutory body, with its headquarters at New Delhi.
- The headquarters of the agency were shifted to Hyderabad, Telangana in 2001.

3.3.1.1 Mission Statement of the Authority

- To protect the interest of and secure fair treatment to policyholders;
- To bring about speedy and orderly growth of the insurance industry (including annuity and superannuation payments), for the benefit of the common man, and to provide long term funds for accelerating growth of the economy;
- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;
- To ensure speedy settlement of genuine claims, to prevent insurance frauds and other malpractices and put in place effective grievance redressal machinery;
- To promote fairness, transparency and orderly conduct in financial markets dealing with insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;
- To take action where such standards are inadequate or ineffectively enforced;
- To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

3.3.1.2 Duties, Powers and Functions of IRDAI

Section 14 of IRDAI Act, 1999 lays down the duties, powers and functions of IRDAI.. Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.

1) Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include,

- issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
- protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
- specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents
- specifying the code of conduct for surveyors and loss assessors;
- promoting efficiency in the conduct of insurance business;
- promoting and regulating professional organisations connected with the insurance and re-insurance business;
- levying fees and other charges for carrying out the purposes of this Act;
- calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;
- control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
- specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
- regulating investment of funds by insurance companies;
- regulating maintenance of margin of solvency;
- adjudication of disputes between insurers and intermediaries or insurance intermediaries;
- supervising the functioning of the Tariff Advisory Committee;
- specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f);

- specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
- exercising such other powers as may be prescribed

Organisational Setup of IRDA

As per the section 4 of IRDAI Act' 1999, Insurance Regulatory and Development Authority of India (IRDAI, which was constituted by an act of parliament) specify the composition of Authority The Authority is a ten member team consisting of

- One Chairman (For 5 Years & Maximum Age - 60 years)
- Five whole-time Members (For 5 Years and Maximum Age- 62 years)
- Four part-time Members (Not more than 5 years)The chairman and members of IRDAI are appointed by Government of India.

The present Chairman of IRDAI is Mr T.S Vijayan.

3.3.1.3 Role of the IRDA in India

The Insurance Regulatory and Development Authority (IRDA) has specified that companies will have to become more transparent. This means that an insurance company will have to give a detailed definition of the conditions and benefits, along with the different product riders, to its customers. The new regulation endeavours to safeguard the customers against any false claims. The IRDA has gone on to say that such information should be available to the customers in the public domain. This includes all insurance products, including life insurance.

General Role of the Regulatory Authority

The IRDA has set a regulatory framework for the functioning of the insurance segment in the country, in order to protect the policy holder's interests, while promoting efficiency in business conduct. It also offers a platform for insured parties to come out with complaints against the insurer or the non-life or life insurance product, if and when needed. To this end, a grievance redressal cell has been set up to address specific issues.

To ensure that customers are provided with standard and quality services, the regulatory authority has given specifications on educational qualifications, practical training and code of conduct for agents and other intermediaries. The authority also adjudicates disputes between the insurer and the insured or any intermediary.Duties and Powers under Section 14 of the IRDAI Act.

Major powers and duties are exercised to safeguard the interests of the non-life or life insurance policy holders. Here are a few other areas of jurisdiction of the IRDA.

1. Issuing a certificate of registration to insurance companies. They are also in charge of modifying and renewing the same. The IRDA may exercise its powers to suspend, withdraw or cancel such a registration, given that there is sufficient reason.

2. The regulation and control of insurance advantages, premium rates and terms & conditions offered to consumers. This is in respect to the general insurance business, which is not under the stringent control of the Tariff Advisory Committee.

3. Power to call for information, conduct enquiries, commence investigation and undertake inspection of insurance companies. This includes audit of insurance companies, intermediaries and other such related parties.

4. Administrating the operations of the Tariff Advisory Committee, under section 64U and other related sections of the Insurance Act of 1938.

5. Stipulating the proportion of general insurance and life insurance business that can be undertaken up by an insurer in a particular sector.

The IRDA takes its responsibility to safeguard the interests of the consumer very seriously and to this end it is constantly reviewing and revising its guidelines for companies operating in the Indian insurance industry.

3.3.2 Power Sector

Power is an indicator of a country is prosperity is an important element essential for economic development.

i) There are conventional and non-conventional sources of energy. Conventional includes commercial and non-commercial sources of power.

ii) Coal is the main source of commercial energy.

iii) Thermal power is the main contributor followed by hydel power generation and nuclear power to power generation.

iv) With increasing population, domestic demand for electricity is growing at a faster rate.

v) In agriculture, rural electrification, power for lift irrigation and energization of pumpsets has increased significantly in the recent years (about 24%).

vi) Insufficient power supply has restricted the growth of industries all over the country with establishment of new industries for example fertilizers, machine tools, there is considerable demand for power.

vii) In contrast electricity consumption by railways and public lighting has reduced.

viii) State Electricity Boards (SEB) are a major component of the indian power sector.

ix) After liberalization SEB were restructured and were made into corporation. There are state regulators along with a central regulator. These regulators rationalize the power tariffs.

x) Monopoly of the SEB's was removed, giving entry to market forces. Through the electricity Act, 2003.

xi) The Accelerated Power Development Reform Programme (APDRP) launched by the government enabled several states to cut losses and improve revenues.

xii) Exploration of Oil and Natural Gas by private and foreign players has increased after deregulation in 2002, disinvestment has also been initiated with sale of IBP.

xiii) The power sector is on the road to recovery.

According to recent estimations it shows that, India's hydel power capacity is nearly 600 bkwh (billion kilowatt hour) at a load factor of 60 percent. The resources of hydel power are not equally supplied in india. Some states have substantial hydel power and some states have little hydel power.

The supply and development of hydel power depends on supply of water in rivers, lakes, dams etc. The two main source of water in the rivers are Rainfall and Snow. Thermal Power The available fuels such as coal, oil and natural gas is the development of thermal power plants to generate electricity. The generation of thermal power result the pollution. To generate thermal power by using fuels are totally use up. The initial cost of thermal plants generally low but power generation and maintenance costs are high.

The developed thermal power in India is very large scale. For the public utilities, the capacity of power plant was 124.3 thousand MN in 2005-06. And the thermal power accounted for 88.6 thousand MN, that is 71.3 percent. Oil resources are limited in India. And coal is the main source of thermal power but, using coal is the most polluting and effect on environment. At present about two-thirds of coal production is used for power generation. Therefore, for better environment the using of coal for power generation should be made to reduce.

3.3.2.1 Power of Central Commission

The Central Commission, shall, for the purposes of any inquiry or proceedings under this Act have the powers as are vested in a civil court under the Code of Civil Procedure, 1908 in respect of the following matters.

a) The summoning and enforcing the attendance of any wit-ness and examining him on oath.

b) The discovery and production of any document or other material object producable as evidence.

c) The reception of evidence on affidavits.

d) The requisition of any public record.

e) The constitution of commission for examination of wit-nesses.

f) Review its decisions, directions and others.

g) Any other matter which may be prescribed.

3.3.2.2 Functions of Central Commission

The Central Commission shall discharge all or any of the following functions, namely :

a) To regulate the tariff of generating companies owned or controlled by the Central Government.

b) To regulate the tariff of generating companies, other than those owned or controlled by the Central Government, if such generating companies enter into or otherwise have a composite scheme for generation and sale of electricity in more than one state

c) To regulate the inter-state transmission of energy including tariff of the transmission utilities.

d) To promote competition, efficiency and economy in the activities of the electricity industry.

e) To aid advise the Central Government in the formulation of tariff policy which shall be,

   i) Fair to the consumers and

   ii) Facilitate mobilization of adequate resources for the power sector

f) To associate with the environmental regulatory agencies to develop appropriate policies and procedures for environmental regulation of the power sector.

g) To frame guidelines in matters relating to electricity tariff

h) To arbitrate or adjudicate upon disputes involving generating companies or transmission utilities in regard to matters connected with clauses (a) to (c) above.

i) To aid and advise the Central Government on any other matter referred to the Central Government by the government.

3.3.2.3 Functions of State Commission

Shall discharge the following functions,

a) To determine the tariff for electricity, wholesale, bulk, grid, or retail, as the case may be.

b) To determine the tariff payable for the use of the transmission facilities in the manner.

c) To regulate power purchase and procurement process of the transmission utilities and distribution utilities including the price at which the power shall be procured from the generating companies, generating stations or from other sources for transmission, sale distribution and supply in the State.

d) To prove competition, efficiency and economy in the activities of the electricity industry in order to achieve the objects and purposes of this Act.

The state government may, by notification in the Official Gazette, confer any of the following functions upon the State Commission.

a) To regulate the investment approval for generation, transmission, distribution and supply of electricity to the entities operating within the state

b) To aid and advise the State Government, in matters concerning electricity generation, transmission, distribution and supply in the State;

c) To regulate the operation of the power system within the State

d) To issue licences for transmission, bulk supply, distribution or supply of electricity and determine the conditions to be included in the licences.

e) To regulate the working of the licensees and other persons authorised or permitted to engage in the electricity industry in the State and to promote their working in an efficient, economical and equitable manner.

f) To require licensees to formulate perspective plans and schemes in coordination with others for the promotion of generation, transmission, distribution, supply and utilisation of electricity, quality of service and to devise proper power purchase and procurement process.

g) To set standards for the electricity industry in the State including standards relating to quality, continuity and reliability of service.

h) To promote competitiveness and make avenues for participation of private sector in the electricity industry in the State, and also to ensure a fair deal to the customers.

i) To lay down and enforce safety standards.

j) To aid an advise the State Government in the formulation of State Power policy.

k) To collect and record information concerning the generation, transmission, distribution and utilisation of electricity (1) To collect and publish data and forecasts on the demand for, and use of, electricity in the State and to require the licence to collect and publish such data,

m) To regulate the assets, properties and interest in properties concerning or related to the electricity industry in the State including the conditions governing entry into, and exit from, the electricity industry in such a manner as to safeguard the public interest.

n) To adjudicate upon the disputes and differences between the licences and utilities and to refer the matter for arbitration.

o) To coordinate with environmental regulatory agencies and to evolve policies and procedures for appropriate environmental regulation of the electricity sector and utilities in the State, and

p) To aid and advise the State Government on any other matter referred to the State commission by such government. Functions of A.P. State Electricity Regulatory Commission.

The commission shall be responsible to discharge amongst others, the following functions,

a) To aid and advise, in matters concerning electricity generation, transmission, distribution and supply in the State.

b) To regulate the working of the licences and to promote their working in an efficient, economical and equitable manner including laying down standards of performance for the licenses in regard to services to consumers.

c) To issue licences in accordance with the provisions of this Act and determine the conditions to be included in the licences.

d) To promote efficiency, economy and safety in the use of the electricity in the State including and in particular regard to quality, continuity and reliability of service.

e) To regulate the purchase, distribution, supply and utilisation of electricity, the quality of service, the tariff and charges payable, keeping in view of both the interest of the consumers as well as the consideration that the supply and distribution cannot be maintained unless the charges for the electricity supplied are adequately levied and duly collected.

f) To promote competitiveness and progressively involve the participation of private sector, while ensuring fair deal to the customers.

g) To collect data and forecast on the demand and use of electricity and to require the licenses to collect such data and forecast.

h) To require licenses to formulate perspective plans and schemes in coordination with others for the promotion of generation, transmission, distribution and supply of electricity.

i) To regulate the assets, properties and interest in properties concerning or related to the electricity industry in the State.

j) To lay down a uniform system of accounts among the licensees.

k) To regulate working of licenses and promote their working in an efficient, economical and equitable manner; and

l) To undertake all incidental or ancillary things.

3.3.3 Telecom Sector

In the recent past the Telecommunication service have spread to each and every nook of the Country. Various types of telecom services like electronic mail, voice mail, data services, audio tax services, video tex services, radio paging and cellular mobile telephone services, writing images and sounds. Intelligence of any nature is also being made available by wire, radio, visual and other electronic means. Most of services are being provided by the private operators - Indian as well as foreign with Indian collaborations. Due to the private operators - Indian as well as foreign with Indian collaborations.

Due to Tremendous growth in the services it was considered essential to regulate the telecommunication services by a statutory body which should be fully improved to control the services, in the best interest of the country as well as the service providers. To create such a body with all the statutory powers the Telecom Regulatory Authority of India Bill was introduced in the Parliament.

Act 24 of 1997

The Telecom Regulatory Authority of India Bill was passed by both the Houses of Parliament and it received the assent of the President on 28th March 1997. It came into force on the 25th day of January, 1997 as the Telecom Regulatory Authority of India Act, 1997 (24 of 1997).

An Act to provide for the establishment of the Telecom Regulatory Authority of India to regulate the telecommunication services, and for matters connected therewith or incidental thereto.

3.3.3.1 Establishment and Incorporation of Authority

i) With effect from such date as the Central Government may, by notification appoint, there shall be established, for the purposes of this Act, an Authority to be called the ***Telecom Regulatory Authority of India. (TRAI)***

ii) The Authority shall be a body corporate by the name aforesaid, having perpetual succession and a common seal, with power, subject to the provisions of this Act, to acquire hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or sued.

iii) The Authority shall consist of a Chairperson, and not less than two, but not exceeding six members, to be appointed by the Central Government.

iv) The head office of the Authority shall be at New Delhi.

3.3.3.2 Functions of Authority

i) Notwithstanding anything contained in the Indian Telegraph Act, 1885 (13 of 1885), the function of the Authority shall be to -

a) Recommend the need and timing for introduction of new service provider;

b) Recommend the terms and conditions of licence to a service provider;

c) Ensure technical compatibility and effective inter-connection between different service providers;

d) Regulate arrangement amongst service providers of sharing their revenue derived from providing telecommunication services;

e) Ensure compliance of terms and conditions of licence;

f) Recommend revocation of licence for non-compliance of terms and conditions of licence;

g) Lay down and ensure the time period for providing local and long distance circuits of telecommunication between different service providers;

h) Facilitate competition and promote efficiency in the operation of telecommunication services so as to facilitate growth in such services;

i) Protect the interest of the consumers of telecommunication service;

j) Monitor the quality of service and conduct the periodical survey of such provided by the service providers;

k) Inspect the equipment used in the network and recommend that type of equipment to be used by the service providers;

l) Maintain register of interconnect agreements and of all such other matters as may be provided in the regulations;

m) Keep register maintained under clause (1) open for inspection to any number of public on payment of such free and compliance of such other requirements as may be provided in the regulations;

n) Settle disputes between service providers;

o) Render advice to the Central Government in the matters relating to the development of telecommunication technology and any other matter relatable to telecommunication industry in general;

p) Levy fees and other changes at such rates and in respect of such services as may be determined by regulations;

q) Ensure effective compliance of universal service obligations;

r) Perform such other functions including such administrative and financial functions as may be entrusted to it by the Central Government or as may be necessary to carry out the provision of this Act.

ii) Notwithstanding anything contained in the Indian Telegraph Act, 1885 (13 of 1885), Authority may, from time to time, by order, notify in the Official Gazette the rates at which the telecommunication services within India and outside India shall be provided under this Act including the rates at which messages shall be transmitted to any country outside India :

Provided that the Authority may notify different rates for different persons or class of persons for similar telecommunication services and where different rates are fixed as aforesaid the Authority shall record the reasons therefor.

iii) While discharging its functions under sub-section (1), the Authority shall not act against the interest of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality.

iv) The Authority shall ensure transparency while exercising its powers and discharging its functions.

Powers of Authority to call for information, conduct investigations, etc.:

i) Where the Authority considers it expedient so to do, it may, by order in writing :

a) call upon any service provider at any time to furnish in writing such information or explanation relating to its affairs as the Authority may require; or

b) appoint one or more persons to make an inquiry the books of account of any service provider; and

c) direct any of its officers or employees to inspect the books of account or other documents of any service provider.

ii) Where any inquiry in relation to the affairs of a service provider has been undertaken under sub-section (1), -

a) every officer of the Government Department, if such service provider is a department of the Government;

b) every director, manager, secretary or other officer, if such service provider is a company; or

c) every partner, manager, secretary or other officer, if such service provider is a firm; or

d) every other person or body of persons who has had dealings in the course of business with any of the persons mentioned in clauses (b) and (c), shall be bound to produce before the Authority making the inquiry, all such books of account or other documents in his custody or power relating to, or having a bearing on the subject-matter of such inquiry and also to furnish to the Authority with any such statement or information relating thereto, as the case may be, required of him, within such time as may be specified.

iii) Every service provider shall maintain such books of account or other documents as may be prescribed.

iv) The Authority shall have the power to issue such directions to service providers as it may consider necessary for proper functioning by service providers.

3.3.3.3 Power of Authority to issue directions

The Authority may, for the discharge of its functions under sub-section (1) of section 11, issue such directions from time to time to the service providers, as it may consider necessary.

3.3.3.4 Authority to settle disputes

i) If a dispute arises, in respect of matters referred to in sub-section (2) among service providers or between service providers and a group of consumers, such disputes shall be adjudicated by a bench constituted by the Chairperson and such bench shall consist of two members:

Provided that if the member of the bench differ on any point or points they shall state the point or points on which they differ and refer the same to a third member for hearings on such point shall be decided according to the opinion of that member.

ii) The bench constituted under sub-section (1) shall exercise, powers and authority as were exercisable immediately before that date by any civil court on any matter relating to -

i) technical compatibility and inter-connections between service providers;

ii) revenue sharing arrangements services and interest of consumers;

iii) quality of telecommunication services and interest of consumers; Provided that nothing in this sub-section shall apply in respect of matters relating to -

a) the monopolistic trade practice, restrictive trade practice and unfair trade practice which are subject to the jurisdiction of the Monopolies and Restrictive Trade Practices Commission established under sub-section (1) of section 5 of the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969);

b) the complaint of an individual consumer maintainable before a Consumer Disputes Redressal Forum or a Consumer Disputes Redressal Commission or the National Consumer Redressal Commission established under section 9 of the Consumer Protection Act, 1986 (68 of 1986);

c) dispute between telegraph authority and any other person referred to in sub-section (1) of section 7B of the Indian Telegraph Act, 1885 (13 of 1885)

3.3.3.5 Procedure and powers of Authority

i) The Authority shall be guided by the principles of natural justice;

ii) The Authority shall have, for the purpose of discharging their functions under this Chapter, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) in respect of the following matters, namely :

   a) summoning and enforcing the attendance of any person and examining him on oath;

   b) requiring the discovery and production of documents;

   c) receiving evidence on affidavits;

   d) issuing commissions for the examination of witnesses or documents;

   e) reviewing its decisions;

   f) dismissing an application for default or deciding it ex parte;

   g) setting aside any order of dismissal of any application for default or any order passed by it ex parte;

   h) any other matter which may be prescribed

iii) Every proceeding before the Authority shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purpose of section 196 of the Indian Penal Code (45 of 1860) and the Authority shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974).

3.3.3.6 Grants by Central Government

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to the Authority grants of such sums of money as are required to pay salaries and allowances payable to the Chairperson and the members and the administrative expenses including the salaries, allowances and pension payable to or in respect of officers and other employees of the Authority.

3.3.3.7 Fund

i) There shall be constituted a fund to be called the Telecom Regulatory Authority of India General Fund and there shall be credited thereto -

   a) all grants, fees and charges received by the Authority under this Act; and

   b) all sums received by the Authority from such sources as may be decided upon by the Central Government.

ii) The Fund shall be applied for meeting -

   a) the salaries and allowances payable to the Chairperson and members and the administrative expenses including the salaries, allowances and pension payable to or in respect of officers and other employees of the Authority; and

   b) the expenses on objects and for purposes authorised by this Act.

3.3.3.8 Power of Central Government to issue directions

i) The Central Government may, from time to time, issue to the Authority such directions as it may think necessary in the interest of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality.

ii) Without prejudice to the foregoing provisions, the Authority shall, in exercise of its powers or the performance of its functions, be bound by such directions on questions of policy as the Central Government may give in writing to it from time to time :

   Provided that the Authority shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

iii) The decision of the Central Government whether a question is one of policy or not shall be final.

UNIT IV	**FOREIGN CAPITAL : Foreign direct investment**: policy-trends -problems - consequences – FEMA- objectives - provisions - multinational corporations - entry strategies - role-growth – problems - consequences. **Mergers and acquisitions**: reasons - trends - advantages and disadvantages - competition law.

4.1 Foreign Direct Investment

4.1.1 Introduction of FDI

The economic liberalisations that swept across the world, particularly since the late 1980s, have very significantly changed the environment for international investments. At the same time, the surging international capital flows, in its turn, are substantially impacting the business environment.

As Peter Drucker in his *Managing For the Future* observers, "increasingly world investment rather than world trade will be driving the international economy. Exchange rates, taxes, and legal rules will become more important than wage rates and tariffs."

Foreign Direct Investment (FDI) is defined as an investment made by an investor of one country to acquire an asset in another country with the intent to manage that asset (IMF, 1993). The IMF definition of FDI includes as many as following elements: equity, capital, reinvested earning of foreign companies, inter-company debt transactions including short-term and long-term loans, overseas commercial borrowings, non-cash acquisition of equity, investment made by foreign venture capital investors, earnings data of indirectly-held FDI enterprises, control premium, non-competition fee and so on.

Foreign investment and technology plays an important role in the economic development of a nation and have been exploited by a number of developing countries. The economic health of transition countries in Eastern Europe, Russia, and Central Asia is smoother due to FDI. Even communist countries like China have welcomed foreign investment to improve their economies.

Meaning and Definition of FDI

Capital flows in the form of Foreign Direct Investment (FDI) have been widely believed to be an important source of growth in recent year. FDI is the process whereby residents of one country (the source country) acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country (the host country).

According to the International Monetary Fund, "FDI is an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise".

According to the United Nation's **World,** "FDI is an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy (foreign direct investor or parent' enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise, affiliate enterprise or foreign affiliate)".

The term "long-term" is used in the last definition in order to distinguish FDI from portfolio investment; FDI does not have the portfolio investment characteristic of being short-term in nature, involving a high turnover of securities.

Foreign Direct Investment (FDI) is permitted under the following forms of investments :

1. Through joint ventures, financial and technical collaborations,
2. Through capital markets via Euro issues,
3. Through private placements or preferential allotments.

4.1.2 Determinants of FDI

The volume of FDI in a country depends on the following factors :

1. Rate of Return on the Underlying Project

The differential rates of return hypothesis represent one of the first attempts to explain FDI flows. This hypothesis postulates that capital flows from countries with low rates of return to countries with high rates of return move in a process that eventually leads to the equality of ex ante real rates of return.

2. Return and Risk

When the assumption of risk neutrality is relaxed, risk becomes another variable upon which the FDI decision is made. If this proposition is accepted, then the differential rates of return hypothesis become inadequate, in which case we resort to the diversification (or portfolio) hypothesis to explain FDI.

3. Natural Resources

Availability of natural resources in the host country is a major determinant of FDI. Most foreign investors seek an adequate, reliable and economical source of minerals and other materials. FDI tends to flow in countries which are rich in resources but lack capital, technical skills and infrastructure required for the exploitation of natural resources. Though their relative importance has declined, the availability of natural resources still continues to be an important determinant of FDI.

4. Availability of Cheap Labour

The availability of low cost unskilled labour has been a major source of FDI in countries like China and India. Low cost labour together with availability of cheap raw materials enables foreign investors to minimise costs of production and thereby increase profits.

5. Market Size

The volume of FDI in a host country depends on its market size. This hypothesis is particularly valid for the case of import- substituting FDI. As soon as the size of the market of a particular country has grown to a level warranting the exploitation of economies of scale, this country becomes a potential target for FDI inflows.

6. Socio-Economic Conditions

Size of the population, infrastructural facilities and income level of a country influence direct foreign investment.

7. Political Situation

Political stability, legal framework, judicial system, relations with other countries and other political factors influence movements of capital from one country to another.

8. Need for Internalisation

According to the internalisation hypothesis, FDI arises from efforts by firms to replace market transactions with internal transactions. For example, if there are problems associated with buying oil products on the market, a firm may decide to buy a foreign refinery. These problems arise from imperfections and failure of markets for intermediate goods, including human capital, knowledge, marketing and management expertise.

9. International Immobility of Factors of Production

According to the location hypothesis, FDI exists because of the international immobility of some factors of production such as labour and natural resources. This immobility leads to location-related differences in the costs of factors of production.

10. Strategic and Long-Term Factors

Some strategic and long-term factors have been put forward to explain FDI. These factors include the following:

i) The desire on the part of the investor to defend existing foreign markets and foreign investments against competitors.

ii) The desire to gain and maintain a foothold in a protected market or to gain and maintain a source of supply that may prove useful in the long-run.

iii) The need to develop and sustain a parent-subsidiary relationship.

iv) The desire to induce the host country into a long commitment to a particular type of technology.

v) The advantage of complementing another type of investment.

vi) The economies of new product development.

vii) Competition for market shares among oligopolists and the concern for strengthening bargaining positions.

4.1.3 Types of FDI

There are two main reasons for firms to go multinational - to serve a foreign market and to get lower cost inputs. There are major two types of FDI, these are given as follows:

1. Horizontal FDI

Horizontal FDI refers to the foreign manufacturing of products and services roughly similar to those the firm produces in its home market. This type of FDI is called “horizontal” because the multinational duplicates the same activities in different countries. Horizontal FDI arises because it is too costly to serve the foreign market by exports due to transportation costs or trade barriers.

2. Vertical FDI

Vertical FDI refers to those multinationals that fragment production process geographically is called "vertical" because MNE separates the production chain vertically by outsourcing some production stages abroad. The basic idea behind the analysis of this type of FDI is that a production process consists of multiple stages with different input requirements. If input prices vary across countries it becomes profitable for the firm to split the production chain.

4.1.4 FDI Policy in India

Foreign Direct Investment (FDI) plays an important role in India's growth dynamics. There are several examples of the benefits of FDI in India. FDI in the retail sector can expand markets by reducing transaction and transformation costs of business through adoption of advanced supply chain and benefit consumers, and suppliers (farmers). This also can result in net gains in employment at the aggregate level.

India has the most liberal and transparent policies on FDI among the emerging economies. FDI upto 100% is allowed under the automatic route in all activities/sectors except the following, which require prior approval of the government :

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

The policy of FDI in India concerns the several points as follows :

1. Procedure under Automatic Route

FDI in sectors/activities to the extent permitted under automatic route does not require any prior approval either by the government or RBI. The investors are only required to notify the Regional Office concerned of RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issue of shares of foreign investors.

2. Procedure under Government Approval

FDI in activities not covered under the automatic route require prior government approval. Approval of all such proposals including composite proposals involving foreign investment/foreign technical collaboration is granted on the recommendations of Foreign Investment Promotion Board (FIPB).

Application for all FDI cases, except Non-Resident Indian (NRI) investments and 100% Export-Oriented Units (EOUs), should be submitted to the FIPB Unit, Department of Economic Affairs (DEA), Ministry of Finance. Application for NRI and 100% EOU cases should be presented to SIA in Department of Industrial Policy and Promotion. Application can be made in Form FC-1L. Plain paper applications carrying all relevant details are also accepted. No fee is payable. The guidelines for consideration of FDI proposals by the FIPB are at Annexure-III of the Manual for FDI.

3. Prohibited Sectors

The extant policy does not permit FDI in the following cases:

i) Gambling and betting;

ii) Lottery business;

iii) Atomic energy;

iv) Retail trading; and

v) Agricultural or plantation activities of agriculture (excluding floriculture, horticulture, development of seeds, animal husbandry, pisciculture, and cultivation of vegetables, mushrooms, etc., under controlled conditions and services related to agro and allied sectors) and plantations (other than Tea plantations).

4. General Permission of RBI under FEMA

Indian companies having foreign investment approval through FIPB route do no require any further clearance from RBI for receiving inward remittance and issue of shares to the foreign investors. The companies are required to notify the concerned Regional Office of the RBI of receipt of inward remittances within 30 days of such receipt and within 30 days of issue of shares to the foreign investors or NRIs.

5. Industrial Licensing

With progressive liberalisation and deregulation of the economy, industrial licence is required in very few cases. Industrial licenses are regulated under the Industries (Development and Regulation) Act 1951. At present, industrial licence is required only for the following :

i) Industries retained under compulsory licensing,

ii) Manufacture of items reserved for small-scale sector by larger units, and

iii) When the proposed location attracts locational restriction.

The following industries require compulsory licence:

i) Alcoholics drinks,

ii) Cigarettes and tobacco products,

iii) Electronic, aerospace and defence equipment,

iv) Explosives, and

v) Hazardous chemicals such as hydrocyanic acid, phosgene, isocyanates and di-isocynates of hydro carbon and derivatives.

6. Procedure for Obtaining an Industrial Licence

Industrial licence is granted by the Secretariat for Industrial Assistance in Department of Industrial Policy and Promotion, Government of India. Application for industrial licence is required to be submitted in Form FC-IL to Department of Industrial Policy and Promotion.

7. Small-Scale Sector

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

8. Locational Restrictions

Industrial undertakings to be located within 25kms of the standard urban area limit of 23 cities having a population of 1 million as per 1991 census require an industrial licence. Industrial licence even in these cases is not required if a unit is located in an area designated as an industrial area before 1991 or non-polluting industries such as electronics, computer software, printing and other specified industries.

9. Environmental Clearances

Entrepreneurs are required to obtain statutory clearances, relating to pollution control and environment as may be necessary, for setting-up an industrial project. This list includes petrochemicals complexes, petroleum refineries, cement, thermal power plants, bulk drugs, fertilizers, dyes, papers, etc.

4.1.5 Advantages and Disadvantages of FDI

When direct investment flows from one country to another, it creates benefits both for the home country and the host country. At the same time, it involves some costs too. Thus, when a firm decides to make FDI, it takes into account the benefits and costs to be accrued to not only its home country but also to the host country.

4.1.5.1 Advantages for Host Country

The important benefits of FDI to the host country are now discussed below :

i) Employment Generation

FDI is helpful in providing employment in the host country, thus leading to employment generation in the economy. Moreover, it is instrumental in raising labour standards in the host country towards the levels prevailing in the investors' home countries.

ii) Impact of FDI on Macroeconomic Growth

Macroeconomic growth is a potent source of poverty reduction in developing countries. FDI has a positive impact on the macroeconomic growth of the host country economy. It usually influences growth by raising total factor productivity in the host economy.

iii) Technology Transfer

Multinational corporations are important global players in developing and using innovative technologies. They generally possess a higher level of technical know-how than what is available in developing countries. A crucial benefit of FDI is the transfer of technology from the parent company to the subsidiary or affiliate company in the host country through FDI.

iv) Human Resources Development

Another benefit of FDI is the potential for enhancing the skills and knowledge of human resources of the host country. The superior managerial skills, knowledge and ability of personnel of the MNCs are passed onto host country personnel employed by them through training and on the job learning.

v) Boosting International Trade

An important benefit of FDI for developing countries lies in its long-term contribution in integrating the host economy more closely with the world economy, leading to the growth of foreign trade of the host country. Foreign investment and foreign trade are mutually supportive. FDI thus provides a boost to the foreign trade of the host country.

vi) Improvement in the Balance of Payments

FDI brings in valuable foreign exchange to the host country. The inward remittance of foreign exchange helps improve the balance of payments of the host country by enhancing the foreign exchange reserves of the country. FDI is also likely to result in import substitution and export promotion; both these measures would improve the position of the current account.

vii) Social and Environmental Benefits

FDI has the potential to bring social and environmental benefits to the host economies through the dissemination of good social and environmental practices and techniques within the MNCs and through their subsequent spill overs to domestic enterprises.

viii) Improvement in the Balance of Payments

FDI helps to improve the balance of payments of the host country. The inflow of investment is credited to the capital account. At the same time, the current account improves because FDI helps either import substitution or export promotion. The host country is able to produce those items that were being imported earlier.

ix) Fostering of Economic Linkages

Foreign firms have forward and backward linkages. They make demand for various inputs that in turn helps develop the input-supplying industries which is known as crowding-in effect. They employ labour force and so help raise the income of the employed people that in turn raises the demand and industrial production in the country.

4.1.5.2 Disadvantages for Host Country

The various disadvantages of FDI to host country are as follows:

i) Political Lobbying

In the past, there have been many instances in which MNCs have resorted to political lobbying in order to get certain policies and laws implemented in their favour. At times, these MNCs are so large that their revenues even exceeded the Gross Domestic Product (GDP) of some smaller nations and compel or threaten them to pass judgements and policies in their favour.

ii) Exploitation of Resources

Exploitation of natural resources of a host country is not a very uncommon phenomenon in the case of FDI. MNCs of other countries have been known to indiscriminately exploit the resources of hosts' countries in order to get short run gains and profits and have even chosen to ignore the sustainability factors associated with the local communities and local habitat, very much like what happened in the 17th century colonialism.

iii) Threaten Small Scale Industries

MNCs have large economic and pricing power due to their large sizes. They do not have much problem with regards to financial capital and can hence resort to using advertising which is a costly affair.

iv) Technology

Although, the MNCs have access to new and cutting edge technology, they do not transfer the latest technology to the host country with a fear that their home country may loose its competitive advantage; hence the maximum potential of the host economy cannot be achieved as a result of old technology transferred.

v) Adverse Effects on Competition

The new foreign subsidiaries may grow to have more economic power and more attractively priced products than the host country companies.

vi) Adverse Effects on Balance-of-Payments

If the foreign subsidiary imports large quantities - this contributes to the home country having a balance-of-payments deficit.

vii) Adverse Effects on Natural Resources

Raw materials are exploited keeping in view the interest of the home country that is sometimes detrimental to the interest of the host country.

viii) No Employment Opportunities

As far as employment of locals is concerned, the MNCs normally show reluctance to train the local people. Technology being normally capital-intensive does not assure larger employment.

4.1.5.3 Advantages for Home country

More benefits of FDI to home country are listed below:

i) Creates New Employment

FDI benefits the home country with the creation of employment. It also assists in ensuring the workers are paid better salaries. This allows them to have an access to an improved life-style as well as more facilities. The manufacturing and production sector is greatly developed in the home country due to FDI investment. This increase in new industries is beneficial creating new employment.

ii) New Technology

Foreign direct investment benefits the host country through introducing advanced skills and technology. New research will be conducted in that home country as the international organisation looks for methods of enhancing its services. This leads to better technology that can be applied in other parts of the nation for further development.

iii) Improves Export

The other vital advantage of FDI to the home country is that it enables these nations to enhance their export resources. Furthermore, research shows that nations who get FDI from other international organisations usually have lower interest rates. This means that their exported products are much cheaper and thus enhances export.

iv) Increases Income

Income generated through taxation is increased by FDI investment. Actually, FDI plays an important role with regards to the increase in productivity of home countries. It improves the local economy and living standards as well.

v) Improvement in Balance of Payment

Inflow of foreign currencies in the form of dividend, interests, etc. Nissan's profits repatriated to Japan are from its FDI in U.K. They helped Japan for positive balance of payments.

vi) Industrial Activity

FDI increases export of machinery, equipment, technology, etc. from the home country to the host country. This in turn enhances the industrial activity of the home country.

vii) Learning Skills

The firm and other home country firms can learn skills from its exposure to the host country and transfer those skills to the industry in the home country.

viii) Improved Political Relations

FDI is a complement to foreign aid; it helps to develop closer political ties between the home country and the host country which is beneficial for both the countries.

4.1.5.4 Disadvantages for Home Country

The ways in which foreign direct investment may be disadvantageous to the home country are as follows:

i) Undesired Outflow of Factors of Production

The cost accruing to the home country is only little. However, it cannot be denied that making of investment abroad takes away capital, skilled manpower and managerial professionals from the country. Sometimes the outflow of these factors of production is so large that it hampers the home country's interest.

ii) Possibility of Conflict with the Host-Country Government

The MNCs operate in different countries in order to maximise their overall profit. To this end, they adopt various techniques that may not be in the interest of the host country. This leads to a tussle between the host government and the home government which may have a deleterious effect on bilateral relations.

iii) Home Country Trade

Home country trade position may deteriorate if the FDI results on low cost goods being brought back to the home country - displacing home country goods.

iv) Loss of Employment

Companies which invest abroad in production and marketing facilities hire labour of the foreign country; in this case, it leads to a loss of employment in the home country. Many times it is seen that MNC even close plants in their home countries and move these production facilities to third world countries in order to benefit from cheaper labour and material sourcing costs.

v) Problem of Repatriation

Many countries especially those countries which have scarce foreign exchange reserves tend to restrict the outflows of profits, dividends and royalties of the MNCs in order to save their foreign exchange for other more important purposes.

vi) Possibility of Loosing Competitive Advantage

This problem is especially true for technologically advanced developed countries. Development of new technology is a costly affair alongwith it requiring a significant investment of time and effort.

4.1.6 Trends of FDI

Following the sweeping changes in the economic policy, foreign investment has been surging in many countries. Today, the worldwide FDI flows and stocks are about 20 times their size in the early 1980s

Trends in Magnitude of Flows

Although foreign direct investment flows have their ups and downs, the long term trend has been one of fast growth. For example, between 1970 and 2000 FDI inflows worldwide increased more than a hundred times. The growth has been the sharpest between 1990 and 2000 thanks to the universal liberalisation, privatisation and the surge in cross-border M&As by these developments.

After peaking in 2000, the FDI flows had a downturn. The upward trend in inflows began again in 2004. FDI inflows peaked in 2007 ($2100 billion but declined in 2008 and 2009).

While the FDI flows had their ups and downs, the stock of FDI has increased tremendously over time. Worldwide FDI inward stock increased from $1 779 billion in 1990 to $ 5 810 in 2000 and further to $11999 billion in 2006. FDI inward stock as a percentage of GDP almost tripled between 1990 and 2006, from 8.4 per cent to 24.8. For developing economies these figures are higher than the world average - 9.6 and 26.7.

Cyclical Behaviour

FDI flows are characterised by cyclical behaviour. The decline in FDI flows after peaking in 2000 followed rapid increases during the late 1990s. As the *World Investment Reports* point out, there was a similar pattern during the late 1980s and early 1990s, and in 1982- 1983. Thus, this is the third downward cycle in FDI, each punctuating a long upward trend in FDI every ten years or so.

4.1.6.1 Factors Affecting the Trend in FDI Flows

The swings in FDI flows reflect changes in several factors. The main ones are business cycles, stock market sentiment and M&As. These short-term factors (including factors such as the terrorist attack of September 11, 2000) work in tandem with longer-term factors, sometimes offsetting and at other times reinforcing them.

There is, on the other hand, a stable and positive relationship between global FDI flows and the level and growth of world GDP. Technological change, shrinking economic distance and new management methods favour international production. Their impact is, however, countered by cyclical fluctuations in income and growth. The decline in FDI in 2001 reflected a slow down in the world economy. More than a dozen countries - including the world's three largest economies fell into recession.

On the supply side, FDI is affected by the availability of investible funds from corporate profits or loans, which is in turn affected by domestic economic conditions. On the demand side, growing overseas markets lead TNCs to invest, while depressed markets inhibit them. The more interdependent host and home economies become, and the more widely a recession or upswing spreads, the greater are the corresponding movements in global FDI.

Data for 1980-2001 show that a bulge in global FDI accompanies high economic growth, and a trough accompanies low growth . However, the relationship between GDP growth and FDI is not uniform across groups of economies. They go together in developed but not in developing countries. One explanation for the different patterns of

FDI flows is that business cycles spread much faster across developed countries than others. A supplementary explanation may be that some countries (as in CEE) had been cut off from substantial FDI flows for so long that they have a lot of "catching up" to do - short- term cycles do not affect their attractiveness.

The rise in global FDI flows in 2006 was partly driven by increasing corporate profits worldwide and resulting higher stock prices that raised the value of cross-border mergers and acquisitions (M&As). M&As continued to account for a high share of FDI flows, but greenfield investment also increased, especially in developing and transition economies. As a result of higher corporate profits, reinvested earnings have become an important component of inward FDI: they accounted for an estimated 30 per cent of total inflows worldwide in 2006 and for almost 50 per cent in developing countries alone.

One of the important determinant of the FDI trend is the trend in cross-border M&A. For example, the dramatic increases in cross-border M&As led to record flows in 1999 and 2000. Cross-border M&As made its contribution to the decline in the FDI too.)

4.1.6.2 Directional Trends

The major chunk of the FDI flows take place between the developed countries. For nearly three decades till the early 1990s, about three-quarters of the FDI have gone to the developed countries. Nearly two thirds of the flows take place between the countries of the *Triad* - the U.S., the European Union and Japan. In 2006. the EU and the US accounted for 57 per cent of the FDI inflows and 73 per cent of the outflows.

FDI is concentrated in a handful of countries — about a dozen countries receive nearly three-fourths of the global FDI flows. A higher degree of concentration is observed in respect of FDI flows to the developing worlti. In 2006, for example, China and Hong Kong alone received about 30 per cent of the inflows to developing economies.

More importantly, there are no signs that the concentration of international production across countries has been declining over time. However, in many least developed countries that have received only small amounts of FDI, such investment is important *vis-a-vis* the size of domestic investment. What remains a challenge for these countries is the ability to attract not only more, but also higher quality FDI — broadly defined as investment with strong links to the domestic economy, export orientation, advanced technology and skill or spillover effects.

The largest recipient of FDI has either been the UK or US. The US has been the largest foreign investor too. France has been one of the largest foreign investors. While UK also has been experiencing large FDI outflow, it has been much lower than the inflow to UK.

As table below shows the share of developing countries in FDI has been fluctuating.

Region / Country	Inflow ($ billion)					Outflow ($ billion)				
	2007	**2008**	**2009**	**2010**	**2011**	**2007**	**2008**	**2009**	**2010**	**2011**
World	1975	1791	1198	1309	1524	2198	1969	1175	1451	1694
Developed countries	1390	1020	606	619	748	1830	1581	858	990	1238
Developing countries	574	650	519	617	684	317	328	268	400	384
S-E Europe and CIS	91	121	72	74	92	S2	60	49	62	73
India	**26**	**43**	**36**	**24**	**32**	**19**	**20**	**IS**	**13**	**15**

Table : Trends in FDI Flows

Important Trends in FDI inflow to Developing Countries Outward FDI from Developing Countries

The share of the FDI going to the developing countries declined substantially from 25 per cent during 1980-85 to 17 per cent during 1986-90. There was, however, an increase in the absolute amount of FDI flows to the developing countries. The economic liberalisations in the developing countries have helped increase the FDI to them. During 2003-06, the share of developing countries in the global FDI ranged between 26 and 39 per cent and increased to nearly 50 per cent in 2009 and reached 52 per cent in 2010. In 2010, 10 developing countries were among the top 20 recipients of FDI, compared to 7 in 2009. Even while the level of FDI inflow to developing countries rise, the fluctuations in the FDI flows to developed economies affect the share of developing countries.

FDI in developing countries has been larger than official inflows for every year since 1993. It was 10 times larger than bilateral official development assistance (ODA) in 2000; this contrasts with the latter half of the 1980s, when the two were about equal. Recently also FDI has accounted for about 90 per cent of the total financial flows to developing countries.

Within the group of the developing countries, the relatively developed among them get the lion's share of the FDI. Very little FDI has taken place in low income economies leaving exceptions like China and India, in most cases, this has been due to the small size of the domestic market and other adverse factors like poor infrastructure, lack of skilled labour etc.

The lion's share of the FDI flows to the developing countries has been cornered by two regions, viz., East Asia and the Pacific and Latin America while Sub-Saharan/ Africa, and Middle East and North Africa got very low shares. The least developed countries, numbering 48, get a very insignificant share.

Outward FDI from Developing Countries

FDI outflows from developing economies have been significantly increasing, reflecting the recognition of firms that in a globalising world economy, they need a portfolio of locational assets to be competitive internationally. In fact, Countries like Malaysia, the Republic of Korea and Singapore already have an established track record and some others such as Chile, Mexico and South Africa have become players relatively recently.

Countries like Brazil, China and India are at the take-off stage. Their investments span all sectors and country groups and involve complex as well as simple industries. Annual FDI outflows from developing countries have grown very faster since the early 1990s. However, even in recent years, only about 15 per cent of the global FDI outflows originate from the developing economies. Negligible until the beginning of the 1990s outward FDI from developing countries accounted for over 15 per cent of the world total stock in 2009.

FDI flows between from developing countries seems to be growing faster than from developing countries to developed countries. The growing importance of South-South FDI indicates that developing countries are more financially integrated with one another than was previously believed. Thus, a typical developing country has access to more sources of investment than before. This is particularly important for small economies, as TNCs from the South, because of their comparative advantages, tend to invest in countries with similar or lower levels of development than their home countries.

4.1.6.3 Sectoral Trends

Although, FDI has grown over time in all three economic sectors - primary, manufacturing and services - the sectoral composition has undergone significant changes with marked shift towards services.

1. **Primary Sector**

   The primary sector's share in world FDI *stock* was less than 10 per cent in 1990 and 2006. However, in the case of FDI *flows* between 1989-1991 and 2001-2002 the share of the primary sector did not decline: it rose from 7 per cent to 9 per cent. While nearly all FDI in the sector continues to originate from developed countries, developing countries - many of them rich in natural resources, but lacking internationally competitive national firms - attract considerable FDI (32 per cent of total primary sector FDI in 2002). Within the primary sector, Mining, quarrying and petroleum dominate the primary sector FDI with over 90 per cent of inward FDI stock. During 2003-06, primary sector accounted for 13 per cent of FDI inflows, up from 7.5 per cent during 1989-91. It was 14 per cent in 2011.

2. Manufacturing Sector

The share of manufacturing in global FDI stock worldwide fell from 42 per cent in 1990 to 30 per cent in 2005. Manufacturing FDI is increasingly geared to more capital- and knowledge-intensive activities because of two developments. There has been a decline in labour-intensive manufacturing in general, and the share of traditional manufacturing employment has also steadily declined.

Technological changes leading to increasing replacement of labour by capital and knowledge has been a key element in the decline of labour-intensive FDI in manufacturing. Secondly, firms in more and more countries, especially developing countries, have developed their own ownership-specific advantages based on different factor endowments, particularly low-cost labour, *vis-a-vis* developed countries. Its share in the global FDI inflow fell from 37 per cent during 1989-91 to 25 during 2003-05. It was 46 per cent in 2011.

3 Services Sector

During the period 1990-2002, while the global FDI stock in the primary sector nearly doubled and in the manufacturing sector increased nearly threefold, in the services sector it more than quadrupled. As a result of more rapid growth in this sector than in the other sectors, services accounted for about two-thirds of the global stock of inward FDI in 2005, compared to less than one-half in 1990 and only one-quarter in the early 1970s. Services continue to receive the lion's share of the FDI. It was 40 per cent in 2011.

4.1.6.4 Problems of FDI

India is focusing on maximizing political and social stability along with a regulatory environment. In spite of the obvious advantages of FDIs, there are quite a few challenges facing larger FDIs in India, such as :

1. **Resource challenge :** India is known to have huge amounts of resources. There is manpower and significant availability of fixed and working capital. At

the same time, there are some underexploited or unexploited resources. The resources are well available in the rural as well as the urban areas. The focus is to increase infrastructure 10 years down the line, for which the requirement will be an amount of about US$ 150 billion. This is the first step to overcome challenges facing larger FDI.

2. **Equity challenge :** India is definitely developing in a much faster pace now than before but in spite of that it can be identified that developments have taken place unevenly. This means that while the more urban areas have been tapped, the poorer sections are inadequately exploited. To get the complete picture of growth, it is essential to make sure that the rural section has more or less the same amount of development as the urbanized ones. Thus, fostering social equality and at the same time, a balanced economic growth.

3. **Political Challenge :** The support of the political structure has to be there towards the investing countries abroad. This can be worked out when foreign investors put forward their persuasion for increasing FDI capital in various sectors like banking, and insurance. So, there has to be a common ground between the Parliament and the Foreign countries investing in India. This would increase the reforms in the FDI area of the country.

4. **Federal Challenge :** Very important among the major challenges facing larger FDI, is the need to speed up the implementation of policies, rules, and regulations. The vital part is to keep the implementation of policies in all the states of India at par. Thus, asking for equal speed in policy implementation among the states in India is important.

   India must also focus on areas of poverty reduction, trade liberalization, and banking and insurance liberalization. Challenges facing larger FDI are not just restricted to the ones mentioned above, because trade relations with foreign investors will always bring in new challenges in investments.

4.1.6.5 Consequences of FDI

Impact of FDI

FDI has a widespread impact on an country not only economically but also socially. Foreign investment is always accompanied by superior technology and transfer of technical know-how. It has an impact on local industry as it provides them both opportunity and threat. It gives consumers a wide choice that too at reasonable price.

FDI increases not only GDP but also exports and therefore results in higher per capita income and large forex reserves.

Impact on Local Industry

McKinsey studied the impact of FDI on local industry and it found that FDI unambiguously helped the receiving economy. It raised productivity and output in the sector involved thereby raising national income, while lowering prices and improving the quality and selection of services and products and consumers. FDI nearly always generated positive spillover for the rest of economy. It generated big opportunities for local manufacturers as they become OEM to them. Hyundai and Suzuki developed ancillary units in India, Coca Cola and Pepsi developed bottling plants of world class; they gave local manufacturer an opportunity to export. Not only an opportunity for manufacturing, FDI also give technical know how to OEM which increases the level of quality. Todays Coca-Cola bottling plant are far better, in fact of international quality than those of Parle which Coca-Cola acquired.

OEMs of Maruti Suzuki not only supplies to Suzuki but also exports. McDonald's trained local farmers and bakers produce product of international quality and today they are not only supplying to McDonald's but are also exporting it. Simultaneously, it gives impetus to service industry. FDI has a big role in the development of the BPO industry in India. The entire framework of BPO industry in India is an outcome of FDI. And today India is the most preferred nation for BPO in the world.

Impact on Employment

FDI in India has contributed in the creation of a more than $10 billion-a-year software and outsourcing industry which employees 5,00,000 people directly. Projections suggest that it will employ more than 2.000,000 people by 2011-12. These are the estimates of only one industry. FDI has created jobs in every field—manufacturing, telecommunication, advertising, media, and above all services.

Impact on Consumer

Perhaps the biggest beneficiary of the FDI is the Indian consumer. By the 1980s, we were driving Ambassador or Premier Padmini and after the investment by Suzuki, eight new models were launched. Now we have access to many international brands. Prices have been steadily decreasing in all the segments because of FDI, like electronics, computers, ACs, automobiles, and even soft drinks, two wheelers, etc. Not only this, today consumer has wider choice as these organizations are launching new variants with improved performance every day. Recendy we have seen that how HLL decreased its price as a reaction to aggressive policy of P&G. Prices of ACs, Television, and Washing Machine are constantly falling down because of MNCs.

Besides this there is a macro economic impact as contribution to GDP, though it may be argued that there is not any significant growth after liberalization as compared to previous decade. But FDI has contributed a lot in transforming whole economy. Earlier we were producing sub-standard goods and driving cars of 1960s and today gradually we are becoming the export hub of telecommunication tools, softwares and automobiles. It has not only improved Balance of Payment but also earned Foreign Exchange for the nation and because of this, Forex reserve of the nation is very high. Opponents of FDI argue that it will cannibalize local industry - to an extent it is true, but it is not the MNCs which threaten them, in fact, it is their inefficiency which is their biggest threat.

4.1.6.6 FDI in India

India has been ranked at the third place in global foreign direct investments in 2009 and has continue to remain among the top five attractive destinations for international investors during 2010-11, according to United Nations Conference on Trade and Development (UNCTAD) in a new report on world investment prospects titled, 'World Investment Prospects Survey 2009-2011' released in July 2009.

The 2009 survey of the Japan Bank for International Cooperation released in November 2009, conducted among Japanese investors continues to rank India as the second most promising country for overseas business operations, after China.

A report released in February, 2010, by Leeds University Business School, commissioned by UK Trade and Investment (UKTI), ranks India among the top three countries where British companies can do better business during 2012-14.

According to Ernst and Young's 2010 European Attractiveness Survey, India is ranked as the fourth most attractive foreign direct investment destination in 2010. However, it is ranked the second most attractive destination following China in the next three years.

Moreover, according to the Asian Investment Intentions survey released by the Asia Pacific Foundation in Canada, more and more Canadian firms are now eyeing India as an investment destination. From 8 per cent in 2005, the percentage of Canadian companies showing interest in India has gone up to 13,4 per cent in 2010.

India attracted FDI equity inflows of US$ 1.2 billion during March 2010. The cumulative amount of FDI equity inflows from August 1991 to March 2010 stood at US$ 132.4 billion, according to the latest data released by the Department of Industrial Policy and Promotion (DIPP).

India FDI Equity Inflows for 2010-2011

According to the statistics released by India's Ministry of Commerce and Industry, the country has received only $18.35 billion in FDI in the first 11 months (April-February) of the financial year 2010-2011, compared to $24.63 billion that came in the 11 months of the previous financial year. Although it is a significant dip, the government has not mentioned the reasons for the fall except for saying that the "trend will be reversed as it has received a few proposals for FDI".

The FDI inflow in the full financial year (April-March) of 2009-2010 was $25 billion. Going by the current data, it is unlikely that India has recorded large numbers in March 2011, to beat last year's FDI inflow.

Among the Reserve Bank of India regional offices that monitor the FDI inflow into the country, Mumbai has received the largest amount of FDI worth about $5.7 billion in the 11 months of 2010-2011, followed by New Delhi with $2.4 billion. This constitutes about 31 per cent and 13.4 per cent respectively. Chennai came third with 7.2 per cent or $1.32 billion, closely followed by Bangalore with 7.1 per cent or $1.3 billion and Hyderabad (6.5 per cent or $.2 billion). Ahmedabad, which has been traditionally receiving higher FDI, got only $692 million in the 11 months of 2010-2011

India FDI Equity Inflows for 2011-2012

Foreign direct investment (FDI) in India spiked 34 per cent to a record $46.8 billion in 2011-12, latest RBI data show. A spate of big-ticket deals resulted in the surge.

As stock valuations dipped, overseas investors were eager to pick up stakes in Indian companies last fiscal. London-listed Vedanta acquired a controlling stake in Cairn India for $9 billion. British major BP paid $7.2 billion for a stake in oil and gas fields operated by Reliance Industries and Vodafone Group purchased partner Essar's shares in their telecom joint venture.

FDI inflows were less than $10 billion prior to 2005-06. They improved thereafter and the country received $34.8 billion in 2010-11.

India FDI Equity Inflows for 2012-2013

Government's efforts to promote India as an investment destination does not seem to be yielding fruits as FDI inflows registered 38 per cent decline to $22.42 billion in 2012-13 compared to the previous year.

In March this year, the country had attracted $1.52 billion FDI, taking the total to $22.42 billion in the entire financial year, an official in the Department of Industrial Policy and Promotion (DIPP) told PTI.

India FDI Equity Inflows for 2013-2014

Foreign direct investment into India grew 8 per cent year-on-year to $24.3 billion in 2013-14, according to the Department of Industrial Policy and Promotion (DIPP) data.

Foreign investment inflows more than doubled to $3.53 billion in March this year from $1.52 in the same month last year.

India FDI Equity Inflows for 2014-2015

Foreign Institutional Investment (FII) inflows surged a record 717 per cent to $40.92 billion in 2014-15 and Foreign Direct Investment (FDI) inflows jumped 48 per cent in September 2014.

FDI equity inflows from October 2014 to April 2015 over the corresponding period last year rose 48 per cent, said the release. The inflows through the approval route grew 87 per cent during 2014-15 to $2.22 billion despite more sectors having been liberalised during this period and with more than 90 per cent of FDI being on automatic route, the release said.

4.2 FEMA

Introduction

The Foreign Exchange Regulation Act of 1973 (FERA) in India was repealed on 1st June, 2000. It was replaced by the FEMA, which was passed in the winter session of Parliament in 1999. Enacted in 1973, in the backdrop of acute shortage of Foreign Exchange in the country, FERA had a controversial 27 year stint during which many bosses of the Indian Corporate world found themselves at the mercy of the Enforcement Directorate. Any offense under FERA was a criminal offense liable to imprisonment, whereas FEMA seeks to make offenses relating to foreign exchange civil offenses. FEMA, which has replaced FERA, has become the need of the hour since FERA had become incompatible with the pro-liberalization policies of the Government of India.

FEMA has brought a new management regime of Foreign Exchange consistent with the emerging framework of the World Trade Organization (WTO). It is another matter that enactment of FEMA also brought with it Prevention of Money Laundering Act, 2002, which came into effect recently from 1st July, 2005 and the heat of which is yet to be felt as 'Enforcement Directorate' would be investigating the cases under PMLA too.

Unlike other laws where everything is permitted unless specifically prohibited, under FERA nothing was permitted unless specifically permitted. Hence the tenor and tone of the Act was very drastic. It provided for imprisonment of even a very minor offence. Under FERA, a person was presumed guilty unless he proved himself innocent whereas under other laws, a person is presumed innocent unless he is proven guilty.

Definitons

The meaning some of the important terms used in FEMA are given below.

Foreign Exchange

Foreign exchange means foreign currency and includes :

i) Deposits, credits and balances payable in any foreign currency,

ii) Drafts, travellers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency,

iii) Drafts, travellers cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency.

Foreign Security

Foreign security means any security, in the form of shares, stocks, bonds, debentures or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency, but where redemption or any form of return such as interest or dividends is payable in Indian currency.

Person

Person includes :

i) An individual.

ii) A Hindu undivided family,

iii) A company,

iv) A firm,

v) An association of persons or a body of individuals, whether incorporated or not,

vi) Every artificial juridical person, not falling within any of the preceding sub-clauses, and

vii) Any agency, office or branch owned or controlled by such person;

Service

Service means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, medical assistance, legal assistance, chit fund, real estate, transport, processing, supply of electrical or other energy, boarding or lodging or both, entertainment, amusement or the purveying of news or: other information, but does not include the rendering of any service free of charge or under a contract of personal service

Authorised Person

Authorised person means an authorised dealer, money changer, off-shore banking unit or any other person for the time being authorized under the Act to deal in foreign exchange or foreign securities;

Currency

Currency includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank;

Current Account Transaction

Current account transaction means a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes, -

i) Payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business,

ii) Payments due as interest on loans and as net income from investments,

iii) Remittances for living expenses of parents, spouse and children residing abroad, and

iv) Expenses in connection with foreign travel, education and medical care of parent, spouse and children.

4.2.1 Scope of FEMA

FEMA provides :

1. Free transactions on current account subject to reasonable restrictions that may be imposed.
2. RBI controls over capital account transactions.
3. Control over realisation of export proceeds.
4. Dealing in foreign exchange through authorised persons like authorised dealer/money changer/ offshore banking unit.
5. Adjudication of Offences.
6. Appeal provision including Special Director (Appeals) and Appellate Tribunal.
7. Directorate of Enforcement.

4.2.2 Objectives of FEMA

The objective of FEMA are :

1. To facilitate external trade and payments.
2. To promote the ordely development and maintenance of foreign exchange market.

4.2.3 Provisions of FEMA

The Act extends to the whole of India. It is highly user-friendly and seeks to promote foreign trade and facilitate payments. Following are a few provisions of FEMA:

- **Section 3: Dealing in Foreign Exchange.**

  No person shall deal in or transfer any foreign exchange or foreign security to any person; make any payment to or to the credit of any person resident outside India in any manner; receive any payments by order or on behalf of any person resident outside India in any manner; and enter into any financial transaction in India as consideration for or in association with acquisition, creation or transfer of the right to acquire any asset outside India by any person, without permission from the Reserve Bank.

- **Section 4: Holding of Foreign Exchange.**

  No person, resident in India, shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India, without permission from the Reserve Bank.

- **Section 5: Current Account Transactions.**

  Any person may sell or draw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction.

- **Section 6: Capital Account Transactions.**

  Any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction.

  The Reserve Bank may, in consultation with the Central Government, specify any class or classes of capital account transactions which are permissible and limit upto which foreign exchange shall be admissible for such transactions.

- **Section 7: Export of Goods and Services.**

  Every exporter of goods or services shall furnish to the Reserve Bank details regarding the export value of such goods or services.

- **Section 8: Realisation and Repatriation of Foreign Exchange.**

  Where any amount of foreign exchange is due or accrued to any person resident in India, such a person shall take steps to realise and repatriate to India, such foreign exchange within a specified period of time.

- **Section 9: Exemption from Realisation and Repatriation.**

  The following are exempted from the operation of Section 4 and Section 8 :

  a) possession of foreign currency or foreign coins by any person upto such limit as the Reserve Bank may specify;

  b) foreign currency account held or opted by such person or class of persons and the limit upto which the Reserve Bank may specify;

  c) foreign exchange acquired or received before the 8th day of July, 1947 or any income arising or accruing thereon which is held outside India by any person in pursuance of a general or special permission granted by the Reserve Bank;

  d) foreign exchange held by a person resident in India upto such limit as the Reserve Bank may specify, if such foreign exchange was acquired by way of gift or inheritance from a person referred to in clause (c) including any income arising therefrom;

  e) foreign exchange acquired from employment, business, trade, vocation, services, honorarium, gifts, inheritance or any other legitimate means upto such limits as the Reserve Bank may specify and

  f) such other receipts in foreign exchange as the Reserve Bank may specify.

4.2.4 FERA Vs FEMA

Sr. No	DIFFERENCES	FERA	FEMA
1	PROVISIONS	FERA consisted of 81 sections, and was more complex	FEMA is much simple, and consist of only 49 sections.
2	FEATURES	Presumption of negative intention (Mens Rea) and joining hands in offence (abatement) existed in FEMA	These presumptions of Mens Rea and abatement have been excluded in FEMA
3	NEW TERMS IN FEMA	Terms like Capital Account Transaction, current Account Transaction, person, service etc. were not defined in FERA.	Terms like Capital Account Transaction, current account Transaction person, service etc., have been defined in detail in FEMA
4	DEFINITION OF AUTHORIZED PERSON	Definition of "Authorized Person" in FERA was a narrow one (2(b)	The definition of Authorized person has been widened to include banks, money changes, off shore banking Units etc. (2 (c)
5	MEANING OF "RESIDENT" AS COMPARED WITH INCOME TAX ACT.	There was a big difference in the definition of "Resident", under FERA, and Income Tax Act	The provision of FEMA, are in consistent with income Tax Act, in respect to the definition of term" Resident". Now the criteria of "In India for 182 days" to make a person resident has been brought under FEMA. Therefore a person who qualifies to be a non-resident under the income Tax Act, 1961 will also be considered a non-resident for the purposes of application of FEMA, but a person who is considered to be non-resident under FEMA may not necessarily be a non-resident under the Income Tax Act, for instance a business man going abroad and staying therefore a period of 182 days or more in a financial year will become a non-resident under FEMA.
6	PUNISHMENT	Any offence under FERA, was a criminal offence , punishable with imprisonment as per code of criminal procedure, 1973	Here, the offence is considered to be a civil offence only punishable with some amount of money as a penalty. Imprisonment is prescribed only when one fails to pay the penalty.
7	QUANTUM OF PENALTY.	The monetary penalty payable under FERA, was nearly the five times the amount involved.	Under FEMA the quantum of penalty has been considerably decreased to three times the amount involved.
8	APPEAL	An appeal against the order of "Adjudicating office", before " Foreign Exchange Regulation Appellate Board went before High Court	The appellate authority under FEMA is the special Director (Appeals) Appeal against the order of Adjudicating Authorities and special Director (appeals) lies before "Appellate Tribunal for Foreign Exchange." An appeal from an order of Appellate Tribunal would lie to the High Court. (sec 17,18,35)
9	RIGHT OF ASSISTANCE DURING LEGAL PROCEEDINGS.	FERA did not contain any express provision on the right of on impleaded person to take legal assistance	FEMA expressly recognizes the right of appellant to take assistance of legal practitioner or chartered accountant (32)
10	POWER OF SEARCH AND SEIZE	FERA conferred wide powers on a police officer not below the rank of a Deputy Superintendent of Police to make a search	The scope and power of search and seizure has been curtailed to a great extent

4.3 Multinational Corporations (MNC's)

Introduction

A multinational corporation / company is an organization doing business in more than one country. Transactional company produces, markets, invests and operates across the world. It is integrated global enterprise which links global resources with global markets at profit. These companies have sales offices and manufacturing facilities in many countries.

A MNC engages in various activities like exporting, importing, manufacturing in different countries.

Meaning of MNC

The process of globalisation has radically transformed our world. It is driven largely by the rapid growth and spread of corporations. Since the end of the Cold War in 1991, nearly all nations in the world have reduced the role of state in the economy and lowered barriers to the international movement of goods, services, capital, ideas and technology. As the walls imposed by nations/states have crumbled, multinational corporations have thrived, spreading across the glob', in search of new markets and factors of production. MNCs have expanded across national borders in two ways: trade and Foreign Direct Investment (FDI). Each has contributed to stable, lasting benefits to the world economy.

Although, modern multinational firms date from the late nineteenth century, the term *Multinational Corporation* did not appear until 1960. At a conference at Carnegie Mellon University, David Lilienthal (1960) distinguished between portfolio and direct investment and thus defined, 'Such corporations which have their home in one country but which operate and live under the laws of other countries as well...' as multinational corporations. It is interest to note that from the beginning the multinational corporation was defined in terms of jurisdiction and potential jurisdictional conflict.

Multinationals Corporations are major players in international business. In an era of WTO, Regional Groupings, Liberalisation, and Globalisation, the role of MNCs has increased tremendously. Almost 3/4 of the total GDP of South Korea comes from only 5 MNCs of South Korea. Out of the 50 largest "economies", 14 are MNCs. In America, Japan, South Korea, Singapore, Malaysia, etc., there are now approximately 63,000 multinational corporations - defined as firms that engage in international production - with over 690,000 foreign affiliates. In 1997, these firms controlled $12 trillion in foreign assets, employed 30 million workers and earned $9.5 trillion in revenues - larger than the annual GDP of the United States or the European Union (EU). The rapid growth of MNCs is a direct result of the worldwide liberalisation of trade and investment. Corporations have grown larger because they now compete in much bigger markets.

A MNC is a company that is head quartered in one country but has operations in one or more than one country.

Definition of MNC

MNCs are defined as an enterprise that is headquartered in one country but has operations in one or more countries. Sometimes it is difficult to know if a firm is an MNC because multinationals often downplay the fact that they are foreign held. For example, most of the people in India are unaware that Bata is a Canadian company, Bayer is a German company, Nestle is a Swiss company and Cadbury-a British company. Various definitions have been given to describe to MNCs. Sak Onkwist and John J. Shah have described MNCs in following manner :

1. **Definition by Size**

   MNCs refer to a company which is big in size, but this size has many dimensions. One company may be big in terms of turnover while another may be in terms of profit and still another in terms of market value. But corporate size in terms of 'sales' is primarily used to describe a company as a Multinational Corporation. The World Investment Report 1997 indicates that there were about 45,000 MNCs with some 2,80,000 affiliates, whereas according to the World Investment Report 2002, there were about 65,000 of them with about 8.5 lakh foreign affiliates. But corporate size alone cannot be used as a criterion to be classified as MNC. GM does not become multinational because it was large but it became large as a result of going international.

2. **Definition by Structure**

   This definition measures MNCs by how many countries it is operating in and by the citizenship of its corporate owners and top managers. For example, Coca Cola operates in approximately 200 nations and has widespread share holdings. The boardroom and the top management of top companies is becoming global.

3. **Definition by Performance**

   Definitions by performance depend on such characteristics as earnings, sales and assets. These performance characteristics indicate the extent of the commitment of corporate resources to foreign operations and the amount of reward from that commitment. A major chunk of Coca Cola's revenue comes from overseas operations. In India, Ranbaxy is considered as a true MNC as half to its turnover comes from the overseas market and this proportion is expected to significantly increase in the coming years.

Human resource or overseas employees are customarily considered as part of the performance requirement rather than as part of the structural requirement. Company's willingness to use overseas personnel is a significant criterion for multinationals.

4. Definition by Behaviour

According to this definition, it is the behavioural characteristics of the top management which decides whether a firm is a multinational or not. Thus, a company becomes more multinational if its management is more international. If a management has a geocentric thinking then this firm is treated as a true MNC. In a geocentric approach, the firm considers the whole world rather than the particular country as its target market.

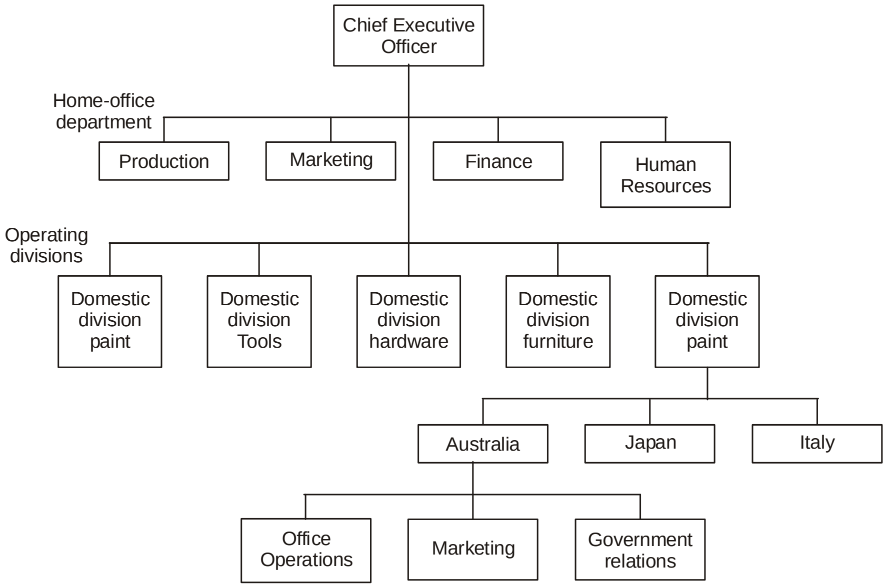
4.3.1 Characteristics of an MNC

1. **Productive organization**: this organization produces various types of goods and services. It is supplies in many countries. It uses its own technology, patent right for manufacturing goods.
2. **World wide**: multinational companies operate in whole world. It extends its business world wide. It establishes many branches in various companies. They extend their business in more than one country.
3. **Ownership and control**: ownership of company remains on both parent and host country. Parent company control, manage and help in the operation of all host countries. They have control in capital, high technology, and trade mark.
4. **Transfer of technology**: these multinational companies are establishes with huge capital and advanced technology. It also transfers the technology in the host countries that can be used for production.
5. **Marketing superiority**: it is large organization which has international name and fame. It has good network world wide for distribution of goods.
6. **High efficiency**: these organizations operate their business with efficiency. They use advanced technology. They also involve keenly in research works. They used many trained persons that helps in the production of quality goods.

4.3.2 Organisational Structure of MNC's

If international operations continue to grow, subsidiaries commonly are grouped into a an international division structure, which handles all international operations out of a division that is created for this purpose. This structural arrangement is useful as it takes a great deal of the burden of the chief executive officer for monitoring the operations of a series of overseas subsidiaries as well as domestic operations.

The head of the international division coordinates and monitors overseas activities and reports directly to the chief executive on these matters.



Pepsi Co. recognized its international soft drink division into six such geographic business units covering 150 countries in which Pepsi does business. These geographic units each have self-sufficient operations and broad local authority.

Companies still in the international stages of international business involvement are most likely to adopt the international division structure. Others that use this structural arrangement include those with small international sales, limited geographic diversity, or executives with international expertise.

A number of advantages are associated with use of an international division structure. The grouping of international activities under one senior executive ensures that the international focus receives top management attention.

The structural arrangement allows the company to develop an overall, unified approach to international operations and the arrangement helps the firm to develop a cadre of internationally experienced managers.

Use of this structure does have a number of drawbacks, however the structural separates the domestic and international managers, which can result in two different camps with divergent objectives.

Also, as the international operations grows larger, the home office may find it difficult to think and act strategically and to allocate resources on a global effort are domestically oriented, so ideas for new products or processes in the international market often are given low priority.

4.3.3 Entry Strategies of MNC's

MNCs have following approaches for international business :

1. Ethnocentric

Ethnocentricity is a belief in the superiority of one's own ethnic group. Ethnocentricity is a strong faith in the home country. Markets and consumers abroad are viewed as unfamiliar and even inferior in taste, sophistication and opportunity. All the important decisions are taken in home country. Products are developed as well as produced in the home country and are exported to gain advantage of marginal business. Though decision making is centralised, sometimes even the most crucial decision, like pricing, is enforced by the headquarter, without understanding the regional requirement.

2. Polycentric

A polycentric MNE is oriented towards foreign markets that are loosely connected to the firm without an integrative system. In polycentrism, control is decentralised and the organization has an orientation to the host country. Polycentrism accepts that there are differences in the market that are caused by income, culture, lifestyle, laws and politics, etc. Polycentric organization allows managers to make decisions according to the local condition.

3. Geocentric

Geocentricity is a compromise between the two extremes of ethnocentricty and polycentricity. Geocentricity considers the whole world as the target customer. Geocentric MNE views the world market from a global perspective, that is, it strives to integrate its world markets and resources acquisition as part of its global strategy to serve customers wherever they may be, acquiring the best quality resources at the lowest level.

A geocentric firm has a global approach in all its activities and it usually manufactures standardised products for the whole world, explores to have the best human resources for its firm, tries to have its manufacturing capacities in the best available locations in the world and acquires various resources for the firm wherever they are available in the world. Corporate resources are allocated without regard to national frontiers and there is no hesitation even in having shareholders of the firm spread all over the world.

4.3.4 Role of MNC's

MNCs have contributed significantly to the development of world economy at large. They have also served as an engine of growth in many host countries. Their importance in a developing country may be traced as follows:

1. MNCs help a developing host country by increasing investment, income and employment in its economy.
2. They contribute to the rapid process of development of the country through transfer of technology, finance and Tnodern management.
3. MNCs promote professionalisation management in the companies of the host countries.
4. MNCs help in promoting exports of the host country.
5. MNCs by producing certain required goods in the host country help in reducing its dependence on imports.
6. MNCs due to their wide network of productive activity equalise the cost of production in the global market.
7. Entry of MNCs in the host country makes its market more competitive and break the domestic monopolies.
8. MNCs accelerate the growth process in the host country through rapid industrialisation and allied activities.
9. The growth of MNCs creates a positive impact on the business environment in the host country.

10. MNCs are regarded as agents of modernisation and rapid growth.
11. MNCs are the vehicles for peace in the world. They help in developing cordial political relations among the countries of the world.
12. MNCs bring ideas and help in exchange of cultural values.
13. MNCs through their positive attitude and efforts work for the establishment of social welfare institutions and improvement of health facilities in the host countries.
14. Growth of MNCs help in improving the balance of payment status of the host country.
15. The MNCs integrate national and international markets. Their growth in these days has remarkably influenced economic, industrial, social environment and business conditions.

In short, through basically seeking maximisation of profits by using all types of resources and strategies of the global economy, eventually globalisation has become the main focus of their business. In this way, it has become a main propelling force behind the expansion of world economy at large.

4.3.5 Growth of MNC's

Several factors contributed for the growth of MNCs :

1. **Expansion of Market Territory :** The growth of the various economies along with the growth of GDP and capital income resulted in the rise in the living standards.
2. **Market Superiorities :** MNCs enjoy a number of market superiorities over the domestic companies they include
   - Available for information
   - Market reputation
   - Less difficulties in marketing the products
   - They adopt more effective advertising and sales promotion techniques.
   - Transportation and warehousing facilities.
3. **Financial superiorities :** MNCs enjoy financial superiorities over national companies. They are :
   - Huge financial resources at the disposal of the MNCs
   - Utilization of funds

- Easy access to external capital markets
- Mobilization of different type of resources
- Easy access to international bank and financial institutions.

4. **Technological Superiorities :** These include
   - Advanced technology
   - They develop the technology through R & D
   - Local manpower facilities
   - Importing technology and goods
   - Optimum utilization of capacity and resources.

5. **Product Innovation :** MNCs spread operations in many countries, collect information regarding customers taste and preferences. MNC's with their strong R & D departments, invest new products and develop the existing products.

4.3.6 Advantages and Disadvantages of MNCs

4.3.6.1 Advantages of MNC's for the host country

MNC's help the host country in the following ways :

1. The investment level, employment level, and income level of the host country increases due to the operation of MNC's.
2. The industries of host country get latest technology from foreign countries through MNC's.
3. The host country's business also gets management expertise from MNC's.
4. The domestic traders and market intermediaries of the host country gets increased business from the operation of MNC's.
5. MNC's break protectionalism, curb local monopolies, create competition among domestic companies and thus enhance their competitiveness.
6. Domestic industries can make use of R and D outcomes of MNC's.
7. The host country can reduce imports and increase exports due to goods produced by MNC's in the host country. This helps to improve balance of payment.
8. Level of industrial and economic development increases due to the growth of MNC's in the host country.

Disadvantages of MNC's for the host country

1. MNC's may transfer technology which has become outdated in the home country.
2. As MNC's do not operate within the national autonomy, they may pose a threat to the economic and political sovereignty of host countries.
3. MNC's may kill the domestic industry by monpolising the host country's market.
4. In order to make profit, MNC's may use natural resources of the home country indiscriminately and cause depletion of the resources.
5. A large sums of money flows to foreign countries in terms of payments towards profits, dividends and royalty.

4.3.6.2 Advantages of MNC's for the home country

MNC's home country has the following advantages :

1. MNC's create opportunities for marketing the products produced in the home country throughout the world.
2. They create employment opportunities to the people of home country both at home and abroad.
3. It gives a boost to the industrial activities of home country.
4. MNC's help to maintain favourable balance of payment of the home country in the long run.
5. Home country can also get the benefit of foreign culture brought by MNC's.

Disadvantages of MNC's for the home country

1. MNC's transfer the capital from the home country to various host countries causing unfavourable balance of payment.
2. MNC's may not create employment opportunities to the people of home country if it adopts geocentric approach.
3. As investments in foreign countries is more profitable, MNC's may neglect the home countries industrial and economic development.

4.3.7 Problems & Consequences

Much of the concern about MNCs stems from their size which can be formidable. Indeed, the profits of some of the larger corporations can exceed the operating budgets of the governments in smaller countries. It is the power that such scale can give that has led to the led to the greatest concern.

Can the MNCs push around their host governments to the advantage of the shareholders and the disadvantage of the citizens of the country of operation? This has led several countries and even th United Nations to investigate the influence of MNCs The issues considered include the following :

It can be difficult to manage economies in which multinationals have extensive investments, such as the economies of Canada and Australia. Since MNCs often have ready access to external sources of finance, they can blunt local monetary policy. When the host government wishes to constrain economic activity, multinationals may nevertheless expand through foreign borrowing.

Similarly, efforts at economic expansion may be furstrated if multinationals move funds abroad in search of yield advantages elsewhere. You do not to be a multinational to frustrate plans for economic expansion integrated financial markets will always produce this effect but MNCs are likely to participate in any opportunities to gain profits.

Furthermore, as we have seen, multinationals can also shift proftis to reduce their total tax burden, they can show larger profits in countries with lower tax rates. This can make the MNC a slippery animal for the tax collector, even through it uses many local public goods provided from general tax revenues.

It has been argued that multinational is can make foreign exchanges markets volatile. For example, it has been claimed that which the U.S. dollar is moving rapidly against the European currencies, the Canadian dollar swings even further.

In particular, a declining value of the U.S. dollar against, for example, the German mark or sterling has been associated with an average larger decline of the Canadian dollar against the same European currency.

Although the existence of this phenomenon has not been formally verified, MNCs have been blamed for such an affect.

It has been claimed that when U S parent companies are expecting an increase in the value of the mark, sterling and so on they buy these foreign currencies and instruct their Canadian subsidiaries to do the same Willi a thinner market in the Dominion currency, the effect of this activity could be greater movement in the value of the Canadian dollar than in the value of the U.S dollar.

Concern has been expressed, especially within the United Slates, the U.S based multinationals can defy foreign policy objectives of the U.S gov ernment through their foreign branches and subsidiaries. A firm might break a blockade and avoid sanction by operating thorough overseas subsidiaries.

This has caused even greater concern within some host countries. Win should companies operating within their boundaries have to follow orders of the U.S government or any other foreign government? Multinational corporations present a potential for conflict between national governments. There is even potential for conflict within international/multinational trade unions.

For example, in 1980 and 1981 Chrysler Corporation was given loan guarantees to help it continue 111 operation. The U.S government insisted on wage and salary rollbacks as a condition. Chrysler workers in Canada does not appreciate the instruction from the U.S congress to accept a reduced wage.

Accusations have been made, most notably with regard to the oil industry, that multinationals can use monopoly power to withhold output to effect price increases for their products. Because the multinationals have such extensive operations, much of the data on which the governments must rely are often data collected and reported by the MNCs themselves.

There is no guarantee that the data are accurate, and there is no easy way to enforce controls and punish culprits. This became one of the leading political issues of the 1980s and 1990s.

Multinationals tend to concentrate and specialize their “good” and “bad” activities within certain locations. This can mean doing R and D within the home country. Highly trained university and technical school graduates who find their employment and promotion opportunities diminished would prefer locally owned and managed enterprises in their country of foreign MNCs.

This has been a controversial problem in countries that consider themselves “branch plant” economies. Canadian and Australian scientists and engineers have been particularly outspoken.

While MNCs have improved prospects for some better- paid workers in their home countries, it has been argue that they have “exported” lower-wage jobs. The evidcnce does not support this claim indeed explains, the opposite may be true.

Direct foreign investment is frequently motivated by strategic considerations, and it can help investing firms retain markets threatened by new entrants In this way jobs at home those supplying partly -processed inputs and R and D are protected

It is not uncommon to hear the view that because MNCs are so large they have reduced competition However, the truth may be the opposite.

In some industrials such as automobiles, computers, steel, and shipbuilding, where a single country might support one or only a few firms in the industry, competition is increased by the presence of foreign MNCs.

That is. the MNCs themselves compete in international markets, and without them monopoly powers in some sectors might be even greater.

Also on the positive side. MNCs have transferred technology and capital to less developed countries (LDCs). and in this way helped accelerate their economic development. U.S and Japanese based MNCs have been particularly active building production facilities in LDCs. For example U.S multinationals influence in Latin America has been particularly strong. The Japanese MNCs influence has also risen, particularly in Asian LDCs.

There is little doubt the MNCs spread a common culture risen. Chain hamburger outlets become the same on Main Street in low a and on the Champs-Ely sees in Paris. Soft-drink bottles with a familiar shape can wash up on any beach, and there is no obvious way of telling from which country they came Hotel looms are alike everywhere.

The same corporate names and product names appear in every major Western language. Even architecture shows a common influence the “international style” Main have decried this development. complaining that it is robbing the world of a good deal of its variety and local interest Yet the local people demand the products of the MNCs This is all part of the unending love hate relationship between concerned people everywhere and the multinational corporation.

4.3.8 Applicability to Particular Business

MNC’s is suitable in the following cases :

1. Where the Government wants to avail of foreign technology and foreign capital e.g. Maruti Udyog Limited, Hind lever, Philips, HP, Honeywell etc.
2. Where it is desirable in the national interest to increase employment opportunities in the country e.g., Hindustan Lever.
3. Where foreign management expertise is needed e.g. Honeywell, Samsung, LG Electronics etc.
4. Where it is desirable to diversify activities into untapped and priority areas like core and infrastructure industries, e.g. ITC is more acceptable to Indians L&T etc.
5. Pharmaceutical industries e.g. Glaxo, Bayer etc.

4.3.9 MNC's in India

Comparatively very little foreign investment has taken place in India due to several reasons, as stated in the previous chapter (like the dominant role assigned to the public sector in the industrial policy and the restrictive Government policy towards foreign investment). Some multinationals, Coca Cola and IBM, even left India in the late 1970s as the Government conditions were unacceptable to them.

A common criticism against the MNCs is that they tend to invest in the low priority and high profit sectors in the developing countries, ignoring the national priorities. However, in India the Government policy confined the foreign investment to the priority areas like high technology and heavy investment sectors of national importance and export sectors. Firms which had been established in non-priority areas prior to the implementation of this policy have, however, been allowed to continue in those sectors.

The controversial Foreign Exchange Regulation Act (FERA), 1973, required the foreign companies in India to dilute the foreign equity holding to 40 per cent (exceptions were allowed in certain cases like high technology and export oriented sectors).

An often heard criticism is that multinationals drain the foreign exchange resources of the developing countries. However, Aiyar's study indicates that, contrary to the popular belief, foreign companies are less of a drain on foreign exchange reserves than Indian ones. He also points out that the public sector has a higher propensity to use foreign exchange on a net basis than multinationals. In fact, the foreign exchange outgo of the public sector alone is greater than the entire trade deficit of the country.

It is not a right approach to estimate the net impact of multinationals on the foreign exchange reserves by taking the net foreign exchange outflow or inflow. If a multinational is operating in an import substitution industry, the net effect on the foreign exchange reserves could be favourable even if there is a net foreign exchange outflow by the company.

Multinationals in several developing countries make substantial contribution to export earnings. The performance in the case of India has, however, been very dismal. This is attributed mostly to the Government policy. "We have consistently followed policies in India that discriminate against export production and in favour of production for the local market. In this milieu it has not made sense for the Indian private sector or public sector to focus on exports. Naturally, it has not made sense for foreign companies either. In 1947, foreign companies did not have an anti- export image. Indeed, the most prominent ones were engaged in the export of tea and jute manufactures. Only after jawaharlal Nehru decided to emphasise import-substitution at the expense of exports did foreign (and Indian) companies shun exports.

Although export promotion has been pursued since the Third Plan, the highly protected domestic market and the unrealistic exchange rate made the domestic market much more attractive than exports. However, since the mid 1980s with the economic liberalisation that increased domestic competition and the steady depreciation of the rupee, exports began to become attractive and several foreign companies and companies with foreign participation, as well as Indian companies, have become serious about exports. This was reflected in the acceleration of the export growth.

Since the economic liberalisation ushered in 1991, many multinationals in different lines of business have entered the Indian market. A number of multinationals which were in India prior to this have expanded their business.

4.3.10 MNC's and Indian Economy

The history of the growth of MNCs in Indian Economy has been quite interesting. After independence, due to the dominant role of public sector and restrictive government policy towards foreign investment, India attracted very little foreign investment. Some multinationals, Coca-Cola and IBM left India in late 1970s in the wake of Foreign Exchange Regulation Act of 1973. The Act meant to 'Indianise' foreign companies, made it mandatory for foreign companies to dilute their shareholdings to 40 percent. Instead of diluting its shareholdings to the required limit prescribed by the Act, Coca-Cola opted to discontinue its operations in India. In the new liberalized and deregulated environment of the nineties, Coke made its reentry into India through its 100 percent owned subsidiary, Hindustan Coca-Cola Holdings.

The new economic policy of 1991 is expected to give a considerable impetus for MNCs investment in India. Since the beginning of liberalization in 1991, many multinationals in different lines of business have entered the Indian market. A number of multinational which were in India prior to this have expanded their business. It is high time that the Government put in place a Competition Policy and Law to ensure fair competition.

India's Presence in Growing Business

India's presence in global business can now be felt more than ever before. Developments at different level have worked in favour of India. The country has a vast educated and skilled human resource, strong R&D base, world class IT firms, excellent track record in manufacturing sector and a vast market. Leveraging these advantages, Indian economy has been registering a consistent GDP growth rate of 8 to 9 percent. Table 19.7 shows the extent of overseas earnings in total revenues of select Indian companies. Table 19.8 lists the major Indian MNCs.

Company	Sector	Percent of Foreign sales in total sales
Infosys	IT	98
Satyam	IT	96
TCS	IT	88
Wipro	IT	75
Ranbaxy	Pharmaceutical	73
Nalco	Manufacturing	59
Tata Tea	Manufacturing	62
Reliance	Manufacturing	36
Cummins	Manufacturing	34
Arvind Mills	Textiles	41

Table : Extent of Overseas Earnings in Total Revenues of Indian Companies

Company	Foreign Company Acquired
Tata Steel	Nat Steel Corns
Tata Motors	Daewoo
Reliance Industries	Flag Telecom
Hindalco	Novelis, Mount Garden, Nifty Copper Mines
Ranbaxy	RPG Aventis
Wockhardt	CP Pharmaceuticals, Wallis Labs
Patni Computers	Cymbal Corp
Dr. Reddy’s	Trigensis
Sundaram	Green Field Project in China, also acquired Dana Spicer
Bharat Forge	Carl Dan Peddinghaus
Wipro	Nervewire Inc.
Infosys	Expert Information Services
Tata Chemicals	Indo Macros Phosphone

Table : Selected Indian MNCs

Compared with global MNCs, Indian firms are miniscule in size, spread, clout and visibility, however, a beginning in the direction towards globalization has been made. As we will proceed, India’s presence in the world markets will gradually be significant.

Rank	Name	Industry	Foreign Assets
1.	Oil and Natural Gas Corporation (ONGC)	Oil and Gas operations	4724
2.	Tata Group of companies	Conglomerate	4169
3.	Videocon Industries Limited	Conglomerate	1626
4.	Ranbaxy Laboratories Limited	Pharmaceuticals	1077
5.	Dr. Reddy's Laboratories Limited	Pharmaceuticals	869
6.	HCL Technologies Limited	IT Services	777
7.	Hindalco Industries Limited	Aluminium Manufacturer	581
8.	Sun Pharmaceutical Industries Limited	Pharmaceuticals	281
9.	Reliance Industries Limited	Oil & Gas operations	250
10.	Suzlon Energy Limited	Power & Energy	135
11.	Larsen & Toubro (L&T) Limited	Engineering & Construction	130
12.	Wipro Technologies	IT Services	128
13.	Bharat Forge Limited	Auto Component solution Provider (forging)	106
14.	Patni Computer System Limited	IT Service	81
15.	Hexaware Technologies Limited	IT Service	69
16.	Biocon Limited	Pharmaceuticals	50
17.	i-Gate Global Solutions Limited	IT Service	49
18.	Max India Limited	Conglomerate	37
19.	Mahindra & Mahindra Limited	Automobile Manufacturer	35
20.	NIIT Limited	IT Service	31
21.	Piramal Healthcare Limited	Pharmaceuticals	26
22.	Birlasoft (India) Limited	IT Service	21
23.	Raymond Limited	Fabric Manufacturer	18
24.	Infosys Technologies Limited	IT Service	9
	Total		15279

Table : ISB-VCC ranking of 24 selected Indian Multinationals, 2006 (millions of USD)

Companies	Year	Number of Students Hired	Number of Students hired in IIMs
MNCs	2008	3031	920
Private Sector	2008	1621	493
MNCs	2009	1606	497
Private Sector	2009	1718	658

Table : Campus hiring in IITs and IIMs

It has been observed that MNCs provide employment opportunities to the Indian students studying in IITs and IIMs. Table 19.10 shows that in the year 2008, 3031 students were hired from IITs and 920 students from IIMs. On the other hand, Indian private sector hired 1621 students from IITs and 493 from six IIMs.

It is further revealed that economic slowdown has adversely affected the Campus hiring by MNCs but not that of hiring by Indian private sectors. In 2009, hiring by MNCs in IITs fell dramatically to 1606. But there was a marginal increase by Indian private sector companies who hired 11718 students. A similar trend can be noticed in IIM. In 2008, MNCs hired 920 students whereas Indian Private Sector companies employed 493 through campus interview. In 2009, hiring by MNCs came down substantially to 497 but that by Indian companies increased to 658 students.

4.4 Mergers and Acquisitions

Introduction

Business combinations, which may take forms of mergers, amalgamation and takeovers, are important features of corporate restructuring and governance. They have played an important role in the growth of a number of leading companies in the world over. Subsequent to the structural adjustment programmes in the Indian economy, restructuring of companies in the form of collaborations, mergers and acquisitions have taken place in most of the industries including Banking, Information Technology, Fast Moving Consumer Goods and Pharmaceuticals.

The factors driving mergers and acquisitions include globalisation, technology, deregulation, favorable economic and financial conditions, and changes in the business laws. The structural adjustment programme and the new industrial policy adopted by the government of India have allowed business firms to undertake any programme of expansion either by entering into a new market or through expansion in an existing market. In that context, many organisations are increasingly resorting to mergers and acquisitions as a means of growth.

Mergers and Acquisitions are part of strategic management of any business. It involves consolidation of two businesses with an aim to increase market share, profits and influence in the industry. Mergers and Acquisitions are complex processes which require preparing, analysis and deliberation. There are a lot of parties who might be affected by a merger or an acquisition, like government agencies, workers and managers. Before a deal is finalized all party needs to be taken into consideration, and their concerns should be addressed, so that any possible hurdles can be avoided.

Meaning and Definition

'Mergers and Acquisitions' is a technical term used to define the consolidation of companies. When two companies are combined to form a single unit, it is known as merger, while an acquisition refers to the purchase of company by another one, which means that no new company is formed, but one company has been absorbed into another. Mergers and Acquisitions are important component of strategic management, which comes under corporate finance. The subject deals with buying, selling, dividing and combining various companies. It is a type of restructuring, with the aim to grow rapidly, increase profitability and capture a greater proportion of a market share.

Definitions

- Mergers result in the combination of two or more companies into one wherein the merging entities lose their identities. Normally, an exchange of shares takes place between the entities involved in such a process. The company that survives is the buyer which retains its identity.
- A merger can be defined as an amalgamation if all assets and liabilities of one company are transferred to the transferee company in consideration of payment in the form of equity shares of the transferee company or debentures or cash or a mix of the above modes of payment.
- An acquisition is aimed at gaining a controlling interest in the share capital of the acquired company. It can be enforced through an agreement with the persons holding a majority interest in the company's management or through purchasing shares in the open market or purchasing new shares by private treaty or by making a takeover offer to the shareholders.
- A joint venture refers to the process of firms joining together (normally, two) under a contractual agreement to run a specific business enterprise with both parties sharing profits and losses. The venture is a new legal entity in which both firms will take equity stake.
- Strategic Alliance is a partnership between two business firms in which both combine efforts involving anything from getting a better price for goods, seeking business together and so on. The idea behind alliances is to maximise the leverage. Partners do not form a new legal entity. It is an arrangement without equity stake.

  i.e.,Joint Venture - Strategic Alliance + Equity Stake + New Legal Entity

Parties in an Acquisition :

- The Target Company is the company that is being acquired.
- The Acquirer company is the company that is acquiring the target.

4.4.1 Strategy of Mergers and Acquisitions

With the process of 'globalisation and liberalisation' gathering momentum, mergers continue to grow at an ever increasing pace. The United States Federal Trade Commission reports that the number of mergers in 2004 was almost three times that of 1998. This same trend is being experienced world-wide.

The key strategy behind buying a company is to create shareholder value. Two companies together are more valuable than two separate companies—at least, that's the rationale behind M&A. Strong companies buy other companies to create more competitive, cost-efficient structure. The companies come together hoping to gain a greater market share and because of potential benefits, target companies often agree to be purchased when they know they cannot survive alone.

Acquisitions have now surpassed Initial Public Offers (IPOs) not only in value, but in number completed. For many companies, the nature of the IPO market is far too risky. With the market

changing so rapidly, organic growth through expansion has become difficult and is not always a viable option. M&A has essentially become an efficient means to enter a new market. Buyers, at times, are more than willing to pay premium prices to gain market entry. Acquisitions can also expand customer base, providing a more solid business base.

Mergers are not without their downsides. They can consume a lot of time, money, legal and tax complications, and problems with mixing corporate cultures. It has been estimated that some companies never achieve the initial goals projected after the merger.

4.4.2 Types of Mergers

1. **Horizontal merger:** It happens when both companies are in the same line of business, which means they are usually competitors. Example: Disney bought Lucas Film. Both companies were involved in production of film, TV shows.
2. **Vertical merger:** This happens when two companies are in the same line of production, but stage of production is different. Example: Microsoft bought Nokia to support its software and provide hardware necessary for the smart phone.
3. **Conglomerate merger:** This happens when the two companies are in totally different line of business. Example, Berkshire Hathaway acquired Lubrizol. This kind of merger mostly takes place in order to diversify and spread the risks, in case the current business stops yielding adequate profits.

4.4.3 Motives for Mergers and Acquisitions

1) Synergy

Synergy is the force that enhances efficiencies of the business after the merger. Synergy takes the form of revenue enhancement and cost savings. By merging, the companies hope to benefit from the following :

i) Staff Reductions Reduction in the number of staff members (downsizing) might be a part of any merger.

ii) Economies of Scale Mergers translate into improved purchasing power for the companies. When placing larger orders, companies would get greater ability to negotiate price with their suppliers. There ought to be economies of scale when two firms are combined.

iii) Acquiring New Technology as a Means to Competitiveness To stay competitive, companies need to stay on top of technological applications. By buying a smaller company with unique technologies, a large company can achieve competitive edge.'

iv) Market Reach and Industry Visibility Companies buy other firms to enter into new markets and increase revenues. A merger might help to expand two companies marketing and distribution, giving them new sales opportunities. A merger can also improve a company's standing in the investment community.

2) Growth

Mergers or acquisitions can exponentially increase the growth of the company, as it has more resources at its disposal. When two companies combine their expertise, assets and market share are also combined, which leads to more opportunity in the market for growth. The market share which was previously shared by two companies will now exclusively belong to one company. The increased market power is likely to generate more opportunities for sales, revenue, and profitability.

3) Acquiring Unique Capabilities

Sometimes, mergers and acquisitions take place in order to acquire unique capabilities or resources, which could prove paradigm-shifting for the company. This would include patents and licenses, which the acquiring company will gain access to once the merger is completed. A patent, license or certain technology could make a lot difference for the company, which could help it substantially increase sales and profits, since it might create a natural monopoly situation for the new company. When two different companies combine, it could also result in unlocking hidden value, which becomes apparent as resources and experiences combined bring innovation and efficiency.

4) Exploiting the Market

Market systems in most economies are not perfect, which means there is room for companies to exploit these imperfections to their own advantage. Taking over another company or merger could facilitate a monopoly-like situation, which would give the company an edge over its competitors. Alternately, a merger could be done with a motive to control the supply of certain raw materials which will give the company an undue advantage over other companies.

5) Government Policies

Mergers and acquisitions also take place in order to cope with adverse government policies, which may require a certain size of a firm to exist. Some governments offer tax breaks and other incentives to large corporations, which encourage mergers as more profit can be made as tax liability is lower. In order to deal with government pressure to survival within an industry, companies mergers and acquisitions have greater leverage to influence government policies.

6) Transfer of Technology

Another popular reason for mergers and acquisitions is transfer of technology, especially for highly specialized companies with unique technologies. Companies buy other companies in an attempt to acquire a certain technology which is patented or unique. Subsequently, these technologies are used to make better products/services, hence greater market share and profits.

7) Large Clients

Mergers and acquisitions, especially in the service industry, also take place in order to follow big clients. There are a lot of examples of such M&A activity happening for law firms, since sometimes the clients are so big, it forces firms to merge in order to serve them better. The merged firms have more resources and expertise to handle powerful clients. It also gives companies a way to bootstrap earning, hence better performance at the stock exchange for listed companies.

8) Diversification

Mergers and acquisitions allow companies to diversify into other areas of business, hence it spreads risks and present opportunity for more sales, profits and recognition in the market. For example, if clothing store merges with a textile company, it would help both companies, since they would be able to keep a greater margin of profit. Diversification can also take place in a totally different industry altogether. For example, if a restaurant chain store acquires a clothing store, it would have reduced its risks, since even if people stop eating out, hypothetically speaking, they could still make money from the clothing store, and other way.

9) Personal Incentives

In some rare cases, a merger or an acquisition is initialized due to managers personal incentives in form of higher salary, benefits etc., and has nothing to do with strategic planning.

4.4.4 Transaction Characteristics

There are several methods of payment for an M&A activity described below.

1. **Stock Purchase Method:** This transaction requires acquirer to provide cash, stock, or combination of cash and stock in exchange for the shares of the company being acquired. This requires shareholders' approval, since shares can't be bought without their consent. Any gain made by the shareholders on their capital is taxed by the government.
2. **Asset Purchase Method:** This requires acquirer to buy all the target firm's assets. The payment in made directly to the firm. This kind of transaction may not require shareholders' approval/permission. Acquirer, in most cases, won't assume the responsibility for firm's liabilities, which would mean that the firm being acquired would have to settle the debt on its own.
3. **Cash Offering Method:** This kind of transaction simply requires payment in cash.
4. **Security Offering Method:** In this case, shareholders are given shares of common stock, preferred stock, or in some cases debt of the acquirer. The exchange ratio is calculated bases on number of securities in exchange for a share of target stock.

Attitude of Management

From the perspective of the board of directors of the target companies, the merger can be classified into two broad categories:

- **A friendly merger:** This happens when the 'board of directors' agree, negotiate and finally accept an offer.

- **A hostile merger:** This happens when the 'board of directors' attempt to prevent the merger.

In case of a hostile takeover, takeover defenses are used, with the intention to either prevent the transaction or increase the bid. Directors may trigger pre-offer mechanism, which makes the target company seem less attractive. This prevents the acquiring firm from making a decent offer. Alternatively, directors may try post-offer mechanism, which include addressing ownership of shares, hence reducing acquirer's power gained from its ownership.

4.4.5 Types of Acquisitions

Like mergers, acquisitions are actions through which companies seek economies of scale, efficiencies and enhanced market visibility. Unlike mergers, all acquisitions involve one firm purchasing an-other -there is no exchanging of stock. Acquisitions are often congenial, with both the parties feeling satisfied with the deal. Otherwise, acquisitions could be hostile.

In an acquisition, as in some of the merger deals as discussed above, a company can buy another company with cash, stock, or a combination of the two. Another possibility, which is common in smaller deals, is that one company acquires all the assets of the another one. Company A buys all of Company B's assets for cash, which means that Company B will only have cash. In the process.

Company B becomes merely a shell and will eventually liquidate.

Another type of acquisition is a reverse merger. A reverse merger occurs when a private company that has strong prospects and is eager to raise finance, buys a publicly-listed company. Together, they become an entirely new public corporation with tradable shares.

Regardless of their category or structure, all mergers and acquisitions have one common goal: to create synergy that makes the value of the combined companies greater than the sum of the two parts. The success of a merger or acquisition depends on how well this synergy is achieved.

4.4.6 The Merger Process

The process involving merger and acquisition is important as it can dictate the benefits derived from the deal. The process involves the following steps :

1. **Preliminary Valuation:** This step primarily focuses on the business assessment of the target company. Not only the latest financials of the target company are scrutinized, its expected market value in future is also calculated. This close analysis includes the company's products, capital requirements, brand value, organizational structure, etc.

2. **Proposal Phase:** Once the target company's business performance is analyzed and reviewed, the proposal for the business transaction is given. It could be either a merger or an acquisition. Generally, the mode of giving a proposal is an issuance of a non-binding offer document.
3. **Planning for Exit:** After the proposal is given to the target company and it takes the offer, the target company then engages in planning for the exit. This includes planning the right time to exit and considering all the options such as full sale or partial sale. This is also a time for tax planning and evaluating the reinvestment options.
4. **Marketing:** Once the exit plan is finalized, the target company engages in a marketing plan and aims to achieve the highest selling price.
5. **Agreement:** In the case of an acquisition deal, the purchase agreement is finalized. In the case of a merger, the final agreement is signed.
6. **Integration:** This is the final step that involves the complete integration of the two companies. It is important to ensure that the same rules are followed through out in the new company.

4.4.7 Payment Mechanism in Mergers

In a merger in which one company buys another, the acquirer pays for the target company's shares with cash, stock, or both.

A cash-for-stock transaction is fairly straightforward: target-company shareholders receive a cash payment for cash share purchased. This transaction is treated as a taxable sale of the shares of the target company.

If the transaction is made with stock instead of cash, then it's not taxable. There is simply an exchange of share certificates at the pre-determined swap ratio. So many M&A deals are carried out based on the swap ratio. (The case of Bank of Madura merger with ICICI Bank, discussed in this chapter, is a classic example.

When a company is purchased with stock, new shares from the acquirer's stock arc issued to the target company's shareholders. When the deal is closed, investors usually receive the acquiring company's stock. Sometimes, investors get new stock of the new corporate entity that is created by the M&A deal.

There are various factors that need to be considered before method of payment is decided. The risk is usually shared among acquirer and target shareholders in a certain ratio. The ratio is decided based on financial standing of each company. Moreover, signaling by the acquiring firm is also important; they are in a much stronger position to dictate terms. Balance sheet and other financial documents are an immense help in ascertaining the capital structure of the acquiring firm, which becomes an important consideration when it comes to method of payment.

4.4.8 Regulations and Other Hurdles

Securities Law

Securities transactions in mergers and acquisitions are primarily regulated by the Securities and Exchange Board of India (SEBI) and the Stock Exchanges, pursuant to the Securities and Exchange Board of India Act, 1992 (SEBI Act) and the Securities Contracts Regulation Act, 1956 (SCRA).

The SEBI Act, under which the SEBI was constituted, is a legislation to protect the interests of investors in securities and promote the development of, and regulate, the securities market. The SEBI Act also provides for registration of investment advisers, stock brokers, banker to an issue and so on, under the provisions of regulations framed for mergers and acquisitions.

Normally, the shares of a listed company have to be in dematerializcd form. The Depositories Act, 19% regulates and facilitates the establishment of depositories and the holding of shares by them. Under the SCRA, contracts for the sale and purchase of securities in mergers and acquisitions, are ordinarily allowed only on a spot delivery basis.

Legal Due Diligence

It is an important exercise of an M&A transaction and helps both parties identify any legal risks associated with the merger. Due diligence also provides an opportunity to minimize those risks. At the initial stage, all corporate documents are thoroughly reviewed which include Articles of Association. It also covers aspects relating to registrations of company's employees with the regulatory authorities. The second phase includes reviewing details related to company's shareholders, financial liabilities, contractual rights and obligations.

There are several regulatory considerations when performing M&A. In some cases, there is a need to obtain specific approvals from an M&A transaction from government regulatory bodies, especially when the company is part of core economic activities of the country like banking, insurance, electricity or water supply. Some areas of economy require licenses and NOCs to collude. Additionally, government agencies exist that ensure industries stay competitive.

M&A transactions usually present a possibility of collusion between firms, in order to raise price and create a monopoly situation. This situation generated extraordinary profits for the company, but exploits consumers, since they don't have a choice and end up purchasing the goods at a higher price. Competition commissions exist on order to make sure that markets stay competitive. Some countries have foreign capital investment laws, which prevent foreign companies from investing locally or set a certain investment limit. There are no ways around these hurdles, which means that M&A transaction cannot be executed and finished.

As the firm grows in size after M&A transaction, a different set of tax brackets may be applicable. This needs to be takes into considerations since it could adversely impact company's profits. Such a development will be irksome to shareholders and other stakeholders.

4.4.9 Advantages and Disadvantages of Mergers and Acquisitions

Advantages

The following are the advantages of the mergers and acquisitions :

1. **Synergy:** The synergy created by the merger of two companies is powerful enough to enhance business performance, financial gains and overall shareholders value in long term.
2. **Cost Efficiency:** The merger results in improving the purchasing power of the company which helps in negotiating the bulk orders and leads to cost efficiency. The reduction in staff reduces the salary costs and increases the margins of the company. Increase in production volume causes the per unit production cost resulting in benefits from economies of scale.
3. **Competitive Edge:** The combined talent and resources of the new company helps it gain and maintain a competitive edge.
4. **New Markets:** The market reach is improved by the merger due to the diversification or the combination of two businesses. This results in better sales opportunities.

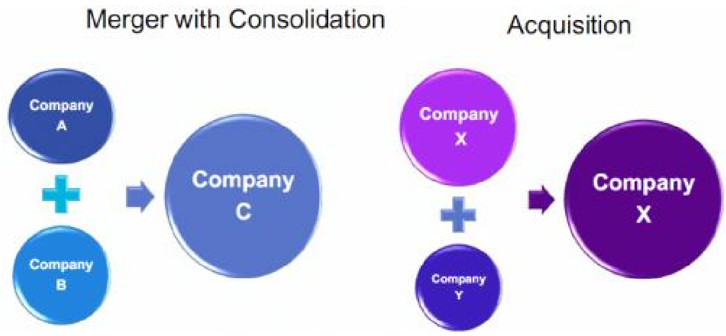
Disadvantages

The following are the disadvantages of the mergers and acquisitions :

1. **Bad for Consumers:** With the merger, competition can reduce in the industry and the new company may have higher pricing power.
2. **Decrease in Jobs:** A merger can result in job losses. An acquiring company may shut down the under-performing segments of the company.
3. **Sometimes Diseconomies of Scale:**The increased size may lead to diseconomies of scale for the new company. It may not have the control required for running a bigger company.

4.4.10 Difference between Merger and Acquisitions

The main difference between a merger and an acquisition is that a merger is a form of legal consolidation of two companies, which are formed into a single entity, while an acquisition happens when one company is absorbed by another company, which means that the company that is purchasing the other company continues to exist. In the recent years, the distinction between the two has become more and more blurred, as companies have started doing joint ventures. Sometimes acquirer wants to keep the name of the acquired company, as it has goodwill value attached to it.



Mergers and acquisitions are complex area of a company long-term strategy. The process takes a long time, at times, even years. It involves number of parties and stakeholders :

1. The two companies which are being merged or coordinating to venture are the main stakeholders, since any changes in the structure of the company is likely impact both companies.
2. Employees will also be affected, since they are an integral part of the companies. At times, during a merger or acquisition employees have to be laid off.
3. The government agencies play a decisive role in any merger or acquisition, as they want to make sure that the M&A does not create a monopoly or impinge on the rights of general public. Any merger of acquisition must not be a hurdle to competitive environment in the industry.
4. Pressure Groups would be interested in the impact the merger or acquisition would have on the environment, worker welfare, consumer welfare and overall social impact the collusion. Some companies manufacture product/services that are controversial, hence detested by some people. Firms must find a way to deal with possible hostility from these people.
5. Competitors would be interested in a possible merger or acquisition between two companies in the industry, since a collusion could threaten to take away their market share as the combined company would be more powerful, financially and strategically.
6. Financial institutions also have a stake in possible merger or acquisition, since the companies involved might have outstanding debt. Alternatively, a company

involved in a post-merger or an acquisition might want to borrow more money, so that the financial institutions would have to evaluate the company's financial standing and ability to repay it later.

The difference between Merger and Acquisition

Merger	Acquisition
• Merging of two organisation in to one.	• Buying one organisation by another
• It is the mutual decision	• It can be friendly takeover or hostile takeover
• Merger is expensive than acquisition (higher legal cost)	• Acquisition is less expensive than merger
• Through merger shareholders can increase their networth.	• Buyer cannot raise their enough capital
• It is time consuming and the company has to maintain so much legal issues.	• It is faster and easier transaction
• Dilution of ownership occurs in merger.	• The acquirer does not experience the dilution of ownership.

Conclusion

Though mergers and acquisitions are considered as synonyms, both the business combinations are different in their own ways. A company needs to understand the process and the resulting advantages and disadvantages well to appreciate the complexities involved.

Scenario in 2015

The Mergers and Acquisitions of Indian companies in 2015 are from 1st Jan 2015 to 14th March 2015.

- Anil Ambani's Mumbai based **Reliance Infrastructure** acquires India's largest ship building and heavy industries company **Pipavav Defence and offshore Engineering Company Ltd** (March)
- Bengaluru based online cab aggregator **Ola Cabs** acquires **TaxiforSure** (March)
- Rupert Murdoch owned Newscorp inc acquires VCCircle Network (March)
- Mumbai based **Star India Pvt ltd** owned by 21st century Fox acquires **Screen** entertainment weekly from Indian Express Group (March)
- German speciality chemicals manufacturer **Evonik Industries AG** acquires Mumbai based catalyst supplier **Monarch Catalyst Pvt Ltd** (March)
- Thomas cook owned **Quiz Coro Ltd** acquires Indian arm of American MNC **Aramark**(Hospitality and healthcare facility management) (Feb)

- New Delhi based online marketplace **Snapdeal** acquires **Exclusively.com** (Feb)
- **Star India** acquires telugu language based **MAA network** (Feb)
- **BookMyShow** acquires Bangalore based Eventifier (Feb)
- Malaysia based **Foodpanda** acquires food ordering portal **Just Eat India** (Feb)
- New Delhi based online restaurant based **Zomato** buys Turkish rival **Mekanist** (Feb)
- Kolkatta based FMCG company **Emami Ltd** acquires Australian personal care firm **Fravin Pty Ltd** (Jan)
- **Temasek Holdings Pte Ltd**, the Singapore govt's investment arm acquires Punj Llyod stake in **Medanta** super speciality hospital owned by Global Health Pvt Ltd (Jan)
- Mumbai based Piramal MNC's **Piramal Enterprises Ltd** acquires **Coldstream Laboratories Inc** (Jan)
- **Hike**, messenger app by a Joint Venture of Bharati enterprises and SoftBank acquires US-based **Zip Phone** (Jan)
- Mumbai based conglomerate's division **Godrej Consumer Products Ltd** acquires South Africa's **Frica Hair (Pty) Ltd** (Jan)
- Chennai based hospital chain, **Apollo Hospital** acquires **Nova Speciality** (Jan)
- Pune based Bharat Forge Ltd MNC's, German arm **CDP Bharat Forge Holding GmBH**acquires **Mecanique Generate Langroise (MGL)**, A French oil and gas machining company (Jan)
- Gurgaon based Refrigerants manufacturer **SRF Ltd** acquires global pharmaceutical propellant business from chemicals maker **DuPont** (Jan)

Scenario: Post 1991

The government introduced liberalisation with the announcement of the New Industrial Policy Statement on July 24, 1991 which included norms authorising Foreign Direct Investment (FDI) and technology collaborations in specific sectors, subject to certain limitations. Initially, FDI was permitted up to 51% in certain high priority industries, requiring large investments and advanced technology. However, these limits have been gradually relaxed over the past two decades. The liberalised economic policies have exposed Indian industry to several challenges. In response to this, the Indian economy has witnessed a sharp increase in mergers and acquisitions. Some of the notable mergers in the recent past have been listed below :

- Dabur acquired Balsara Group of Companies in 2005
- Reliance Industries merged with Reliance Petroleum in March 2002
- Merger of ICICI Limited. ICICI Capital Services Ltd and ICICI Personal Financial Services Limited with ICICI Bank in 2002
- ICICI Bank acquired Madura Bank in 2000
- IDBI & IDBI Bank in 2004
- Recent acquisition of Kochi Refinery by BPCL
- Punjab National Bank acquired Kerala-based Nedungadi Bank
- HCL Tech merged with HCL Enterprise systems
- L&T Cement Division acquired Grasim
- Arena Multimedia and Aptech Training
- Global Trust Bank amalgamated with Oriental Bank of Commerce
- Daksh acquired by IBM
- Wipro acquired Spectramind
- The Tata Oil Mills Company Ltd merged with HLL in April 1993
- Ponds India Ltd merged with HLL in January 1998
- Lipton India Ltd merged with Brooke Bond India Ltd and name changed to Brooke Bond Lipton India Ltd. in July 1993
- Kissan Products Ltd merged with Brooke Bond India Ltd in April 1993
- Brooke Bond Lipton India Ltd merged with HLL in January 1996
- Polaris merged with Orbitech.

UNIT V	**WTO AND TRADE POLICY : WTO agreements** - Agreement on Agriculture (AOA) - Multi-fibre Agreement (MFA) - Trade Related Intellectual Property Rights (TRIPS) - Trade Related Investment Measures (TRIMS) - General Agreement on Trade in Services (GATS) - Barriers to trade. **Trade policy changes consequent to WTO** - Recent EXIM policy - Consequences of WTO for India.

5.1 World Trade Organization (WTO)

Introduction

There are a number of ways of looking at the W TO. An organization for liberalising trade; a forum for governments to negotiate trade agreements; a place for them to settle trade disputes. It operates a system of trade rules.

At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations. These documents provide the legal ground-rules for international commerce. They are essentially contracts, binding governments to keep their trade policies within agreed limits. Although negotiated and signed by governments, the goal is to help producers of goods and services, exporters, and importers conduct their business, while allowing governments to meet social and environmental objectives.

5.1.1 Principles of the Trading System

The following principles are the foundation of the multilateral trading system :

1. Trade without Discrimination

It should not discriminate between its trading partners and it should not discriminate between its own and foreign products, services or nationals. Imported and locally produced goods should be treated equally — at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents.

2. Free Trade: Gradually, through Negotiation

Lowering trade barriers is one of the most important principles of WTO to encourage trade. The WTO agreements allow countries to introduce changes gradually, through “progressive liberalisation”. Developing countries are usually given longer time to fulfill their obligations.

3. Predictability: Binding atid Enforceable Commitments

The multilateral trading system is an attempt by governments to make the business environment stable and predictable. It ensures that there will not be frequent and arbitrary changes in tariffs.

4. Promoting fair Competition

It does not altogether eliminate tariffs and other barriers but allows it in limited circumstances. In fact it promotes a level playing field and fair competition by scrapping high tariffs, other trade barriers and promotes fair competition in anti-dumping duties and supports various agreements in agriculture, intellectual property, services, etc.

5.1.2 Objectives / Functions of WTO

Instead of calling it Word Trade Organization, it should be called World Trade of Opportunities. WTO gives an opportunity to the nations to sit together and talk trade. It gives them the forum where nations can negotiate with the objective of a win-win situation. WTO administers the 28 agreements contained in the final Act and a number of plurilateral agreements and government procurements through various councils and committees. It enforces the multilateral trade rules. The functions of the WTO can be briefly listed as follows :

1. Helps Developing and Transition Economies

Developing countries make up about three quarters of the total WTO membership. The role of WTO increases as most of these developing countries are in transition phase as they are shifting from planned economic system to market based economic system.

The WTO Secretariat’s Training and Technical Cooperation Institute organizes a number of programmes to train government officials and negotiators. Besides Geneva, these programmes also take place in the country concerned. Various number of programmes are organized jointly with other international organizations.

WTO provides data of tariff and trade to developing nations to help them in their export.

2. Specialised help for Export

In 1964, the WTO established the International Trade Centre to help developing countries in their exports. It is jointly operated by the WTO and the United Nations. It provides information and advice on export markets and marketing techniques. It assists in establishing export promotion and marketing services, and in training personnel required for these services.

3. The WTO in Global Economic Policy Making

WTO cooperates with the International Monetary Fund, the World Bank and other multilateral institutions to achieve greater coherence in global economic policy-making. A separate ministerial declaration was adopted at the Marrakesh Ministerial Meeting in April 1994 to underscore this objective.

4. Taking Information

WTO takes regular information from the member countries regarding their policies and tariffs. According to many agreements, the government has to notify the WTO about the modified trade measures like safety standards, technical standards, anti-dumping and countervailing duties, etc. In this way, it keeps itself updated regarding developments but also it disseminates information to the member countries, which help them in increasing their exports.

5. Giving Information to Public

It also disseminates information to the public about the developments in WTO through its publication and its websites.

6. Encouraging Development and Economic Reform

GATT allows for special assistance and trade concessions for developing countries. WTO agreements give them transition periods to adjust to the more unfamiliar and, perhaps, difficult framework. A ministerial decision adopted at the end of the round says better-off countries should accelerate implementing market access commitments on goods exported by the least-developed countries, and it seeks increased technical assistance for them.

5.1.3 Rules of WTO (Agreements)

WTO agreements encompass goods, services and intellectual property. It has an objective of reducing tariffs to zero. It enables liberalisation and allows limited exemption regarding duties. It establishes a system to resolve disputes and ensures transparency regarding the trade policy of the government. The present WTO system is based on the Uruguay Round Agreements, which are as follows :

1. Binding and Cutting of Tariff

This includes commitment to cut and 'bind' custom duty rate on import of goods. In some cases, tariffs are being cut to zero. There is significant increase in the bound tariffs.

Developed countries' tariff cut were for the most part phased in over five year from January 1, 1995.

On March 26, 1997, 40 countries which account for more than 92% of the old trade in information technology products, agreed to eliminate import duties and other charges on the product by 2000 (by 2005 in a handful of cases).

2. More Bindings

Developed countries increased the number of import whose tariff rate are "bound" (committed and difficult to increase) from 78% of product line to 99%. For developing countries, the increase is considerable: from 21% to 73%.

Economies in transition increased their binding from 73% to 98%.

5.1.4 Trade Policy Review

Transparency is achieved by the WTO in two ways: governments have to inform the WTO and fellow-member of specific measures, policies or laws through regular "notification"; and the WTO conducts regular review of individual countries' trade policies. The objectives of the review are:

1. To increase the transparency and understanding of countries' trade policies and practice through regular monitoring.
2. Improve the quality of public and intergovernmental debate on the issues.
3. To enable a multilateral assessment of the effect of policies on the world trading system.

Over a period of time, all WTO members are to come under scrutiny. The frequency of the review depends on the country's size:

1. The four biggest traders — the European Union, the United States, Japan and Canada (the "Quad") — are examined approximately once every two years.

2. The next 16 countries (in terms of their share of world trade) are reviewed every four years.

3. The remaining countries are reviewed every six years, with the possibility of a longer interim period for the least-developed countries.

For each review two documents are prepared: a policy statement by the government under review and a detailed report written independently by the WTO Secretariat.

Plurilaterals

In WTO, there are few agreements where there are only a few signatories. They were negotiated at the Tokyo Round, known as "plurilateral agreements". Following are included in the Plurilateral Agreements:

1. **Fair Trade in Civil Aircraft :** The Agreement on Trade in Civil Aircraft entered into force on January 1, 1980. It now has 30 signatories. The agreement eliminates import duties on all aircraft, other than military aircraft, as well as their parts and components.

2. **Government Procurement :** An Agreement on Government Procurement was first negotiated during the Tokyo Round and came into force on January 1, 1981. The objective of the agreement is to make law, regulation, procedures and practices regarding government procurement more transparent, and to ensure they do not protect domestic products and suppliers, or discriminate against foreign products or suppliers.

3. **Dairy and Bovine meat Agreements :** The International Dairy Agreement and International Bovine Meat Agreements were scrapped at the end of 1997. Countries that had signed the agreement decided that these sectors were better handled under the Agriculture and Sanitary and Phytosanitary agreement.

5.1.5 Organization of WTO

The WTO is run by its member-governments. All major decisions are made by the membership as a whole, either by ministers (who meet at least once ever two years) or by their ambassadors or delegates (who meet regularly in Geneva). Decisions are normally taken by consensus. WTO is a member-driven, consensus-based organization.

- **Highest Authority: The Ministerial Conference**

  WTO belongs to its members. The countries make their decisions through various councils and committees, whose membership consists of all WTO members. Topmost is the ministerial conference which has to meet at least once ever two years. The Ministerial Conference can take decisions on all matters under any of the multilateral trade agreements.

- **Second Level: General Council in Three Guises**

  Day-to-day work in between the ministerial conferences is handled by three bodies :

  1. The General Council
  2. The Dispute Settlement Body
  3. The Trade Policy Review Body

  The General Council acts on behalf of the Ministerial Conference on all WTO affairs. The General Council has other organs - Dispute Settlement Board and the Trade Policy Review Board to oversee procedures for settling disputes between members and to analyse members' trade policies.

- **Third level: Councils for each Broad Area of Trade, and More**

  Three more councils, each handling a different broad area of trade, report to the General Council :

  1. The Council for Trade in Goods (Goods Council)
  2. The Council for Trade in Services (Services Council)
  3. The Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council)

  The three are responsible for the workings of the WTO agreements dealing with their respective areas of trade. Again, they consist of all WTO members.

- **Fourth level: Down to the Nitty-gritty**

  Each of the higher level councils has subsidiary bodies. The Goods Council has 11 committees dealing with specific subjects (such as agriculture, market access, subsidies, anti-dumping measures and so on). Again, these consist of all member countries. Also reporting to the Goods Council is the Textiles Monitoring Body, which consists of a chairman and 10 members acting in their personal capacities, and groups dealing with notifications (governments informing the WTO about current and new policies or measures) and state trading enterprises.

The Services Council's subsidiary bodies deal with financial services, domestic regulations, GATS rules and specific commitments.

At the General Council level, the Dispute Settlement Body also has two subsidiaries: the dispute settlement "panels" of experts appointed to adjudicate on unresolved disputes, and the Appellate Board that deals with appeals.

- **HODs : The Need for Informality**

  Besides formal meetings there are informal meetings also to resolve the matter such as those of Head of Delegation (HOD). The practice is that the chairperson of a negotiating group tries to attempt to build a compromise by holding consultations with delegations individually, in twos or threes, or in groups of 20-30 of the most interested delegations. In the end, decisions have to be taken by all members through consensus.

How to Join the WTO: The Accession Process

Any state or customs territory having full autonomy in the conduct of its trade policies may join ("accede to") the WTO, but WTO members must agree on the terms.

The accession process has four stages :

1. **First,** the government applying for membership has to describe all aspects of its trade and economic policies that have a bearing on WTO agreements. This is submitted to the WTO in a memorandum which is examined by the working parties dealing with the country's application. These working parties are open to all WTO members.

2. **Second,** when the working part has made sufficient progress on principles and policies, parallel bilateral talks begin between the prospective new member and individual countries. The talks determine the benefits (in the form of export opportunities and guarantees) other WTO members can expect when the new member joins.

3. **Once** the working part has completed its examination of the applicant's trade regime, and the parallel bilateral market access negotiations are complete, the working party finalises the terms of accession. These appear

in a report, a draft membership treaty ("protocol of accession") and lists ("schedules") of the members to-be's commitments.

4. **Finally** the report, protocol and lists of commitments, is presented to the WTO General Council or the Ministerial Conference. If a two-thirds majority of WTO members vote in favour, the applicant is free to sign the protocol and to accede to the organization.

5.1.6 Regional Groups in WTO

Many groups operate in the WTO. Some are for economic integration - custom unions, free trade areas, and common markets, such as the European Union, ASEAN, NAFTA and MERCOSUR. These groups of countries, when they adopt common positions, can reach a consensus more easily. Sometimes specific groups are created to compromise and break a deadlock. But there are no hard and fast rules about the impact of groupings in the WTO.

The largest and most comprehensive group is the European Union and its 15 member states for legal reasons known officially as the "European Communities" in WTO business. The European Commission alone speaks for the EU at almost all WTO meetings. The EU is a WTO member in its own right as are each of its member states.

Association of South East Asian Nations (ASEAN) members also coordinate positions among themselves and speak with a single voice in the WTO. The role of a spokesman rotates among ASEAN members and can be shared according to the topic.

There are many other groupings which occasionally present unified statements: the African Group, the least-developed countries, the African, Caribbean and Pacific Group (ACP) and the Latin American Economic System (SELA).

Then there is a different kind of group in the WTO, the Cairns Group. It was set up just before the Uruguay Round began in 1986 to argue for agricultural trade liberalisation. The group became an important third force in the farm talks and remains in operation.

The WTO Secretariat and Budget

The WTO Secretariat is located in Geneva. It has around 550 staff and is headed by a director-general.

Its responsibilities include :

1. Administrative and technical support for WTO delegate bodies (councils, committees, working parties, negotiating groups) for negotiations and the implementation of agreements.
2. Technical support for developing countries, and especially the least-developed.
3. Trade performance and trade policy analysis by WTO economists and statisticians.
4. Assistance from legal staff in the resolution of trade disputes involving the interpretation of WTO rules and precedents.
5. Dealing with accession negotiations for new members and providing advice to governments considering membership.

The WTO budget is over 150 million Swiss francs with individual contributions calculated on the basis of shares in the total trade conducted by WTO members. Part of the WTO budget also goes to the International Trade Centre.

5.1.7 Advantages/Benefits of WTO

The WTO has proved its worth in the past years. After its inception with only 23 members, it now has 153 members. Its members include even communist countries like China, and more countries like Vietnam and Laos are eager to gain its membership because it gives many advantages to member countries. It is a forum where everybody wins by making others win. A few distinct advantages of the WTO are :

1. **The system promotes peace.** Economic tension sometimes results in political tension and political tension sometimes results in disasters. We have seen in the 1930s, how for short term gains, countries raised their tariff barrier which resulted in political tension all over Europe. This resulted in the great depression of the 1930s and became one of the biggest reasons of World War II.

   This has not happened since the inception of the WTO. Now nations don't have to go to war to decide these issues because now they come to the round table at WTO and discuss the matter and resolve the issues. Erstwhile economic and political arch rivals China, USA, Russia, Cuba, Poland, etc., sit together and discuss the matter and decide the rules of trade. These arch rivals today discuss how they can avail opportunities available with them. All this results in an economic harmony, which is a sound base for political peace.

2. **Disputes are handled constructively.** Since its inception from 2005, some 300 issues have been brought to the WTO. As said earlier, it gives a platform to countries to resolve their issues. As trade rises among countries, so do the complexities and all this results in more disputes. WTO not only provides rules to resolve the issues, it also provides a platform where the countries can bring their issues and provides a well-defined procedure to reach a solution.

3. **Rules make life easier for all.** WTO works on the principle of consensus and non-discrimination. Unlike other international forums, it doesn't work on the principle of majority. Here, every country has equal rights and the voting power is not decided by the power of wealth.

   It reduces the inequalities and gives more power to smaller countries to raise there voice. It gives the smaller countries opportunities to form alliances and to pool resources. Many are doing, like the Cairns group.

   On the other hand, it gives opportunities to economic powers to simultaneously discuss trade issues with many countries. All this results in a conducive environment to trade and to talk trade.

   Because the WTO decides the rules for all the procedures, it results in a more systematic environment.

4. **Freer trade cuts the cost of living.** If customs duties were also to be eliminated, economists calculate the result could be a gain to the world of around \$23 billion, including \$12.3 billion for the US, \$0.8 billion for Canada, \$2.2 billion for the EU and around \$8 billion for developing countries. (WTO.org). Because of restriction on imports, the country and the consumer have to pay high price. Often resources of the country get wasted in producing uneconomical goods which can't be exported and which can be easily be imported at a much lesser price, but the consumer pays a high price for those goods when they could be available at cheaper rates through imports. The WTO makes it possible to have access to the better products at lower cost, thus, improving the standard of living.

5. **It provides more choice of products and qualities.** Restriction on international trade restricts the choice of consumer. Many a times, the consumer is compelled to purchase substandard goods and overpriced goods. His choice is also restricted as he is left with a limited number of options. It is very harmful for the industry, as it has to compromise on the quality of final product because

of lack of desired quality of components. WTO gives consumers a wide variety of options available all over world. It gives the industry to choose components available all over world, so in a sense WTO makes the world a better place to live.

6. **Trade gives impetus to economic growth and raises incomes.** The WTO's own estimates for the impact of the 1994 Uruguay Round trade deal were between $J09 billion and $510 billion added to world income (depending on the assumptions of the calculations and allowing for margins of error). WTO increases the level of income of its member countries. It gives them various opportunities in terms of trade avenues, in terms of increased productivity, in terms of giving new employment opportunities. In India itself millions of jobs have been created in the field of telecommunication, software, manufacturing, infrastructure, and above all in BPOs. India is becoming the centre for back office operations of the world.

7. **Free trade reduces the manufacturing cost.** WTO helps in decreasing cost and increasing efficiency. It provides opportunities for availing of economies of scale and use the opportunity to use the best technology and components available in the market.

   More than this it helps by maintaining uniform policies and transparency that keeps people and countries aware of the policies of nations. It increases profitability and reduces cost by creating an environment of certainty because now organizations can operate in a more certain environment. Its biggest role is trade facilitation i.e. simplification and standardisation of customs procedure, removal of red tape, centralised databases of information, and other measures designed to simplify trade that come under its purview.

8. **Governments are shielded from lobbying.** Governments are better-placed to defend themselves against lobbying from narrow interest groups by focusing on trade-offs that are made in the interests of everyone in the economy.

9. **The system encourages good governance.** Under WTO rules, once a commitment has been made to liberalise a sector of trade, it is difficult to reverse the same. The rules also discourage a range of unwise policies. For businesses, that means greater certainty and clarity about trading conditions. For governments it can often mean good discipline. In fact after accepting the WTO agreement nations accept in broad terms to follow a particular economic policy It is especially

helpful in good governance in a multiparty system because thereafter, to give advantage to a certain sector, the government cant change the policy.

In fact, in India, we witnessed frequent changes in rates between 1950 and 1995. On the other hand, after 1995 whichever government came to power followed a predefined tariff policy. This shows commitment of all political parties to the WTO agreement.

5.1.8 Dispute Settlement

There is no use having rules and procedures and multilateral agreement unless and until there is a proper body to resolve disputes. The objective of WTO is to harmonise international trade, and it is not possible without having a proper dispute settlement process.

In WTO, the Dispute Settlement Body consists of all its members. This body appoints a panel of experts to consider the case. It has the authority to accept or reject the findings of the panel. It monitors the implementation of the rulings and recommendations, and has the power to authorise retaliation when a country does not comply with a ruling. The dispute settlement process has the following stages:

- **First Stage: Consultation (up to 60 days)**

  In the first stage countries in dispute talk with each other and try to solve the issue mutually and if they fail to do so they can seek the mediation of WTO director-general to get help in resolving issue.

- **Second Stage: The panel**

  In case consultation fails, the complaining countries can ask for appointment of the Panel.(up to 45 days for a panel to be appointed, plus 6 months for the panel to conclude).

  If the panel decides that the disputed trade measure does break a WTO agreement or an obligation, it recommends that the measure be made to conform with WTO rules. The panel may suggest how this could be done.

  The report becomes the Dispute Settlement Body's ruling or recommendation within 60 days unless a consensus rejects it. Both sides can appeal against the report.

  The report of the panel can be rejected by consensus in the Dispute Settlement Body, so its conclusions are difficult to overturn. The panel's findings should be based on the agreements cited.

The panel's final report should normally be given to the parties to the dispute within six months. In cases of urgency, including those concerning perishable goods, the deadline is shortened to three months.

- **Appeals**

  Either side can appeal a panel's ruling. Each appeal is heard by three members of a permanent seven- member appellate body set up by the Dispute Settlement Body. Members of the Appellate Body have four-year terms. They have to be individuals with recognised standing in the field of law and international trade, not affiliated with any government. The appeal can uphold, modify or reverse the panel's legal findings and conclusions. The Dispute Settlement Body has to accept or reject the appeal's report within 30 days — and rejection is only possible by consensus.

- **The Rulings**

  The Dispute Settlement Agreement stresses that, "prompt compliance with recommendations or rulings" of the Dispute Settlement Body (DSB) is essential in order to ensure effective resolution of disputes to the benefit of all Members.

5.2 WTO Agreements

5.2.1 Agrement on Agriculture (AOA)

GATT allows countries to use some non-tariff measures such as import quota and subsidies. The Uruguay Round produced the first multilateral agreement dedicated to the Agriculture sector. It was implemented over a six-year period and for developing nations that began in 1995.

Tariff on Agriculture

Tariff on all agricultural products are now bound. Almost all import restrictions besides tariffs have been converted to tariffs, a process known a"tariffication". The first step in "tariffication" is to replace these restrictions with a tariff that represents about the same level of protection. Then, over six years from 1995 to 2000, the tariff gradually reduced (the reduction period for developing countries end in 2005). In addition, it includes countries' commitment to reduce domestic support and export subsidies on agricultural product.

The new rules and commitment apply to :

1. Market Access

The WTO supports tariffication in the field of Agriculture. It has replaced all non-tariff barriers in the field of agriculture by Tariffs giving the same level of protection as provided by the previous policy.

Even for the product whose tariffication has been done, the governments were allowed to take special emergency action ("special safeguard") in order to prevent falling prices or urge in import from hurting their farmer.

Four countries used the "special treatment" provision to restrict import of particular products, mainly rice, during the implementation period (to 2000 for developed countries, to 2004 for developing ones). These four countries were: Japan, South Korea, and the Philippine for rice; and Israel for sheepmeat, wholemilk powder and certain varities of cheese.

2. Domestic Support

The Agriculture Agreement distinguishes between agriculture support programmes of Govt, as policies that do not have a direct effect on production and trade that do have a direct impact. Policies which have a direct impact on production and trade have to be cut back.

This category of domestic support is sometimes called the "amber box."

Measures that have minimal impact on trade can be used freely—they are in a "green box". They include government services such as research, disease control, infrastructure, and food security. They also include payment made directly to the farmer that do not stimulate production, such as certain forms of direct income support, assistance to help farmers in restructuring agriculture and direct payment under environmental and regional assistance programme.

Also permitted, are certain direct payments to farmers. Here the farmers are required to limit production (sometimes called "blue box" measure), certain government assistance programmes to encourage agricultural and rural development in developing countries, and other support on a small scale ("de minimis") when compared with the total value of the product or product supported (5% or less in the scale of developed countries and 10% or lesser for developing countries).

3. Export Subsidies

The Agriculture Agreement prohibits export subsidies on agricultural products except those specified in a member's list of commitment. Even if they are listed, the agreement requires WTO members to cut both the amount of money they spend on export subsidy and the quantities of export that receive subsidies.

Taking the average for 1986—90 at the base level, developed countries agreed to cut the value of export subsidies by 36% over the six years starting in 1995 (24% over 10 years for developing countries). During the six-year implementation period, developing countries are allowed, under certain conditions, to use subsidies to reduce the cost of marketing and transporting export.

WTO makes certain measures for the provision of food aid and aid for agricultural development of the least developed and poor countries because they cannot afford costly imports and need assistance to export.

5.2.2 Multi - Fibre Agreement (MFA)

Introduction

Over the periods of time different agreements was established on international textile sector to make the sector more strong, independent and self reliant. Today we can see that the textile is one of the most influencing sectors on international business and economy. There are many country in the world that's economy is mostly dependent on textile. The objects of different agreement were also different. MFA was one of the agreements which were introduced by USA and EU for developing countries.

5.2.2.1 History of Approving

Exports of textiles and clothing from developing countries have long faced restrictive blocks to their exports called quotas. Brought in force as a temporary relief measure in favour of the domestic textile manufacturers in the developed countries, it has been in force for 40 years now. In 1962, a Long Term Agreement (LTA) regarding international trade in cotton textiles was signed. It replaced the one-year Short Term Agreement that existed at the time. LTA underwent several renewals and was subsequently replaced by the Multi Fibre Agreement (MFA) in 1974.

The Multi-Fiber Agreement was set up in 1974 as a set of formal quota agreements and restrictions, governing textiles and the clothing trade between developing countries and the developed world. The MFA replaced the 1964 Agreement in International Trade in Cotton Textiles.

Under the MFA, the United States and the European Union restricted imports from developing countries in an effort to protect their own domestic industries. Under the agreement, each developed country was assigned a quota or quantities of a specific item which could be exported to the U.S. and EU.

Meaning of Multi-Fiber Arrangement

The Multi Fiber Arrangement (MFA, also known as the Agreement on Textile and Clothing (ATC)) governed the world trade in textile and garments from 1974 through 2004, imposing quotas on the amount developing countries could export to developed countries. It expired on 1 January 2005.

The MFA was introduced in 1974 as a short-term measure intended to allow developed countries to adjust to imports from the developing world. Developing countries have a natural advantage in textile production because it is labor intensive and they have low labor costs. According to a World Bank/International Monetary Fund (IMF) study, the system has cost the developing world 27 million jobs and $40 billion a year in lost exports.

So in a word an international trade agreement on textile and clothing that was active from 1974 till 2004. The agreement imposed quotas on the amount that developing countries could export in the form of yarn, fabric and clothing to developed countries.

MFA came into force to allocate export quotas to the low cost developing countries, limiting the amount of imports to countries whose domestic industries were facing serious challenge from rapidly increasing imports. It sought to expand trade, reduce barriers to trade and progressively liberalize world trade.

5.2.2.2 Objects of MFA

There are a number of reasons cited for the introduction of the MFA, although the most widely accepted is that of the developed world using it as a form of protectionism to secure their own textile industries against the threat posed by low-cost competition from less developed countries.

However, by giving quotas to individual nations, it also gave them a guaranteed share of the rich countries.' (BBC News, 2004) This is in contrast to some other justifications for the MFA, for example 'a major aim of the multi-fibre agreement has been to provide greatest scope for newly industrialized countries to increase their share of world trade in textile products whilst at the same time maintaining some stability for textile production in the developed economies.'

5.2.2.3 Effects after removing MFA

In 1994, as part of the Uruguay Round of multilateral trade negotiations, it was decided that the MFA should be phased-out by January 1st 2005, as part of the Agreement on Textiles and Clothing. This was to ensure that the clothing and textile industry become better aligned with the principles of WTO, and the promotion of free trade. However, large tariffs remain in place on many textile products.

Bangladesh was expected to suffer the most from the ending of the MFA, as it was expected to face more competition, particularly from China. However, this was not the case. It turns out that even in the face of other economic giants; Bangladesh's labor is "cheaper than anywhere else in the world." While some smaller factories were documented making pay cuts and layoffs, most downsizing was essentially speculative – the orders for goods kept coming even after the MFA expired. In fact, Bangladesh's exports increased in value by about $500 million in 2006.

After Effects on Other Countries

There will be a number of beneficiaries from the removal of the MFA. China is going to be by far the largest gainer from removal of quotas, the level of Chinese clothing exports raised from 11 million units in 1995 to 213 million units in 2004.

During early 2005, textile and clothing exports from China to the West grew by 100% or more in many items, leading the US and EU to cite China's WTO accession agreement allowing them to restrict the rate of growth to 7.5% per year until 2008. In June, China agreed with the EU to limit the rate to 10% for 3 years. No such agreement was reached with the US, which imposed its own import growth quotas of 7.5% instead.

When the EU announced their new quotas to replace the lapsed MFA, Chinese manufacturers accelerated their shipping of the goods intended for the European market. This used up a full year's quota almost immediately. As a result, 75 million items of imported Chinese garments were held in European ports in August 2005. A diplomatic resolution was reached at the beginning of September 2005 during Tony Blair's visit to China, putting an end to a situation the UK press had dubbed "Bra Wars".

'The end of a global quota system means that Cambodia will have to compete with larger and cheaper rivals, like China and Vietnam. The garment industry provides jobs for 270,000 people in Cambodia and is the country's biggest industry by some distance.

The removal of quotas is likely to have political, consumer and efficiency implications for the countries involved. Politically, this is likely to test the ability of the

WTO to influence multinational trading agreements. The knock-on effect of removing quotas should also be an overall increase in efficiency as greater competition is introduced into the market, and removes the distortions to world market prices.

The removal of the MFA is unlikely to benefit everyone, and smaller producers, and those with higher costs, such as South Africa, may lose out from its removal. Competition levels are also likely to increase following the removal of quotas, with those countries which depend on clothing and textiles exports likely to suffer the most, such as Mauritius, Bangladesh, and Lesotho. (BBC News, 2004)

5.2.3 Trade Related Intellectual Property Rights (TRIPS)

The WTO Agreement on Trade-Related Aspect of Intellectual Property Right (TRIPS), negotiated in the 1986-94 Uruguay Round, introduced intellectual property rule into the multilateral trading system for the first time. The WTO TRIPS Agreement is an attempt to narrow the gap in the way rights are protected around the world, and to bring them under common international rules.

As GATT and GATS, TRIPS also works on the principle of treating national and foreigner players equally and giving equal treatment to nationals of all trading partners in the WTO.

TRIPS agreement has an additional important principle of intellectual property protection, that is, it should contribute to technical innovation and the transfer of technology. It says that both producer and user should benefit, and economic and social welfare should be enhanced.

TRIPS provide adequate protection of intellectual property in the following categories :

1. **Copyright:** The TRIPS agreement says that computer programs will be protected as literary work is under the Berne Convention and outlines how database should be protected.

   It also expands the international copyright rule to cover rental right. For instance, authors of computer programmes and producers of sound recording must have the right to prohibit the commercial rental of their work to the public.

   A similar exclusive right is applied to films.

   The agreement also says a performer must also have the right to prevent unauthorised recording, reproduction and broadcast of live performances for no less than 50 years. The producer of sound recording must have the right to prevent the unauthorised reproduction of recording for a period of 50 years.

2. **Trademark:** The agreement defines the type of sign that must be eligible for protection as a trademark, and it describes the minimum rights of trademark owners. According to that, a service mark must be protected in the same way as trademark used for goods.

3. **Geographical indications:** This tool gives protection to goods that can be identified as originating or manufactured in the territory of a country, or a region or locality in that territory where a given quality, reputation or other characteristics of such goods is essentially attributable to its geographical origin.

   The name of a place is sometimes used to identify a product. This "geographical indication" does not only say where the product is made but also identifies its special characteristics, which are the result of the product's origin.

   Well-known examples include "Champagne", "Scotch", "Tequila", and "Roquefort" cheese. Wine and spirit makers are particularly concerned about the use of place and name to identify a product and the TRIPS Agreement contains special provisions for these goods.

   But using the name of a place when the product is made elsewhere or when it does not have the usual characteristics, it can mislead a consumer, and can lead to unfair competition. The TRIPS Agreement say countries have to prevent misuse of place and name.

   Some exceptions are allowed, for example, if the name is already protected as a trademark or if it had become a generic term. But any country wanting to make an exception for this reason must be willing to negotiate with the country that wants to protect the geographical indication in question.

4. **Industrial designs:** Under the TRIPS Agreement, industrial design must be protected for at least 10 years.

   It must be able to prevent the manufacture, sale or importation of article bearing or embodying a design which is a copy of the protected design.

5. **Patents:** The agreement says that patent protection must be available for invention for at least 20 years. Patent protection must be available for both product and process, in almost all fields of technology. The government can refuse to issue a patent for an invention if its commercial exploitation is prohibited for reason of

public order or morality. They can also exclude diagnostic, therapeutic and surgical methods, plant and animal (other than micro organism), and biological process for the production of plant or animal (other than microbiological processes).

Plant varieties, however, are protected by patent or by a special system (such as the breeder's right provided in the convention of UPOV — the International Union for the Protection of New Varieties of Plant). The agreement describes the minimum right that a patent owner must enjoy. But it also allows certain exceptions. A patent owner could abuse his right, for example, by failing to supply the product in the market. To deal with the situation, Article 31 of TRIPs provides the provision of compulsory licensing, which means a situation where a government allows an agent to produce a patented product without the consent of the original patent owner. If attempts to obtain the right to produce a patented product from a patentee fails, and if a compulsory license is issued, then adequate remuneration will paid to the original rights holder.

If a patent is issued for a production process, then the right must extend to the product directly obtained from the process. Under certain conditions, alleged infringers may be ordered by a court to prove that they have not used the patented process.

6. **Layout Design for Integrated Circuit :** The scope of layout design for integrated circuit is to protect the chip and also the articles incorporated on it. TRIPS says that here protection must be given for ten years.

7. **Undisclosed Information and Trade Secrets:** Trade secrets and other types of "undisclosed information" which have commercial value must be protected against breach of confidence and other acts that are contrary to honest commercial practices. But reasonable steps must be taken to keep the information secret. A test data submitted to the government to obtain marketing approval for new pharmaceutical or agricultural chemicals must be protected against unfair commercial use.

8. **Curbing anti-competitive Licensing Contracts:** The owner of a copyright, patent or other form of intellectual property right can issue a license for someone else to produce or copy the protected trademark, work, invention, design, etc. The agreement recognises that the term of a licensing contract could restrict competition or impede technology transfer. It says that under certain conditions,

governments have the right to take action to prevent anti-competitive licensing that abuse intellectual property rights. It also says governments must be prepared to consult each other on controlling anti-competitive licensing.

Para 3 of TRIPS states that a government should take steps to implement TRIPS. It further states that the government should impose tough penalties to check the infringement, and should keep the procedure easy, fair and equitable.

9. **Transition Arrangements:** Developed countries were given one year since the implementation of TRIPs that is since 1 January, 1995, to ensure that their law and practice conforms with the agreement. Developing and transition countries have to implement it in five years and the least developed countries have the flexibility to execute it after 11 years that is until 2006, which can be extended to 2016 for pharmaceutical patent.

5.2.4 Trade Related Investment Measures (TRIMS)

Investment Measures (TRIMS)

TRIMS states that no member shall apply any measure that discriminates against foreigners or foreign products (i.e. violate “national treatment” principle in GATT). It also outlaws investment measures that lead to restriction in quantities (violating another principle in GATT). It restricts the measures as ‘local content requirement’ which compels the enterprise to use particular level of local components, or which set restrictions on the level of import which an enterprise can do or which set the target for the company to export (trade balancing requirement).

TRIMs (Trade Related Investment Measures)

TRIMs has the following significant features :

1. Abolition of restriction is imposed on foreign capital.
2. No restrictions on any area of investment.
3. No limitation or ceiling on the quantum of foreign investment. In other words participation of foreign equity should be allowed upto 100%.
4. Granting of permission without restrictions to improve raw material and other components.
5. No force on the foreign investors to use total products or materials.
6. Export of the part of the final product will not be mandatory.
7. Restrictions on repartiation of divided, interest and royalty will be removed.
8. Phased manufacturing programme will be introduced to increase the domestic contact of the manufacture.

5.2.5 General Agreement on Trade in Services (GATS)

GATS is the first and only set of multilateral rules governing international trade in service. Negotiated in the Uruguay Round, it was developed in response to the huge growth of the service economy over the past 30 years and the greater potential for trading service brought about by the communication revolution.

General Obligations and Disciplines

The agreement covers all internationally-traded services like banking, telecommunication, tourism, professional services, etc. It also defines four ways (or 'modes') of trading service :

1. Service supplied from one country to another (e.g. international telephone calls), officially known as "cross -border supply" (in WTO jargon, 'mode 1').
2. Consumer or firm making use of a service in another country (e.g. tourism), officially "consumption abroad" ('mode 2').
3. A foreign company setting up subsidiaries or branches to provide services in another country (e.g. foreign bank setting up operation in a country), officially 'commercial presence' ('mode 3').
4. Individual travelling from their own country to supply service in another (e.g. fashion model or consultant), officially 'presence of natural person' ('mode 4').

MFN means treating one's trading partner equally on the principle of non-discrimination. Under GATS, if a country allows foreign competition in a sector, equal opportunities in that sector should be given to the service provider from all other WTO members. Governmental services are explicitly carved out of the agreement and there is nothing in GATS that forces a government to privatise service industries. In fact, the word 'privatise' does not even appear in GATS.

Governmental services are defined in the agreement as those that are not supplied commercially and do not compete with another supplier. These services are not subject to any GATS discipline.

1. Transparency

GATS says that a government must publish all relevant law and regulation, and set up an enquiry point within their bureaucracies. And they have to notify the WTO of any change in regulation that applies to the service that comes under their specific commitment.

2. Regulation

GATS does not require any service to be deregulated. It says that the government should regulate services reasonably, objectively and impartially. The government naturally retains their right to set the level of quality, safety, or price, or to introduce regulation to pursue any other policy objective they see fit.

3. Recognition

When two (or more) governments have an agreement to recognise each other's qualification (for example, the licensing or certification of a service supplier), GATS says another member must also be given a chance to negotiate a comparable pact. The recognition of other countries' qualification must not be discriminatory, and it must not amount to protectionism in disguise. These recognition agreement have to be notified to the WTO.

4. International Payment and Transfer

It says that if once the government has opened the service sector to foreign competition then it should not restrict transfer of money out of country as a payment for service supplied ("current transaction") in that sector.

The Uruguay round was the beginning of negotiations on GATS. Negotiations are still going on in WTO on GATS as today the service sector is a dominant sector of world economics and it is more dominant in the case of developed economies. Developed and developing economies both have their reservations and interest on the issue of services. In India itself, there are parties who favour globalisation today but are not so liberal on the issue of services, especially in the case of financial services.

5.3 Barriers to Trade

Trade and nor-tariff barriers (NTBs) which have come up around the globe, following the formation of WTO, have hurt the exports from developing countries. As far *as India* is concerned, the report on NTBs prepared by the trade policy division of the Union Commerce ministry sometime ago identified 13 different non-tariff barriers put up by 16 countries against India.

The report found that as far as textile exports are concerned, the MFA (multi-fibre arrangement) pur up by the USA and European Union has been a major barrier MFA stands dissolved from January, 1, 2005. As far as agricultural exports are concerned, NTBs in this category include import alert on shrimps by the USA, EU regulations on fish products, Saudi Arabian ban on frozen fish and products, ban on use of pesticides in mangoes, bananas, grapes and potatoes, sales tax discrimination by Australia, restrictions on tea by EU and Japan, on sesame, tobacco and cut flowers by Japan, on milk products by EU and on meat by Saudi Arabia and EU. The other NTS hitting India is the use of human rights issues like child labour by US, Canada and EU, constant threat of Special 301 by the US against drugs" and pharmaceuticals exports, use of standard specifications and export subsidies as NTBs and stalling movement of personnel from India.

Barriers are classified into two types, i.e.,

1. Trade barriers (TARIFF)
2. Non-trade barriers.

5.3.1 Trade barriers (TARIFF)

Definition of Tariff

Tariff is derived from a French word which means rate, price or list of changes. It is a customs duty or a tax on products that move across borders. Tariffs can be classified in several ways.

5.3.2 Types of Tariffs

1. Import and Export Tariffs

Tariffs are often imposed on the basis of the direction of product movement that is, on imports or exports, with the latter being the less common. When export tariffs are levied, they usually apply to an exporting country's scarce resources or raw materials (rather than finished manufactured products).

Companies exporting from Russia must pay an average export tariff of a about 20 percent on a number of goods sold in cash transactions and an average export tariffs of about 30 percent for goods sold to non-cash (barter) transactions.

2. Protective and Revenue Tariffs

Tariffs can be classified as protective tariffs and revenue tariffs, based on purpose. The purpose of protective tariff is to protect home industry, agriculture and labour against foreign competitors by trying to keep foreign goods out of the country.

The South American markets, for instance have high import duties that hinder the import of fully built cars.

The purpose of a revenue tariff in contrast is to generate tax revenues for the government. When compared to a protective tariff, revenue tariff is relatively low. When Japanese and other foreign cars are imported into the United States, there is a 3 percent duty.

On the other hand, American cars exported to Japan are subjected to a variety of import taxes. Even the cost of shipping is taxed, since Japan considers that the shipping cost adds value to a car.

As a result, a U.S. Car sold in Japan can easily cost twice as much as its price in the United States. The U.S. Tax is a revenue tariff whereas the Japanese tax is more of a protective tariff.

3. Tariff Surcharge versus Counter vailing Duty

Protective tariffs can be further classified according to length of time. A tariff surcharge is a temporary action, whereas a countervailing duty it a permanent surcharge.

Countervailing duties are imposed on certain imports when products are subsidized by foreign governments. These duties are thus accessed to offset a special advantage or discount allowed by an exporter's government. Usually, a government provides a an export subsidy by rebating certain taxes if goods are exported.

4. Specific, Ad Valorem and Combined

Specific duties are a fixed or specified amount of money per unit of weight, gauge or other measure of quality. Based on a standard physical unit of a product, there are specific rates of so many rupees for a given unit of measure.

Product costs or prices are irrelevant in this case. Because the duties are constant for low and high priced products of the same kind, this method is discriminatory and effective for protection against cheap products because of their lower unit value. That is, there is a reverse relationship between product value and duty percentage. As product price goes up, a duty when expressed as a percentage of this price will fall.

5. Distribution and Consumption Taxes

Some taxes are collected at a particular point of distribution or when purchases and consumption occur. These indirect taxes, frequently adjusted at the border, are of four kinds : Single stage, Value added, Cascade and Excise.

Single-stage sales tax is a tax collected only at one point in the manufacturing and distribution chain. This tax is perhaps most common in the United States, where retailers and wholesalers make purchases without paying any taxes simply by showing a sales tax permit. The single-stage tax is not collected until products are purchased by final consumers.

5.3.3 Reasons for Trade Barriers

a) Price-based Barriers

Price-based barriers are also known as tariffs. Tariffs are the taxes imposed on imports. Tariffs are of two types, i.e., specific tariffs and ad valorem tariffs.

The specific tariffs levied as a fixed change for each unit of the product imported are known as specific tariffs. For example, a tariff of Rs. 1500 on each TV imported. Ad Volorem tariff is the tariff levied as a proportion of the value of the imported goods. For example, an imposition of 30 percent tax on the value of computers imported.

b) Quantity Limits

Quantity limits are also known as quotas. An import quota is a direct restriction on the quantity of some goods that may be imported into a country. A variant on the import quota is the voluntary export restraint (VER). It is a quota on trade imposed by the exporting country, typically at the request of the importing country's government.

c) International Price Fixing

It is also known as cartels. Cartels normally control prices and are often accompanied by output and investment quotas for making the price control effective.

d) Financial Limits

Financial limits are restrictive monetary policies designed to control capital, flow, so that currencies can be defended or imports can be controlled.

e) Foreign Investment Controls

Countries possess restrictions on what foreigners may own in their country. This is based on the pressure that domestic land, assets, and industry in general should be held by residents of the country.

5.3.4. Non-Tariff Barriers

Non-tariff barriers affects price or quantity that has been adversely affected by tariffs. Due to the erosion of tariffs as an activity of protecting domestic countries or competition of foreign countries, the non-tariff barriers have emerged as political and protective measure. Nor tariff barriers are of two kinds. They are,

1. Price influencing NTBs
2. Quantity influencing NTBs.

5.3.4.1 Price Influencing Non-tariff Barriers (NTBs)

The NTB's which influence price includes as,

i) Subsides

ii) Aid and loans

iii) Custom valuation

iv) Anti-dumping Actions

v) Administered minimum price levels

vi) Custom deposits and special fees

vii) Countervailing duties.

i) Subsides. Subsidy is a help given by the government in terms of monetary value to the local firms in order to make them competitive. Due to the subsidy the operation cost of the firm's comes down which leads to make them more competitive both in terms of quality subsidy is use of public funds to make an a industry competitive. The payment made by the government to the firms can be direct or indirect. The agricultural subsides are the most common one in occurrence in many of the countries and when local farmers are given these subsides they will be much competitive enough with the other countries exporting similar kind of agricultural products. As a result, the subsides become a non- tariff barrier to the other countries products.

a) Indirect subsides

b) export subsides

c) Conditional subsides.

The above three are the different types of subsides given.

a) **Indirect Subsides :** When some of the inputs expenses are bearable by the government out of public funds it is termed as "Indirect subsidy" the indirect subsides are quite difficult to differentiate. In order to make "international trade free. WTO is striving hard to reduce NTBs.

b) **Export Subsides :** It have been said as china sells corn at lower prices as compared to the world price and below the cost of domestic procurement. It is an export subsidy. Through the strategies of pool pricing, cross subside nation long-term supply agreements made between government the China, Canada and Australia are creating defect export subsides. WTO is making efforts to discourage such practices.

c) **Conditional Subsides** Subsidy made on conditions.

Example. "Subsidy required to meet certain export targets or to use domestic goods instead of imported goods are being abolished by the WTO. They are being abolished on the grounds that they are made to distort the international trade and which hurts the other countries. And if the dispute settlement concept of WTO confirms that the-subsidy is abolished, then it should be withdrawn immediately. Otherwise the complaining country can take counter measures,

ii) **Aids and Loans.** The Government also sanction aid and loans to other countries. If the recipient spend the funds in the donor country, it is called as "tied aid or tied loans", some products can compete abroad that might be non competitive. The Tied Loans of Tied aid helps in winning contracts for infrastructure like Telecommunications railways etc. The Tied aid may slows down the development of local suppliers and shields suppliers of the donor countries from competition.

iii) **Custom Valuation.** For exporter and importer a temptation exists for the declaration of low prices on invoices in order pay slow "ad valorem tariff'. Customs officials must declare invoice price. And if the doubt arises on the authencity of it then enhancement should be made on the basis of value of identical goods. Hence this procedure is adopted for custom valuation as it is difficult for the custom officials to determine the honesty of import invoices.

iv) **Anti Dumping Actions.** Exporting a product at a relatively low price than the normal actual price in its home market, it is said to be 'dumping' the product which makes the company to suffer loss in export, for the effort of getting a slice of overseas market. A country fears that foreign company can use its financial strength to suffer losses for extended periods till they captures the entire domestic market. Thus, the company being in monopolistic situation charges any price to recover its initial losses. Dumping the products, capturing the overseas market, marginalizing the domestic players and milking the market. The developing countries scared of dumping of products by the developed countries.

v) **Administered Minimum Price Levels.** Entry of overseas product at low price may be set by the importing country. This will limit the competitiveness of overseas product in the importing country. The foreign product can be competitive enough on the basis of its quality but not considering cost. It acts as a tariff measure.

vi) **Custom Deposits and Special Fees.** Increase in the cost of the imported goods by paying deposits as an advance of customs of the shipment. This advance paying of custom act as a financial hurdles to the foreign export. And some pays the special fees at customs for making expensive and less competitive import.

vii) **Countervailing Duties.** If an importing country gets hurt because of the subsides in exporting country, then the importing country can use the WTO's dispute settlement for the removal of the effect of subsidy. Or else the country can start its own investigation and charge extra duty. This extra duty is said to be as countervailing duties.

5.3.4.2 Quantity Influencing Non-tariff Barriers

The NTB's which are quantity influencing includes as,

i) Quotas

ii) 'Buy local' legislation,

i) **Quotas.** The quotas are the restrictions made on the imports of products. The quotas can be of maximum value/maximum number of goods. The aim of import quotas is to limit the competition for the domestic products producers. Quotas are allocated on the basis of country, product, or by category of product. The importing country will confined with different quotas for different countries and also for different products and its categories.

a) **Multi Fiber Arrangement :** It is one of the major example of Quota the Multi Fiber Arrangement (MFA). It was emerged in 1974. MFA in the quotas on textiles and garments. Several countries had a competitive merit on highly-labour intensive textile and clothing of the developed countries. So, these quotas have been brought into. The MFA resulted in shifting of textile and clothing from developed countries to the developing ones.

The shifting of textiles and clothing due MFA creates opportunity for the challenges of the market to the developing countries. The most countries will depend upon the production capacities basis cost of production, availability of the inputs, ready infrastructure and supply chains, financing ability and nearness to the market for facing challenge.

b) **Export Quotas and Other Quotas :** To protect and conserve the natural resources the export quotas exists and also for the purpose of influencing the word pricing of the product. Export quotas are intended to regulate the supply of resources in the world and also control the price.

There are different forms of quotas given as,

- Global quotas
- Bilateral quotas (in between 2 countries) f > Seasonal quotas
- Quotas linked with performance of export
- Quotas linked with purchase of local goods
- Quotas for sensitive product category.

From all export linked import quotas are very commonly used in India.

ii) **'Buy Local' Legislations.** It is another form of trade control of NTB's Quantity influencing. The maximum part of total expenditures in many of the countries is government purchases and domestic producers are more favourable by the government. At times government restricts the domestic content which means a percentage of goods should be of local origin and at times favours through price mechanism the domestic procedures. These are the "buy local" laws.

Reasons for Non-tariff Barriers

Tariffs though generally undesirable, are at least straightforward and obvious. Non-tariff barriers, in comparison are more elusive or non-transparent. Tariffs have declined in importance. While non-tariff barriers have become more prominent.

There are several hundred types of non-tariff barriers. These barriers can be grouped in five major categories. Each category contains a number of different non-tariff barriers.

1. Government Participation in Trade

The degree of government involvement in trade varies from passive to active. The types of participation include administrative guidance, state trading and subsidies.

a) **Administration Guidance :** Many governments routinely provide trade consultation to private companies. Japan has been doing this on a regular basis to help implement its industrial policies. The systematic co-operation between the government and business is labeled "Japan.Inc".

To get private firms to conform to the Japanese government's guidance, the government, the government uses carrot-and-stick approach by exerting influence through regulations, recommendations, encouragement, discouragement, or prohibition.

b) **Government Procurement and State Trading :** State trading is ultimate in government participation, because the government itself is now the customer or buyer who determines, what, when, where, how, and how much to buy. In this practice the state engages in commercial operations, either directly or indirectly, through the agencies under its control.

Such business activities are either in place of or in addition to private firms. Although government involvement in business is most common with the communist countries, whose governments are responsible for the central planning of the whole economy, the practice is definitely not restricted to those nations.

When the government is further involved in reselling imported products, matters become even more complicated. American Tobacco companies complained that Japan's Tobacco and Salt Agency kept prices of their products artificially high and that sales representatives from the government tobacco monopoly participated in discrediting the advertising of American products.

c) **Subsidies :** According to GATT, "subsidy is a 'financial contribution' provided directly or indirectly by a government and which confers a benefit".

Subsidies can take many forms including cash, interest rate, value-added tax, corporation income tax, sales tax, freight, insurance and infrastructure. Subsidized loans for priority sectors, preferential rediscount rates, and budgetary subsidies are among the various subsidy policies of several Asian countries.

There are several other kinds of subsidies that are not so obvious. Brazil's rebates of the various taxes, coupled with other forms of assistance, can be viewed as subsidies. Sheltered profit is another kind of subsidy. A country may allow a corporation to shelter its profit from abroad.

2. Customs and Entry Procedures

Customs and entry procedures can be employed as non-tariff barriers. These restrictions involve classification, valuation, documentation, licence, inspection and health and safety regulations.

a) **Classification :** How a product can be classified can be arbitrary and inconsistent, and often is based on a customs officer's judgement, at least at the time of entry. Product classification is important because the way in which a product is classified determines its duty status. A company can sometimes take action to affect the classification of its product.

   For example, A ruling of the U.S. Customs resulted in a 100 percent punitive tariff on certain Japanese computers. Most countries ban obscene, immoral and seditious materials, as well as imports of counterfeit coins, bills, securities, postage stamps and narcotics.

b) **Valuation :** Regardless of how products are classified, each product must still be valued. The value affects the amount of tariffs levied. A customs appraiser is the one who determines the value.

   The process can be highly subjective, and the valuation of product can be interpreted in different ways, depending on what value is used and how this value is constructed.

c) **Documentation :** Documentation can present another problem at entry because many documents and forms are often necessary, and the documents required can be complicated. Documentation requirements vary from country to country.

Usually the following documents are either required for requested : commercial invoice, proforma invoice, certificate of origin, bill of loading, packaging list, insurance certificate, import licence, and shipper's export declarations.

Without proper documentation, goods may not be cleared through customs. At the very least, such complicated an lengthy documents serve to slow down product clearance.

d) **Licence Permit :** Not all products can be freely imported, controlled imports require license or permits. For example, importations of distilled spirits, wines, malt beverages, arms, ammunition and explosives into United States require license. India requires license for almost all imported goods except those, which have been placed on Open General License (OGL) list.

An article is considered prohibited if not accomplished by a license. It is not always easy to obtain an important license, since many countries will issue one, only if goods can be certified as being necessary.

e) **Inspection :** Inspection is an integral part of product clearance. Goods must be examined to determine quality and quantity. This step is related to other customs and enter procedures. First, inspection classifies and values products for tariff purposes.

Second, inspection reveals whether imported items are consistent with those specified in the accompanying documents and whether such items require any licenses.

Third, inspection determines whether products meet health and safety regulations in order to make certain that food products are fit for human consumption or that the products can be operated safely.

Fourth, inspection prevents the importance of prohibited articles. Inspection can be used intentionally to discourage imports.

3. Product Requirements

For goods to enter a country, product requirements set by the country must be met. Requirements may apply to product standard and product specifications as well as to packaging, labeling and marketing.

a) **Product Standards :** Each country determines its own product standards to protect the health and safety of its consumers. Such standards may also be erected as barriers to prevent or to slow down importation of foreign goods.

Standards set by countries make it necessary to repeat the product approval process when a slight product modification occurs (such as color), even though the performance of the product in question remains the same. Furthermore, these standards are frequently changed in certain countries to exclude imports.

b) **Product Testing :** Many products must be tested to determine their safety and suitability before they can be marked. The European Union's global approach to testing and certification for product safety provides manufacturers with one set of procedures for certifying product compliance with EU health, safety, and environmental requirements.

The various means by which manufacturers can certify product conformance include manufacturer's self-declaration of conformity, third-party testing, quality assurance audit and/or approval by a body authorized by an EU member state recognized by the EU commission.

c) **Product Specification :** Product specifications, though appearing to be an innocent process, can wreak havoc on imports. Specifications can be written in such a way as to favor local bidders and to keep out foreign suppliers. For example, specifications can be extremely detailed, or they can be written closely to resemble domestic products.

Thus, they can be used against foreign suppliers who cannot satisfy the specifications without expensive or lengthy modifications.

4. Quotas

Quotas are a quantity control on imported goods. Generally, they are specific provisions limiting the amount of foreign products imported in order to protect local firms and to conserve foreign currency. Quotas can be used for export control as well.

An export quota is sometimes required by national planning to preserve scarce resources. From a policy standpoint, a quota is not as desirable as a tariff since a quota generates no revenues for a country. There are three kinds of quotas : absolute, tariff and voluntary.

a) **Absolute Quotas :** An absolute quota is the most restrictive of all. It limits in absolute terms the amount imported during a quota period. Once filled, further entries are prohibited. Some quotas are global, but others are allocated to specific foreign countries.

b) **Tariff Quotas :** A tariff quota permits the entry of limited quantity of the quota product at a reduced rate of duty. Quantities in excess of the quota can be imported but are subjected to higher duty rate. Through the use of tariff quotas, a combination of tariffs and quotas is applied with a primary purpose of importing what is needed discouraging excessive quantities through higher tariffs.

c) **Voluntary Quotas :** A voluntary quota differs from the other two kinds of quotas, which are unilaterally imposed. A voluntary quota is a formal agreement between nation and an industry. This agreement usually specifies the limit of supply by product, country, and volume.

5. Financial Control

Financial regulations can also function to restrict international trade. These restrictive monetary policies are designed to control capital flow so that currencies can be defended or import controlled. For example, to defend the weak Italian lira, Italy imposed a 7 percent tax on the purchase of foreign currencies. There are several forms that financial restrictions can take.

a) **Exchange Control :** An exchange control is a technique that limits the amount of the currency that can be taken abroad. The reason exchange controls are usually applied is that the local currency is overvalued. Thus, imports to be paid for in smaller amounts of currency. Purchasers then try to use the relatively cheap foreign exchange to obtain items either unavailable or more expensive in the local currency.

Exchange controls also limit the length of time and amount of money an exporter can hold for the goods. French exporters, for example must exchange the foreign currency for Francs within one month.

By regulating all types of capital outflows in foreign currencies, governments either make it difficult to get imported products or make such items available only at higher prices.

b) **Multiple Exchange Rates :** Multiple exchange rates are another form of exchange regulation or barrier. The objectives of multiple exchange rates are to encourage exports and imports of certain goods and to discourage exports and imports of others.

This means that, there is no single rate for all products or industries. With the application of multiple exchange rates, some products and industries will benefit and some will not.

Because multipole exchange rates are used to bring in hard currencies (through exports) as well as to restrict imports, this system is condemned by the International Monetary Fund (IMF). According to the IMF, any unapproved multiple currency practices are a breach to obligations and the member will become ineligible to use its resources.

In addition to depending on earnings from the scale of goods abroad, many countries depend substantially on revenue from the foreign sale of such services as transportation, insurance, consulting and banking.

c) **Essentiality :** Countries consider certain services industries to be essential because they serve strategic purposes or because they provide social assistance to their citizens. They sometimes prohibit private companies, foreign or domestic in some sector because they feel the services should not be for profits.

In other case, they set price controls for private competitors or subsidize government-owned service organizations giving disincentives for foreign private participation.

Mail, education and hospital health services are not for profit sectors in which a few foreign firms compete. When a government permits private companies, foreign firms may not be able to compete because countries do not want to depend on foreign companies for a service they consider essential.

d) **Standards :** Governments limit foreign entry into many service professionals to ensure the staffing of only qualified personnel. The licensing standards of these personnel vary form one country to another country and include such professionals as accountants, actuaries, architects, electricians, engineers, etymologists, hair stylists, lawyers, physicians, real estate brokers and teachers.

e) **Immigration :** Clearing a foreign country's standards is no guarantee that it will permit foreign personnel to work here. Simply countries want to protect the employment of their own citizens.

But governmental regulations often require that an organization domestic or foreign-search extensively for qualified personnel locally before it can even apply for work permits for personnel it would like to bring in from abroad. The delays favor local companies that can respond rapidly to unique market needs.

Strategies to reduce the tariff and non-tariff barriers

To overcome Tariff and Non-Tariff barriers, companies adopt any of the below given strategies.

a) Local Partners

To relay on local partners with excellent contracts to the host country governing elite is a strategy that has been used effectively by many companies. This may range from placing local nations on the board of foreign subsidies for accepting a substantial capital participation from local investors.

Though many host countries requires some form of local participation as a condition for entering their market, there are many firms that do so voluntarily.

b) Invaluable Status

Achieving a status of indispensability is an effective strategy for firms that have exclusive access to high technology or specific products. Such companies keep research an development out of reach of their politically vulnerable subsidiaries and at the same time enhance their bargaining power with host governments by emphasizing their contributions to the economy.

When texas instruments wanted to open an operation in Japan more than twenty years ago, the company was able to resist pressures to take on a local partner due to its advanced technology. This occurred at a time when many other foreign companies were forced to accept local partners. The appearance of being irreplaceable obviously helps in reducing political risk.

c) Vertical Integration

Companies that maintain specialized plants in various countries, each dependent on the other, are expected to incur fewer political risks than firms with fully integrated and independent plants in each country. A firm practicing this form of distributed sourcing can offer economies of scale to a local operation.

This can become crucial for success in many industries. If a host government were to take over such a plant, its output level would be spread over to many units, products, or components, thus rendering the local company uncompetitive due to a cost disadvantage.

Unless multiple sources exists, company could be virtually shutdown if only one of its plants were affected negatively.

d) Local Borrowing

One of the reasons why Cabot Corporation prefers local partners is that they are then able to borrow locally instead of bringing foreign exchange to a host country.

Financing local operations from indigenous banks and maintaining a high level of local accounts payable minimize the negative effect on the local economy if adverse political actions were taken.

Typically, host governments do not expropriate themselves, and they are reluctant to cause problems for their local financial institutions.

e) Minimizing Fixed Investments

Political risk of course is always related to the amount of capital at risk. Given equal political risk, an alternative which comparable lower exposed capital amounts is preferable.

A company can decide to lease facilities instead of buying them, or they can rely more on outside suppliers provided they exist. In any case, companies should keep exposed assets to minimum, to limit damage due to political risk.

f) Political Risk Insurance

As a final recourse, international companies can purchase insurance to cover their political risk. The process of risk insurance depends, of course, on the country.

Rates range from as low as 0.5 percent for the best areas to about 3 percent for risky countries, and they can go as high as 9 percent for high risks. The average risk premium paid is about 1 percent of contract value.

5.4 Trade Policy Changes Consequent to WTO

The Indian economy has grown rapidly over the past decade, with real GDP growth averaging some 6% annually, in part due to the continued structural reform, including trade liberalization, according to a WTO Secretariat report on the trade policies and practices of India.

Social indicators, such as poverty and infant mortality have also improved during the last ten years. In order to achieve further significant reductions in poverty, India is currently targeting higher real GDP growth of between 7% and 9% (compared with 5.4% expected for 2001/02); to meet this goal, it will be important, as stressed by the authorities, to continue, and even accelerate, the reform process and increase competition in the economy.

The WTO Secretariat report, along with the policy statement by the Government of India, will serve as a basis for the third Trade Policy Review (TPR) of India by the Trade Policy Review Body of the WTO on 19 and 21 June 2002.

Recognizing the important linkages between trade and economic growth, the Government has simplified the tariff, eliminated quantitative restrictions on imports, and reduced export restrictions. It plans to further simplify and reduce the tariff. However, the level of protection through the tariff remains relatively high and the anti-export bias inherent in imports and other constraints still remains. To help counteract this anti-export bias, export promotion measures have gained in importance. The Government has recently announced a further increase in these measures and plans to continue reforms of the tariff and other taxes.

Tariff and tax reform are also crucial to address the problem of high fiscal deficits, which have continue to grow despite efforts to reduce public spending. Moreover, with the customs tariff accounting for some 30% of net government tax revenue, further reform of the tariff may depend on major tax reform.

The report notes that the authorities are firm in their view that improving the economic growth rate requires further structural reform. As restrictions on trade and competition have been reduced, constraints associated with infrastructure and regulatory bottlenecks have become increasingly evident and need to be addressed urgently both through regulatory reform and through increased investment. Despite further liberalization of the FDI regime, India's record in attracting investment remains disappointing, with FDI accounting for some 1% of GDP. The government has also taken various steps to improve enforcement of intellectual property rights which should help to attract FDI.

A major development since the previous Review was the removal of all import restrictions maintained for balance-of-payments reasons. Thus, the customs tariff has become the main form of border protection. There have been significant recent efforts to rationalize the tariff, but, with numerous exemptions based on end-use, it remains complex and applied tariffs, which averaged some 32% in 2001/02, remains relatively high. As a result of additional bindings taken by India in the WTO, the share of tariff lines that are bound has increased since the previous Review, from 67% to 72%. The average (final) bound rate is 50.6%, higher than the applied MFN rate; this gap provided ample scope for applied rates to be raised recently on a few agricultural products.

While import licensing and tariff restrictions are generally declining, there appears to have been an increase in other border measures such as anti-dumping, with some 250 cases initiated since 1995. Internal reforms have concentrated on improving efficiency and competition in the economy. Thus, while industrial policy remains important, its scope seems to have been reduced significantly. In addition, since the previous review, there has been a reduction in the number of activities reserved for the public sector and for the small scale industry.

The need for increased competition is being addressed by gradually reducing the degree of direct government involvement in economic activities, including through a programme to restructure and privatize state-owned companies. The privatization programme has thus far had limited success and must also be stepped up to address the fiscal deficit. In addition, price controls, currently maintained on several products including fertilizers, petroleum products and in agriculture, add to the fiscal burden of subsidies. (implicit and explicit subsidies were estimated at some 14,5 % of GDP in the mid-1990s).

Policy in the agriculture sector has been guided by domestic supply and self-sufficiency considerations. Thus, the sector is shielded through import and export controls, including tariffs, state trading, export restrictions and, until recently, import restrictions. The result of this policy has been a substantial increase in stocks to unsustainable levels and the costs associated with maintaining these stocks.

In services, significant reforms have been pursued since the previous Review, especially in telecommunications, financial services and, to some extent, in infrastructure services, such as power and transport. Liberalization of telecommunication services has resulted in an increase in availability and a reduction in tariffs. The reduction in telecommunication tariffs is also likely to benefit the software sector, one of the major success stories in recent years.

Efforts have also been made to address transportation and power shortages although with mixed results. Electricity, in particular, remains in short supply and constrained by the loss making state electricity boards (SEBs).

It concludes that India's economic reform programme resulted in strong economic growth throughout the 1990s. The recent slowdown, although partly due to the overall slowdown in the world economy, also demonstrates the necessity of continuing these reform efforts. In particular, difficult decisions are required to redress the fiscal imbalance, by reducing subsidies, completing the process of tariff and tax reform, and stepping-up privatization of state-owned enterprises.

5.5 Trade Policy Review

Transparency is achieved by the WTO in two ways: governments have to inform the WTO and fellow-member of specific measures, policies or laws through regular "notification" and the WTO conducts regular review of individual countries' trade policies.

The objectives of the review are :

1. To increase the transparency and understanding of countries' trade policies and practice through regular monitoring.
2. Improve the quality of public and intergovernmental debate on the issues.
3. To enable a multilateral assessment of the effect of policies on the world trading system.

Over a period of time, all WTO members are to come under scrutiny. The frequency of the review depends on the country's size :

1. The four biggest traders — the European Union, the United States, Japan and Canada (the "Quad") — are examined approximately once every two years.
2. The next 16 countries (in terms of their share of world trade) are reviewed every four years.
3. The remaining countries are reviewed every six years, with the possibility of a longer interim period for the least-developed countries.

For each review two documents are prepared: a policy statement by the government under review and a detailed report written independently by the WTO Secretariat.

5.6 Recent EXIM Policy (2015-2020)

Highlights

A) Simplification & Merger of Reward Schemes

Export from India Schemes :

1. Merchandise Exports from India Scheme (MEIS)

a) Earlier there were 5 different schemes (Focus Product Scheme, Market Linked Focus Product Scheme, Focus Market Scheme, Agri. Infrastructure Incentive Scrip, VKGUY) for rewarding merchandise exports with different kinds of duty scrips with varying conditions (sector specific or actual user only) attached to their use. Now all these schemes have been merged into a single scheme, namely Merchandise Export from India Scheme (MEIS) and there would be no conditionality attached to the scrips issued under the scheme.

2. Service Exports from India Scheme (SEIS)

a) Served From India Scheme (SFIS) has been replaced with Service Exports from India Scheme (SEIS). SEIS shall apply to 'Service Providers located in India' instead of 'Indian Service Providers'. Thus SEIS provides for rewards to all Service providers of notified services, who are providing services from India, regardless of the constitution or profile of the service provider. The list of services and the rates of rewards under SEIS are at Annexure-2.

b) The rate of reward under SEIS would be based on net foreign exchange earned. The reward issued as duty credit scrip, would no longer be with actual user condition and will no longer be restricted to usage for specified types of goods but be freely transferable and usable for all types of goods and service tax 3 debits on procurement of services / goods. Debits would be eligible for CENVAT credit or drawback.

3. Duty credit scrips to be freely transferable and usable for payment of custom duty, excise duty and service tax.

a) All scrips issued under MEIS and SEIS and the goods imported against these scrips would be fully transferable.

b) Scrips issued under Exports from India Schemes can be used for the following :

   i) Payment of customs duty for import of inputs / goods including capital goods, except items listed in Appendix 3A.

ii) Payment of excise duty on domestic procurement of inputs or goods, including capital goods as per DoR notification.

iii) Payment of service tax on procurement of services as per DoR notification.

c) Basic Customs Duty paid in cash or through debit under Duty Credit Scrip can be taken back as Duty Drawback as per DoR Rules, if inputs so imported are used for exports.

4. Status Holders

a) Business leaders who have excelled in international trade and have successfully contributed to country's foreign trade are proposed to be recognized as Status Holders and given special treatment and privileges to facilitate their trade transactions, in order to reduce their transaction costs and time.

b) The nomenclature of Export House, Star Export House, Trading House, Star Trading House, Premier Trading House certificate has been changed to One, Two, Three, Four, Five Star Export House.

c) The criteria for export performance for recognition of status holder have been changed from Rupees to US dollar earnings.

The new criteria is as under:- 5 Status category Export Performance FOB / FOR (as converted) Value (in US $ million) during current and previous two years

1) One Star Export House 3,

2) Two Star Export House 25,

3) Three Star Export House 100,

4) Four Star Export House 500,

5) Five Star Export House 2000

5. Reduced Export Obligation (EO) for domestic procurement under EPCG scheme:

6. Higher level of rewards under MEIS for export items with high domestic content and value addition. It is proposed to give higher level of rewards to products with high domestic content and value addition, as compared to products with high import content and less value addition.

7. C. Trade Facilitation & Ease of Doing Business

8. Online filing of documents/ applications and Paperless trade in 24x7 environment:

9. Online inter-ministerial consultations:

It is proposed to have Online inter-ministerial consultations for approval of export of SCOMET items, Norms fixation, Import Authorisations, Export Authorisation, in a phased manner, with the objective to reduce time for approval. As a result, there would not be any need to submit hard copies of documents for these purposes by the exporters.

10. Simplification of procedures/processes, digitisation and e-governance

11. Forthcoming e-Governance Initiatives

12. New initiatives for EOUs, EHTPs and STPs

13. Facilitating & Encouraging Export of dual use items (SCOMET).

a) Validity of SCOMET export authorisation has been extended from the present 12 months to 24 months. It will help industry to plan their activity in an orderly manner and obviate the need to seek revalidation or relaxation from DGFT.

b) Authorisation for repeat orders will be considered on automatic basis subject to certain conditions.

c) Verification of End User Certificate (EUC) is being simplified if SCOMET item is being exported under Defence Export Offset Policy. Outreach programmes will be conducted at different locations to raise awareness among various stakeholders.

14. Facilitating & Encouraging Export of Defence Exports

a) Normal export obligation period under advance authorization is 18 months. Export obligation period for export items falling in the category of defence, military store, aerospace and nuclear energy shall be 24 months from the date of issue of authorization or co-terminus with contracted duration of the export order, whichever is later. This provision will help export of defence items and other high technology items.

b) A list of military stores requiring NOC of Department of Defence Production has been notified by DGFT recently. A committee has been formed to create ITC (HS) codes 16 for defence and security items for which industrial licenses are issued by DIPP.

15. e-Commerce Exports

a) Goods falling in the category of handloom products, books / periodicals, leather footwear, toys and customized fashion garments, having FOB value up to

Rs.25000 per consignment (finalized using eCommerce platform) shall be eligible for benefits under FTP. Such goods can be exported in manual mode through Foreign Post Offices at New Delhi, Mumbai and Chennai.

b) Export of such goods under Courier Regulations shall be allowed manually on pilot basis through Airports at Delhi, Mumbai and Chennai as per appropriate amendments in regulations to be made by Department of Revenue. Department of Revenue shall fast track the implementation of EDI mode at courier terminals.

16. Duty Exemption

a) Imports against Advance Authorization shall also be eligible for exemption from Transitional Product Specific Safeguard Duty.

b) In order to encourage manufacturing of capital goods in India, import under EPCG Authorisation Scheme shall not be eligible for exemption from payment of anti-dumping duty, safeguard duty and transitional product specific safeguard duty.

17. Additional Ports allowed for Export and import Calicut Airport, Kerala and Arakonam ICD, Tamil Nadu have been notified as registered ports for import and export.

18. Duty Free Tariff Preference (DFTP) Scheme India has already extended duty free tariff preference to 33 Least Developed Countries (LDCs) across the globe. This is being notified under FTP.

19. Quality complaints and Trade Disputes

a) In an endeavour to resolve quality complaints and trade disputes, between exporters and importers, a new chapter, namely, Chapter on Quality Complaints and Trade Disputes has been incorporated in the Foreign Trade Policy.

5.7 Consequences of WTO for India

The World Trade Organization (WTO) is a global international organization dealing with the rules of trade between nations. The work of WTO moves around WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business.

India is a founder member of the General Agreement on Tariffs and Trade (GATT) 1947 and its successor, the World Trade Organization (WTO), which came into effect on 1 January 2012 after the conclusion of the Uruguay Round (UR) of Multilateral Trade Negotiations. India's participation in an increasingly rule based system in the governance of international trade is to ensure more stability and predictability, which ultimately would lead to more trade and prosperity.

Impact on India

Services exports account for 40% of India's total exports of goods and services. The contribution of Services to India's GDP is more than 55%. The sector (domestic and exports) provides employment to around 142 million people, comprising 28% of the work force of the country. India's exports are mainly in the IT and IT enabled sectors, Travel and Transport, and Financial sectors. The main destinations are the US (33%), the EU (15%) and other developed countries. India has an obvious interest in the liberalisation of services trade and wants commercially meaningful access to be provided by the developed countries. Since the Uruguay Round, India has autonomously liberalised its Services trade regime across the board.

India's interest in services lies in the large pool of trained, qualified experienced manpower providing services by temporarily moving to provide services and then returning to India (Mode 4). Trade in Mode 4 accounts for only a minuscule 1% of global trade at the moment. India has asked for a commitment from the developed countries in Mode 4, inter alia in I.T and I.T Enabled Services, Engineering Services, Health Services, Education Services etc.

The other manner in which India can deliver services is by way of remote supply of services with improved connectivity and vast pool of professionals in various services sectors (Mode 1). It includes outsourcing, BPO etc. Global trade in Mode 1 accounts for only 18% of total global trade. The major concern for India in the area of services is that the markets for services in the larger economies are not sufficiently open, particularly in respect of labour and labour-related services. Furthermore, in order to realise effective access in the larger markets, there is a need to ensure that predictable and transparent disciplines are put in place for Domestic Regulations so that they are not abused to deny access or to create barriers.

One of the primary objectives of the WTO was to substantially reduce the distortions that have plagued global agricultural markets, caused primarily through subsidies and protection by the developed countries. Discussions in WTO are aimed at reducing subsidies in developed countries and protection in developing countries. Although the negotiations in the Doha Round made a serious attempt to reduce farm subsidies, little progress has been made towards this end in real terms. Besides reductions in the high levels of farm subsidies, developing countries seeking market access have been seeking reductions in tariffs on agricultural commodities. The focus of the market access negotiations in agriculture has been on reduction in non-ad valorem tariffs that have been used in good measure by a number of developed countries.

Protection of intellectual property rights (patents, copyrights, trademarks etc.) has been made stringent. It is argued that the TRIPs (Trade related Intellectual Property Rights) agreement goes against the Indian Patents Act, 1970. Only process patents can be granted in food, chemicals and medicines under the Indian Patents Act. TRIPs agreement provides for granting product patents also. Under TRIPs patents can be granted to methods of agriculture and horticulture, bio-technological process including living organism like plants and animals. The duration of patents under TRIPs is 20 years. Introduction of product patents in India will lead to hike in drug prices by the MNCs who have the product patent. This will hit the poor people who will not have the generic option open.

The extension of intellectual property right to agriculture has negative effects on India. Presently, plant breeding and seed production are largely, in the public domain. Indian scientists have undertaken plant breeding and multiplication is in the hands of National and State Seed Corporations. Government, through this machinery, provides seed to Indian farmers at very low prices. Indian scientists, in future will find it extremely difficult to breed new varieties and Indian research institutions will be unable to compete financially with MNCs and will be denied access to patented genetic material. MNCs will get the control over our genetic resources and as such the control over food production would be jeopardised.

The most important things for India to address are speed up internal reforms in building up world-class infrastructure like roads, ports and electricity supply. India should also focus on original knowledge generation in important fields like Pharmaceutical molecules, textiles, IT high end products, processed food, installation of cold chain and agricultural logistics to tap opportunities of globalization under WTO regime. India's ranking in recent Global Competitiveness report is not very encouraging due to infrastructure problems, poor governance, poor legal system and poor market access provided by India. Our tariffs are still high compared to Developed countries and there will be pressure to reduce them further and faster.

India has solid strength, at least for medium term (5-7 years) in services sector primarily in IT sector, which should be tapped and further strengthened.

India would do well to reorganize its Protective Agricultural policy in name of rural poverty and Food security and try to capitalize on globalization of agriculture markets. It should rather focus on Textile industry modernization and developing international Marketing muscle and expertise, developing of Brand India image, use its traditional arts and designs intelligently to give competitive edge, capitalize on drug sector opportunities, and develop selective engineering sector industries like automobiles & forgings & castings, processed foods industry and the high end outsourcing services.

It wont be a bad idea if Indian textile and garment Industry go multinational setting their foot in western Europe, North Africa, Mexico and other such strategically located areas for large US and European markets.

Therefore, India must improve legal and administrative infrastructure, improve trade facilitation through cutting down bureaucracy and delays. Corruption will also have to be checked by bringing in fast remedial public grievance system, legal system and information dissemination by using e-governance.

Short Question & Answers

UNIT - I

1. Micro Environment

Ans :

Micro environment or the Competitive environment refers to the environment whickafi organization faces in its specific arena. This arena may be an industry, or it may be what is referred to as a strategic group.

Besides looking at primary demand and supply factors, firms examine the state of competition they face because that determines whether they will remain in the same industry or start a new one. All the business decisions - what business, pricing, distribution channel, promotion strategy, product portfolio, etc. - depends on the competitive position of a firm.

2. Macro Environment

Ans :

The **Macro**/General environment consists of factors external to the industry that maSive a significant impact on a firm's strategies. six broad dimension emographic, socio-cultural. political/legal, technological, economic and global.

These dimens.ons not only influence businesses, but also influence each other. After a political change »n 1991 when Congress government came to power, major economic change took place in the form of LPG, i.e., Liberalization, Privatization, and Globalization This led to an enhancement in the technological environment of the country. This technological and economical change has transformed the socio-cultural environment of the country.

3. Environmental scannign

Ans :

The conditions in a nation that govern how companies are created, organised and managed and the nature of domestic rivalry.

The process by which organisations monitors their environment to identify opportunities and threats affecting their business, is known as environmental scanning.

The following factors are considered for environmental scannings :

1. **Events :** Important and specific occurrences that take place in a certain sector.
2. **Trends :** The general tendencies or courses of action along which these events take place.
3. **Issues :** The current concerns that arise in response to events and trends.
4. **Expectations :** The demands made by interested groups in the light of their concern for issues.

4. Fiscal Policy

Ans :

The term, fiscal policy, embraces the tax and expenditure policies of the government. Fiscal policy may be defined as that part of governmental economic policy which deals with taxation, expenditure, borrowing and the management of public debt in an economy. It is an instrument of modern public finance.

Thus, fiscal policy operates through the control of government expenditures and tax receipts. It encompasses two separate but related decisions; public expenditures, and the level and structure of taxes. The amount of public outlay, the incidence and effects of taxation, and the relation between expenditure and revenue exert a significant impact upon the free enterprise economy.

5. Monetary Policy in India

Ans :

The conduct of monetary policy was guided by the objective of provision of adequate liquidity to meet credit growth and support investment demand in the economy while continuing a vigil on the movements in the price level. Ensuring macroeconomic stability was a concurrent objective with intensified monitoring of price movements, in view of the hardening of international commodity prices, especially crude oil. Strong capital inflows posed a challenge for monetary management.

The Reserve Bank responded with a policy mix of prepayment of external debt and liberalisation of foreign exchange transactions to maintain monetary conditions in line with the overall objectives. The monetary management with additional instruments in the context of the large volume of capital inflows led to the institution of a Market Stabilisation Scheme (MSS). Interest rates on nonresident deposits were gradually aligned with those prevailing in the international markets in view of the rapid expansion in banks' external liabilities.

UNIT - II

1. Fiscal reforms

Ans :

Fiscal reforms mean increasing the revenue receipts and reducing the public expenditure of the government in a manner that production and economic welfare are not adversely affected. Its main objective was to reduce fiscal deficit that stood at 8.5% of GDP in 1990-91, to 3%. Several reforms were undertaken to achieve this objective, e.g., control over public expenditure, increase in taxes, sale of share of public sector enterprises, and increased price of public sector products. On the basis of the recommendations of Raja J. Chelliah Committee Report, long-term fiscal policy was announced. This fiscal policy initiated many reforms. The main fiscal reforms are as follows:

i) Taxation system was made more scientific and rational. The maximum limit of income-tax was reduced from 50% to 30%,

ii) Taxation system has been simplified,

iii) Custom duties were brought down from 250% to 10%,

iv) Excise duty on several commodities was reduced,

v) Subsidies were cut down, and

vi) Special efforts are being made by the government to cut public expenditure.

2. Privatastion reforms

Ans :

The Government of India runs coal mines as well as discotheques. Public enterprises account for nearly half of India's capital stock and enjoy commanding market shares in industries like mining, smelting, banking, and railways. Most, however, exhibit poor productivity of labour and capital. Many public enterprises were created and kept alive for political reasons. For example, a fertilizer factory in Haldia, West Bengal, kept thousands of workers on its payroll for years without ever commencing production.

3. Liberalisation

Ans :

Liberalisation refers to the relaxation of the previous government restriction usually in area of social and economic policies. When government liberalised trade, it means it has removed the tariff, subsidies and other restriction on the flow of goods and services between the countries. Economic liberalisation, in its modern form, usually describes internal economic reform such as deregulation and privatisation and the removal of barriers to trade in services as well as the more conventional view of free trade as the removal of tariffs on physical imports.

Liberalisation deels with the economic conditions in which rules, regulations and controls are eliminated to promote competition.

4. Globalisation

Ans :

Another external force which was challenging India's tradition of "centralised and inward- directed business policy" is what is termed globalisation, i.e., the "internationalisation of the world economy". It became clear to developing countries (LDCs), such as India that, "with the world economy becoming increasingly interdependent", it was vital that they "devote greater efforts to linking their economies and development strategies to the world economy".

Now, at the heart of globalisation are the MNCs, which have brought about "global diffusion of production technology and worldwide homogenisation of markets". In fact, it can be argued that, "with the worldwide resources at their command", it is the MNCs which "have spawned an integrated international economic system". Consequently, India realised that, in order to link itself with the world economy, it was essential that it first link itself to the driving force behind globalisation, namely, the multinationals.

5. Infrastructure

Ans :

A short drive through any Indian city reveals some of the serious deficiencies of India's infrastructure - roads full of potholes, relentless traffic, suffocating pollution. Although an efficient infrastructure is in the national interest, state governments control many infrastructure projects. Large private sector organisations are taking care of their own infrastructure needs in response to state governments' neglect. Infosys, e.g., maintains a fleet of nearly 600 buses to transport its 12,000 employees to work. Prime Minister Singh has declared that India must raise levels of investment in infrastructure to enable the nation to reach its goal of 8% growth. Unfortunately, due to India's large deficit, the nation often skimps on infrastructure spending. Additionally, improvements in centre-state cooperation are greatly needed.

UNIT - III

1. IRDA

Ans :

Insurance Regulatory Development and Authority is the statutory, independent and apex body that governs and supervise the Insurance Industry in India.

It was constituted by Parliament of India Act called Insurance Regulatory and Development Authority of India (IRDA of India) after the formal declaration of Insurance Laws (Amendment) Ordinance 2014, by the President of India Pranab Mukherjee on December 26,2014.

2. Powers of central commission

Ans :

The Central Commission, shall, for the purposes of any inquiry or proceedings under this Act have the powers as are vested in a civil court under the Code of Civil Procedure, 1908 in respect of the following matters.

a) The summoning and enforcing the attendance of any wit-ness and examining him on oath.

b) The discovery and production of any document or other material object producable as evidence.

c) The reception of evidence on affidavits.

d) The requisition of any public record.

e) The constitution of commission for examination of wit-nesses.

f) Review its decisions, directions and others.

g) Any other matter which may be prescribed.

3. TRAI

Ans :

i) With effect from such date as the Central Government may, by notification appoint, there shall be established, for the purposes of this Act, an Authority to be called the ***Telecom Regulatory Authority of India. (TRAI)***

ii) The Authority shall be a body corporate by the name aforesaid, having perpetual succession and a common seal, with power, subject to the provisions of this Act, to acquire hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or sued.

iii) The Authority shall consist of a Chairperson, and not less than two, but not exceeding six members, to be appointed by the Central Government.

iv) The head office of the Authority shall be at New Delhi.

4. Functions of State Commission

Ans :

a) To determine the tariff for electricity, wholesale, bulk, grid, or retail, as the case may be.

b) To determine the tariff payable for the use of the transmis-sion facilities in the manner.

c) To regulate power purchase and procurement process of the transmission utilities and distribution utilities including the price at which the power shall be procured from the generating companies, generating stations or from other sources for transmission, sale distribution and supply in the State.

d) To prove competition, efficiency and economy in the ac-tivities of the electricity industry in order to achieve the objects and purposes of this Act.

5. Privatastion

Ans :

Privatisation is the process of involving the private sector in the ownership or operation of a state-owned or public sector undertaking. In a broader sense, it connotes private ownership. In other words privatisation means transfer of ownership and/or management of an enterprise from the public sector to the private sector. It also means the withdrawal of the State from an industry or sector, partially or fully. Another dimension of privatisation is opening-up of an industry that has been reserved for the public sector to the private sector.

According to Stuart M. Butler, Privatisation is “the transfer of government assets or functions to the private sector”.

According to D. R. Pendse, Privatisation is “any process which reduces the involvement of the state or the government sector in the nation’s economic affairs is a privatisation process”.

UNIT - IV

1. Horizontal

Ans :

Horizontal FDI refers to the foreign manufacturing of products and services roughly similar to those the firm produces in its home market. This type of FDI is called "horizontal" because the multinational duplicates the same activities in different countries. Horizontal FDI arises because it is too costly to serve the foreign market by exports due to transportation costs or trade barriers.

2. Vertical

Ans :

Vertical FDI refers to those multinationals that fragment production process geographically is called "vertical" because MNE separates the production chain vertically by outsourcing some production stages abroad. The basic idea behind the analysis of this type of FDI is that a production process consists of multiple stages with different input requirements. If input prices vary across countries it becomes profitable for the firm to split the production chain.

3. FEMA

Ans :

The Foreign Exchange Regulation Act of 1973 (FERA) in India was repealed on 1st June, 2000. It was replaced by the FEMA, which was passed in the winter session of Parliament in 1999. Enacted in 1973, in the backdrop of acute shortage of Foreign Exchange in the country, FERA had a controversial 27 year stint during which many bosses of the Indian Corporate world found themselves at the mercy of the Enforcement Directorate. Any offense under FERA was a criminal offense liable to imprisonment, whereas FEMA seeks to make offenses relating to foreign exchange civil offenses. FEMA, which has replaced FERA, has become the need of the hour since FERA had become incompatible with the pro-liberalization policies of the Government of India.

4. MNC

Ans :

A multinational corporation / company is an organization doing business in more than one country. Transactional company produces, markets, invests and operates across the world.

The process of globalisation has radically transformed our world. It is driven largely by the rapid growth and spread of corporations. Since the end of the Cold War in 1991, nearly all nations in the world have reduced the role of state in the economy and lowered barriers to the international movement of goods, services, capital, ideas and technology. As the walls imposed by nations/states have crumbled, multinational corporations have thrived, spreading across the glob', in search of new markets and factors of production. MNCs have expanded across national borders in two ways: trade and Foreign Direct Investment (FDI). Each has contributed to stable, lasting benefits to the world economy.

5. Conglomerate

Ans :

This happens when the two companies are in totally different line of business. Example, Berkshire Hathaway acquired Lubrizol. This kind of merger mostly takes place in order to diversify and spread the risks, in case the current business stops yielding adequate profits.

6. Vertical merger

Ans :

This happens when two companies are in the same line of production, but stage of production is different. Example: Microsoft bought Nokia to support its software and provide hardware necessary for the smart phone.

UNIT - V

1. TRIPS

Ans :

The WTO Agreement on Trade-Related Aspect of Intellectual Property Right (TRIPS), negotiated in the 1986-94 Uruguay Round, introduced intellectual property rule into the multilateral trading system for the first time. The WTO TRIPS Agreement is an attempt to narrow the gap in the way rights are protected around the world, and to bring them under common international rules.

As GATT and GATS, TRIPS also works on the principle of treating national and foreigner players equally and giving equal treatment to nationals of all trading partners in the WTO.

TRIPS agreement has an additional important principle of intellectual property protection, that is, it should contribute to technical innovation and the transfer of technology. It says that both producer and user should benefit, and economic and social welfare should be enhanced.

2. TRIMS

Ans :

TRIMS states that no member shall apply any measure that discriminates against foreigners or foreign products (i.e. violate "national treatment" principle in GATT). It also outlaws investment measures that lead to restriction in quantities (violating another principle in GATT). It restricts the measures as 'local content requirement' which compels the enterprise to use particular level of local components, or which set restrictions on the level of import which an enterprise can do or which set the target for the company to export (trade balancing requirement).

3. Quotas

Ans :

Quotas are a quantity control on imported goods. Generally, they are specific provisions limiting the amount of foreign products imported in order to protect local firms and to conserve foreign currency. Quotas can be used for export control as well.

An export quota is sometimes required by national planning to preserve scarce resources. From a policy standpoint, a quota is not as desirable as a tariff since a quota generates no revenues for a country. There are three kinds of quotas : absolute, tariff and voluntary.

4. MEIS

Ans :

Earlier there were 5 different schemes (Focus Product Scheme, Market Linked Focus Product Scheme, Focus Market Scheme, Agri. Infrastructure Incentive Scrip, VKGUY) for rewarding merchandise exports with different kinds of duty scrips with varying conditions (sector specific or actual user only) attached to their use. Now all these schemes have been merged into a single scheme, namely Merchandise Export from India Scheme (MEIS) and there would be no conditionality attached to the scrips issued under the scheme.

5. STIS

Ans :

a) Served From India Scheme (SFIS) has been replaced with Service Exports from India Scheme (SEIS). SEIS shall apply to 'Service Providers located in India' instead of 'Indian Service Providers'. Thus SEIS provides for rewards to all Service providers of notified services, who are providing services from India, regardless of the constitution or profile of the service provider. The list of services and the rates of rewards under SEIS are at Annexure-2.

b) The rate of reward under SEIS would be based on net foreign exchange earned. The reward issued as duty credit scrip, would no longer be with actual user condition and will no longer be restricted to usage for specified types of goods but be freely transferable and usable for all types of goods and service tax 3 debits on procurement of services / goods. Debits would be eligible for CENVAT credit or drawback.

Choose the Correct Answers

UNIT - I

1. Business environment is ________ in nature [c]

   (a) Simplex (b) Complex

   (c) Compound (d) Creative

2. ________ include gross national product, corporate profits, inflation rates [c]

   (a) Social environment (b) Political environment

   (c) Economic environment (d) All

3. ________ refers to factors existing with a business firms [b]

   (a) External factors (b) Internal factors

   (c) Social factors (d) All

4. Porter's five forces model ignores a ________ [b]

   (a) Value analysis (b) Sixth force

   (c) Both (d) None

5. CSF stands for ________ [a]

   (a) Critical success factor (b) Critical strategy factor

   (c) Critical success force (d) None

6. ________ consists of macro level factors related to the means of production and distribution of wealth [b]

   (a) Political environment (b) Economic environment

   (c) Social environment (d) Cultural environment

7. _________ Government of India announced New Industries Policy 1991 [a]

   (a) July 24 1991 (b) June 24 1991

   (c) March 24 1991 (d) July 23 1991

8. FERA was replaced with _________ in 1999 [b]

   (a) FEMN (b) FEMA

   (c) FERR (d) FEME

9. Under manufacturing enterprise micro enterprise _________ investment in plant & machinery [c]

   (a) Upto 10 lakhs (b) Upt to 15 lakhs

   (c) Upto 25 lakhs (d) Upto 30 lakhs

10. Under service enterprise micro enterprise _________ investment in equipments [a]

   (a) Upto 10 lakhs (b) Upto 15 lakhs

   (c) Upto 5 lakhs (d) Upto 2 lakhs

UNIT - II

1. _________ means increasing the revenue receipts and reducing the public expenditure of the government [c]

   (a) Financial reforms (b) Fiscal reforms

   (c) Industrial sector reform (d) None

2. _________ Refer to reforms in country's monetary and banking polices [a]

   (a) Financial reforms (b) Fiscal reforms

   (c) Industrial sector reforms (d) None

3. _________ involves freedom in deciding the scale of business activities and fixing prices of goods and services. [b]

   (a) Privatasation (b) Liberalisation

   (c) Globalisation (d) All

4. ________ helps Indian entrepreneur to know about the competitor, recent trends, quality of products [c]
   (a) Privatasation (b) Liberalisation
   (c) Globalisation (d) All

5. ________ Established to negotiate proposals from large international firms and clearance of the investment proposals [b]
   (a) FIIP (b) FIPB
   (c) FICC (d) FIDP

6. LERMS stands for ________ [b]
   (a) Liberalised exchange rate management system
   (b) Liberalised extra rate management system
   (c) Liberalised exchange risk management system
   (d) None

7. ________ Act eliminate the need for prior approval by large companies [c]
   (a) Monopoly (b) Oligopoly
   (c) MRTP (d) All

UNIT - III

1. ________ means state ownership and operation of industrial, financial and commercial undertakings [a]
   (a) Public sector (b) Private sector
   (c) Both (d) None

2. VRS stands for ________ [a]
   (a) Voluntary retirement scheme (b) Voluntary retirement source
   (c) Voluntary retirement system (d) None

3. ________ companies come into existence by virture of companies Act [c]
   (a) Public trust (b) Public corporation
   (c) Joint stock companies (d) Holding company

4. _________ company is one that holds 51% (or) more capital of other companies [d]

(a) Public trust (b) Public corporation

(c) Joint stock companies (d) Holding company

5. _________ have been set up under River Board Act 1956 [b]

(a) Public trust (b) Control board

(c) Holding company (d) All

6. _________ major component of the Indian power sector [a]

(a) SEB (b) SFI

(c) Both (d) None

7. TRAI chair person, members are appointed _________ [a]

(a) Central govt (b) State govt

(c) Union govt (d) None

8. The present headquater of IRDA is located at _________ [c]

(a) New delhi (b) Mumbai

(c) Hyderabad (d) Kolkata

9. _________ organisation government enters into contract with an old and experienced private company for managing an enterprise [a]

(a) Operating contracts (b) Holding company

(c) Public corporation (d) Private

10. MOU stands of unity [b]

(a) Memorandum of unity (b) Memorandum of understanding

(c) Memorandum of unit (d) Memorandum of universe

UNIT - IV

1. FDI is classified into ________ types [c]

   (a) 3 (b) 4

   (c) 2 (d) 5

2. ________ When 2 companies are in totally different line of business [a]

   (a) Conglomerate merger (b) Horizontal merger

   (c) Vettical merger (d) None

3. ________ transcations requires acquired to provide cash, stock (or) combination of stock and cash [b]

   (a) Asset purchase method (b) Stock

   (c) Joint stock companies (d) Holding company

4. ________ requires acquires to buy all the target firm's asset [a]

   (a) Asset purchase method (b) Stock

   (c) Joint stock companies (d) Holding company

5. ________ transcation simply requires payment in cash [c]

   (a) Asset purchase method (b) Stock

   (c) Joint stock companies (d) Holding company

6. The agreement signed by Ranboxy labroatary and Bayer AG of Germany int he year 1999 is an example of [c]

   (a) Subsidiary (b) Jointventure

   (c) Stragic international alliance (d) License agreement

7. ________ motivation is opportunites available in the host country as well as a home country [b]

   (a) Reactive (b) Proactive

   (c) Exporting (d) Importing

8. Microsoft - Nokia is an example for [a]
   (a) Merger and acquistion (b) Joint venture
   (c) Turnkey (d) Contract
9. Mr. Aditya peri is a CEO is _____ [a]
   (a) HDFC ICICI (b) ICICI
   (c) IDBI (d) BOB
10. Present CEO of microsoft [a]
   (a) Satya Nadella (b) Sundar pichi
   (c) Padama sree (d) Zucker berg

UNIT - V

1. Out of the following, one is not related with WTO [d]
   (a) TRIPS (b) Ministerial Conference
   (c) TRIMS (d) TRAI
2. How many member countries are there in the 'World Customs Organization'? [d]
   (a) 160 (b) 162
   (c) 172 (d) 181
3. The comparative cost theory of International trade was developed by [a]
   (a) David Ricards (b) Haberlar
   (c) Adam Smith (d) Allfred Marshall
4. GATT was replaced by WTO on [a]
   (a) 1st January 1995 (b) 1st June 1995
   (c) 1st January 1996 (d) 1st June 1996
5. Which one is the source of external finance? [a]
   (a) WTO funds (b) World bank group
   (c) Export credit (d) Foreign direct investment

6. The country where the headquarters of a multinational company is located is known as [b]

   (a) Host country (b) Home country

   (c) Third country (d) None

7. When an international firm follows a strategy of choosing only from the nationals of the parent country, it is called ________ approach. [ ]

   (a) Polycentric (b) Geocentric

   (c) Ethnocentric (d) None

8. CEO of HSBC bank in India [a , d]

   (a) Naina Lai Kidwai (b) Shikha Sharma

   (c) Indra Krishnamurthy Nooyi (d) Kiran Mazumdar-Shaw

9. The agreement signed by Ranbaxy Laboratory and Bayer AG of Germany in the year 1999 is an example of [c]

   (a) Subsidiary (b) Joint venture

   (c) Strategic International Alliance (d) License agreement

10. ________ is the oniy international option dea,ing with the poiieies and ru.es related to trade between Countries [a]

    (a) WTO (b) GATT

    (c) TRIPS (d) TR1MS

Fill in the blanks

UNIT - I

1. _________ is the aggregate of all conditions, events and influence that surrounds and affects it.
2. _________ describes the characteristics of the society in which the organization exists.
3. Indian Trade mark Act _________.
4. Micro environment is also known as _________.
5. CSF stands for _________.
6. LPG stands for _________, _________, _________.
7. _________ comprises government efforts to aleter industrial structure to promote productivity.
8. MSME stands for _________.
9. CRR stands for _________.
10. _________ restricts the lending capacity of a banks to grant advance again.

ANSWERS

1. Business environment
2. Social environment
3. 1969
4. Competitive environment
5. Critical success factors
6. Liberalisation, privatatisation, globalization
7. Industrial policy
8. Micro small medium enterprise
9. Cash reserve ratio
10. Ceiling on credit

UNIT - II

1. FIPB stands for ________ board.
2. ________ increasing the revenue receipts and reducing the public expenditure of the government.
3. ________ refers to the relaxation of the previous government restriction usually in areas of social and economic policies.
4. Liberalisation simplified the policos to attract ________ and ________ to India capital.
5. NGO's stands for ________.
6. ________ helps Indian entrepreneur to known about the competitors recent tends and quality of products.
7. ________ of the company is a very important determinant of success in global business.
8. PPP stands for ________.
9. ________ helped in improvement of financial.
10. LERMS stands for ________.

ANSWERS

1. Foreign investment promotion
2. Fiscal forms
3. Liberalisation
4. Foreign
5. Non-governmental organisations
6. Globalisation
7. Competitive advantage
8. Purchasing power parity
9. Liberalisation
10. Liberalized exchange rate management system

UNIT - III

1. Indian economy is a ________ economy.
2. ________ plays a significant role in the economic development of our country.
3. VRS stands for ________.
4. ________ is the fourth form of organisation of public enterprises.
5. Control boards have been set up under ________ Act 1956.
6. IRDA stands for ________.
7. IRDA authority consists of ________ members.
8. ________ is the main source of commercial energy.
9. The Telecom regulatory authority of India came into force of ________.
10. APDRP stands for ________.

ANSWERS

1. Mixed
2. Public enterprise
3. Voluntary retirement scheme
4. Joint stock companies
5. River board
6. Insurance Regulatory development and authority
7. 10
8. Coal
9. 25/1/1997
10. Accelerated power development reform programme

UNIT - IV

1. Availability of _________ in the host country is a major determine of FDI.
2. _________ refers to the foreign manufacturing of products and services roughly similar to those to the firm products in home market.
3. _________ plays an important rob in India's growth dynamics.
4. FERA is replaced by _________.
5. _________ transactions means a transactions other than capital account transaction.
6. Multinational/corporation is an organization doing business in more than one counssy.
7. In MNL David lillientual distinguished between and _________.
8. When two companies are combined to form a single unit _________.
9. _________ refers to the process of firm joining togetnes under a contractual agreement to run a specific business enterprise.
10. _________ refers when both companies are in the same line of business.

ANSWERS

1. Natural resources
2. Horizontal FDI
3. FDI
4. FEMA
5. Current account
6. Multinational corporation
7. Portfolio and Capital investment
8. Merger
9. Joint venture
10. Horizontal merger

UNIT - V

1. The first ever set of multilateral, legally enforceable rules covering international trade in services is ________.
2. ________ is 164th member country of WTO.
3. Ultimately GATT was replaced by the WTO on ________.
4. When one company acquires another, the acquired becomes a ________ of the acquiring company.
5. ________ is simplest and widely used mode to enter into foreign markets.
6. NTB STANDS FOR ________.
7. MEIS stands for ________.
8. ________ an integral part of product clearance.
9. MFA stands for ________.
10. The headquaters of WTO located at ________.

ANSWERS

1. General agreement on trade in services.
2. Afghanistan
3. 1st Jan. 1995
4. Subsidiary
5. Export
6. Non tariff barriers
7. Merchandise exports from India schemes
8. Inspection
9. Multi fibre agreement
10. Geneva

FACULTY OF COMMERCE

M.Com. II - Semester (CBCS) (New Syllabus) Examination

May- 2017

BUSINESS ENVIRONMENT & POLICY

Time : 3 Hours	Max. Marks: 80

Note: Answer all the questions from Part-A and Part-B
Each question carries 4 marks in Part-A and 12 Marks in Part-B.

PART - A (5 × 4 = 20 Marks)

[Short Answer Type]

1. Fiscal policy **(Unit-I, Topic . 1.13, Pg. No. 28)**

2. Structural reforms

Ans :

Structural Reforms

Structural Reforms take obstacles to be fundamental drivers of growth by liberalising labour, product and service markets, thereby encouraging job creation and investment and improving productivity. They are designed to boost an economy's competitive growth potential and adjustment capacity.

3. TRAI

Ans :

The telecom regulatory authority of India bill was passed by both the houses of parliament and it received the assent of the president on 28/3/1997. It come into force on 25/1/1997 as the Telecom regulatory authority of India Act 1997. With effect from such data as the central government may, by notification appoint there shall be established, for the purpose of this Act, as Authority to be called the Telecom Regulatory Authority of India (TRAI)

The authority shall consists of a chair person, and not less than two, but not exceeding six members to be appointed by the central Government. The head office of the Authority shall be at New Delhi

4. Advantages of mergers and acquisitions **(Unit-IV, Topic: 4.4.9, Pg. No. 178)**

5. TRIPS **(Unit-V, Topic: 5.2.3, Pg. No. 200)**

PART - B (5 × 12 = 60 Marks)

[Essay Answer Type]

6. a) Explain the external factors that influence Business environment. **(Unit-I, Topic: 1.6.2, Pg. No. 8)**

OR

b) Explain the salient features of Industrial Policy 1991. **(Unit-I, Topic: 1.12, Pg. No. 25)**

7. a) Discuss the improvement and achievements of the liberalization programme launched by the Government of India. **(Unit-II, Topic: 2.2.3, Pg. No. 68)**

OR

b) What is the approach of India towards the globalization process? Discuss. **(Unit-II, Topic: 2.3.4, Pg.No. 76)**

8. a) Examine the need and importance of Public Sector in India. **(Unit-III, Topic:3.1.3, Pg.No. 85)**

OR

b) What is Private Sector? Discuss the role of private sector in Indian economy.

Ans :

Private Sector

1. Privatisation is the transfer of government assets (or) functions to the private sector”

M. Butter.

2. Privatisation is any process which reduces the involvement of the state (or) government sector in the nations economic affairs is a privatisation process.

D.R. Pendse

Role of Private Sector in Indian Economy

Refer Unit-III, Topic 3.2.7, Page No. 106.

---

9. a) Discuss the rationale for encouraging foreign direct investment.

Ans :

Foreign investment is called ‘direct’ if it provides actual control to the investor in the invested in enterprise. The investment is termed indirect (or) portfolio, if the ownership rights are not accompanied by actual control. The control over the enterprise doesn’t merely involve in the control of the invested capital, it is control in terms of actual powers of management and effective decisions making. Some of the major appeds of the major appeds of the economy which point to the magnificent FDI potential of the economy of the following.

1. Large size of the economy, particularly the large and growing middle class.
2. open door policy towards FDI.
3. Diversified industrial sector.
4. Cheap and abundant availability of technical manpower at various levels of skills liberal policy towards technology and capital goods imports.
5. Price stability
6. Declining structure of interest rates in tune with global friends.
7. Good international economic and political relations.
8. Advertisement media
9. Large base of existing MNCs in a number of industrial segments.

OR

b) Evaluate the impact of MNCs on Indian Economy. **(Unit-IV, Topic: 4.3.10, Pg.No. 166)**

10. a) Explain the contribution of WTO in the economic development of India. **(Unit-V, Topic: 5.1.2, Pg. No. 184)**

OR

b) What are the salient features or provisions of the new Export - Import policy of India? **(Unit-V, Topic: 5.6, Pg. No. 224)**

FACULTY OF COMMERCE

M.Com. II-Semester (CBCS / Non - CBCS) Examination

May / June - 2016

BUSINESS ENVIRONMENT AND POLICY

Time : 3 Hours]	[Max. Marks : 80

Note: Answer all the questions in not more than one page each.

SECTION - A (5 × 4 = 20 Marks)

1. Micro environment

2. Monetary policy

3. Privatization

4. FEMA

5. Agreement on Agriculture

SECTION - B (5 × 12 = 60 Marks)

Note: Answer all the questions by using internal choice in not exceeding 4 pages each.

6. (a) Discuss in detail about the macro environmental elements of business.

OR

(b) Explain in detail about the Fiscal Policy of India.

7. (a) What is meant by Globalization? Explain the factors affecting it.

OR

(b) Explain the importance and affects of liberalization.

8. (a) Discuss the various forms of privatization.

OR

(b) Explain the role, importance and relevance of public sector in Indian Economy.

9. (a) Give an overview on recent trends in Foreign Direct Investment Policy.

OR

(b) Outline the merits and demerits of MNCs.

10. (a) Briefly explain about Trade related intellectual property rights.

OR

(b) Explain the consequences of WTO to Indian Economy.

Solutions to May / June - 2016

SECTION - A

1. Micro environment

Ans :

Refer to Unit-I, Page No. 9, Topic : 1.7

2. Monetary policy

Ans :

Refer to Unit-I, Page No. 41, Topic : 1.14

3. Privatization

Ans :

Refer to Unit-II, Page No. 97, Topic : 3.2

4. FEMA

Ans :

Refer to Unit-IV, Page No. 147, Topic : 4.2

5. Agreement on Agriculture

Ans :

Refer to Unit-V, Page No. 195, Topic : 5.2.1

SECTION - B

Note: Answer all the questions by using internal choice in not exceeding 4 pages each.

6. (a) Discuss in detail about the macro environmental elements of business.

Ans :

Refer to Unit-I, Page No. 15, Topic : 1.8

OR

(b) Explain in detail about the Fiscal Policy of India.

Ans :

Refer to Unit-I, Page No. 28, Topic : 1.13

7. (a) What is meant by Globalization? Explain the factors affecting it.

Ans :

Refer to Unit-II, Page No. 70, 76, Topic : 2.3 & 2.3.4

OR

(b) Explain the importance and affects of liberalization.

Ans :

Refer to Unit-II, Page No. 66, 68, Topic : 2.2.2 & 2.2.3

8. (a) Discuss the various forms of privatization.

Ans :

Refer to Unit-III, Page No. 97, 101, Topic : 3.2 & 3.2.5

OR

(b) Explain the role, importance and relevance of public sector in Indian Economy.

Ans :

Refer to Unit-III, Page No. 85, Topic : 3.1.3

9. (a) Give an overview on recent trends in Foreign Direct Investment Policy.

Ans :

Refer to Unit-IV, Page No. 138, Topic : 4.1.6.1

OR

(b) Outline the merits and demerits of MNCs.

Ans :

Refer to Unit-IV, Page No. 160, Topic : 4.3.6

10. (a) Briefly explain about Trade related intellectual property rights.

Ans :

Refer to Unit-V, Page No. 200, Topic : 5.2.3

OR

(b) Explain the consequences of WTO to Indian Economy.

Ans :

Refer to Unit-V, Page No. 227, Topic : 5.7

FACULTY OF COMMERCE

M.Com. II - Semester Examination

May / June - 2015

BUSINESS ENVIRONMENTAL AND POLICY

Time : 3 Hours] [Max. Marks : 80

Note: Answer all the questions from Part - A and Part - B. Each question carries 4 marks in Part - A an 12 marks in Part - B.

SECTION - A **(5 × 4 = 20)**

1. What is Monetary Policy?
2. What is Liberalization?
3. Strategic sale
4. Balance of Payments
5. What are the objective of WTO?

SECTION - B **(5 × 12 = 60)**

Note: Answer all the questions by using internal choice in not exceeding 4 pages each.

6. a) What is Business Environment? Explain the impact of economic environment of business.

Or

b) Explain the factors facilitation and impeding globalization in India.

7. a) Critically evaluate the impact of economic reforms on business.

Or

b) What is globalization? Describe the entry strategies available to enter global markets.

8. a) Explain the role of public sector in globalized era.

Or

b) What is privatization? and explain the regulatory framework with reference to insurance and power sectors.

9. a) Explain the various factors that influence the Foreign direct investment.

Or

b) What do you understand by Mergers? Explain the salient features of competition law.

10. a) Bring out the provisions of various agreements under WTO and their impact on Indian Business.

Or

b) Explain various provisions of Trade Related Intellectual Property Rights (TRIPS).

Answers to May / June - 2015

SECTION - A

1. Refer to Unit - I, Page No. 41, Topic No. 1.14

2. Refer to Unit - II, Page No. 65, Topic No. 2.2

3. Refer to Unit - III, Page No. 100, Topic No. 3.2.4 (6)

4. **Ans :**

The balance of payments (BOP) is the method countries use to monitor all international monetary transactions at a specific period of time. Usually, the BOP is calculated every quarter and every calendar year. All trades conducted by both the private and public sector are accounted for in the BOP in order to determine how much money is going in and out of a country. If a country has received money, this is known as a credit and if a country has paid or given money, the transaction is counted as a debit. Theoretically, the BOP should be zero, meaning that assets (credits) and liabilities (debits) should balance. But in practice this is rarely the case and thus, the BOP can tell the observer if a country has a deficit or a surplus and from which part of the economy the discrepancies are stemming.

5. Refer to Unit - V, Page No. 187, Topic No. 5.1.5

SECTION - B

6. (a) Refer to Unit - I, Page No. 1 and 6, Topic No. 1.1.2 and 1.6

OR

(b) Refer to Unit - II, Page No. 76, Topic No. 2.3.4

7. (a) Refer to Unit - II, Page No. 57, Topic No. 2.1

OR

(b) Refer to Unit - II, Page No. 70 and 73, Topic No. 2.3 and 2.3.3

8. (a) Refer to Unit - III, Page No. 85, Topic No. 3.1.3

OR

(b) Refer to Unit - III, Page No. 97, 109 and 113, Topic Nos. 3.2, 3.3.1 and 3.3.2

9. (a) Refer to Unit - IV, Page No. 126, Topic No. 4.1.2

OR

9. (b) **Ans :**

Main Provisions

Main provisions of the Act pertain to prohibition of anti-competitive agreements, prevention of abuse of dominant position and regulation of combinations. The Act also provides for the establishment of a Competition Commission to take care of these provisions and to protect the interests of consumers.

The Competition Act has essentially four components. The Act :

- Prohibits anti-competitive agreements like cartels, which restrict freedom of trade and cause consumer harm by way of limiting production and distribution of goods and services and fixing prices higher than normal.
- Prohibits abusive behaviour of a dominant firm, who through its position of dominance may restrict markets and set unfair and discriminatory conditions.
- Regulates mergers and acquisitions of large corporations in order to safeguard competitive markets.
- Mandates competition advocacy. (With the objective to create awareness on competition issues, the Commission organizes interactive meetings, workshops and seminars, etc., with different regulatory bodies, policy makers, trade organizations, consumer associations and public at large.

10. (a) Refer to Unit - V, Page No. 227, Topic No. 5.7

OR

(b) Refer to Unit - V, Page No. 200, Topic No. 5.2.3

FACULTY OF COMMERCE

M.Com. II - Semester Examination

April / May- 2014

BUSINESS ENVIRONMENTAL AND POLICY

Time : 3 Hours] [Max. Marks : 80

Note: Answer all the questions from Part - A and Part - B. Each question carries 4 marks in Part - A an 12 marks in Part - B.

SECTION - A (5 × 4 = 20)

1. Micro environment of Business
2. Globalization
3. Disinvestment
4. Foreign direct investment
5. W.T.O.

SECTION - B (5 × 12 = 60)

Note: Answer all the questions by using internal choice in not exceeding 4 pages each.

6. a) Explain the salient features of industrial policy resolutions 1956 and 1991.

Or

b) What is Business environment ? Explain the factors influencing the Business environment of India.

7. a) Give a brief note on economic reforms undertaken in 1991.

Or

b) Discuss the problems and prospects of globalization.

8. a) Explain the public sector reforms in India.

Or

b) Explain the various methods of disinvestment.

9. a) Explain the role of MNC's in Indian Business.

Or

b) What are the factors affecting foreign investment ?

10. a) Explain any two important Trade agreements, entered by India under WTO.

Or

b) Discuss the business changes in India due to WTO.

Answers to April / May - 2014

SECTION - A

1. Refer to Unit - I, page no. 7, Topic No. 1.7
2. Refer to Unit - II, page no. 70, Topic No. 2.3
3. ***Ans :*** It is also called negative investment. A decrease in capital goods, either because worn out equipment is not replaced or bedcause inventories are reduced, affecting the total supply of capital goods.
4. Refer to Unit - IV, page no. 125, Topic No. 4.1
5. Refer to Unit - V, page no. 183, Topic No. 5.1

SECTION - B

6. (a) Refer to Unit - I, Topic No. 1.11, 1.12, Page no. 23, 25

OR

(b) Refer to Unit - I, Topic No. 1.1, 1.6, Page no. 1 and 6

7. (a) Refer to Unit - II, Topic No. 2.1.2, Page no. 58

OR

(b) Refer to Unit - II, Topic No. 2.3.5, page no. 77

8. (a) Refer to Unit - II, Topic No. 2.1.3, page no. 60

OR

(b) **Ans :**

The Disinvestment Process in India

The following are the three methods adopted by the Government of India for disinvesting the Public sector undertakings. There are three broad methods involved, which are used in valuation of shares.

1. Net Asset Method: This will indicate the net assets of the enterprise as shown in the books of accounts. It shows the historical value of the assets. It is the cost price less depreciation provided so far on assets. It does not reflect the true position of profitability of the firm as it overlooks the value of intangibles such as goodwill, brands, distribution network and customer relationships which are important to determine the intrinsic value of the enterprise. This model is more suitable in case of liquidation than in case of disinvestment.

2. Profit Earning Capacity Value Method : The profit earning capacity is generally based on the profits actually earned or anticipated. It values a company on the basis of the underlying assets. This method does not consider or project the future cash flow.

3. Discounted Cash Flow Method: In this method the future incremental cash flows are forecasted and discounted into present value by applying cost of capital rate. The method indicates the intrinsic value of the firm and this method is considered as superior than other methods as it projects future cash flows and the earning potential of the firm, takes into account intangibles such as brand equity, marketing & distribution network, the level of competition likely to be faced in future, risk factors to which enterprises are exposed as well as value of its core assets. Out of these three methods the Discounted cash flow method is used widely though it is the most difficult.

And, In order to achieve the various objectives and goals of disinvestment many methods have been formulated and implemented. These include :

a) **Public Offer :** Offering shares of public sector enterprises at a fixed price through a genera prospectus. The offer is made to the general public through the medium of recognised market intermediaries. Initially equity was offered to retail investors through domestic public issues. This was followed by issuance of the Global Depository Receipts (GDRs) to tap the overseas market.

b) **Sale of Equity :** Sale of equity through auction of share amongst pre-determined clientele, whose number can be large. The reserve price for the PSE's equity can be determined with the assistance of merchant bankers.

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

d) **Cross Holding :** In the case of cross holdings, the government would simply sell part of its shares of one PSU to one or more PSUs.

e) **Golden Share :** In this model, the government retains a 26 percent share in the PSU. This 26 percent share will continue to give the Government the status of majority shareholder.

f) **Warehousing :** Under this model, the government owned financial institutions were expected to buy the government's share in select PSUs and holding them until third buyer emerged.

g) **Strategic Sale :** Of late, Government is pursuing the strategic sale method. Under this method, the government sells a major portion (51 percent and above) of its stake to a strategic buyer and also gives over the management control. Disinvestment price will be market based and not prefixed and PSUs shares will be under the department of Disinvestment.

9. (a) Refer to Unit - IV, Topic No. 4.3.4, page no. 158

OR

(b) Refer to Unit - IV, Topic No. 4.1.2, page no. 126

10. (a) Refer to Unit - V, Topic No. 5.2.3, 5.2.4, page no. 200, 203

OR

(b) Refer to Unit - V, Topic No. 5.7, page no. 227

FACULTY OF COMMERCE

M.Com. II - Semester Examination

April / May- 2013

BUSINESS ENVIRONMENTAL AND POLICY

Time : 3 Hours] [Max. Marks : 80

Note: Answer all the questions from Part - A and Part - B. Each question carries 4 marks in Part - A an 12 marks in Part - B.

SECTION - A (5 × 4 = 20)

1. SWOT.
2. Liberalization.
3. Ptivatisation.
4. Competition Law.
5. W.T.O.

SECTION - B (5 × 12 = 60)

Note: Answer all the questions by using internal choice in not exceeding 4 pages each.

6. a) Bring out the changes introduced in 1991 Industrial Policy relating to Licensing and public sector enterprises.

Or

b) Briefly explain Macro environments and its influence on Business.

7. a) Bring out the changes introduced by the Govt, in Fiscal policies after 1991 as part of economic reforms.

Or

b) State the characteristic features of globalization and its impact on Indian Business.

8. a) State the factors that necessitated reforms in public sector and examine the impact of the reforms on public sector in India.

Or

b) Elucidate different methods of disinvestment in public sector enterprises giving advantages associated with each of them.

9. a) Bring out the provisions in the economic reforms of 1991 on Foreign Direct Investment and their impact on Indian Business.

Or

b) State the role played by the Multinational Corporations in India and the problems involved with Multinational Corporations.

10. a) Bring out the provisions of various agreements under WTO and their impact on Indian Business.

Or

b) Present the changes introduced in the Export-Import policy of 2009-2014 and their impact on India's Export Import Business.

Answers to April / May - 2013

SECTION - A

1. **Ans :**

SWOT Analysis

A scan of the internal and external environment is an important part of the strategic planning process. Environmental factors internal to the firm usually can be classified as strengths (S) or weaknesses (W). and those external to the firm can be classified as opportunities (0) or threats (T). Such an analysis of the strategic environment is referred to as a SWOT analysis.

The SWOT analysis provides information that is helpful in matching the firm's resources and capabilities to the competitive environment in which it operates. As such, it is instrumental in strategy formulation and selection.

2. Refer to Unit - II, Page No. 65, Topic No. 2.2,

3. Refer to Unit - II, Page No. 97, Topic No. 3.2,

4. **Ans :**

The Competition Act, 2002 was enacted in 2002 keeping in view the economic developments that resulted in opening up of the Indian economy, removal of controls and consequent economic liberalisation which required that the Indian economy be enabled to allow competition in the market from within the country and outside. It was subsequently amended in 2009.

The Act aims at curbing negative aspects of competition through the medium of the CCI.

The Act confers power upon the CCI to levy penalty for contravention of its orders, failure to comply with its directions, making of false statements or omission to furnish material information, etc.

The Competition Act aims at repealing the Monopolies and Restrictive Trade Practices Act, 1969 and the dissolution of the Monopolies and Restrictive Trade Practices Commission. The Act provides that cases pending before the Monopolies and Restrictive Trade Practices Commission will be transferred to the CCI, except those relating to unfair trade practices, which are proposed to be transferred to the relevant for a established under the Consumer Protection Act, 1986.

5. Refer to Unit - V, Page No. 183, Topic No. 5.1

SECTION - B

6. (a) Refer to Unit - I, Page No. 25, Topic No. 1.12

OR

(b) Refer to Unit - I, Page No. 15, Topic No. 1.8

7. (a) Refer to Unit - I, Page No. 37, Topic No. 1.13.5

OR

(b) Refer to Unit - II, Page No. 71 and 77, Topic No. 2.3.1, 2.3.5

8. (a) Refer to Unit - II, Page No. 58 and 63, Topic No. 2.1.2, 2.1.4

OR

(b) Refer to April/May - 2014, Q.No. 8 (b)

9. (a) **Ans :**

Foreign Investment

In the sphere of foreign investment, industrial policy took revolutionary steps. The Reserve Bank of India was empowered to approve equity investment up to 51% in 34 industries through the automatic approval route. Subsequently, automatic approval was made available to most of the industries except those of public sector monopoly and industrial licensing. In eight categories, including mining services, electricity generation and transmission, and construction of roads, bridges, ports, harbours and runways, the automatic approval route is available for equity investment of up to 74%.

The automatic approval of FDI up to 100% is given in all manufacturing activities in Special Economic Zones, except those subject to licensing or public sector monopoly. Presently, even defence is also open to the private sector for 100% investment, with FDI up to 26%.

1. 100% foreign equity is welcome in export-oriented units, power sector, electronics and software technology parks.

2. Foreign Investment Promotion Council was formed to promote investment opportunities in the country.

3. Where foreign investment is not permissible through the automatic route, the proposals for foreign investment have to be submitted to the Secretariat of Industrial Approvals or Foreign investment proposal.

4. RBI allowed automatic approval to foreign technology agreements within prescribed monetary limit.

5. Existing enterprises were also allowed to raise equity up to 51% either as part of an expansion programme or without expansion programme.

6. Foreign equity is permitted even in small scale enterprises up to 24%. Foreign Investment Promotion Council was formed to promote investment opportunities in India.

7. Foreign Investors need not have a local partner, even when the foreign investor wishes to hold less than full equity of the company. The portion of the equity not proposed to be held by the foreign investor can be subscribed to by the public.

8. Use of Foreign Brand names/trademarks for sale of goods in India is permitted.

9. Dividend balancing was required initially in all sectors involving foreign equity up to 51% in high priority industries. It is said that outflow of foreign exchange on account of dividend payments must be balanced by export earning for a period of seven years from the date of commencement of production. But later, the dividend balancing condition was withdrawn for all industries except a few consumer goods industries.

Foreign capital invested in India is allowed to be repatriated with capital appreciation, if any, after the payment of taxes due on them.

(b) Refer to Unit - IV, Page No. 158, Topic No. 4.3.4

10. (a) Refer to Unit - V, Page No. 195 to 204, Topic No. 5.2 to 5.2.6

OR

(b) **Ans :**

FDI Policy 2009-2014

The new Foreign Trade Policy (FTP) takes an integrated view of the overall development of India's foreign trade and goes beyond the traditional focus on pure exports.

This would be clear from the following statement in the policy document, "Trade is not an end in itself, but a means to economic growth and rational development. The primary purpose is not the mere earning of foreign exchange, but the stimulation of greater economic activity."

The government unveiled a mix of procedural measures and fiscal incentives to trade with non- traditional destinations to bolster export order books drying out in two top regional markets-the US and the European Union.

New emerging markets have been given a special focus to enable exports to be competitive. Incentive schemes are being rationalised to identify leading products which would catalyse the next phase of export growth.

The government plans to introduce a nation-wide uniform GST from next year that would subsume the complex web of indirect taxes imposed by state governments. The introduction of zero duty capital goods scheme will add to expansion and modernization of production base at a time when investment is drying up in export industries.

Other important features of the policy include :

i) $ 200 billion or Rs 98,000 crore is the export target for 2010-11.

ii) 100% growth of India's export of goods and services by 2014.

iii) 15% growth target for next two years; 25% thereafter.

iv) 3.28% targeted India's share of global trade by 2020 double from the current 1.64%.

v) Jaipur, Srinagar Anantnag, Kanpur, Dewas and Ambur identified as towns of export excellence.

vi) 26 new markets added to focus market scheme.

vii) Provision for state-run banks to provide dollar credits.

viii) Duty entitlement passbook scheme extended till Dec. 2010.

ix) Tax sops for export-oriented and software export units extended till March 2011.

x) New directorate of trade remedy measures to be set up.

xi) Plan for diamond bourses.

xii) New facility to allow import of cut and polished diamonds for grading and certification.

xiii) Export units allowed to sell 90% of goods in domestic market.

xiv) Export oriented instant tea companies can sell up to 50% produce in domestic market.

xv) Single-window scheme for farm exports.

xvi) Number of duty-free samples for exporters raised to 50 pieces.

xvii) Value limits of personal carriage increased to $5 million (Rs 24.5 core) for participation in overseas exhibitions.

Impact on India

Indian Textile Industry is one of the leading industries in the world. Though was predominantly unorganized industry even a few years back, but the scenario started changing after the economic liberalization of Indian economy in 1991. It accounts for 14% of the total Industrial production, contributes to nearly 12% of the total export and is the second largest employment generator after agriculture. This manuscript deals with structure, growth and size of the Indian textile industry, role of textile industry in economy, key advantages of the industry, textile industry export and global scenario and strength, weakness, opportunities and treats of the Indian textile industry.

Research is done mainly by collecting and analyzing secondary data. The major sources of these data are websites of Ministry of Textile, WTO etc. A fair amount of information is collected from magazines and other academic publications to obtain Knowledge working procedure regarding in this field. The export of textiles and clothing aggregated to US$ 22.42 billion in 2009–10. The Government fixed the target for 2010–11 at US$ 25.48 billion and it has achieved US$ 26.82 billion.

FACULTY OF COMMERCE

M.Com. II - Semester Examination

May / June - 2012

BUSINESS ENVIRONMENTAL AND POLICY

Time : 3 Hours] [Max. Marks : 80

Note: Answer all the questions from Part - A and Part - B. Each question carries 4 marks in Part - A an 12 marks in Part - B.

SECTION - A **(5 × 4 = 20)**

1. Internal environment.
2. Balance of payments.
3. Multinational corporations.
4. Disinvestment.
5. Barriers to trade.

SECTION - B **(5 × 12 = 60)**

Note: Answer all the questions by using internal choice in not exceeding 4 pages each.

6. a) What is business environment ? Discuss the macro environment of business.

Or

b) Explain the objectives and features of New Economic Policy.

7. a) Bring out the impact of liberalisation on the Indian economy.

Or

b) Define globalisation and explain its merits and demerits.

8. a) Critically comment on the changing role of public sector in India.

Or

b) Examine the role of various regulatory agencies in India.

9. a) Delineate the trends in foreign direct investment and analyse the consequences thereof.

Or

b) Explain the advantages and disadvantages of mergers and acquisitions.

10. a) Discuss the various agreements under WTO.

Or

b) Explain the principles and functions of WTO.

Answers to April / May - 2012

SECTION - A

1. Refer to Unit - I, Page no. 9, Topic No. 1.7

2. Refer to May/June-2015, Q.No. 4

3. Refer to Unit - IV, Page no. 153, Topic No. 4.3

4. Refer to May/June-2014, Q.No. 3

5. Refer to Unit - V, Page no. 205, Topic No. 5.3

SECTION - B

6. (a) Refer to Unit - I, Page no. 15, Topic No. 1.1, 1.8

OR

(b) Refer to Unit - II, Page no. 58, Topic No. 2.1.2

7. (a) Refer to Unit - II, Page no. 68, Topic No. 2.2.3

OR

(b) Refer to Unit - II, Page no. 77, Topic No. 2.3.5

8. (a) Refer to Unit - II, Page no. 60, Topic No. 2.1.3

OR

(b) **Ans :**

The following is a **list of regulators in India**.

Regulators exercise regulatory or supervisory authority over a variety of endeavors in India.

Sectors	Regulator	Established
Inland Waterways for shipping and navigation	Inland Waterways Authority in India	27-10-1986
Commodity Market	Forward Markets Commission	1953
Telecommunication Industry	Telecom Regulatory Authority in India	20-02-1997
Financial Audit and Accounting professions	Institute of Chartered Accountants of India	1-05-1949
Financial system and monetary policy	Reserve Bank of India	01-05-1935
Food Safety	Food safety and Standards Authority of India	Aug-2011
Security Market	Securities and Exchange Board of India	12-April-1992
Aeronautical Tariff	Airports Economic Regulatory Authority	12-May-2009
Insurance industry	Insurance Regulatory of Development Authority	1999
Company- related matters	Registrar of Companies	1956
Power sector	Central Electricity Regulatory Commission	24-July-1998
Pension sector	Pension Fund Regulatory and Development Authority	10-Oct-2003
Warehouses	Warehousing Development and Regulatory Authority	2007

Categories :

- Regulatory agencies of India
- India-related lists.

9. (a) Refer to Unit - IV, Page no. 137, Topic No. 4.1.6

OR

(b) Refer to Unit - IV, Page no. 178, Topic No. 4.4.10

10. (a) Refer to Unit - V, Page no. 195 to 227, Topic No. 5.2 to 5.6

OR

(b) Refer to Unit - V, Page no. 183, 184, Topic No. 5.1.1, 5.1.2

FACULTY OF COMMERCE

M.Com. II - Semester (CBCS) (New Syllabus) Examination

May / June - 2018

BUSINESS ENVIRONMENT & POLICY

Time : 3 Hours	Max. Marks: 80

Note: Answer all the questions from Part-A and Part-B
Each question carries 4 marks in Part-A and 12 Marks in Part-B.

PART - A (5 × 4 = 20 Marks)
[Short Answer Type]

1. Environmental scanning **(Unit-I, Topic: 1.9)**
2. Factors that promote globalization **(Unit-II, Topic: 2.3.4)**
3. Technological factors influencing business environment. **(Unit-I, Topic: 1.6)**
4. Objectives of FEMA **(Unit-IV, Topic: 4.2.2)**
5. General Agreement on Trade in Services. **(Unit-V, Topic: 5.1.3)**

PART - B (5 × 12 = 60 Marks)
[Essay Answer Type]

6. (a) Examine in detail the socio-cultural environmental factors that influence decisions of a business unit. **(Unit-I, Topic: 1.6, 1.6.1, 1.6.2)**

OR

(b) Critically review the Industrial Policy Resolution 1956 and Industrial Policy 1991. **(Unit-I, Topic: 1.11, 1.12)**

7. (a) Explain the merits and demerits of Globalization. **(Unit-II, Topic: 2.3.5)**

OR

(b) Do you agree with the opinion that the liberalized economic policies being pursued in India during the last three decades caused much harm than good to the Indian Economy Give reasons. **(Unit-II, Topic: 2.2.3)**

8. (a) Explain the various methods of Privatization. **(Unit-III, Topic: 3.2.5)**

OR

(b) Discuss the role of IRDA in creating healthy competition between public sector and private sector players in India's insurance sector. **(Unit-III, Topic: 3.3.1 3.3.1.1, 3.3.1.3)**

9. (a) What are the differences between FERA and FEMA ? Also explain the salient features of FEMA. **(Unit-IV, Topic: 4.2.4, 4.2)**

OR

(b) Discuss the recent trends in mergers and acquisitions in India corporate sector with a special focus on the policy of Indian government. **(Unit-IV, Topic: 4.4.1, 4.4.8)**

10. (a) Review the initiatives taken by the Indian government in promoting exports through the latest Foreign Trade Policy. **(Unit-IV, Topic: 4.1.6.6)**

OR

(b) Explain the role of WTO in promoting trade. **(Unit-V, Topic: 5.4)**