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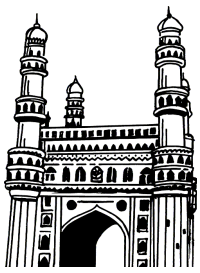

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*Ans :* **(Imp.)**

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UNIT I

**INTRODUCTION**

Business environment – concept - elements - Economic environment -economic systems - Policy Environment - Fiscal Policy - Monetary Policy –Political environment - Role of government in business - Legal Environment- Consumer protection Act - Competition Act - Socio - Cultural Environment- corporate social responsibility.

## 1.1 BUSINESS ENVIRONMENT

### 1.1.1 Concept

**Q1. Define Business Environment.**

*Ans :*

**Meaning of Environment**

Environment is the sum of all living and non-living things that surround an organism or group of organisms. Environment includes all elements, factors and conditions that have some impact on the growth and development of certain organism. Environment includes both biotic and abiotic factors that have influence on observed organism.

**Meaning of Business Environment**

Environment of a business means the external forces influencing the business decisions. They can be forces of economic, social, political and technological. These forces are beyond the control of the business. The success of every business depends on adapting itself to the environment within which it functions. For example, when there is change in the government policies, the business firm has to make necessary changes to adapt it to the new policies. Similarly, a change in technology may render the existing products obsolete. It has seen that the introduction of computer has replaced the typewriters; the color television has made the black and white television out of fashion. Again a change in the fashion or customers taste and preferences may shift the demand in the market for a particular product. All these aspects are external factors that are beyond the control of the business. So the business units must have to adapt themselves to these kind of changes, in order to survive and succeed in the competitive world.

Business environment is an environment in which business is carried out. Business environment encompasses all those factors that affect a company's operations; including customers, competitors, suppliers, distributors, industry trends, substitutes, regulations, government activities, the economy, demographics, social and cultural factors, innovations and technological developments.

An example of a business environment is a business office, such as an insurance office because they carry out the business of selling insurance policies to people.

**Definitions of Business Environment**

(i) **According to Barry M. Richman and Melvgtt Copen,** "Business environment consists of factors that are largely if not totally, external and beyond the control of individual industrial enterprise and their managements. These are essentially the 'givers' within which firms and their management must operate in a specific country and they vary, often greatly, from country to country".

(ii) **According to William F. Glucck,** "Business environment as the process by which strategists monitor the economic, governmental, market, supplier, technological, geographic and social settings to determine opportunities and threats to their firms".

**Q2. Explain the nature of business environment.**

*Ans :*

The nature of business environment is as follows:

1. **Environment is Inseparable Part of Business**

   Environment is an integral part of any business. Business cannot work without

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environment. Business requires good framework of legal, political, social, cultural and economic factors. Both business and environment have influence over each other.

They share a symbiotic relationship. Success of the business lies in understanding the environmental changes and adapting the business policies accordingly. There is a mutual interdependence between business and its environment. Business enterprises continuously interacts with its environment for taking inputs like raw materials, capital, labour, energy, etc., and transform them into goods and services and then send them back to the environment.

**2. Environment is Dynamic**

Business environment is dynamic in nature. No environment remains constant or static for a longer period of time. The government may change certain policies; there may be changes in consumer tastes, preferences, etc., changes in technology also affect the business. Environmental forces influence business decisions. The surrounding of business enterprise that is constantly changing carries both opportunities and threats with them. The success of business depends upon alertness and adaptability with the changing environment.

**3. Business Lacks Control Over Environment**

Business environment is a constantly changing process. Business lacks control over external environment. It cannot directly influence the changes in external environment. But it is possible to have influence over internal environment. Internal environment is controllable where as external environment is uncontrollable.

**4. Internal and External Factors**

The environment of business comprises of internal and external factors.

Internal environment includes plans and policies, employees, business objectives, etc.

The external environment is again subdivided into micro factor and macro factor. Micro factor includes customers, suppliers, competitors, society, etc. Macro factor comprise of social, economic, legal, technological and other factors, which are unpredictable and uncontrollable.

**5. Environment is Complex**

In the business environment, there are numerous complex situations in which one must understand in order to maximise the benefits of success. Modern business is more complex, flexible and highly unpredictable. The modem business has grown in size and scope and so is the environment. Any change in the environment can adversely affect the business organisation. Business environment is growing extremely complex due to government interventions and social consciousness.

**6. Environment is Multifaceted**

Any change in the environment is followed by a chain of positive and negative reactions. A change may be favourable to someone and unfavourable to others. Changes in the environment can be perceived differently by different entrepreneurs. Environmental changes may bring opportunities to some people and obstacles to others.

**7. Opportunities and Obstacles**

Business environment is flexible. It keeps on changing. Sometimes it may provide opportunities to the business, whereas on the other hand may create new challenges and obstacles in the working of the organisation. Opportunities may prove favourable to the firm and obstacles may create threat and unfavourable to the firm affecting its growth and profitability. Opportunities for growth and expansion is created when the environment is favourable, on the other hand it creates problems and obstacles when it is unfavourable.

**8. Regulates the Scope of Business**

Environment provides a framework within which business organisation has to operate. All the business activities are expected to be conducted within social, political, economic and legal structures. These changing

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structures should be minutely monitored by the business firm for its survival and growth. The business must learn to adjust itself with the ever-changing business environment.

**9. Long Lasting Impact**

The environment can have both positive and negative impact on the business. Changes in the environmental factors have long lasting effects on the functioning of the business. These changes may create favourable and unfavourable impact on the firm. A systematic analysis and diagnosis gives strategies to anticipate opportunities and threats. This helps to develop preventive measures to cope up with the threats effectively.

**10. Uncertainty**

Business environment is largely uncertain, as it is very difficult to predict future happenings, especially when environmental changes take place too frequently. The enterprises must continuously monitor their environment and adopt suitable business practices not only improve their present performance but also continue to succeed in the market for a longer period.

**Q3. Explain the scope of business environment.**

*Ans :* **(Imp.)**

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 analyse 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.

**Q4. Explain the significance of business environment.**

*Ans :*

**1. First Mover Advantage**

Awareness of environment helps an enterprise to take advantage of early opportunities instead of losing them to competitors.

**For example,** Maruti Udyog became the leader in small car market because it was the first to recognise the need for small car on account of rising petroleum prices and a large section of middle class people.

**2. Early Warning Signal**

Environmental awareness serves as an early warning signal. It makes a firm aware of the impending threat or crisis so that the firm can take timely action to minimise the adverse effects, if any.

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**For example,** when new firms entered in the mid segment cars (threat), Maruti Udyog increased the production of its Esteem threefold. Increase in production enabled the company to make faster delivery.

**3. Customer Focus**

Environmental understanding makes the management sensitive to the changing needs and expectations of consumers.

**For example,** Hindustan Unilever and several other FMCG companies launched small sachets of shampoo and other products realising the wishes of customers. This move helped the firms to increase sales.

**4. Strategy Formulation**

Environmental monitoring provides relevant information about the business environment. Such information serves as the basis for strategy making.

**For example,** ITC realised that there is a vast scope for growth in the travel and tourism industry in India and the government is keen to promote this industry because of its employment potential.

**5. Change Agent**

Business leaders act as agents of change. They create a drive for change at the grassroot level. In order to decide the direction and nature of change, the leaders need to understand the aspirations of people and other environmental forces through environmental scanning.

**For example,** contemporary environment requires prompt decision-making and power to people. Therefore, business leaders are increasingly delegating authority to empower their staff and to eliminate procedural delays.

**6. Public Image**

A business firm can improve its image by showing that it is sensitive to its environment and responsive to the aspirations of public. Leading firms like Reliance Industries, ICICI Bank and others have built good image by being sensitive and responsive to environmental forces.

**7. Continuous Learning**

Environmental analysis serves as broad based and ongoing education for business executives. It keeps them in touch with the changing scenario so that they are never caught unaware. With the help of environmental learning managers can react in an appropriate manner and thereby increase the success of their organisations.

**8. Giving Direction for Growth**

The interaction with the environment leads to opening up new frontiers of growth for the business firms. It enables the business to identify the areas for growth and expansion of their activities.

**9. Image Building**

Environmental understanding helps the business organisations in improving their image by showing their sensitivity to the environment within which they are working. **For example,** in view of the shortage of power, many companies have set-up Captive Power Plants (CPP) in their factories to meet their own requirement of power.

### 1.1.2 Elements of business environment

**Q5. What are the factors affecting business environment ?**

*Ans :*

It is very important for business firms to understand their environment and changes occurring in it. Business -enterprises which know their environment and are ready to adapt to environmental changes would be successful. On the other hand, firms which fail to adapt to their environment are unlikely to survive in the long- run. There are two broad components of business environment:

1. Internal Factors, and
2. External Factors

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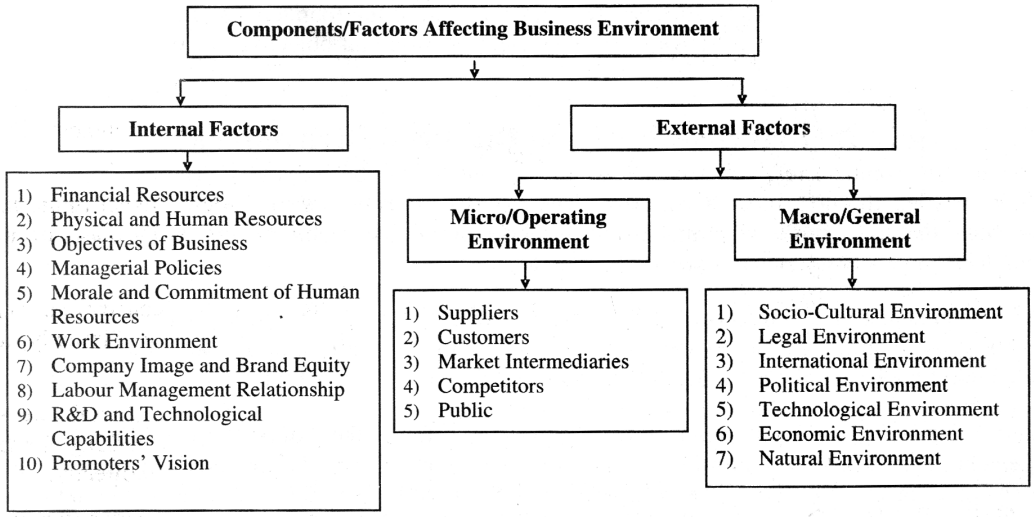


**Fig.**

**Q6. Explain internal factors influencing business environment.**

*Ans :* **(Imp.)**

**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.

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**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 raising 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.

**Q7. Explain External Factors Influencing Business Environment.**

**(or)**

**Discuss the macro environment of business.**

**(or)**

**Briefly explain macro environments and its influence on business.**

*Ans :* **(Dec.-20, May-17, May-16, May.14, May-12 Imp.)**

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. Micro Environment**

The forces which are close to the company and affect its ability to work constitute micro environment. It is known as operating environment of business. It consists of company's immediate environment that affects the performance of company. It includes suppliers, customers, market intermediaries, competitors and public. Some of the micro factors may be particular to a

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firm. When competing firms in an industry have the same micro elements, the relative success of the firm depends on their relative effectiveness in dealing with these elements:

**(i) Suppliers:** These are those who supply the inputs like raw materials and components to the company. Uncertainties regarding the supply or other supply constraints often compel companies to maintain high inventories causing cost increases. Factories in India maintain indigenous stocks of 3-4 months and imported stocks of 9 months whereas it is an average of a few hours to two weeks in Japan.

**(ii) Customers:** Customer is the central point of any business. Success of a business organisation depends upon identifying customers, their needs, tastes, liking, etc., and enhancing the level of customer satisfaction. Because of increase in competition, attracting and satisfying the customer has become more challenging. For attracting new customers, companies conduct consumer research, design product as per needs and requirements of customers, spend heavily on advertisement, provide after-sale services, etc. The major task of a business is to create and sustain customers.

**(iii) Competitors:** A firm's competitors include not only the other firms, which market the same or similar products, but also all those who compete for the discretionary income of the consumers. Business has to adjust its various activities according to actions and reactions of competitors. Competitor means other business units which are marketing or producing similar products or a very close substitute of our product.

**(iv) Marketing Intermediaries:** They are the firms that aid the company in promoting, selling and distributing its goods to final buyers. Marketing intermediaries are vital links between the company and the final consumers. Market intermediaries help the company to promote, sell and distribute its goods to final buyers.

**(v) Public:** "A public is any group that has an actual or potential interest in or impact on an organisation's ability to achieve its interests." Media publics, citizens' action publics and local publics are some examples. Some companies are seriously affected by such publics. Growth of consumer publics is an important development affecting business. Public includes users and non-users of the product.

**2. Macro Environment**

Macro environment means general environment of business. Macro forces are uncontrollable in comparison to the micro forces of environment. These factors create opportunities and pose threats to the business. The macro forces are more uncontrollable than the micro forces. The important macro environmental forces are as follows:

**(i) Socio-Cultural Environment:** The socio-cultural environmental factors consist of human relationships and the development, form and functions of such a relationship have a bearing on the business of an organisation. Some of the important factors and influences operating in the social environment are the buying and consumption habits of people, their languages, beliefs and values, customs and traditions, tastes and preferences, education and all factors that affect the business.

**(ii) Legal Environment.:** Every country follows its own system of law. The companies operating in the globai market have to take into account the provisions with respect to the legal environment prevalent in the countries with which they do business. The Central Government, State Government and local bodies affect business operations. They pass legislation on such matters as

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wages and prices, employment opportunities, safety and health at work, location, what the plant can emit into the air, how much noise the product can make and other similar matters. These laws and regulations affect the day-to-day operation of business.

**(iii) International Environment:** The international environment is particularly important for industries directly depending on imports or exports and import-competing industries.

**For example,** a recession in foreign markets, or the adoption of protectionist policies by foreign nations, may create difficulties for industries depending on exports. On the other hand, a boom in the export market or a relaxation of the protectionist policies may help the export-oriented industries.

**(iv) Political Environment:** The political environment consists of factors related to the management of public affairs that have a considerable impact on the business of an organisation. A political system serves as a primary factor for economic development if it is stable, honest, efficient, and dynamic; ensures political participation of the people; and, assures security to citizens and business organisations. It impacts the legislations and government rules and regulations under which business organisations operate in a country.

**5. Technological Environment:**

Technological environment comprises both machines (hard technology) and scientific thinking (soft technology) used to solve problems and promote progress. It consists of not only knowledge and methods required to carry-on and improves production and distribution of goods and services but also entrepreneurial expertise and professional know-how. The technological environment comprises factors related to the type of materials and levels of machines that are used in manufacturing goods and services in a given market. It also represents the degree of advancement of goods and services that are prevalent in a country or a region.

**6. Economic Environment**

The economic environment consists of macro-level factors related to means of production and distribution of wealth in a country or region. These factors have a significant impact on the demand and supply of a business of an organisation. These also determine the feasibility of a country or a region for the conduct of a particular business from a financial perspective.

**7. Natural Environment**

Geographical and ecological factors, such as natural resource endowments, weather and climatic conditions, topographical factors, location aspects in the global context, port facilities, etc.. are all relevant to business. Differences in geographical conditions between markets may sometimes call for changes in the marketing mix. Geographical and ecological factors also influence the location of certain industries.

## 1.2 ECONOMIC ENVIRONMENT

**Q8. Define economic environment. Explain the components and importance of economic environment.**

*Ans :*

**Economic Environment**

Economic environment refers to those economic factors which have impact on the working of business. Economic environment is complex in nature.

Economic environment consists of economic factors that influence the business in country. These factors include gross national product, corporate, profits, inflation rate, employment, balance of payments, interest rates consumer income, etc.

In a developing country, the low income may be the reason for the very low demand for a product. Economic environment of business has reference to the board characteristics of the

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economic system in which the business operates. The business sector has economic relation with the government, capital market; household sector and global sector. These sectors together influence the trends and structure of the economy. The form and functioningof the economy vary widely.

The importance external factors that affect the economic environment of a business are:

**(i) Economic Conditions**

Economic conditions include income level, distribution of income, demand and supply trends, etc. If the company is in boom condition, it positively affects demand and market share. On the other hand if the economy is in depression it will have negative effects on the business.

**(ii) Economic policies**

Economic policies are framed by the government. These policies establish relationship between business and government. The effect of these policies may be favorable or unfavorable. Some of the policies are:

(a) Industrial Policies

(b) Fiscal Policies

(c) Monetary Policies

(d) Foreign Investment Policies

(e) Export-import (EXIM) Policies

**(iii) Economic System**

Different economic systems prevail in different countries. These systems affect the business. The economic system includes capitalism, socialism and mixed economies. The world economy is primarily governed by three types of economic systems i.e.,

(a) Capitalist economy

(b) Socialist economy

(c) Mixed economy

**(iv) Economic Growth**

The stage of economic growth of the economy has direct impact on the business strategies. Increased economic growth rate and increase in consumption expenditure, lower the general pressure within an industry and offers more opportunities then threats.

**(v) The rate of interest**

The rate of interest affects the demand for the products in the economy, particularly when general goods are to be purchased through borrowed finance. Low interest rated provides opportunities to the industries to expand whereas rising interest rates pose a threat to these institutions.

**(vi) Currency Exchange**

Current exchange rates have direct impact on the business environment. When the rupee was devalued in 1991, it was to make Indian products cheaper in the world market and consequently boost India's exports.

**Components of Economic Environment**

The economic environment comprises of:

**(i) Income and wealth**

Income in an economy is measured by GDP, GNP and per capita income. High values of these factors show a progressive economic environment.

**(ii) Employment levels**

High employment represents a positive picture of the economy. However, there are many forms of unemployment, including partial employment and disguised unemployment.

**(iii) Productivity**

This is the output generated from a given amount of inputs. High levels of productivity support the economic environment.

**Importance of Economic Environment**

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

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**(i) Capitalizing early opportunities**

Environment friendly enterprise is 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.

**(ii) Activating management to changing needs**

The knowledge of environmental changes sensitizes the management to make strategy to cope with the emerging problems.

**(iii) 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.

**Q9. Explain the impact of economic environment on business.**

*Ans :*

Any business organization has one goal, to maximize profit. The process of maximizing revenue is simple. Evaluate need for customers, and provide appropriate provide, within top quality and quantity. There are nevertheless many factors which affect this simple operation. These elements are often categorized as macro as well as mini, internal and external, technical as well as non-technical. All the same, the actual product sales, production and procurement of the business organizations, straight or not directly depends upon these types of elements.

Therefore, you will find which entrepreneurs carefully analyze and ponder upon the economic elements impacting business companies. The impact of economic environment on business considers the following concepts:

**(i) Demand and offer**

The need and offer are 2 primary elements that affect the working associated with a business design. The need is the will as well as capability of shoppers to buy a specific item and the provide may be the ability of the company to provide for the need for customers. It should be mentioned that all the standards which are included in this list are inter-connected. You may even study need and supply analysis.

**(ii) Marginal and Complete Power**

Utility may be the quantity of fulfillment, that's produced by consumers from consumption of goods. This so happens that whenever continuous and successive use of units of the same goods, the fulfillment that's experienced by consumer begins decreasing. This often results into short term or even long-term fall of sales. Some organizations get ready for the actual launch of some other brand name be' ore the fall in power and sales is experienced. The actual release of new brand, helps to ensure that the actual revenue pattern from the company does not drop.

Decreasing power is among the exterior elements affecting business. You may even read more on diminishing minor utility.

**(iii) Cash as well as Finance**

Financial allows for financial and financial policies which impact company as well as the clients from the business. Money in circulation dictates the having to pay power or rather the demand of the actual customers and also the financial facility dictates the borrowing capability of people along with the business.

**(iv) Financial Development and growth**

Financial development dictates the quantity of finances that the society in particular is actually earning as well as improvement signifies the amount of money that's being spent in to channels associated with long-term up-gradation. Amongst all the financial elements affecting business environment, improvement is an essential one, since the company needs to focus on the actual need for a good economically dynamic society.

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**(v) Income and Employment**

An additional very important facet of the economic climate that impacts the significant from the business may be the degree of work as well as rate of earnings. The actual for each capita income as well as density of work determines the speed of need, denseness associated with need and also the purchasing power of those.

**(vi) Common Price Level**

An additional very important facet of the actual economy, which impacts the business, is the general price levels from the goods which additionally modify the product sales from the business. Expenses of recyclable, having to pay power of individuals, price of production and finally, cost of transport are a few of the important components that determine the general cost level and also, the actual product sales from the firm.

**(vii) Industry Cycles**

Industry series are the changing expenses of products as well as commodities within an economic climate. Increase, stability, a continual and drop are some of the important series which modify the costs away all goods for example uncooked materials, credit score, last products, and so on. Trade cycles additionally often modify the general cost degree.

**Q10. Explain the factors affecting economic environment.**

*Ans :*

**1. Growth strategy**

Growth strategy is a strategy based on investing in companies and sectors which are growing faster than their peers. The benefits are usually in the form of capital gains rather than dividends.

**2. Economic system**

An economic system is the combination of the various agencies, entities that provide the economic structure that defines the social community. The economics system involves production, allocation of economic inputs and distribution of economic outputs, Landlords and land availability, households, Capitalists, Banks and Government. It is a set of institutions and their various social relations.

**3. Economic planning**

Economic planning refers to any directing or planning of economic activity outside the mechanisms of the market, in an attempt to achieve specific economic or social outcomes. Planning is an economic mechanism for resource allocation and decision-making in contrast with the market mechanism. Most economies are mixed economies, incorporating elements of market mechanisms and planning for distributing inputs and outputs.

**4. Industry**

As per Section 2(j) of Industrial Disputes Act, 1947 "Industry" means any systematic activity carried on by co-operation between an employer and his workmen (whether such workmen are employed by such employer directly or by or through any agency, including a contractor) for the production, supply or distribution of goods or services with a view to satisfy human wants or wishes.

**5. Agriculture**

Agriculture is the cultivation of animals, plants, fungi and other life forms for food, fiber, and other products used to sustain life. Agriculture was the key development in the rise of sedentary human civilization, whereby farming of domesticated species created food surpluses that nurtured the development of civilization. The study of agriculture is known as agricultural science. Agriculture generally speaking refers to human activities, although it is also observed in certain species of ant and termite.

**6. Infrastructure**

Infrastructure is basic physical and organizational structures needed for the operation of a society or enterprise or the services and facilities necessary for an economy to function. It can be generally

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defined as the set of interconnected structural elements that provide frame work supporting an entire structure of development. It is an important term for judging a country or region's development.

**7. Financial and fiscal factor**

Financial factors consider the income statement is a simple and straightforward report on the proposed business's cash-generating ability. It is a score card on the financial performance of your business that reflects when sales is made and when expenses are incurred. It draws information from the virious financial models developed earlier such as revenue, expenses, capital and cost of goods. Fiscal policy is the use of government expenditure and revenue collection (taxation) to influence the economy. Fiscal policy can be contrasted with the other main type of macroeconomic policy, monetary policy, which attempts to stabilize the economy by controlling interest rates and spending.

**8. Removal of regional imbalance**

Government had appointed a Fact Finding Committee (FFC) in August, 1983 under the Chairmanship of Dr. V.M. Dandekar for studying the problem of imbalance between different regions of the State to identify regional backlog on the basis of such a study and to suggest measures for removal of the regional backlog including long term measures to avoid such regional imbalance in the future.

**9. Price and distribution control**

During the ongoing post-communist economic transitions, the relative well-being of many people is changing rapidly and governments are not well positioned to accurately measure individual living standards. Under such circumstances, continued price controls over basic consumer goods within the state sector, and the associated queuing, can form a serviceable device for targeting poor people for subsidies.

**10. Economic reforms**

India was a latecomer to economic reforms, embarking on the process in earnest only in 1991, in the wake of an exceptionally severe balance of payments crisis. The need for a policy shift had become evident much earlier, as many countries in East Asia achieved high growth and poverty reduction through policies which emphasized greater export orientation and encouragement of the private sector.

**11. Per capita and national income**

Per capita income or income per person is a measure of mean income within an economic aggregate, such as a country or city. It is calculated by taking a measure of all sources of income in the aggregate (such as GDP or Gross National Income) and dividing it by the total population. It does not attempt to reflect the distribution of income or wealth.

## 1.3 Economic Systems

**Q11. Explain concept of Economic Systems.**

*Ans :*

Economic system is a social organism through which people make their living. It is constituted of all those individuals, households, farms, firms, factories, banks and government, which act and interact to produce and consume goods and services.

**The Concept of Economic Scarcity**

The economist's idea of 'scarcity' centers on the relationship between a society's needs and wants and the resources available to satisfy them. In essence, economists argue that whereas needs and wants tend to be unlimited, the resources which can be used to meet those needs and wants are finite and accordingly no society at any time has the capacity to provide for all its actual or potential requirements. The assumption here is that both individual and collective needs and wants consistently outstrip the means available to satisfy them, as exemplified, for instance, by the inability of governments to provide instant health care, the best roads, education, defence, railways, and so on,

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at a time and place and of a quality convenient to the user. This being the case, 'choices' have to be made by both individuals and society concerning priorities in the use of resources, and every choice inevitably involves a 'sacrifice' (i.e. forgoing an alternative).

Economists describe this sacrifice as the 'opportunity cost' (or) 'real cost' of the decision that is taken (e.g. every pound spent on the health service is a pound not spent on some other public service) and it is one which is faced by individuals, organizations (including firms), governments and society alike.

From a societal point of view the existence of economic scarcity poses three serious problems concerning the use of resources:

1. What to use the available resources for? That is, what goods and services should be produced (or not produced) with the resources (sometimes described as the 'guns v. butter' argument)?
2. How best to use those resources? For example, in what combinations, using what techniques and what methods?
3. How best to distribute the goods and services produced with them? That is, who gets what, how much and on what basis?

In practice, of course, these problems tend to be solved in a variety of ways, including barter (voluntary, bilateral exchange), price signals and the market, queuing and rationing, government instruction and corruption (e.g. resources allocated in exchange for personal favors), and examples of each of these solutions can be found in most, if not all, societies, at all times. Normally, however, one or other main approach to resource allocation tends to predominate and this allows analytical distinctions to be made between different types of economic system. One important distinction is between those economies which are centrally planned and those which operate predominantly through market forces, with prices forming the integrating mechanism. Understanding this distinction is fundamental to an examination of the way in which business is conducted and represents the foundation on which much of the subsequent analysis is built.

### 1.3.1 Types of Economic Systems

#### 1.3.1.1 Capitalism

**Q12. Define Capitalism.**

*Ans :*

The economic system in which business units or factors of production are privately owned and governed is called Capitalism. The profit earning is the sole aim of the business units. Government of that country does not interfere in the economic activities of the country. It is also known as free market economy. All the decisions relating to the economic activities are privately taken. Examples of Capitalistic Economy: England, Japan, America etc.

Capitalism is variously defined by sources. There is no consensus on the definition nor on how the term should be used as a historical category. There is general agreement that capitalism is an economic system that includes private ownership of the means of production, creation of goods or services for profit or income, the accumulation of capital, competitive markets, voluntary exchange, and wage labor. The designation is applied to a variety of historical cases, varying in time, geography, politics and culture. There is general agreement that capitalism became dominant in the Western world following the demise of feudalism.

Economists, political economists and historians have taken different perspectives on the analysis of capitalism. Economists usually emphasize the degree that government does not have control over markets (laissez faire), and on property rights. Most political economists emphasize private property, power relations, wage labor, class and emphasize capitalism as a unique historical formation. Capitalism is generally viewed as encouraging economic growth. The extent to which different markets are free, as well as the rules defining private property, is a matter of politics and policy, and many states have what are termed mixed economies. A number of political ideologies have emerged in support of various types of capitalism, the most prominent being economic liberalism.

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**Q13. What are the Merits and Demerits of Capitalism?**

*Ans :*

**Merits**

The main merits of this system are given below:

**(i) Economic Freedom**

The foremost advantage of this system is that everybody enjoys' economic freedom as one can spend one's income according to one's wishes. Producers have complete freedom to invest in any business or trade.

**(ii) Automatic Working**

Another advantage according to classical economists is an automatic system. Equilibrium point is automatically come with the forces of demand and supply.

**(iii) Variety of Goods and Services**

All the basic decisions of what to produce, how to produce and for whom to produce are taken by producers. Every producer gives attention to consumers' taste and preferences. Hence, there are large variety of goods and services; produced in the economy.

**(iv) Optimum Use of Resources**

All natural resources are used to their optimum level as production is undertaken with a sole purpose: of earning profit and no scope for wastages at all.

**(v) Efficient Producer**

There is very tough I competition among entrepreneurs. They always encouraged to produce best quality of products. Thus, technical development will lead to increase in higher productivity as well as efficiency.

**(vi) Higher Standard of Living**

Varieties of goods at cheap rates make it easy to be within the; reach of poor and weaker sections of society. This results in rise in their standard of living. Demerits of Capitalistic System:

**According to Karl Marx,** "Capitalism contains the seeds of its own destruction."

**Demerits**

The main demerits of this system are given below:

**(i) Labour Exploitation**

The main defect of capitalism is the exploitation of labour. Labourers get less wages in comparison to their working hours. The wages less than their marginal productivity are not sufficient for their livelihood.

**(ii) Class Struggle**

A lion's share of income and resources is controlled by the upper sections of the society, while others remain deprived of the basic amenities of life. Thus, the entire society is divided between 'haves and 'have not's. Hence, the continuous class struggle spoils the health environment of the economy.

**(iii) Wasteful Competition**

Capitalism is a wasteful competition. A lot of money is spent on advertisement and publicity for pushing the sale of the commodity. Its burden ultimately is borne by the poor consumers in the form of increased price.

**(iv) Threat of Over-Production**

The production is made on a large scale which cannot be changed in a short period. Therefore, under capitalism, fear of over-production always exists. The Great Depression of 1930s in USA is an example of it.

**(v) Economic Fluctuations**

Being automatic in nature, capitalist economy always faces the problem of economic fluctuations and unemployment. This means the state of instability and uncertainty,

**(vi) Unbalanced Growth**

All the resources are put only to those channels where there is maximum profit. Other sectors of the economy are neglected. As there is no check on the economic system, the growth is unbalanced in nature.

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**(vii) No Welfare Activities**

In capitalism, the sole motive is maximum profit, but not the public welfare. Variety of goods are produced according to market demand, not for any welfare activity.

**(viii) Monopoly Practices**

This economic system has been criticized on the fact that it develops monopoly activities within the country.

### 1.3.1.2 Socialism

**Q14. Define Socialism.**

*Ans :*

Under socialism economic system, all the economic activities of the country are controlled and regulated by the Government in the interest of the public. The first country to adopt this concept was Soviet Russia.

A socialist economic system would consist of an organization of production to directly satisfy economic demands and human needs, so that goods and services would be produced directly for use instead of for private profit driven by the accumulation of capital, and accounting would be based on physical quantities, a common physical magnitude, or a direct measure of labour-time. Distribution of output would be based on the principle of individual contribution.

As a political movement, socialism includes a diverse array of political philosophies, ranging from reformism to revolutionary socialism. Proponents of state socialism advocate for the nationalization of the means of production, distribution and exchange as a strategy for implementing socialism. Social democrats advocate redistributive taxation in the form of social welfare and government regulation of capital within the framework of a market economy. In contrast, anarchism and libertarian socialism propose direct worker's control of the means of production and oppose the use of state power to achieve such an arrangement, opposing both parliamentary politics and state ownership over the means of production.

Modern socialism originated from an 18th-century intellectual and working class political movement that criticized the effects of industrialization and private property on society. In the early 19th-century, "socialism" referred to any concern for the social problems of capitalism regardless of the solution. However, by the late 19th-century, "socialism" had come to signify opposition to capitalism and advocacy for an alternative system based on some form of social ownership. Utopian socialists such as Robert Owen (1771-1858) tried to found self-sustaining communes by secession from a capitalist society. Socialists inspired by the Soviet model of economic development, such as Marxist-Leninists, have advocated the creation of centrally planned economies directed by a single-party state that owns the means of production.

**The two main forms of Socialism are:**

**i) Democratic Socialism**

All the economic activities are controlled and regulated by the government but the people have the freedom of choice of occupation and consumption.

**ii) Totalitarian Socialism**

This form is also known as Communism. Under this, people are obliged to work under the directions of Government.

**Q15. What are the Merits and Demerits of Socialism?**

*Ans :*

**Merits**

**(i) No Labour Exploitation**

There is only one class in a socialistic economy hence there is no question of exploitation.

There are no concept of strikes and lock-outs. Everybody works in a well-knit family way.

**(ii) Proper Utilization of Resources**

Under this economy, all types of natural resources are utilized in a most organized manner. Its main objective is to exploit these resources for the welfare of society.

**(iii) No Wasteful Advertisement**

The government is virtually the owner of almost every sector. Hence, all the individual producers are also more according to the plan targets. Therefore, the competition among the producers is almost nil. Hence, very less money is spent on wasteful advertisement.

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**(iv) Proper Planning**

In order to solve various problems, which arise from time to time, there is proper economic plan in this type of economy. Thus, with the help of economic plans socialist economy will adopt the balanced development strategy.

**(v) No Cyclical Fluctuations**

Under socialist economy, no cyclical fluctuations are found. It means economy faces no boom, depression, unemployment or over production etc. Economic stability is maintained by the government on the basis of economic planning.

**(vi) Social Welfare**

The aim of socialist economy is to maximize social welfare of the society. It provides equal opportunities of employment to all individual according to their abilities.

**(vii) Rapid Economic Development**

The Central Planning Authority is the main figure in a socialist economy. It coordinate the natural, human and physical resources to attain economic progress of the country. In turn it accelerates the path of tremendous progress and people enjoy higher standard of living.

**(viii) Most Suitable to Developing Countries**

This type of economic system is most suitable to the needs of developing countries as all means of production are controlled by the government.

**Demerits**

Economists like Robbins, Maurice Dobb, Georg Halm etc. have criticised the socialist economy on the following grounds:

**(i) Loss of Consumer Sovereignty**

A consumer has no choice of his own, he acts as a mere slave under this system. Government produces goods and services keeping in view the needs of the people.

**(ii) Less Democratic**

Socialist economy is always less democratic as it possesses no element of freedom. It is also like government dictatorship.

**(iii) No Automatic Functioning**

Under this system, no automatic function in system exists at all. It is the Central Authority, i.e., government, that governs the country according to its own interest.

**(iv) Evils of Bureaucracy**

In socialist economy, all economic activities are controlled by the government. Thus, they develop all evils of bureaucracy like favouritism, delay, corruption and other sue evils,

**(v) Rigid Economy**

Socialist economy is very rigid and not susceptible to change according to requirements. Hence people work like a machine and never get any incentive to work.

**(vi) Burden on Government**

All the economic activities are performed by the Central Authority on behalf of the government. Hence, it is overburdened with daily activities and, therefore, it gets very less time to think and plan for the economic prosperity of the economy.

**(vii) Expenditure on Planning**

In fact, planning is a long process in a socialist economy. This expenditure is unnecessarily wasteful and a burden on the national economy.

### 1.3.1.3 Mixed Economy

**Q16. What is Mixed Economy? Explain the elements of Mixed Economy.**

*Ans :*

The economic system in which both public and private sectors co-exist is known as Mixed Economy. Some factors of production are privately owned and some are owned by Government. There exists freedom of choice of occupation and consumption. Both private and public sectors play key roles in the development of the country.

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The basic plan of the mixed economy is that the means of production are mainly under private ownership; that markets remain the dominant form of economic coordination; and that profit-seeking enterprises and the accumulation of capital would remain the fundamental driving force behind economic activity. However, the government would wield considerable indirect influence over the economy through fiscal and monetary policies designed to counteract economic downturns and capitalism's tendency toward financial crises and unemployment, along with playing a role in interventions that promote social welfare. Subsequently, some mixed economies have expanded in scope to include a role for indicative economic planning and/or large public enterprise sectors.

There is not one single definition for a mixed economy, but the definitions always involve a degree of private economic freedom mixed with a degree of government regulation of markets. The relative strength or weakness of each component in the national economy can vary greatly between countries. Economies ranging from the United States to Cuba have been termed mixed economies. The term is also used to describe the economies of countries which are referred to as welfare states, such as Norway and Sweden. Governments in mixed economies often provide environmental protection, maintenance of employment standards, a standardized welfare system, and maintenance of competition. As an economic ideal, mixed economies are supported by people of various political persuasions, typically centre-left and centre-right, such as social democrats or Christian democrats. Supporters view mixed economies as a compromise between state socialism and laissez-faire capitalism that is superior in net effect to either of those.

### Elements of Mixed Economy

The elements of a mixed economy have been demonstrated to include a variety of freedoms:

i) To possess means of production (farms, factories, stores etc.).

ii) To participate in managerial decisions (cooperative and participatory economics).

iii) To travel (needed to transport all the items in commerce, to make deals in person, for workers and owners to go to where needed).

iv) To buy (items for personal use, for resale; buy whole enterprises to make the organization that creates wealth a form of wealth itself).

v) To sell (same as buy).

vi) To hire (to create organizations that create wealth).

vii) To fire (to maintain organizations that create wealth).

viii) To organize (private enterprise for profit, labor unions, workers' and professional associations, non-profit groups, religions etc.).

ix) To communicate (free speech, newspapers, books, advertisements, make deals, create business partners, create markets).

x) To protest peacefully (marches, petitions, sue the government, make laws friendly to profit making and workers alike, remove pointless inefficiencies to maximize wealth creation).

**Q17. What are the Merits and Demerits of Mixed Economy?**

*Ans :*

### Merits of Mixed Economy

There are several advantages of mixed economy which are as below:

**(i) Encouragement to Private Sector**

The most important advantage of mixed economy is that it provides encouragement to private sector and it gets proper opportunity to grow. It leads to increase in capital formation within the country.

**(ii) Freedom**

In a mixed economy, there is both economic and occupational freedom as found in capitalist system. Every individual has a liberty to choose any occupation of his choice. Similarly, every producer can take decisions regarding production and consumption.

**(iii) Optimum Use of Resources**

Under this system, both private and public sectors work for the efficient use of resources.

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Public sector works for social benefit while private sector makes the optimum use of these resources for maximization of profit.

**(iv) Advantages of Economic Planning**

In the mixed economy, there are all advantages of economic planning. Government takes measures to control economic fluctuations and to meet other economic evils.

**(v) Lesser Economic Inequalities**

Capitalism enhances economic inequalities but under mixed economy, inequalities can easily controlled by the efforts of government.

**(vi) Competition and Efficient Production**

Due to competition between both private and public sectors, the level of efficiency remains, high. All factors of production work efficiently in the hope of profit.

**(vii) Social Welfare**

Under this system, the main priority is given to social welfare through effective economic, planning. The private sector is controlled by the government. Production and price policies of private sector are determined to achieve maximum social welfare.

**(viii) Economic Development**

Under this system, both government and private sector join their hands for the development of socio-economic infrastructures, Moreover, government enacts many legislative measures to safe guard the interests of the poor and weaker section of the society. Hence, for any underdeveloped country, mixed economy is a right choice.

**Demerits of Mixed Economy**

The main demerits of mixed economy are as follows:

**(i) Un-stability**

Some economists claim that mixed economy is most unstable in nature. The public sector gets maximum benefits whereas private sector remains controlled.

**(ii) Ineffectiveness of Sectors**

Under this system, both the sectors are ineffective in nature. The private sector does not get full freedom, hence it becomes ineffective. This leads to ineffectiveness among the public sector. In true sense, both sectors are not only competitive but also complementary in nature.

**(iii) Inefficient Planning**

There are no such comprehensive planning in mixed economy. As a result, a large sector of the economy remains outside the control of the government.

**(iv) Lack of Efficiency**

In this system, both sectors suffer due to lack of efficiency. In public sector it is so because government employees do not perform their duty with responsibility, while in private sector, efficiency goes down because government imposes too many restrictions in the form of control, permits and licenses, etc.

**(v) Delay in Economic Decisions**

In a mixed economy, there is always delay in making certain decisions, especially in case of public sector. This type of delay always leads to a great hindrance in the path of smooth functioning of the economy.

**(vi) More Wastages**

Another problem of the mixed economic system is the wastages of resources. A part of funds allocated to different projects in public sector goes into the pocket of intermediaries. Thus, resources are misused.

**(vii) Corruption and Black Marketing**

There is always corruption and black marketing in this system. Political parties and self- interested people take undue advantages from public sector. Hence, this leads to emergence of several evils like black money, bribe, tax evasion and other illegal activities. All these ultimately bring red-tapism within the system.

**(viii) Threat of Nationalism**

Under mixed economy, there is a constant fear of nationalism of private sector. For this reason private sector does not put into use their resources for the common benefits.

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**Q18. Compare and contrast capitalism, socialism and mixed economy.**

*Ans :* **(Imp.)**

| S.No. | Basis for Difference | Capitalism | Socialism | Mixed Economy |
|---|---|---|---|---|
| 1. | **Economic Markets** | Freedom to compete with right to invest, free competition. | Absence of competition. State-owned markets and industries. | Limited competition with state-owned industries. |
| 2. | **Individual Incentives** | Profits and wages in relation to one's ability and willingness to work. Goal is personal profit. | Profits not allowed. Workers urged to work for glory of the state. Bonuses for exceeding quotas. All gains accrue to state which distributes among individuals. | Profits recognised, wages set by state, based on workers, needs. Major gains accrue to state. |
| 3. | **Capital Sources** | Capital invested by owners who may also borrow on credit Capital may be re-invested invested from profits. | State provides all resources to start a business owned by the State. No Depreciation. industries. | Obtained from owners and from State-issued bonds for State-owned industries. Depreciationpermitted. |
| 4. | **Labour** | Workers generally free to select an employer and an occupation. Independent unions. | The State determines one's employer and employment, State controls occupational choice and unions. | Workers allowed to select occupation, State planning ncourages employment. Restricted right to unions. |
| 5. | **Management** | Managers selected on basis Managers have members | Key managers must be party to qualify. Absence freedom to make decisions. Managers appointed by the State. | Managers in State- owned indus. industries must answer to the State. Non-monetary rewards emphasised. |
| 6. | **Business Ownership** | Individuals have a right to own a business and to contract with others, Private ownership of means of production. | State owns all productive capacityincluding communes. | State owns basic industries including steel, mines and transportation. Other businesses may exist privately. |
| 7. | **Risk Assumption** | Losses assumed by owners; may transfer business risk to other business through insurance. | Economic production owned by the State, risks assumed by the State, losses reduce standard of living. | People assume risks of State-owned industries, Losses taken from taxes. |
| 8. | **Central Problems** | Decided by market mechanism. | Decided by centralised planning by the State. | Decided by mechanism. combination of market system and State planning. |
| 9. | **Consumer's Sovereignty** | Full freedom of choice. | No freedom of choice. | Limited freedom of choice. |

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## 1.4 POLICY ENVIRONMENT

**Q19. Define Industrial Policy. What are the objectives of Industrial Policy ?**

*Ans :*

**Introduction**

The Industrial Policy plan of a nation, sometimes shortened IP, denotes a nation's declared, official, total strategic effort to influence sectoral development and, thus, national industry portfolio. These interventionist measures comprise "policies that stimulate specific activities and promote structural change".

Industrial policy means rules, regulations, principles, policies, and procedures laid down by government for regulating, developing and controlling industrial undertakings in the country. It prescribes the respective roles of the public, private joint and cooperative sectors for the development of industries.

It also indicates the role of the large , medium , and small sector. It incorporates fiscal and monetary policies, tarif policy, labour policy and the government attitude towardsforeign capital, and role to be played by multinationalcorporations in the development of the industrial sector.

**Definition**

**(i) According to World Bank,** "Industrial policy comprises government efforts to alter industrial structure to promote productivity based growth".

**(i) 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".

**(ii) 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".

**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,

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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.

**Q20. Elucidate the various reasons of Industrial Policy.**

*Ans :*

A well-designed industrial policy is important for several reasons:

**1. Establishes Co-ordination**

Industrial policy establishes co-ordination between:

**i) Industry and Agricultural Development:** It is helpful in establishing co-ordination between industrial development and agricultural development.

**ii) Public and Private:** It is helpful in establishing co-ordination between public sector and private sector.

**iii) Capital and Physical Resources:** It is helpful in establishing effective co-ordination between capital and physical resources on one hand and natural and social resources on other hand.

**2. Directs National Resource**

It is helpful in directing national resources in desired direction. It can direct the flow of scarce resources in the most desirable areas of investment in accordance with national priorities.

**3. Helps in Industrial Development**

It can help correct the lopsided development of industrial structure and thereby bring about desirable balance and diversification in the country's economic structure. It is helpful in formulating a plan of industrial development. It is helpful in formulating rules, principles and policies for the management regulation and control of industrial undertakings. It is helpful in formulating the target and programme of industrial development.

**4. Prevents Economic Power Concentration**

It is helpful in preventing the concentration of economic power. It can prevent, through industrial licensing and other supporting measures of fiscal and monetary policies, the concentration of wealth and economic power in few hands so that the emergence and evils of monopoly capitalism can be effectively curbed.

**5. Proper Control**

It empowers the State to regulate and control the establishment and expansion of the industrial undertakings in the private sector, in accordance with national planned objectives. It can help to demarcate the areas of economic activity between different sectors of the economy.

**6. Promotes Export**

It is helpful in promoting exports and reducing the dependence on imports. It is helpful in maintaining regional balances.

**7. Prevents Duplication of Economic Resources**

It can prevent duplication or uneconomic use of resources so that the country can ensure conservation and the judicious use of the country's limited resources (both exhaustible and renewable.

In short, industrial policy provides guidelines for effective coordination and integration of the activities of the various sectors of the economy with a view to achieving a balanced and self-reliant pattern of development that can ensure rapid growth of output and employment.

**Q21. Explain the Importance of Industrial Policy.**

*Ans :*

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

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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.

**Q22. Explain the main features of Industrial policy 1948.**

*Ans :* **(May-17, Imp.)**

Industrial policy of 1948 constitutes the first industrial policy of a country which was declared by the Indian government on April 6, 1948.

**Main Features of the Industrial Policy of 1948**

**1. Acceptance of the Importance of Both Private and Public Sectors**

The industrial policy resolution of 1948 has given equal importance to both the sectors of an economy [private and public sector]. It has broadened the scope of operation of the state.

**2. Division of the Industrial Sector**

The resolution of 1948 classified industries into four categories which includes:

(i) Industries that are managed and controlled by a state.

(ii) Mixed sector

(iii) Industries that are under the government control and

(iv) The private enterprises.

**(i) Industries that are Managed and Con-trolled by a State**

Three types of industries namely, Arms and Ammunition, Atomic energy and Rail Transport were included under this category.

**(ii) Mixed Sector**

It consists of six industries. They are as follows, Coal, iron, and steel, aircraft manufacturing, ship building, Telegraph and wireless apparatus and mineral oil. A provision was made for the existing private companies to survive for ten years, after that period it would be Government which decides its acquisition after paying the compensation on a fair and equitable basis.

**(iii) Industries that are under Government Control**

The government realized the importance of the following industries and had emphasized on their regulation and control. Automobiles, heavy chemicals, heavy machinery, fertilizers, machine tools, electrical engineering, sugar, paper, cotton and woollen textiles etc.

**(iv) The Private Enterprises**

The industries which were not included in the above three categories were included under the control of the private enterprises.

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**3. Role of Small and Cottage Industries**

The 1948 policy accepted the role of small and cottage industries for the development of industrial sector. These industries were established for the exploitation of employment opportunities and for using local resources.

**4. Other Important Features of the Industrial Policy**

Industrial policy helps in identifying the role of foreign capital for bringing the industrial development of the economy. At the same time, it is also used for regulating and controlling the domestic economy. According to industrial policy, Indians need to occupy major proportion of ownership and management, if the foreign investment was to be made in their industries. Such resolution also focussed on the development of harmonious relationships between the management and its employees. For developing such relationships, labour policy was initiated which is further used for providing fair wages to the employees. It also stressed upon the participation of labours in management affairs.

**Q23. Explain briefly about Industrial policy 1956.**

*Ans :* **(May-14, Imp.)**

Industrial policy of 1948 brought so many changes in the Indian economy. Some of the them include the transformation of India into a Republic Nation, the emergence of the First Five Year Plan, significant importance was laid down on the public sector, establishment of the socialistic pattern of the society and the existence of both private and public sector etc. All such changes led to the development of a new resolution which is called as the Industrial Policy Resolution of 1956. This policy was declared on 30 April, 1956.

The following were the objectives of Industrial Policy Resolution of 1956,

(a) To make the process of industrialisation faster in India.

(b) To broaden the base of public sector.

(c) To take the effective measures for the development of heavy and capital goods industries.

(d) To strive for the achievement of the economic growth of the country.

(e) To build, grow and to expand the co-operative sector.

(f) Promoting the role of private sector industries.

(g) To prevent the economy from the concentration of economic power, monopolies to only few hands.

(h) Improving small-scale, medium and cottage industries and to achieve balanced economic development.

(i) This policy aims at industrial development through the active participation of labours in management affairs and also in promoting and maintaining the culture of industrial peace.

The Industrial Policy of 1956 acts as an important policy to bring drastic improvements in industrial sectors. This policy is considered as, 'Magna Carta' for Indian industry till the emergence industrial policy of 1991.

**Classification of industries**

The industries are categorized under the following three heads,

1. Schedule "A"
2. Schedule "B" and
3. Schedule "C".

Even though, such classification was initiated in 1956 but it tends to be followed by the subsequent industrial policies.

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List of industries which are grouped under schedule 'A', schedule 'B' and schedule 'C' are as follows,

| Schedule 'A' | Schedule 'B' | Schedule 'C' |
|---|---|---|
| Schedule 'A' industries are classified into '17' industries. They are as follows, | Schedule 'B' industries consists of 12 industries. They are as follows. | The industries which do not come under schedule 'A' and 'B' were included under schedule 'C'. |
| 1. Atomic energy<br>2. Iron and steelmetals which are left out inschedule 'A'.<br>3. Heavy castingsminerals defined under MineralConcession Rules, 1949, sec 'B'.<br>4. Arms and ammunition<br>5. Coal and lignite related to chemical industries such as Drugs, Dyestuffs, plastics, etc.<br>6. Heavy machinery<br>7. Mineral oils<br>8. Railway transport<br>9. Heavy electrical plant<br>10. Air-transport<br>11. Ship-building<br>12. Mining of ores such as iron ore, chrome ore, gold, diamonds etc.<br>13. Mining and processing of elements such as Tin, lead, copper, zinc etc.<br>14. Aircraft<br>15. Minerals as per atomic energy order, 1953.<br>16. Generation and distribution of electricity.<br>17. Telephone cables, telegraph etc. | 1. Ferro alloys and tools, steels.<br>2. Aluminium and other non-ferrous<br>3. Other minerals excluding minor<br>4. Antibiotics and other essential drugs.<br>5. Basic and intermediate products<br>6. Fertilisers<br>7. Carbonisation of coal<br>8. Antibiotics and other essential drugs<br>9. Sea port<br>10. Road transport<br>11. Chemical pulp<br>12. Synthetic rubber | These industries are owned by private sector. |
| Industries listed above were state-owned. private sectors). | Industries listed above were owned by mixed-sector (i.e., by both public and | |

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Basically, schedule A industries were state-owned whereas, those industries which were progressively state-owned constituted the schedule B industries. All the privately-owned industries were included under the schedule C of the industrial policy 1956.

However, such categorisation was not rigid. It underwent alterations depending upon the planning needs of the country.

The industrial policy resolution of 1956 was responsible for bringing positive results to the industrialisation approach.

(a) It mainly strives for the maintenance of balanced regional development. By properly maintaining the regional development, the rapid industrial growth can be ensured.

(b) It was intended for the generation of sufficient manpower ensuring the development of industries and for maintaining industrial peace by developing cordial relationship with private, public, large, medium and small scale sectors.

(c) Small sectors were given permission to establish some of the industries that were grouped under the schedule 'A' of 1956 industrial policy so as to promote small-scale sectors.

(d) Priority was given to small-scale sector and were protected by providing,
   (i) Specially designed incentive system
   (ii) Direct subsidies and
   (iii) Differential tax rates.

## 1.5 Fiscal Policy

**Q24. What is fiscal policy. Explain the objectives of fiscal policy.**

*Ans :* **(May-19, May-17)**

**Definition**

**According to Harvey and Johnson M,** defined fiscal policy as the changes in government expenditure and taxation designed to influence the pattern and level of activity. An effective fiscal policy includes policy decisions associated with the whole financial structure of the government such as tax revenue, public expenditures, loans, transfers, debt management, budgetary deficit etc.

**Objectives**

The following are the objectives of fiscal policy:

1. To achieve the growth of public sector for achieving the aim of socialistic pattern of society.
2. To gather the needed resources for financing different programmes and projects used for economic development.
3. To control inflationary pressures in economy for achieving economic stability.
4. To minimize unequal distribution of income and wealth.
5. To eliminate poverty and unemployment.
6. To minimize regional conflicts.
7. To increase the rate of savings and investment for increasing the rate of capital formation.
8. To make optimum utilization.
9. To encourage the development needed in private sector through fiscal incentive.

**Q25. What are the tools and techniques of Fiscal Policy ?**

*Ans :*

The following are the important tools of fiscal policy. They are as follows,

**1. Taxation Policy**

One of the major sources of income for the Indian government is tax revenue. The government imposes both direct and indirect taxes. Direct taxes are continuous (or) progressive in nature whereas indirect tax are regressive in nature. Taxation plays a vital role in gathering resources for the five year plans.

**The following are the main objectives of taxation policy in India,**

(i) To gather the resources for financing economic development.

(ii) To encourage saving and investment through time deposits, investment in government bonds, units, insurance etc., for capital formation.

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(iii) To achieve quality in distribution of income and wealth by imposing progressive direct taxes.

(iv) To achieve price stability by using an anti inflationary taxation policy.

**2. Public Expenditure Policy**

Public expenditure plays a crucial role in the economic development of a developing country like India. The amount of public expenditure in an immensely populated country like India is increasing at a rapid rate due to rise in the responsibilities of the government and increasing involvement of the government in the economic activities of the country. There are two kinds of public expenditure. They are as follows,

(i) Development expenditure is usually associated with development activities like development of infrastructure, educational centres, industry, health facilities etc.

(ii) The non-developmental expenditure is related with the maintenance kind of expenditure which is associated with the maintenance of law and order, defence administrative services etc.

**3. Deficit Financing Policy**

The government of India has been using the deficit financing policy for financing its developmental plans. Deficit financing policy was initiated by J.M Keynes. In Indian context, the deficit financing denotes that the government is obtaining loans from RBI by issuing fresh currency. By taking into consideration the low income levels, low saving rates and capital formation, the government is undertaking a resource for deficit financing. Deficit financing is regarded as the forced savings which are the outcome of increase in the prices during the period of government investment.

**4. Public Debt Policy**

In underdeveloped countries like India there is a taxation limit given due to poor taxable ability of the individuals, so the government makes use of public debt for financing its developmental expenses. Public debt is classified into two types, which are as follows,

**(i) Internal Debt**

Internal debt is the amount of loan acquired by the government from within the country. Internal public debt is obtained from an open market by the process of issuing bonds, cash certificates and 15 years annuity certificates.

**(ii) External Debt**

External debt is the amount of loan taken from external sources i.e., from abroad in the form of capital goods, foreign currency etc. The central government can also acquire funds from international funding agencies like World Bank, IDA, IMF and IFC for financing different developmental projects. In order to finance different infrastructure projects, inter-governmental loans are taken by the government from different developed countries.

**Q26. State the features of Fiscal Policy.**

*Ans :*

The following are the main features of fiscal policy,

**1. No Change in the Rate of Direct Taxes**

As per the new policy, there will be no change in the following rates such as income tax rate and wealth tax rate in the coming five years. In order to raise the percentage share of direct tax in the entire tax revenue, revenues which are generated from direct taxes are also raised.

**2. Tax Evasion**

The government of India is putting special efforts on this aspect to eliminate the aspect of 'tax evasion'. If anyone found to avail tax evasion facility will be punished severely by the government.

**3. Corporate Tax**

According to new policy, there is no surtax and surcharge on corporate tax in one provision. The rate of corporate tax will not be higher or lower. It will be constant.

**4. Gift Tax**

According to new policy, this aspect is used for constructive usage which benefits the

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country by way of savings. Funds from gift tax are utilized in order to save more.

**5. Change in the Structure of Indirect Taxes**

A new policy has one provision which relates to change in the structure of indirect taxes. This provision means to impose excise duty at the final stage of production rather than imposing excise duty at each stage of production.

**6. Small-scale Industries**

The new policy aims at developing and improving the role of small-scale industries. This policy aims at strengthening small-scale industries.

**7. Import Duties**

The new policy aims at regulating imports by way of import duties instead of import restrictions. The equipments which are not produced in a country can avail the facility of low import duties.

**8. Agricultural Sector**

According to the new policy there is no such provision to impose tax on this agricultural sector.

**9. Immovable Property**

According to new policy tax evasion of immovable property is investigated. If such property is undervalued then in such case the government has the right to possess it by paying 15% more than the actual price of that property.

**10. Restrictions on Consumer Goods**

The consumer can avail lower tax rate or tax free exemptions on essential consumer goods like edible oils, life saving drugs etc. For non-essential goods the tax rate will be same. The price of food grains will be in accordance with the cost of production.

**11. New Saving Scheme**

According to the new policy, the government setup this new saving scheme. According to this scheme no tax for 50% of capital invested and the capital invested will benefit by way of earning 10% on capital investment.

**12. Modern Technology**

According to new policy to strengthen this modem technology 'entrepreneur development fund' by investing ` 10 crore is initiated by new fiscal policy. This policy also suggests that 5% will be imposed on imported technology which in turn serves as a source of revenue from this established fund.

**13. Employment Oriented Opportunities**

The new policy also strives towards generating employment opportunities and subsequently providing financial support for the welfare of the country.

**14. No Secrecy Regarding Budget**

According to new policy, there will be no secrecy in annual budget. It should be fair and open to the general public and economic experts which in turn helps in understanding the income and expenditure in an efficient manner. Level budget gets approval after proper discussion at the parliamentary committee.

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**Q27. Analyse the merits and shortcomings of the fiscal policy of India. Suggest necessary reforms in the fiscal policy of the country.**

*Ans:*

**Merits/Advantages of Fiscal Policy of India**

Fiscal policy has its own pros and cons which can be studied as follows,

**1. Formation of Capital**

A country's fiscal policy plays a vital role in increasing the rate of capital formation both in the public and the private sectors. There was a continuous growth in the gross domestic capital formation from 10.2% (in 1950-51) to 24% (in 1997-98). By bringing the drastic growth in the formation of capital it has also paved the path for the development of both private and public sectors.

**2. Mobilization of Resources**

Through different types of taxes, public debt and other sources of finances, adequate amount of resources can be generated by the new fiscal policy.

**3. Incentives to Savings**

Different types of incentives have been provided by the Indian fiscal policy so as to increase the saving capability of both the household sector and the corporate sector. Some of the incentives include the tax exemptions, tax concessions and so on.

**4. Incentive to Private Sector**

In order to expand the activities of the private sectors, the fiscal policy of the country provides necessary inducements to the private sector in the form of tax concessions tax exemptions subsidies etc. As an assistance measure, such incentives were incorporated in the budgets of the private sectors so that sufficient amount of finance can be provided to those which are involved in the infrastructure and export sectors.

**5. Reduction of Inequality**

The fiscal policy has made certain provisions which helped the Indian government to restrict the unequal concentration of wealth and income. According to fiscal policy, the inequalities and regional disparities could be reduced to a great extent by providing income and wealth tax exemptions, subsidies and grants.

**6. Export Promotion**

Continuous efforts have been witnessed by the government during the formulation of a new fiscal policy. The main purpose of fiscal policy is to promote export by using different budgetary policy measures such as subsidies, allowances etc.

**7. Alleviation of Poverty and Unemployment**

New fiscal policy is significant as it had made several steps towards the elimination of poverty and towards the generation of employment. It had established several poverty eradication and employment generation programmes. The most prominent among them were, IRDP (Integrated Rural Development Programme), JRY (Jawahar Rozgar Yojana), EAS (Employment Assurance Scheme) etc.

**Shortcomings of Indian Fiscal Policy**

The new fiscal policy of India has been criticized due to the following reasons,

**(i) Instability**

It is devoid of bringing and implementing the stable economic situations for the country. The increased deficit financing led to the inflationary rise in the levels of prices. Even, the external stability of the country was affected by the disequilibrium or deficits in the BOP.

**(ii) Defective Tax Structure**

The fiscal policy was not able to propose in providing an appropriate tax structure for the country. The existing tax structure could not be found to raise the productivity of the direct taxes, because of which the country had to predominantly depend on the indirect taxes.

**(iii) Inflation**

The new fiscal policy led to the emergence of several types of inflation in the Indian economy. The increased levels of public expenditure on the non-developmental activities and deficit financing resulted into the occurrence of the demand-pull inflation whereas, the cost-push inflation was the resultant of the higher rate of indirect taxes. Besides, the direct taxes have also failed to keep a watch on the expansion of black money which further worsened the inflationary price levels.

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**(iv) Growing Inequality**

Country's fiscal policy has failed to make equitable distribution of wealth and income among all the sectors of the economy. The increased dependency on the tax evasions resulted into the increased ineffectiveness. On the other hand, when the indirect taxes were given due importance, the tax structure tends to become regressive.

**Suggestions for bringing necessary Reforms in Fiscal Policy**

Some of the important measures have been adopted by the Indian government for the implementation of the necessary reforms.

**(a) Progressive Taxes**

A country's tax structure must make an effort to include progressive elements in such a way that the rich sectors must be greatly affected with it when compared to the weaker sections of the society. Required changes need to be made with regard to irrigation tax, sales tax, property tax, excise duty etc.

**(b) Agriculture Sector**

The existing tax provisions must be extended to the rich agriculturists so as to tap their huge proportion of revenues.

**(c) Broad-based Tax Net**

It must consider all those industries, individuals, governmental and foreign bodies who are capable of paying the taxes.

**(d) Checking Tax Evasion**

Effective measures should be taken against those who are evading the taxes. Tax machinery needs to be organized, structured and efficient, so as to improve its performance. Tax rates must be fixed at the appropriate levels, so that the tax compliance could be increased drastically.

**(e) Increasing Trust on Direct Taxes**

Tax structure should depend more on the income generated through the direct taxes than on indirect taxes. Therefore, tax machinery of the country must make an effort to introduce estate duty, gift tax,

**(f) Simplified Tax Structure**

The tax structure and rules must be simplified for encouraging the tax compliance among the re people and to protect the tax payers from unnecessary harassments from the government.

**(g) Reduction of Non-development Expenditure**

A country's fiscal policy must make efforts to increase the investments so as to perform the developmental activities of the country. This in turn helps in reducing the volume of unproductive expenditure, thereby reducing the inflationary impact of such expenditures.

**(h) Checking Black Money**

The fiscal policy must lay down certain rules for checking the problems of black money, corruption, political interferences, smuggling and other nefarious activities. In this context, VDIs should be implemented.

**(i) Raising the Profitability of PSUs**

Certain policies related to the management of PSUs need to be revised which should ensure the efficiency and increased rate of return on the capital invested in raising PSUs. They must be efficiently managed with less government intervention.

## 1.6 MONETARY POLICY

**Q28. Define Monetary Policy. What are the objectives of Monetary Policy?**

*Ans :* **(May-16, May-15, Imp.)**

**Meaning of Monetary Policy**

Monetary policy refers to the process by which the monetary authority of a country controls the supply of money, often targeting a rate of interest to attain a set of objectives oriented towards the growth and stability of the economy.

**Definitions of Monetary Policy**

Many economists have given various definitions of monetary policy. Some prominent definitions are as follows:

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**(i) According to Prof. Harry Johnson,** "Monetary policy is a policy employing the central banks control of the supply of money as an instrument for achieving the objectives of general economic policy is a monetary policy."

**(ii) According to A.G Hart,** "Monetary policy is a policy which influences the public stock of money substitute of public demand for such assets of both that is policy which influences public liquidity position is known as a monetary policy."

### Objectives Of Monetary Policy

The objectives of a monetary policy in India are similar to the objectives of its five year plans. In a nutshell planning in India aims at growth stability and social justice. After the Keynesian revolution in economics, many people accepted significance of monetary policy in attaining following objectives:

**i) To ensure the Rapid Economic Growth**

It is the most important objective of a monetary policy. The monetary policy can influence economic growth by controlling real interest rate and its resultant impact on the investment. If the RBI opts for a cheap or easy credit policy by reducing interest rates, the investment level in the economy can be encouraged. This increased investment can speed up economic growth. Faster economic growth is possible if the monetary policy succeeds in maintaining income and price stability.

**ii) To helps for Price Stability**

All the economics suffer from inflation and deflation. It can also be called as Price Instability. Both inflations are harmful to the economy. Thus, the monetary policy having an objective of price stability tries to keep the value of money stable. It helps in reducing the income and wealth inequalities. When the economy suffers from recession the monetary policy should be an 'easy money policy' but when there is inflationary situation there should be a 'dear money policy'.

**iii) To assists for Exchange Rate Stability**

Exchange rate is the price of a home currency expressed in terms of any foreign currency. If this exchange rate is very volatile leading to frequent ups and downs in the exchange rate, the international community might lose confidence in our economy. The monetary policy aims at maintaining the relative stability in the exchange rate. The RBI by altering the foreign exchange reserves tries to influence the demand for foreign exchange and tries to maintain the exchange rate stability.

**iv) To assists for Balance of Payments (BOP) Equilibrium**

Many developing countries like India suffer from the Disequilibrium in the BOP. The Reserve Bank of India through its monetary policy tries to maintain equilibrium in the balance of payments. The BOP has two aspects i.e. the 'BOP Surplus' and the 'BOP Deficit'. The former reflects an excess money supply in the . domestic economy, while the later stands for stringency of money. If the monetary policy succeeds in maintaining monetary equilibrium, then the BOP equilibrium can be achieved.

**v) To ensure the Full Employment**

The concept of full employment was much discussed after Keynes's publication of the "General Theory" in 1936. It refers to absence of involuntary unemployment. In simple words 'Full Employment' stands for a situation in which everybody who wants jobs get jobs. However it does not mean that there is Zero unemployment. In that senses the full employment is never full. Monetary policy can be used for achieving full employment. If the monetary policy is expansionary then credit supply can be encouraged. It could help in creating more jobs in different sector of the economy.

**vi) To ensure the Neutrality of Money**

Economist such as Wicksted, Robertson has always considered money as a passive factor. According to them, money should play only a role of medium of exchange and not more

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than that. Therefore, the monetary policy should regulate the supply of money. The change in money supply creates monetary disequilibrium. Thus monetary policy has to regulate the supply of money and neutralize the effect of money expansion. However this objective of a monetary policy is always criticized on the ground that if money supply is kept constant then it would be difficult to attain price stability.

**vii) To support for Equal Income Distribution**

Many economists used to justify the role of the fiscal policy is maintaining economic equality. However in recent years economists have given the opinion that the monetary policy can help and play a supplementary role in attainting an economic equality. Monetary policy can make special provisions for the neglect supply such as agriculture, small-scale industries, village industries, etc. and provide them with cheaper credit for longer term. This can prove fruitful for these sectors to come up. Thus in recent period, monetary policy can help in reducing economic inequalities among different sections of society.

**Q29. Explain different types of Monetary Policy?**

*Ans :*

**1. Inflation targeting**

Under this policy approach the target is to keep inflation, under a particular definition such as Consumer Price Index(CPI), within a desired range.

The inflation target is achieved through periodic adjustments to the Central Bank interest rate target. The interest rate used is generally the interbank rate at which banks lend to each other overnight for cash flow purposes. Depending on the country this particular interest rate might be called the cash rate or something similar.

The interest rate target is maintained for a specific duration using open market operations. Typically the duration that the interest rate target is kept constant will vary between months and years. This interest rate target is usually reviewed on a monthly or quarterly basis by a policy committee.

Changes to the interest rate target are made in response to various market indicators in an attempt to forecast economic trends and in so doing keep the market on track towards achieving the defined inflation target.

**2. Price level targeting**

Price level targeting is similar to inflation targeting except that CPI growth in one year over or under the long term price level target is offset in subsequent years such that a targeted price-level is reached over time, e.g. five years, giving more certainty about future price increases to consumers. Under inflation targeting what happened in the immediate past years is not taken into account or adjusted for in the current and future years.

**3. Monetary' aggregates**

In the 1980s, several countries used an approach based on a constant growth in the money supply. This approach was refined to include different classes of money and credit (MO, MI etc.). While most monetary policy focuses on a price signal of one form or another, this approach is focused on monetary quantities.

**4. Fixed exchange rate**

This policy is based on maintaining a fixed exchange rate with a foreign currency. There are varying degrees of fixed exchange rates, which can be ranked in relation to how rigid the fixed exchange rate is with the anchor nation.

Under a system of fiat fixed rates, the local government or monetary authority declares a fixed exchange rate but does not actively buy or sell currency to maintain the rate. Instead, the rate is enforced by non-convertibility measures (e.g. capital controls, import/export licenses, etc.). In this case there is a black market exchange rate where the currency trades at its market/unofficial rate.

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Under a system of fixed-convertibility, currency is bought and sold by the central bank or monetary authority on a daily basis to achieve the target exchange rate. This target rate may be a fixed level or a fixed band within which the exchange rate may fluctuate until the monetary authority intervenes to buy or sell as necessary to maintain the exchange rate within the band. Under a system of fixed exchange rates maintained by a currency board every unit of local currency must be backed by a unit of foreign currency (correcting for the exchange rate). This ensures that the local monetary base does not inflate without being backed by hard currency and eliminates any worries about a run on the local currency by those wishing to convert the local currency to the hard (anchor) currency.

These policies often abdicate monetary policy to the foreign monetary authority or government as monetary policy in the pegging nation must align with monetary policy in the anchor nation to maintain the exchange rate. The degree to which local monetary policy becomes dependent on the anchor nation depends on factors such as capital mobility, openness, credit channels and other economic factors.

**5. Gold standard**

The gold standard is a system under which the price of the national currency is measured in units of gold bars and is kept constant by the government's promise to buy or sell gold at a fixed price in terms of the base currency. The gold standard might be regarded as a special case of "fixed exchange rate" policy, or as a special type of commodity price level targeting.

The minima! gold standard would be a long-term commitment to tighten monetary policy enough to prevent the price of gold from permanently rising above parity. A full gold standard would be a commitment to sell unlimited amounts of gold at parity and maintain a reserve of gold sufficient to redeem the entire monetary base.

Today this type of monetary policy is no longer used by any country, although the gold standard was widely used across the world between the mid-19th centuries through 1971. Its major advantages were simplicity and transparency. The gold standard was abandoned during the Great Depression, as countries sought to reinvigorate their economies by increasing their money supply. The Bretton Woods system, which was a modified gold standard, replaced it in the aftermath of World War II. However, this system too broke down during the Nixon shock of 1971.

**Q30. Explain different tools of Monetary Policy?**

*Ans :*

**1. Monetary base**

Monetary policy can be implemented by changing the size of the monetary base. Central banks use open market operations to change the monetary base. The central bank buys or sells reserve assets (usually monetary instruments such as bonds) in exchange for money on deposit at the central bank. Those deposits are convertible to currency. Together such currency and deposits constitute the monetary base which is the general liabilities of the central bank in its own monetary unit. Usually other banks can use base money as a fractional reserve and expand the circulating money supply by a larger amount.

**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 loan able funds. This acts as a change in the money supply.

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Central banks typically do not change the reserve requirements often because it creates very volatile changes in the money supply due to the lending multiplier.

**3. Discount window lending**

Discount window lending is where the commercial banks/and other depository institutions, are able to borrow reserves from the Central Bank at a discount rate. This rate is usually set below short term market rates. This enables the institutions to vary credit conditions (i.e., the amount of money they have to loan out), thereby affecting the money supply. It is of note that the Discount Window is the only instrument which the Central Banks do not have total control over.

By affecting the money supply, it is theorized, that monetary policy can establish ranges for inflation, unemployment, interest rates and economic growth. A stable monetary environment is created in which savings and investment can occur, allowing for the growth of the economy as a whole.

**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. One cannot set independent targets for both the monetary base and the interest rate because they are both modified by a single tool open market operations; one must choose which one to control. In other nations, the monetary authority may be able to mandate specific interest rates on loans, savings accounts or other monetary assets. By raising the interest rate(s) under its control, a monetary authority can contract the money supply, because higher interest rates encourage savings and discourage borrowing. Both of these effects reduce the size of the money supply.

**5. Currency board**

A currency board is a monetary arrangement that pegs the monetary base of one country to another, the anchor nation. As such, it essentially operates as a hard fixed exchange rate, whereby local currency in circulation is backed by foreign currency from the anchor nation at a fixed rate. Thus, to grow the local monetary base an equivalent amount of foreign currency must be held in reserves with the currency board. This limits the possibility for the local monetary authority to inflate or pursue other objectives. The principal rationales behind a currency board are threefold:

i) To import monetary credibility of the anchor nation;

ii) To maintain a fixed exchange rate with the anchor nation;

iii) To establish credibility with the exchange rate (the currency board arrangement is the hardest form of fixed exchange rates outside of dollarization).

In theory, it is possible that a country may peg the local currency to more than one foreign currency; although, in practice this has never happened (and it would be a more complicated to run than a simple single-currency currency board). A gold standard is a special case of a currency board where the value of the national currency is linked to the value of gold instead of a foreign currency.

**Q31. What are the various challenges of monetary of policy.**

*Ans :*

1. Financial markets are unperturbed; with the flattening of yield curves, the compression of risk spreads and the search for yields continues unabated.

2. Global imbalances have actually increased with no fears of hard landing, but with some sense of readying for a bumpy soft landing. Movements in major exchange rates are not reflecting fundamentals in an environment of generalized elevation in asset prices and abundant liquidity.

3. Strong global economic growth could be accompanied by emerging pressures on core

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inflation. The challenge facing us is to judge the compatibility of the current pace of growth with non-accelerating inflation. In the event of a judgment that the current growth momentum is more cyclical than structural, the stance of monetary policy would need to reflect sensitivity to the inevitability of a downturn. On the other hand, the judgment that structural factors predominate would warrant a different policy stance.

4. An overriding concern faced by the Reserve Bank is the persistently high growth of bank credit, with attendant worries relating to the quality of bank credit The sharp increase in credit to sectors such as housing, commercial real estate and retail loans have also been worrisome on account of the vulnerability of banks to credit concentration risks.

5. It is difficult to arrive at a clear judgment as to what rate of credit growth is too high in relation to potential growth.

6. Some of the models integrate policy behavior with the banking system, the demand for a broad monetary aggregate, and a rich array of goods and financial market variables, providing a more complete understanding of the monetary transmission mechanism. Weak economic assumptions and large models corqbine to reveal difficulties with sorting out policy effects that other approaches fail to bring out.

## 1.7 Political Environment

**Q32. Explain briefly about Political Environment.**

*Ans :* **(Imp.)**

The political environment of business refers to the political or government actions that impact business operations. The political factors usually go hand in hand with the legal ones and are generally viewed as the non-market forces that impact businesses. Political decisions ultimately affect the economic, social and cultural environments as a whole.

The political environment can be studied in terms of the central government, the citizens of a country, rules, and regulations or international relations. Examples of political factors related to the central government of a country are levels of bureaucracy, corruption, and government stability. A culture of corruption in a country stifles business operations by creating an unlevel playing field where corrupt individuals are more empowered to advance their business goals than their non-corrupt counterparts. A highly unstable government is unable to offer businessmen the security they need to trade peacefully, hence a highly volatile trading environment. Examples of political factors tied to international relations are policies on trade tariffs, policies on importation and exportation of goods and services and international trade agreements.

**Factors**

**1. Tax and economic policies**

Increasing or decreasing rate of taxes is a good example of a political component. Government regulations may raise the tax rate for some businesses and can lower the same for others due to specific reasons. This decision will directly impact businesses. This is why maintaining a strategy which can deal with such situations is very important.

**2. Political stability**

Lack of political stability within a country can significantly impact the operations of a business. This can especially be true for businesses that are operating on the global scale. For instance, a hostile takeover can take over a government. Eventually, such a situation will lead to looting, riots and general disorder within the environment. Such situations can disrupt business operations and activities which can have a major impact on its bottom line.

**3. Foreign Trade Regulations**

Every business has a need to expand business operation to other countries. However, political background of a country can influence the desire for a business to expand its operations. Tax policies that are particularly controlled by the government can induce a particular business to expand operations in different regions whereas; other tax policies

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can hinder the process of business expansion for some industries. Government initiatives, which have been designed to support local businesses, might work against international companies when the question is of their competitiveness in a foreign region.

**4. Employment Laws**

Employment laws are made to protect the rights of employees and include every aspect of employer/employee relationship. Employment law is an aspect that is very complex and involves several pitfalls as well. When businesses' are in touch with the latest developments in this law, they can manage to take their business in the right direction however, those who get it wrong needs to be completely prepared for the expensive results it will generate. In modern corporations, employees are almost 98% of the company for the accomplishments or lack thereof and any changes within employment law will, of course, have a great impact on the business operations.

### 1.7.1 Role of Government in Business

**Q33. Explain the Role of Government in Business.**

*Ans :* **(Imp.)**

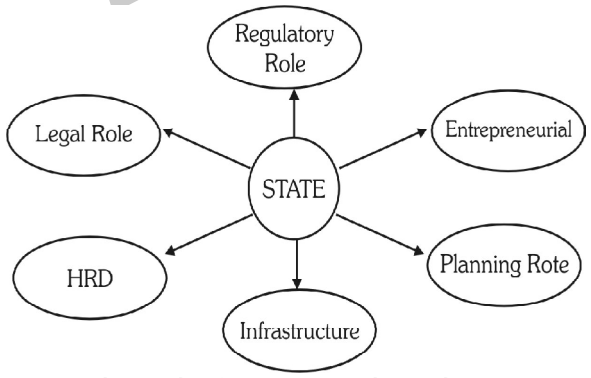


**Fig. : Role of Government in Business**

**(A) Regulatory Role**

The Governments regulate the business. They not only decide the rules of the game but also look after the implementation of those rules.

**1. Reservation**

The governments limits the spheres of investment by reserving the industry for small scale, public and the co-operative sector. For instance, before liberalisation, petroleum, telecommunication, coal, power, etc., were the monopoly of the public sector. But liberalisation brought new investment opportunities for the private sector. Now only two sectors, i.e., railways and atomic energy are reserved for the public sector.

Many industries are still reserved for the small-scale sector. Because of this policy, we have seen a boom in many industries over the last fifteen years. As of now, along with telecom services, Reliance has established one of the largest grassroots refineries of the world. Other big telecom players like Bharti Telecom and TATA have also invested heavily in telecommunication.

New power projects have been established by the private sector. Aviation is no more a government monopoly as dozens of private players as Sahara Airlines, Kingfisher Airlines, Spicejet, Air Deccan have entered this field. Hosts of new players have entered the finance sector, especially the insurance, with business houses like TATAs, A V Birla, Bajaj, ICICI, etc., making the most of new opportunities.

**2. Licensing**

Licensing is an effective tool in the hands of government to regulate business. Earlier, for almost every new venture, a licence was required from the government, which used to keep a tight control on production in the private sector. But now only investment in a few industries requires licences. Though, in some cases, industry may have to acquire license from other authorities like pollution control, Ministry of Environment & Forests, Food & Drug Administration, etc.

**3. Expansion**

The government can provide a business house both, the opportunity to expand as well as restrict their expansion activities. Earlier, through the MRTP Act, the government restricted the expansion of big houses, besides

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which various restrictions were imposed on increasing production capacity or launching new variants. Restriction existed even on the advertisement budget of big business houses or on their investments abroad.

This is the prime reason that we were driving the same car in 1980 which we drove in 1950; even as late as 1990, we had just one new option in the form of Maruti car. But when this restriction was repealed, the whole equation of business underwent a change. Ranbaxy, A V Birla, Dr. Reddy's Lab, ONGC, L&T, etc., are now multinational companies. Asian Paints has operations in 28 nations of the world. Indian companies have achieved amendable economies of scale and consumers have a wider choice available from big product portfolios of companies. But even now, the expansion of many companies continues to remain at/on the mercy of the government.

**4. Foreign Direct Investment**

It is the government that decides whether MNCs can invest in a country or not. Because of these government policies there were very few MNCs in India. Even companies like IBM and Coca Cola had to leave India in the past because of these policies. Today, MNCs are present in sectors like insurance, petroleum, banks and publication, but they are still not present in the retail sector as the government doesn't allow foreign participation in the retail sector.

**5. Import and Export Policy**

With a small declaration, the government can open and close various avenues for export and import. As a matter of policy, the government can use various tools to impose restrictions on imports such as quota, tariffs, cumbersome import process, import licenses, etc. Till 1991, India followed a protectionist policy to keep the industry away from imports that were deemed harmful. But now the policy has been amended and imports are easy. This has badly affected various industries in India and many had to shut down their operations. Thus, it is the government which decides what can be imported or exported and what cannot.

**6. Taxes**

The government regulates industry through taxes. It usually imposes a high rate of tax on the industry which it doesn't want to encourage. For instance, after independence, a very high excise was imposed on products like airconditioners, automobiles, etc., whereas there was virtually no tax on production of products reserved for the small scale industry. Also, to increase the use of certain products, the government provides subsidy on items such as fertilizers, tractors and other farm equipment. The government also tries to influence the location of the industry by permitting tax breaks for establishing industry in a particular region.

**7. Supply of Money**

Demand depends upon the purchasing power of the consumer which, in turn, depends upon supply of money and the supply of money is decided by the government (RBI). There are many ways through which the government regulates the supply of money. The RBI can increase the supply of money in the market by decreasing the CRR, SLR, etc. which reduced the interest rate in the market. In the last 15 years, interest rates have fallen drastically, which has lent more purchasing power to the consumer. This has boosted the consumer goods industry and the housing industry as well. The government can also increase or decrease the supply of money by increasing or decreasing income tax rate and interest rate on savings. So an industry is, to an extent, dependent on the government for enhancing demand.

**8. Supply of Foreign Exchange (FOREX)**

The government not only regulates import and export through its policy decisions, but also controls it through control of the supply of foreign exchange. Before liberalisation, it was the government which used to decide the exchange rate. To restrict import, it restricts the supply of Forex whereas to boost export

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and discourage import, it devaluates the currency. Even after liberalisation, when the Rupee was convertible, the RBI controlled supply and exchange rate through open market operations. Besides all these, the government regulates business through administrative and physical controls. So we see that government regulates almost every aspect of business. It provides the opportunity to invest and simultaneously restricts investment in a particular area.

**9. Incentives**

The government also regulates the industry by providing incentives in the key thrust areas. For instance, it gives tax beaks if an industrial unit is established in a backward area. It also grants subsidies under various schemes to the small scale sector. To support export, it establishes special zones like SEZs, it grants subsidies and tax relaxations on exports, import licenses and less import duty for exporters, and easy financing through banks. To support a particular industry in the national interest, it also directs financial institutions to give liberal loans to that sector at easy terms. To provide a boost to the housing industry, the government has given exemption to housing loans from income tax.

**(B) Legal Role**

The Parliament is the law making authority and it is the council of ministers that presents the proposed law in the parliament. It is the government which decides and implements the legal structure of the country. For instance, in the 1980s, the famous NRI Swaraj Paul attempted to take over Escorts, the prevailing legal environment saved the company. A new law was enacted which stipulated that a Non- Resident Indian could not acquire any stake in an Indian company beyond a certain limit.

The government has enacted many laws to regulate industry. As in the case of IDRA, the MRTP Act was amended to the Competition Act to ensure fair competition among organizations. The Essential Commodities Act, the Environment Act, the Companies Act, the SEBI Act, the Consumer Protection Act, Labour Laws, etc. have been enacted to protect human resource from exploitation. While doing business, enterprises have to abide by the law. This not only ensures healthy competition but it also gives companies a level playing field. It is the law which protects the intellectual capital of an organization. Business flourishes only in those states which have a healthy legal system.

**(C) Infrastructure Development**

In developing nations, the growth of infrastructure is imperative and the government plays a critical role in this. It is said that "take care of roads and electricity and development and employment generation will take care of itself". Well-established infrastructure is the basic requirement for the establishment and growth of industry. In a developing nation, where infrastructure is in a poor state, the government has to take steps to develop the same, i.e., construction of roads, development of railways, supply of power, transport, finance sector, training and guidance, research and development, etc.

Since independence, the state in India has invested heavily on infrastructure. Now under the new regime, even the private sector is playing a critical role in developing infrastructure.

**(D) Human Resource Development**

Today, it is not the raw material or geographical proximity to the market which decides the location of a unit, but the availability of human resources which nowadays plays a decisive role in settling down on the location of any establishment. Today, when research, new product development, economies of scale, low production cost are the mantra to success, trained and skilled human resources have become the critical success factors for every industry.

But in developing nations like India, the state plays a critical role in developing human resources as at the time of independence, the private sector was not in a position to invest in higher and technical education. Unlike developed nations, the masses of India were and still are not in a position to afford higher technical education. This is the reason that the state invested heavily in higher technical education and established premier institutes like IITs, IIMs,, IVRIs, AIMS, BHU and other universities.

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Not only this, thanks to Pt Nehru that India retained English as a medium of instruction in education. Because of these efforts of the State, India is justifiably proud of its human resources. Today many businesses such as BPO, software, electronics, etc., are flourishing in India because of its human resources and India is becoming a manufacturing hub for mobile phones, pharmaceuticals, fundamental research, etc. Technical and knowledge level of HR is also a critical input for the industry and the State plays a vital role in influencing and deciding this.

### (E) Entrepreneurial Role

The State also plays the role of an entrepreneur by investing in business. The Government of India has been one of the biggest investors in business and industry since Independence. Through its investment, the government considerably influences the business environment. In India, after independence, the government reserved some industries for Public Sector where the private sector cannot invest. But the government has also invested in other areas, which were not reserved for public sector. In a developing nation, investment by the government helps the private sector a lot.

After independence, the Indian government heavily invested in capital intensive industry where gestation period is high and private entrepreneurs are not interested—such as Steel (SAIL), Aluminum (Indal), Railways, Power (NTPC,), Heavy Machines, Earth Moving Machines, Heavy Electrical Machinery (BHEL), Petroleum, Telecommunication, etc. All these investments promoted the private industry by making available raw material and machines.

### (F) State Role

State is an architect of the industrial scenario in a country. It is true for a country like India where the state also performs the task of a planner. India has followed a policy of five year planning system. It is the planning commission which plans the direction of investment for the following five years. This significantly influences the business environment. The planning commission declares the key areas where the state is going to invest and support in the coming five years. All this even influences the investment decision of the private sector, as they get support from the government when they invest in a priority sector.

## 1.8 Legal Environment

**Q34. Define Legal Environment. Explain the need for Legal Environment.**

*Ans :*

Legal Environment refers to the set of laws and regulations which influence the business organization and their operations. Every business organization has to obey and work within the framework of law. The legal environment is derived partly from the political climate in a country and as three distinct dimensions to it:

(a) The laws of the home country

(b) The laws of the foreign markets

(c) International law in general

The legal environment of a business refers to the relevant laws and regulations under which the business operates. Legal environment includes factors that provide rules, and penalties for violations, designed to protect society and consumers from unfair business practices and to protect businesses from unfair competitive practices. It assures uniform application of the laws by regulating the behavior and interactions of individuals against each other.

**Needs for Legal Environment**

i) Legal Environment maintain status quo in society ensuring stability and security of social order, enable individuals, maximum of freedom to assert themselves and determine the sphere within which the existence and activity of each individual will be secure and free.

ii) The principle of law provides uniformity and certainty to the administration of justice.

iii) The existence of fixed principles of law avoids the dangers of arbitrary, biased and dishonest decisions.

iv) The fixed principles of law protect administrators of justice from the errors of individual judgment.

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**Q35. Explain the importance of Legal Environment.**

*Ans :*

**Legal environment is important because it incorporates the following ways :**

**(i) Laws on Production or Sales**

The production or sale of certain goods is prohibited, or at least severely restricted in many countries. This includes, among others, selling of dangerous drugs, guns and explosives, for instance. Aerosol cans containing CFCs, which are harmful to the environment, or more specifically, the ozone layer, are banned and no longer produced.

**(ii) Consumer Protection**

Most countries have laws ensuring customers are being treated fairly by businesses. This includes the act regulating weights and measurements, ensuring that goods sold actually are the weight or size they are sold at, and the Trade Description Act, making misleading descriptions of products illegal.

Other laws include the Consumer Credit Act, ensuring consumers are aware of loan durations, interest rates etc when taking out a loan, as well as receiving copies of credit agreements, and the Sale of Goods Act, making it illegal to sell faulty or damaged goods. The return of goods and refunds, etc, is also governed by laws.

**(iii) Employee Protection**

Laws to protect employees include laws against unfair discrimination based on race, color, religion, sex or age; laws against unfair dismissal and sexual or other harassment; health and safety laws and laws regulating minimum wages. Many countries make written contracts between employer and employees mandatory.

**(iv) Tax and Financial Laws**

These laws vary between countries, but generally regulate accountancy practices, interest rates on loans, taxes etc. Businesses are executed to provide sufficient documentation of income and expenditure, for instances.

## 1.9 CONSUMER PROTECTION ACT

**Q36. Define the terms :**

**(1) Consumer, (2) Goods**

**(3) Person (4) Services**

*Ans :*

**1. Consumer [Sec. 2(1)].**

'Consumer' means any person, who –

(i) Buys any goods for a consideration (a) Which has been paid or promised or partly paid and partly promised, or (b) Under any system of deferred payment. The use of such goods must be made with the approval of the buyer.

'Consumer' does not include a person who obtains goods for resale or for any commercial purpose.

'Commercial purpose' does not include use by a person of goods bought and used by him and services availed by him exclusively for the purposes of earning his livelihood by means of self employment.

(ii) Hires or avails of any service for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment. 'Consumer' also includes any beneficiary of such services other than the person who hires or avails of such services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment. Further such services must be availed of by the beneficiary with the approval of the hirer but does not include a person who avails of such services for any commercial purpose.

**2. Good [Sec. 2(1)]**

It means goods as defined in the Sale of Goods Act, 1930. According to Sec. 2(7) of

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the Sale of Goods Act, 1930, goods means : "Every kind of movable property other than actionable claims and money, and includes stocks and shares, growing crops, grass and things attached to or forming part of land which are agreed to be served before sale or under the contract of sale."

**3. Person [Sec. 2(1)(m)]**

'Person' includes -

(i) A firm whether registered or not ;

(ii) A hindu undivided family ;

(iii) A co-operative society ;

(iv) Every other association of persons whether registered under the Societies Registration Act, 1860 or not.

**4. Service[Sec.2(1)(o)]**

It means service of any description which is made available to potential users. It includes provision of facilities in connection with (a) banking, (b) financing, (c) insurance, (d) transport, (e) processing, (f) supply of electrical or other energy, (g) board or lodging or both, (h) house construction, (i) entertainment, amusement or other purveying of news or other information.

The expression 'service' includes in its scope provision of facility in connection with telephone provided by Telecommunication Department and houses and plots by the Housing & Development Board.

'Service' however does not include the rending of any service free of charge or under a contract of personal service.

**Q37. What are the objectives of Consumer Protection Act, 1986 ?**

*Ans :*

Consumer protection is a type of protection which is provided to the consumers against the effect of malpractices of the marketers and firms and the social evils such as corruption, ill treatment, exploitation, unhygienic working conditions, injurious manufactures, deceitful market practices including black marketing, overcharging, misguidance by advertising, mislabelling, misuse of trademarks, patents etc.

Consumer protection specifies the protection provided to the consumers against the adverse market conditions such as price hikes, black marketing etc. The three important aspects of consumer protection include,

(i) Physical protection of consumers

(ii) Protection of consumer's economic interest

(iii) Protection of public interest.

**Objectives of Consumer Protection Act, 1986**

Some of the objectives of Consumer Protection Act, 1986 are listed down below.

**1. To Protect Consumer Rights**

Consumer protection act aims at protecting and promoting the rights of consumers like,

(i) The right to have awareness regarding the quantity, quality, competency, standard and price of goods or services in order to protect the consumers from unfair trade practices.

(ii) The right to hear and get assurance that forums will give attention to the consumer interests.

(iii) Right concerning consumer education.

(iv) The right to get protection against hazardous goods and services which may cause harm to the life and property of consumer.

(v) The right to have access to goods and services at competitive prices and

(vi) The right to get redressal against the restrictive trade practices, unfair trade practices or unethical exploitation of consumers.

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**2. To Provide Quasi-Judicial Redressal Agencies and Commission for Fast Redressal of Consumer Disputes**

The consumer protection act aims at providing fast and easy redressal to consumer disputes and for doing this quasi-judicial redressal agencies are established at central, state and district level. These quasi-judicial agencies and commission are required to possess knowledge about the principles of natural justice and have power,

(i) To provide reliefs of some type and

(ii) To reward consumer with compensation where ever desirable.

Penalties are imposed if rules laid down by the quasi- judicial machinery are disobeyed.

**3. To Protect the Interest of Consumers**

The consumer protection act aims at giving better protection to the consumers interest. For doing this, consumer protection act makes provision for setting up consumer councils and other bodies to settle the disputes of consumers and other related matters.

**4. To Setup Consumer Protection Councils**

In order to protect consumer rights and consumer interest, consumer protection councils are set up at central and state levels.

**Q38. Discuss briefly about Rights of Consumer.**

*Ans :*

**Rights of Consumer**

Consumers play a vital role in the economic system of a nation because in the absence of effective demand that emanates from them, the economy virtually collapses. Mahatma Gandhi said, "A consumer is the most important visitor on our premises. He is not dependent on us, we are on him. He is not an interruption to our work, he is the purpose of it.

We are not doing a favour to a consumer by giving him an opportunity. He is doing us a favour by giving us opportunity to serve him. But, of late, unfortunately cheating by way of overcharging, black marketing, misleading advertisements, etc. has become the common practice of greedy sellers and manufacturers to make unreasonable profits.

In this context, it is the duty of the government to confer some rights on consumers to safeguard their interests.

**Consumer Rights**

**1. Right to Safety**

The right to be protected against goods which are hazardous to life and property.

**2. Right to Information**

The right to be informed about the quality, quantity, purity, price and standards of goods.

**3. Right to Choose**

The right to be assured access to a variety of products at competitive prices, without any pressure to impose a sale, i.e., freedom of choice.

**4. Right to be Heard**

The right to be heard and assured that consumer interests will receive due consideration at appropriate forums.

**5. Right to Seek Redressal**

The right to get relief against unfair trade practice or exploitation.

**6. Right to Education**

The right to be educated about rights of a consumer.

**Q39. Explain in detail the consumer protection councils.**

*Ans :*

Consumer Protection Councils are the advisory bodies which have been established at three levels-Central. State & District levels. These bodies have been set up for promoting and protecting the interests of the consumers. These councils have been entrusted the task of protecting the rights of the consumers.

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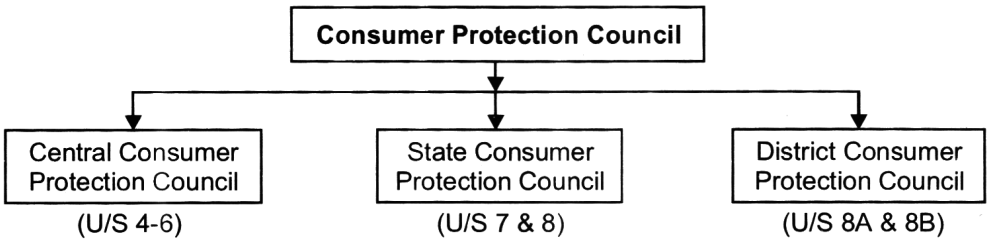


The interests of consumers are sought to be promoted and protected under the Act by establishment of Consumer Protection Councils at the central, state and district levels These Councils are advisory bodies. The Consumer Protection Act, 1986 comprising of sections 4 to 8B deals with Consumer Protection Councils.

### A) Central Consumer Protection Council

Establishment of Central Consumer Protec-tion Council (Section 4).

Section 4 provides that the Central Government shall by notification establish a council to be known as the Central Consumer Protection Council (hereinafter referred to as the Central Council) which shall consist of the following members, viz ;

(a) The Minister in charge of consumer affairs who shall be its Chairman

(b) Such number of other official or non-official members representing such interests as may be prescribed.

The membership has been thus left to the rule making power of the Government. The Consumer Protection Rules were promulgated in 1987. As per the Consumer Protection Rules, the Central Council shall consist of 150 members and the term of the Council shall be 3 years.

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### Meetings of Councils (Section 5)

Section 5 of the Act provides that the Central Council shall meet as and when necessary but at least one meeting shall be held every year. The Central Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed.

### Objectives of Central Council (Section 6)

Section 6 states the objects of the Central Council as being promotion and protection of the rights of the consumers. These rights are

(a) The right to be protected against the marketing of goods which are hazardous to life and property:

(b) The right to be informed about the quality, quantity, potency, purity, standard and price of goods so as. to protect the consumer against unfair trade practices;

(c) The right to be assured, wherever possible, access to a variety of goods at competitive price;

(d) The right to be heard and to be assured that consumers' interests will receive due consideration at appropriate forums;

(e) The right to seek redressal against unfair trade practices or unscrupulous exploration of consumers ; and

(f) The right to consumer eduction. (Section 6)

Section 6 of the Act spells out these objects and charges the Central Council with the responsibility of fulfilling these objects.

**B) State Consumer Protection Council**

Section 7 provides for the establishment of State Consumer Protection Councils by any State Government (by notification) to be known as Consumer Protection Council for (name of the state). The State Council shall consist of a Minister incharge of Consumer Affairs in the State Government who shall be its Chairman and such number of other official or non-official members representing such interests as may be prescribed by the State Government.

The State Council shall meet as and when necessary but not less than two meetings shall be held every year. The procedure to be observed in regard to the transaction of its business at such meetings shall be prescribed by the State Government.

As per section 8, the objects of the State Consumer Protection Councils are described in section 7 to be same as those of the Central Council, namely the points, enumerated in section 6.

**C) The District Consumer Protection Council**

As per newly inserted Section-8A, the State Govt, shall by notification, establish for every district a council to be known as District Protection Council. It shall consist of the following members :

(a) The collector of the district, shall be its chairman.

(b) Such number of other members official or non-official as may be prescribed by State Govt.

The District Council shall meet as and when necessary but not less than two meetings shall be held every year.

**Objectives of District Council (Sec. 8B)**

The objective of every district council shall be to promote and protect within the district the rights of the consumers laid down in clauses (a) to if) of section 6.

**How to file a Complaint**

Procedure for filing complaints and seeking redressal are simple and speedy. A complaint should contain the following information

(a) Any allegation in writing made by a complainants (s) regarding certain grievances as provided under Section 2(1) (c) of the Act; and the facts relating to complaint and when and where it arose;

(b) The name, description and the address of the complainant or authorised agent;

(c) The name (s) description and address of the opposite party/parties, as the case may be ;

(d) The documents, if any, and affidavit in support of the allegations contained in the complaint.

(e) The relief (compensation, etc.) asked for by complainant.

(f) Complaint should be signed by the complainant (s) or his authorised agent.

(g) Prescribed fee for filing a complaint before Consumer Redressal Forum is to be deposited;

(h) Complaint can be presented before the Consumer Redressal Forum by complainant/ authorised agent in person ;

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(i) Also the complaint can be sent by registered post in order to be filed before Consumer Redressal Forum.

It has been held that the complaint filed without entire facts and pleadings, poorly drafted and even not corroborated with any documents in support of the case, the Commission should proceed in the case in the interest of justice.

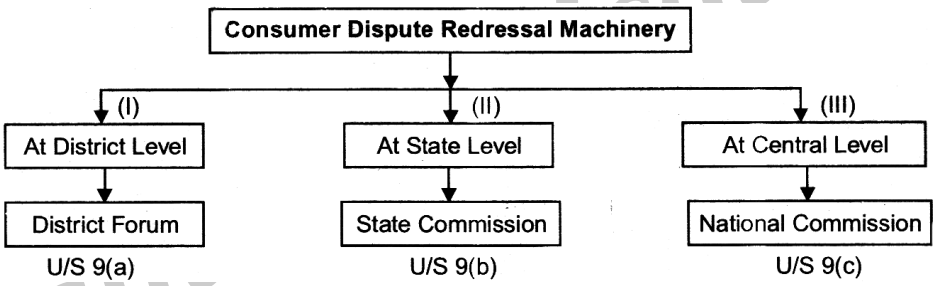
**Q40. Explain briefly about consumer redressal agencies.**

*Ans :*

The Consumer Dispute Redressal Machinery

is a THREE-TIER, QUASI-JUDICIAL MACHINERY for speedy and inexpensive redressal of consumer grievances and disputes. The Consumer Dispute Redressal Machinery is an easy redressal alternative for the consumers than the ordinary process of the civil court which is a very expensive and time consuming litigation process.

It is clear that the Legislature while legislating intended to provide affordable and accessible machinery to an aggrieved consumer so that a consumer should be in position to seek adjudication on the subject-matter of dispute. The only condition to be fulfilled is that on the date when the consumer dispute has arisen and a complaint is filed before the Consumer Dispute Redressal Forum, the cause of action should not have become time-barred under the Limitation Act.




**Q41. Discuss briefly about District Forum.**

**(OR)**

**Explain the working and composition of District Forum.**

*Ans :*

**Composition** (Sec. 10). Each District Forum shall consist of:

(a) A person who is, or has been, or is qualified to be a District Judge, who shall be its President;

(b) 2 other members, one of whom shall be a woman, who shall have the following qualifications, namely,

(i) Be not less than 35 years of age.

(ii) Possess a bachelor's degree form a recognised university,

(iii) Be persons of ability, integrity and standing, and have adequate knowledge and experience of at least 10 years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration'.

Further a person shall be disqualified for appointment as a member, if he:

(a) Has been convicted and sentenced to imprisonment for an offence which, in the opinion of the State Government, involves moral turpitude ; or

(b) Is an undischarged insolvent ; or

(c) Is of unsound mind and stands so declared by a competent court ; or

(d) Has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government ; or

(e) Has, in the opinion of the State Government, such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member ; or

(f) Has such other disqualifications as may be prescribed by the State Government. [This clause has been substituted by Consumer Protection (Amendment) Act, 2002.]

**Appointment on the recommendation of Selection Committee**

Every appointment shall be made by the State Government on the recommendation of a selection committee consisting of the following, namely,

(i) President of the State Commission—Chairman.

(ii) Secretary, Law Department of the State—Member.

(iii) Secretary incharge of the Department dealing with consumer affairs in the State—Member.

Where the President of the State Commission is, by reason of absence or otherwise, unable to act as Chairman of the Selection Committee, the State Government may refer the matter to the Chief Justice of the High Court for nominating a sitting Judge of that High Court to act as Chairman.

**Term of office**

Every member of the District Forum shall hold office for a term of 5 years or up to the age of 65 years, whichever is earlier. He shall not be eligible for re-appointment. However, a member shall be eligible for re-appointment for another term of 5 years or up to the age of 65 years, whichever is earlier, subject to the condition that he fulfils the qualifications and other conditions for appointment and such reappointment is also made on the basis of the recommendation of the Selection Committee.

**Resignation**

A member may resign his office in writing under his hand addressed to the State Government. On such resignation being accepted, his office shall become vacant. The vacancy so caused may be filled by appointment of a person possessing the qualifications mentioned above in relation to the category of the member who has resigned.

**Salary and terms of condition of service**

The salary or honorarium and other allowances payable to, and the other terms and conditions of service of, the members of the District Forum shall be prescribed by the State Government. However, the appointment of a member on whole-time basis shall be made by the State Government on the recommendation of the President of the State Commission taking into consideration such factors as may be prescribed including the work-load of the District Forum. [Inserted by the Consumer Protection (Amendment) Act, 2002).

**Jurisdiction (Sec. 11)**

The District Forum shall have jurisdiction to entertain complaints where the value of the goods or services and the compensation, if any, claimed does not exceed Rs. 20,00,000. This is however subject to other provisions of this Act.

A complaint shall be instituted in a District Forum within the local limits of whose jurisdiction,—

(a) The opposite party (i.e., the person who answers complaint or claim) or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office, or personally works for gain, or

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(b) Any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office or personally works for gain, provided that in such case either the permission of the State Commission is given or the opposite parties who do not reside or carry on business or have a branch office or personally works for gain, as the case may be, acquiesce in such institution; or

(c) the cause of action, wholly or in part, arises.

**Powers of the District Forum**

The District Forum shall have the same powers as are vested in District Court under the Code of Civil Procedure, 1908, while trying a suit in respect of the following matters, namely.

(i) The summoning and enforcing attendance of any defendant or witness and examining the witness on oath ;

(ii) The discovery and production of any document or other material object producible as evidence ;

(iii) The reception of evidence on affidavits ;

(iv) The requisitioning of the report of the concerned analysis or test from the appropriate laboratory or from any other relevant source ;

(v) Issuing of any commission for the examination of any witness ; and

(vi) Any other matter which may be prescribed.

Every proceeding before the District Forum shall be deemed to be a judicial proceeding within the meaning of Secs. 193 and 228 of the Indian Penal Code, 1860 and the District Forum shall be deemed to be a Civil Court for the purposes of Sec. 195, and Chapter XXVI of the Code of Criminal Procedure, 1973.

Where the complainant is a consumer, the provisions of Rule 8 of Order I of the First Schedule to the Code of Civil Procedure, 1908 shall apply subject to the modification that every reference therein to a suit or decree shall be construed as a reference to a complaint or the order of the District Forum thereon.

**Q42. Explain the composition and working of state commission as a redressal agency under the consumer protection act 1986.**

*Ans :*

**The State Commission – Secs. 16 to 19**

Composition [Sec. 16 as amended by the Consumer Protection (Amendment) Act, 2002]. Each State Commission shall consist of:

(a) A person who is or has been a Judge of a High Court, appointed by the State Government, who shall be its President. However, no appointment under this Clause shall be made except after consultation with Chief Justice of the High Court.

(b) Not less than 2 and not more than such number of members as may be prescribed and one of whom shall be a woman who shall have the following qualifications, namely,

(i) be not less than 35 years of age ;

(ii) possess a bachelor's degree from a recognised university ; and

(ii) Be person of ability, integrity and standing and have adequate knowledge and experience of at least 10 years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

However, not more than 50 per cent of the members shall be from amongst persons having a judicial background.

The expression "persons having a judicial background" shall mean person having knowledge and experience for at least a period of 10 years as presiding officer at the district level court or any tribunal at equivalent level.

Further a person shall be disqualified for appointment as a member, if he

(a) Has been convicted and sentenced to imprisonment for an offence which, in the opinion of the State Government, involves moral turpitude ; or

(b) Is an undercharged insolvent ; or

(c) Is of unsound mind and stands so declared by a competent court ; or

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(d) Has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government ; or

(e) Has, in the opinion of the State Government, such financial or other interest, as is likely to affect prejudicially the discharge by him of his functions as a member ; or

(f) Has such other disqualifications as may be prescribed by the State Government.

Every appointment under Sec. 16 shall be made by the State Government on the recommendation of a Selection Committee consisting of the following members, namely.

(i) President of the State Commission ... Chairman.

(ii) Secretary of the Law Department of the State ... Member.

(iii) Secretary in charge of the Department dealing with Consumer Affairs in the State... Member.

**Jurisdiction [Sec. 17 (1)]**

The State Commission shall have jurisdiction

(a) To entertain - (i) complaints where the value of the goods or services and compensation, if any, claimed exceeds Rs. 20 lakh but does not exceed Rs. 1 crore; and (ii) appeals against the orders of any District Forum within the State; and

(b) To call for the records and pass appropriate order in any consumer dispute which is pending before or has been decided by a District Forum within the State where it appears to the State Commission that such District Forum (i) has exercised a jurisdiction not vested in it by law, or (ii) has failed to exercise a jurisdiction so vested, or (iii) has acted in exercise of its jurisdiction illegally or with material irregularity.

**A complaint shall be instituted in a State Commission within the limits of whose jurisdiction,**

(a) The opposite party or each of the opposite parties, where there are more than one at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office or personally works for gain ; or

(b) Any of the opposite parties where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain, provided that in such case either the permission of the State Commission is given or the opposite parties who do not reside or carry on business or have a branch office or personally work for gain, as the case may be, acquiesce in such institution ; or

(c) The cause of action, wholly or in part, arises [Inserted by the Consumer Protection (Amendment) Act, 2002].

**Transfer of cases** [New Sec. 17-A as inserted by the Consumer Protection (Amendment) Act, 2003], On the application of the complainant or of its own motion, the State Commission may, at any stage of the proceeding, transfer any complaint pending before the District Forum to another District Forum within the State if the interest of justice so requires.

**Circuit Benches** [New Sec. 17-B as inserted by the Consumer Protection (Amendment) Act, 2002]. The State Commission shall ordinarily function in the State Capital but may perform its functions at such other place as the State Government may, in consultation with the State Commission, notify in the Official *Gazette,* from time to time.

**Procedure** (Sec. **18).** The provisions of Secs. **12, 13** and **14** and the rules made thereunder for the disposal of complaints by the District Forum shall, with such modifications as may be necessary, be applicable to the disposal of disputes by the State Commission.

**Appeal** (Sec. **19).** Any person aggrieved by an order made by the State Commission may prefer an appeal against such order to the National Commission within a period of 30 days from the late of the order. The National Commission may

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entertain an appeal after the expiry of this period :t 30 days if it is satisfied that there was sufficient cause for to filing the appeal within that period.

Further no appeal by a person, who is required to pay any amount in terms of an order of the State Commission, shall be entertained by the National Commission unless the appellant has deposited in the prescribed manner 50 per cent of the amount or Rs. 35,000 whichever is less.

**Hearing of appeal** [Sec. 19-A inserted by the Consumer Protection (Amendment) Act, 2002). An appeal filed before the State Commission or the National Commission shall be heard as expeditiously as possible and an endeavour shall be made to finally dispose of the appeal within a period of 90 days from the date of its admission.

No adjournment shall be ordinarily granted by the State Commission or the National Commission as the case may be, unless sufficient cause is shown and the reasons for grant of adjournment have been recorded in writing by such Commission.

**Q43. Explain the formation and role of national commission in consumer protection Act 1986.**

*Ans :*

National Consumer Disputes Redressal Commission (National Commission - Secs. 20 To 23)

**Composition** [Sec. 20 as amended by the Consumer Protection (Amendment) Act, 2002[. The National Commission shall consist of

(a) A person who is or has been a Judge of the Supreme Court, to be appointed by the Central Government, who shall be its President. However, no appointment under this Clause shall be made except after consultation with the Chief Justice of India ;

(b) Not less than 4 and not more than such number of members, as may be prescribed and one of whom shall be a woman who shall have the following qualifications, namely,

(i) be not less than 35 years of age ;

(ii) possess a bachelor's degree from a recognised university ; and

(iii) be persons of ability, integrity and standing and have adequate knowledge and experience of at least 10 years in dealing with problems relating to economics, law, commence, accountancy, industry, public affairs or administration.

However, not more than 50 per cent of the members shall be from amongst the persons having a judicial background.

The expression 'persons having a judicial background' shall mean persons having knowledge and experience for at least a period of 10 years as a presiding officer at the district level court or any tribunal at equivalent level.

**Further a person shall be disqualified for appointment, if he**

(a) Has been convicted and sentenced to imprisonment for an offence which, in the opinion of the Central Government, involves moral turpitude ; or

(b) Is an undischarged insolvent ; or

(c) Is of unsound mind and stands so declared by a competent court ; or

(e) Has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government ; or

(d) Has, in the opinion of the Central Government, such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member ; or

(f) Has such other disqualifications as may be prescribed by the Central Government.

Every appointment referred to above shall be made by the Central Government on the recommendation of a Selection Committee consisting of the following, namely,

(a) A person who is a judge of the Supreme Court to be nominated by the

**-Chairman Chief Justice of India**

(b) The Secretary in the Department of Legal Affairs in the Government of

**- Member India**

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(c) Secretary of the Department dealing with Consumer Affairs in the

**- Member/ Government of India**

**Place of the National Commission**

The office of the National Commission shall be located in the Union Territory of Delhi (Rule 5 of the Consumer Protection Rules, 1957).

**Jurisdiction** (Sec. 21). Subject to the other provisions of this Act, the National Commission shall have jurisdiction-

(1) To entertain (i) complaints where the value of the goods or services and compensation, if any, claimed exceeds Rs. 1 crore, and (ii) appeals against the orders of any State Commission ; and

(2) To call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any State Commission where it appears to the National Commission that such State Commission (i) has exercised a jurisdiction not vested in it by law, or (ii) has failed to exercise a jurisdiction so vested, or (iii) has acted in the exercise of its jurisdiction illegally or with material irregularity.

**Appeal** (Sec. 23). Any person, aggrieved by an order made by the National Commission in exercise of its powers, may prefer an appeal against such order to the Supreme Court within a period of 30 days from the date of the order. The Supreme Court may entertain an appeal after the expiry of this period of 30 days if it is satisfied that there was sufficient cause for not filing the appeal within that period.

Further no appeal by a person who is required to pay any amount in terms of an order of the -National Commission shall be entertained by the Supreme Court unless that person has deposited in the prescribed manner 50 per cent of that amount or Rs. 50,000, whichever is less.

**Finality of orders** (Sec. 24). Every order of a District Forum, the State Commission or the National Commission shall, if no appeal has been preferred against such order under the provisions of this Act, be final.

Secs. 24-A and 24-B which have been inserted by the Consumer Protection (Amendment) Act, 2002 deal with 'limitation period' and 'administrative control' respectively.

**Enforcement of orders of the District Forum, the State Commission or the National Commission** [Sec. 25 as substituted by the Consumer Protection (Amendment) Act, 2002]. Where an interim order made under this Act is not complied with, the District Forum or the State Commission or the National Commission, as the case may be, may order the property of the person, not complying with such order to be attached.

No such attachment shall remain in force for more than 3 months at the end of which, if the non-complacence continues, the property attached may be sold and out of the proceeds thereof, the District Forum or the State Commission or the National Commission may award such damages as it thinks fit to the complainant and shall pay the balance, if any, to the party entitled thereto.

## 1.10 COMPETITION ACT

**Q44. Explain briefly about competition act.**

*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

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transferred to the CCI, except those relating to unfair trade practices, which are proposed to be transferred to the relevant fora established under the Consumer Protection Act, 1986.

**Q45. Define the following terms are used in competition act 2002 :**

**(a) Acquisition**

**(b) Agreement**

**(c) Consumer**

**(d) Enterprise**

**(e) Goods**

**(f) Person**

**(g) Service**

*Ans :*

**(a) Acquisition**

[Sec. 2 (a)]. It means, directly or indirectly, acquiring or agreeing to acquire-

(i) shares, voting rights or assets of any enterprise; or

(ii) control over management or control over assets of any enterprise.

**(b) Agreement**

[Sec. 2 (b)]. It includes any arrangement or understanding or action in concert,

(i) whether or not, such arrangement, understanding or action is formal or in writing; or

(ii) whether or not, such arrangement, understanding or action is intended to be enforceable by legal proceedings.

The element of mutuality is inherent in the word agreement. A mere direction or recommendation by one party not warranting acceptance of any obligation (whether legal or moral) by the other party cannot constitute an agreement.

Agreements contemplated under the Competition Act may be horizontal agreements and vertical agreements.

Horizontal agreements are agreements among competitors engaged in the same activity. For *example,* the agreements between producers or between wholesalers or between retailers, dealing in similar kind of products.

Vertical agreements are agreements between non-competing undertakings. For *example,* the agreements between manufacturers of components, manufacturers of products, between producers and wholesalers or between producers, wholesalers and retailers.

**(c) Consumer**

[Sec. 2 (f)]. 'Consumer' means any person who-

(i) buys any goods for a consideration which has been paid or promised, or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for resale or for any commercial purpose;

(ii) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of the services for any commercial purpose.

It is noteworthy that the definition of consumer is substantially the same as given to the expression under Section (d) of the Consumer Protection Act, 1986 with some variations.

**(d) Enterprise**

[Sec. 2 (h)]. It means a person or a department of the Government, who or which is, or has been or is proposed to be, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through

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one or more of its units or divisions or subsidiaries (whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the government relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

**Explanation :** for the purposes of this clause,

(a) 'activity' includes profession or occupation ;

(b) 'article' includes a new article and 'service' includes a new service ;

(c) 'unit' or 'division', in relation to an enterprise, includes –

(i) a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods ;

(ii) any branch or office established for the provision of any service.

**(e) Goods**

[Sec. 2 (i)]. 'Goods' means goods as defined in the Sale of Goods Act, 1930 and includes-

(A) products manufactured, processed or mined;

(B) debentures, stocks and shares after allotment;

(C) in relation to goods supplied, distributed or controlled in India, goods imported into India.

All moveable property, stocks and shares, growing crops, trade marks, copyrights, patent rights, goodwill, electricity, water, gas are goods. But any actionable claim and money are not covered under the meaning of goods.

**(f) Person**

[Sec. 2 (*l*)]. '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, in India or outside India ;

(vi) any corporation established by or under any Central, State or Provincial Act or a Government company as defined in Sec. 617 of the Companies Act, 1956 ;

(vii) any body corporate incorporated by or under the laws of a country outside India ;

(viii) a co-operative society registered under any law relating to co-operative societies;

(ix) a local authority ; and

(x) every artificial juridical person, not falling within any of the preceding sub-clauses.

**(g) Service**

[Sec. 2 (u)]. 'Services' means service of any description which is made available to potential users. It includes the provision of services in connection with business of any industrial or commercial matters such as accounting, banking, communication, education, financing, insurance, chit funds, real estate, transport, storage, material treatment, processing, supply of electrical or other energy, boarding, lodging, entertainment, amusement, construction, repair, conveying of news or information and advertising.

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**Q46. What are the objectives of competition act 2002?**

*Ans :*

**Objective of the Competition Act, 2002**

An Act, keeping in view of the economic development of the country, was laid down to provide for an establishment of a commission with the following object:

- to prevent practices having adverse effect on competition,
- to promote and sustain competition in markets,
- to protect the interests of consumers,
- to ensure freedom of trade carried on by other participants in markets in India and - for matters connected therewith or incidental thereto.

**Q47. Explain the Features of Competition Act, 2002.**

*Ans :* **(Dec.-20)**

The focus of the new law is towards the following areas affecting competition namely:

**1. Prohibition of certain agreements, which are considered to be anti-competitive in nature**

Such agreements [namely tie in arrangements, exclusive dealings (supply and distribution), refusal to deal and resale price maintenance] shall be presumed as anti-competitive if they cause or are likely to cause an appreciable adverse effect on competition within India.

**2. Prohibition of Abuse of dominant position**

If an enterprise by imposing unfair or discriminatory conditions or limiting and restricting production of goods or services or indulging in practices resulting in denial of market access or through in any other mode are prohibited.

**3. Regulation of combinations**

Regulation of combinations which cause or are likely to cause an appreciable adverse affect on competition within the relevant market in India is also considered to be void.

**4. Entrust**

Competition Commission of India the responsibility of undertaking competition advocacy, awareness and training about competition issues.

**Q48. Explain briefly about competition commission in India.**

*Ans :* **(Dec.-20, Imp.)**

**Establishment of Commission (Section 7)**

Section 7 provides for the establishment of the Competition Commission of India. The Commission shall be a body corporate by the aforesaid name having perpetual succession and a common seal with power to acquire, hold and dispose of property and to contract and shall sue or be sued. The place of head office of the Commission shall be decided by the Central Government. Further, the Commission may establishment offices at other places in India.

**Composition of Commission (Section 8)**

The Commission shall consist of the Chairperson and not less than two and not more than six other Members, to be appointed by the Central Government. The Chairperson and every other Member shall be a person of ability, integrity and standing and who has special knowledge of, and such professional experience of not less then 15 years in international trade, economics, business, commerce, law, finance, accounting, management,

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industry, public affairs or competition matters, including competition law and policy, which in the opinion of the Central Government, may be useful to the Commission. The Chairperson and other members shall be whole time members.

**Selection Committee for Chairperson and other Members of the commission (Section 9)**

The Chairperson and other Members of the Commission shall be appointed by the Central Government from a panel of names recommended by a Selection Committee consisting of

| | | | |
|---|---|---|---|
| (a) | the Chief Justice of India or his nominee | --- | Chairperson; |
| (b) | the Secretary in the Ministry of Corporate | --- | Member; |
| (c) | Affairs the Secretary in the Ministry of Law and Justice | --- | Member; |
| (d) | two experts of repute who have special knowledge of, and professional experience in international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs or competition matters including competition law and policy. | --- | Members. |

The term of the Selection Committee and the manner of selection of panel of names shall be such as may be prescribed.

**Term of office of Chairperson and other Members (Section 10)**

The Chairperson and every other Member shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for re-appointment. However, no Chairperson or other Member shall hold office as such after he has attained the age of sixty-five years.

**Resignation, removal and suspension of Chairperson and other members (Section 11)**

The Chairperson or any other Member may, by notice in writing under his hand addressed to the Central Government, resign his office.

**Restriction on employment of Chairperson and other Members in certain cases (Section 12)**

The Chairperson and other Members shall not, for a period of two years from the date on which they cease to hold office, accept any employment in, or be connected with the management or administration of, any enterprise which has been a party to a proceeding before the Commission.

**Administrative powers of Chairperson (Section 13)**

The Chairperson shall have the powers of general superintendence, direction and control in respect of all administrative matters of the Commission. The Chairperson may also delegate such of his powers relating to administrative matters of the Commission, as he may think fit, to any other Member or officer of the Commission.

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**Salary and allowances and other terms and conditions of service of Chairperson and other Members**

**(Section 14)**

The salary, and the other terms and conditions of service, of the Chairperson and other Members, including travelling expenses, house rent allowance and conveyance facilities, sumptuary allowance (expenses of living) and medical facilities.

**Vacancy, etc. not to invalidate proceedings of Commission (Section 15)**

**Appointment of Director General, etc. (Section 16)**

The Central Government may, by notification, appoint a Director General for the purposes of assisting the Commission in conducting inquiry into contravention of any of the provisions of this Act and for performing such other functions as are, or may be, provided by or under this Act.

The number of other Additional, Joint, Deputy or Assistant Directors General or such officers or other employees in the office of Director General and the manner of appointment of such Additional, Joint, Deputy or Assistant Directors General or such officers or other employees shall be such as may be prescribed.

**Duties**

**Duties of Commission (Section 18)**

This section provides that it shall be the duty of the Commission to eliminate

practices having adverse effect on competition, to promote and sustain competition in markets in India, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets in India. The Commission may for the purpose of discharging its duties or performing its functions under this Act, enter into any memorandum or arrangement, with the prior approval of the Central Government, with any agency of any foreign country.

**Q49. Explain the various provisions for competition law.**

*Ans :*

The important provisions relating to competition law are,

**1. Prohibition of Anti-Competitive Agreements**

Under the Act, the individuals and undertakings are prohibited to enter into any agreement which has negative impact or effect on competition in any department such as supply, distribution, production, storage, acquisition, management of goods or supply of services in the country. The following agreements are prohibited by the Act as these have negative effect on competition,

1. Decisions taken by the organisations and individuals on the following issues,
   - (a) Determination of purchase or sale price directly or indirectly
   - (b) Controls production, supply, markets, technical development, investment or supply of services
   - (c) Through distributing the geographical area the markets are shared, goods are produced, services are provided
   - (d) Results in bid or collusive rigging which means already fixing the judgement of something.
2. Tie-in arrangements
3. Exclusive or sole supply an arrangements
4. Refusal to deal
5. Maintenance of resale price.

MRTP Act also consists most of these provisions.

**2. Prohibition of Abuse or Misuse of Dominant Position**

The abuse or misuse of dominant position by any firm is restricted under Sec. 4(1). Sec 4 states that an abuse of dominant position exists, if an enterprise,

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(a) Either directly or indirectly enforce unfair or discriminatory,

(i) Purchase or sale condition of goods or services, or

(ii) Purchase or sale price of goods or services, or

(b) Impose restrictions on,

(i) Production of goods or provision of services or market for that reason or

(ii) Technical or scientific improve-ments associated with goods or services towards the discrimination of consumers, or

(c) Dealing in practices which results in the rejection of market access, or

(d) Provide conclusion to contracts that depends on the acceptance by other parties of supplementary obligations which does not have any link with the subject of such contracts, or

(e) Make use of its dominant position in one significant market to enter into other market or protect other related market.

(f) "Dominant position" refers to a position of strength, occupied by an enterprise, in the significant market, whether in India or outside India. The dominant position helps the firm to,

(i) Independently operate the competitive forces existing in the significant market, or

(ii) Influence its competitors or consumers or the related market in their favour.

Sec 4 (2) defined predatory price as " the sale of goods or provision of services at a price which is below the cost, or may be determined by regulations of production of goods or provision of services with a view to reduce competition or eliminate the competitors.

### 3. Regulation of Combinations

According to Sec 5 combination means, the acquisition of one or more enterprises by one or more persons. It is also referred as merger or amalgamation of enterprises and persons or enterprises if some conditions are satisfied.

#### I. Acquisition of Control, Voting Rights, Shares or Assets

Any acquisition will be referred as combination if,

(i) The acquirer and the enterprise whose assets are being acquired have,

(a) Either the assets amounting to more than ` 1000 crores or turnover more than ` 3000 crores in India or

(b) In aggregate, the assets of the value of more than 500 million US dollars or turnover more than 1500 million US dollars in India or outside India or

(ii) Any group or an organization relating to the group whose assets which are being acquired jointly have,

(a) The value of assists more than ` 4000 crores or turnover more than ` 12000 crores either in India, or

(b) In aggregate, the assets value of more than 2 billion US dollars or turnover more than 6 billion US dollars, or

#### II. Acquisition of Control Over Production, Distribution or Trading

Combination also exists when a person acquires control over a firm even though it already has direct or indirect control over another firm which is dealing in production, distribution or trading of identical or substitutable goods or services, if,

(i) Both the enterprises i.e., the acquired and the acquirer jointly have,

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(a) The assets valuing more than ` 1000 crores or turnover more than ` 3000 crores either in India, or

(b) In aggregate, the assets of the value of more than 500 million US dollars or turnover more than 1500 million US dollars in India or outside India, or

(ii) The group which has been acquired by the firm jointly have,

(a) The assets valuing more than ` 4000 crores or turnover more than ` 12000 crores either in India or

(b) In aggregate, the assets valuing more than 2 billion US dollars or turnover more than 6 billion US dollars in India or outside India.

**III. Merger or Amalgamation**

Any merger or amalgamation will be considered as a combination if,

(i) The firm which is left after merger or the enterprise formed as a result of the amalgamation have,

(a) The assets valuing more than ` 1000 crores or turnover more than ` 3000 crores either in India or

(b) In aggregate, the assets valuing more than 500 million US dollars or turnover more than 1500 million US dollars, or

(ii) Apart or a group enterprise which is left after the merger or the enterprise formed due to amalgamation have,

(a) The assets valuing more than ` 4000 crores or turnover more than ` 12000 crores either in India, or

(b) The assets valuing more than 2 billion US dollars or turnover more than 6 billion US dollars in India or outside India.

**Forming a Combination Involves the Following Purposes**

**(a) Control**

It involves the activities which controls the affairs of the management by,

(i) One or more enterprises having control over the other enterprise or group either combinedly or individually.

(ii) One or more groups having control over other group or enterprise either combinedly or individually.

**(b) Group**

Group includes two or more enterprises which directly or indirectly have the authority to,

(i) Practise or use 26 percent or more of the voting rights in another firm, or

(ii) Recruit more than 50 percent of the members of the board of directors in another firm, or

(iii) Regulate the management affairs of the other firm rise.

**(c) The Value of Assets**

The value of assets is ascertained by considering the book value of the assets available in audited books of account of the firm in financial year which immediately precedes the financial year in which the merger is proposed. The value of assets involves the brand value, value of goodwill or value of copyright, patent, permitted use, collective mark, registered proprietor, trademark, user, homonymous geographical indication, design or layout-pattem or similar other commercial rights, if any, mentioned in Sec 5(5).

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**Regulation of Combinations (Sec.6)**

According to sec 6(1), a person or enterprise must not enter into a combination which leads to or has a chance of causing a negative impact on competition in the market in India and considered such a combination as void.

**Exemption**

The person or enterprise who or which is willing to enter in to a combination must provide notice to the competition commission of India, the fee that is fixed by regulations and should disclose the details of the proposed combination, within 7 days of the,

(a) Acceptance of the proposal associated with the merger or amalgamation specified in sec 5(c) by the board of directors of the firms which are related to such merger or amalgamation,

(b) Implementing any agreement or other document for acquisition specified in sec 5(a) or acquiring or control specified in sec 5 [sec.6(2)J

After receiving the notice, the commission must deal with such notice according to provisions mentioned in sections 29, 30 and 31 [sec 6(3)]. These sections are related with the (i) Procedure for investigation combinations (sec 29), Inquiry into disclosures (sec 30) and orders of the commission on certain combinations (sec 31).

According to sec 6(4), the provisions of sec.6 is not employed to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any convenient of a loan agreement or investment agreement.

The public financial institution, foreign institutional investor, bank or venture capital fund must file as per the form specified by regulations with the commission within 7 days along with the details of the acquisition. Sec 6(5) states that the form must contain details relating to control, the situations of exercising such control and the consequences of default occurring due to loan agreement or investment agreement (as the case may be).

## 1.11 Socio - Cultural Environment

**Q50. Explain briefly about Socio - Cultural Environment.**

*Ans :*

Society and culture primarily govern the lifestyle of an individual. An individual's eating habits, shopping behaviour, dressing priorities, physical possessions, etc., are all influenced by the society. Many times people spend a lot of money for the sake of simply to adhere to social and cultural norms. It is only due to societal pressure that people spend so much money in marriages, celebrations, and even on funerals. In India, expenditure on festivals like Holi, Diwali, Id, Rakshabandhan, Durga Puja, Ganesh Puja, Pongal, etc., runs into billions of rupees every year. So culture itself is a big opportunity for business:

When a person buys a gift for someone else, purchases clothes for a party or a morning walk, purchases a particular model of motorcycle or automobile, takes admission in a particular college/ school, all of these decisions are influenced by the prevailing societal and cultural environment.

With all these purchases, he is satisfying his social needs because he has a subconscious desire to appear as smart and intelligent consumer and individual in the eyes of society. It has been seen that in the case of middle class and upper class, expenditure on social needs of consumers forms a considerable part of their income. This ratio increases in favour of social needs as we go up the income ladder. This is the reason most organizations try to position their products around social needs.

To study the effect of socio-cultural environment on business, we can categorise the same in the following ways:

1. Family
2. Social Class
3. Culture

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**1. The Family**

A consumer is born every ten seconds. (Edwin Newman, 1976)

The Family is the smallest unit of society. It is also the first school of the child and of course, the school that has maximum and lasting influence on an individual. A family plays a key role in the development of a person's attitude, his understanding of the environment, his beliefs, and his preferences. Drastic differences have been seen in the attitude and preferences of individuals who have been nurtured in a joint family as against a nuclear family, or a family where both husband and wife are professionals, or those who have been brought up in hostel.

A family performs four basic function for an individual: economic support, emotional support (love, affection, intimacy, etc.), establishment of a suitable lifestyle, and socialization of family. Socializations is a central function of a family as it imparts basic values and modes of behaviour to the child, consistent with one's culture. These generally include moral and religious principles, interpersonal skills, dress and grooming standards, socially acceptable manners and speech, and a selection of suitable educational and occupational goals.

**2. Social class**

The term social class is now used more generally to describe the ranks of people in a society. Social class is defined by Roger D. Blackwell as relatively permanent and homogenous divisions in a society into which individuals or families sharing similar values, lifestyles, interests, wealth, status, education, economic position, and behaviour can be categorised

People who are grouped within the same social class are approximately equal in terms of their social standing in the community. They work in roughly similar occupations, and they tend to have similar lifestyles by virtue of their income levels and common tastes. These people tend to socialise with one another and share many ideas and values regarding the way of life that should be lived.

Status group reflects a community's expectations regarding style of life among each class, as well as the positive or negative social estimation of honour given to each class.

**3. Culture**

**Definitions**

**(i) According to Leon G. Schiffman and L. L. Kanuk describe culture as,** "the sum total of learned beliefs, values and customs that serve to direct the consumer behaviour of members of a particular society."

**(ii) According to Roger D. Backwell says,** "Culture can be referred as a set of values, ideas, artifacts and other meaningful symbols that help individuals communicate, interpret and evaluate as members of society."

**Q51. Discuss the family life cycle and its role in decision making of an individual.**

*Ans :*

**(i) Young Singles**

Young bachelors who live alone or with their family, or with friends, have low individual income, don't usually have any financial burden, are less price sensitive, usually buy a two wheeler, audio system, gifts items, fashion items, movies, computers, mobile phones, etc. Purchases are influenced by the opposite sex.

**(ii) Newly Married Couples**

These families tend to spend a substantial amount of their income on cars, clothing, vacations, and other leisure activities. They are more susceptible to advertising.

**Full Nest I :**

At this stage, the first child arrives and roles within the family change. Purchases shift from leisure to baby products and toys.

**Full Nest II :**

At this stage, the youngest child has reached school, and family spending is children centric. Money is invested in various financial instruments for the future of their children and themselves.

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**Full Nest III :**

At this stage, parents enter their 40s. Family income increases and simultaneously, expenditure, as children are more demanding. A major share of their income goes for their education, and their belongings like motorbikes, computers, clothing, fashion, mobiles, etc.

**Empty Nest I :**

At this stage, children have left the home and established their own nest. Financial condition of the couple becomes better as now they have lesser responsibilities and income is at its peak. In the Indian contest, at this stage, nowadays spending is usually on health products, tonics, and gifts for their newly married children. It has been seen that in India, usually at this stage, the biggest spending is on the newly married couple and on their children. In fact, in some cases, spending on grandchildren is high. This means that in India, target customers for baby products are not only their parents but also grand parents.

**Empty Nest II :**

This stage sees a reduction of income for individuals. In India, in case of business families and private jobs, they get dependent on their children and spending is on their grandchildren and health.

**Solitary Survivor**

Spending habits of solitary survivor remain the same as that of empty nest II.

The family life cycle influences the product mix and marketing mix of almost every company.

**Q52. Define the term social stratification.**

*Ans :*

Social stratification can be described as the processes in a social system by which scarce and valuable resources are distributed unequally to status positions that become more or less permanently ranked in terms of the share of valuable resources each receives. It can also be described as perceived hierarchies in which consumers rate others as higher or lower in social status. Those who earn a higher status due to work or study have 'achieved' status, whereas those who are lucky to be born wealthy or beautiful achieve 'ascribed' status.

**Q53. State the components of social class.**

*Ans :*

**1. Occupation**

What a person does for living is one of the most telling indicators of social class. The occupation dictates other signs of class membership such as income, personal associations, and status. Not only this, it also decides availability and use of leisure of time, allocation of family resources, political orientation, stress on the type of education to children, and many other things. Sometimes, occupation is also seen as a synonym of class. For instance, we think CAs, doctors, businessmen, etc., belong to the upper class, while teachers, engineers, etc., belong to the middle class, etc.

**2. Income**

Income is the most critical determinant of social class as it directly influences the buying power and market potential. People performing the same occupation can have different levels of income. Consumption patterns are determined by the level of income.

It is also possible that people having the same level of income may spend it in different ways because of different occupations or different level of education or because of other social reasons. In all societies, distribution of income is in a pyramid shape and follows the rule of 80/20. Meaning, 20% of the people command 80% of the wealth. This is more true in case of developing countries.

**3. Possessions**

Possessions are symbols of class membership. Conspicuous consumption and people's desire to provide visible evidence of their ability to afford luxury goods help explain why different people buy different products. For example, possessions of luxury cars and

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membership of a particular club are clearly indicative of a higher class, while possession of small cars or two wheelers are clearly indicative of another class. Through analysis of personal possessions, sometimes called 'artifacts', marketers can gain a picture of not only the class to which individuals belong, but the strength of their identification with that class. For people, who are striving to become associated with higher classes, the purchase of brands may be partially based on the desire for such affiliation or identification.

**4. Associations**

The consumption of people is directly related to the social network of people they interact with. People spend their leisure time with others who share their tastes and recreational activities, and they imbibe new tastes, lifestyles, dressing sense, etc., from those with whom they are associated. Selection of and interaction with friends, relatives and even one's life partner varies according to class membership.

**5. Level of Influence**

Class, rank and influence go hand in hand. Members of higher classes usually command higher level of influence. Even marketers use them as opinion leaders to influence the lower classes.

**Q54. Describe the elements that influence culture.**

*Ans :*

**Elements of Culture**

The four social institutions that most strongly influence values and behaviour are schools, religion, families and most recently, the media. Following are the elements which influence culture the most:

**1. Family**

The family is a learning centre for an endless stream of attitudes, behaviours and skills that the child carries through life. Family experience also serves as a window to the world. They learn how to behave in society. In India, boys are taught to work and focus on their career, while women are taught to be good housewives. It is thus the family that instills basic beliefs, values and ideas in an individual.

**2. Religion**

When there was no law, religion was the only law. Religion came into existence as a social law. Earlier, civilisations had no explanation for the happenings in the society and so religion came into force. Till today, religion controls human behaviour all over world.

The kind of religious training or lack of it that we receive during socialisation affects people's behaviour as consumers. Religious practice may dictate the use of some goods and services or prohibit the consumption of others. Sometimes religious rules are more binding than the law of the land.

In strict religious cultures such as the Islamic culture of Iran, religion governs all aspects of life, from family to education to the workplace to the government. On the other hand in a secular state like India, there are many religions. All over the world, companies have to change their product portfolio, packaging and communication strategy according to the local religion. For Hindus saffron colour is sacred while for Muslims it is green. KFC doesn't include beef and pork in its portfolio in India only because of religion. Religion can often lead to extremism in many cases.

It is the religion which decides many social ideas like marriage, polygamy, monogamy, number of children in family, festivals, rituals, etc. These festivals decide the purchasing pattern of different religions. Hindus do most of their purchasing around Diwali, Christians shop during Christmas and Muslims during Eid. Accordingly, companies launch their campaigns to attract the right kind of buyers.

**3. Education**

Education and educational institutions are a major influence on the lives, culture and society of its people. Socialising through educational institutions influences consumption in several ways. Interaction with teachers.

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**For example,** may lead to more informed choices in the marketplace. A teacher's guidance regarding appropriate food choices, basic, medical and dental care, reproductive health, concern for the environment and the problems associated with drugs, alcohol, and tobacco products all encourage a certain kind of marketplace behaviour.

It is the level of education on which the success of many products depends. In India, it is because of the poor level of education that campaigns like Pulse Polio couldn't meet with much success. AIDS, once considered to be a problem of the West is now the biggest social problem of the Middle-East and Africa. This is because of the level of education. Now the West knows how to check AIDS but in a country like India or a continent like Africa, where the level of education is very low, it is very difficult to communicate the right message to everybody.

### 4. Mass Media

The mass media are modes of communication that reach out to a large population on a regular basis. The critical question these days is: does the mass media mirror culture or does it shape culture? Television, newspapers, magazines, radio, Internet and cinema halls are some examples of mass media. Modern culture and society has been revolutionised by mass media. Today's fashion products, beauty aids, cars, soft drinks, and foods are all promoted in a way so as to make them seem socially 'right' for the target customer. They also make society open up to new ideas. For instance, certain things (like revealing fashion and expression of love) that were considered taboo some years back are now perfectly acceptable—thanks to the mass media.

### 5. Language and Symbols

To acquire a common culture, the members of a society must be able to communicate with each other through a common language. It is the language through which people communicate with each other and it is distinct with every nation and culture. In India itself, there are more than 25 languages and more than 800 dialects spoken. Every organization must have a deep understanding of the language of people with whom they want to do business. Every culture and nation loves its language and feels proud about it.

### 6. Technology

Every culture has its own level of technology. The level of technology is evident in many ways. Countries like United States, Japan and Germany have a high level of technology. The general population has a broad level of technical understanding that allows them to adapt and learn new technology.

In countries like India, Sri Lanka, Pakistan and Bangladesh, the level of technology is low and that is why they resist any technological change.

One instance of ignorance of technology is the opening of the Bhakra Nangal Dam. Farmers of surrounding areas believed that the water of the canal is useless for irrigation because the power of water has been extracted while producing electricity. Similarly, initially many organizations resisted computers. Depending on the level of technology people look for scientific answers for every happening.

### 7. Aesthetics

Aesthetics i.e. arts, folklore, music, drama and dance have effect on people and are part and parcel of culture. Aesthetics are of particular interest to the marketer because of their role in interpreting the symbolic meanings of various methods of artistic expression, colour, and standard of beauty in each culture. Customers everywhere respond to images, myths and metaphors that help them define their personal and national identities and relationship within a context of culture and product profile.

### 8. Rituals

Culture includes various ritualised experiences and behaviour. A ritual is a type of symbolic activity consisting of a series of steps occurring

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in a fixed sequence and repeated over time. In practice, these rituals are extended over a period from birth to death. These rituals can be public, elaborate, religious, or civil ceremonies. From the standpoint of business, with every ritual, certain products are associated. The sale of sweets and crackers in India is at an all-time high during Diwali. In north India, many butchers and barbers keep their shops closed on Tuesdays because many people don't eat meat and avoid having a haircut on that day of the week.

## 1.12 Corporate Social Responsibility

**Q55. Define Corporate Social Responsibility. Explain the list of CSR activities.**

*Ans :* **(Imp.)**

**Meaning Of Corporate Social Responsibility**

Rule 2(c) of the Companies (Corporate Social Responsibility Policy) Rules, 2014 defines the term "Corporate Social Responsibility (CSR)" which means and includes but is not limited to :

(i) Projects or programs relating to activities specified in Schedule VII to the Act; or

Projects or programs relating to activities undertaken by the board of directors of a Company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

**Applicability**

Under Section 135 of the Companies Act, 2013 every company:

- having net worth of ` 500 crore or more ; or
- having turnover of ` 1000 crore or more; or
- having net profit of ` 5 crore or more

during any financial year shall constitute a CSR committee of the Board.

**Meaning of "Net Profit"**

Rule 2(f) of the CSR Rules, 2014 provides meaning of the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely :

(i) any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and

(ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

Provided that net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956 (1 of 1956) shall not be required to re-calculated in accordance with the provision of the Act:

Provided further that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sur section (1) of section 381 read with section 198 of the Act.

**CSR Activities**

Rules 4 of the CSR says that the CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

The Board of a company may decide to undertake its CSR activities approved by the CSr Committee, through a registered trust or a registered society or a company established by the company or its holding or subsidiary or associate company under section 8 of the Act or otherwise :

**Provided that**

(i) If such trust, society or company is not established by the company or its holding or subsidiary or associate company, it shall have an established track record of three years or undertaking similar programs or projects;

(ii) The company has specified the project or programs to be undertaken through these entities the modalities of utilization of funds

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on such projects and programs and the monitoring and reporting mechanism.

- A company may also collaborate with the companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committee of respective companies are in ; position to report separately on such projects or programs in accordance with these rules.
- U/S 135 (5) the CSR projects or programs or activities undertaken in India only shall amour: to CSR Expenditure.
- The CSR projects or programs of activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.
- Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure shall not exceed five percent of total CSR expenditure of the company in one financial year.
- Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

**list of CSR Activities**

Schedule VII of the Companies Act, 2013 sets out the activities, which may be included by "companies in their CSR policies.

These activities relate to :

(i) Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation and making available safe drinking water.

(ii) Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and live lihood enhancement projects

(iii) Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.

(iv) Ensuring environmental substitutability, ecological balance, protection of flora and fauna, animal, welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water.

(v) Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

(vi) Measures for the benefit of armed forces veterans, war windows and their dependents.

(vii) Training to promote rural sports, nationally recognized sports, paralympic sports and Olympic sports.

(viii) Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

(ix) Contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government.

(x) Rural development projects.

**Q56. Describe the role and responsibility of board of directors in context to CSR.**

*Ans :*

**Role of Board of Directors**

Section 135(4) provides that the Board of Directors shall

(a) After taking into account the recommendations made by the CSR Committee, approve the CSR Policy for the company and

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disclose contents of such Policy in the Directors' Report and also place it on the company's website, if any in the Form specified under Companies (CSR) Rules, 2014; and

(b) Ensure that the activities as are included in CSR Policy of the company are undertaken by the company;

(c) Ensure 2% spending on CSR activities;

(d) Report CSR activities in Board' report and

(e) Disclose non-compliance (if any) with the CSR provisions.

CSR Rules, 2014 provide the format in which all qualifying companies shall report the details of their CSR initiatives in the Director's report and in the company's website.

**Responsibility of the Board of Directors**

(a) To ensure that atleast 2% of average net profit of last 3 preceding years in spent on CSR activities every year, 'Net Profit' shall mean, net profit before tax per books of accounts and shall not include profits arising from branches outside India.

(b) 2% CSR spending would be computed at 2% of the average net profits made by the company during every block of three years. For the purpose of First CSR reporting the Net Profit shall mean average of the annual net profit of the preceding three financial years ending on or before 31 March 2014.

(c) To approve the CSR Policy after considering recommendations of CSR Committee.

(d) To disclose CSR policy and initiatives in Board's report and Company's website.

(e) To ensure that activities reflected in CSR policy are actually undertaken by company.

(f) If the company does not spend 2% of net profits as required, then Board to report the reasons in the Board's report.

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# Short Question and Answers

**1. Define Business Environment.**

*Ans :*

**Meaning of Environment**

Environment is the sum of all living and non-living things that surround an organism or group of organisms. Environment includes all elements, factors and conditions that have some impact on the growth and development of certain organism. Environment includes both biotic and abiotic factors that have influence on observed organism.

**Meaning of Business Environment**

Environment of a business means the external forces influencing the business decisions. They can be forces of economic, social, political and technological. These forces are beyond the control of the business. The success of every business depends on adapting itself to the environment within which it functions. For example, when there is change in the government policies, the business firm has to make necessary changes to adapt it to the new policies. Similarly, a change in technology may render the existing products obsolete. It has seen that the introduction of computer has replaced the typewriters; the color television has made the black and white television out of fashion. Again a change in the fashion or customers taste and preferences may shift the demand in the market for a particular product. All these aspects are external factors that are beyond the control of the business. So the business units must have to adapt themselves to these kind of changes, in order to survive and succeed in the competitive world.

Business environment is an environment in which business is carried out. Business environment encompasses all those factors that affect a company's operations; including customers, competitors, suppliers, distributors, industry trends, substitutes, regulations, government activities, the economy, demographics, social and cultural factors, innovations and technological developments.

An example of a business environment is a business office, such as an insurance office because they carry out the business of selling insurance policies to people.

**Definitions of Business Environment**

**(i) According to Barry M. Richman and Melvgtt Copen,** "Business environment consists of factors that are largely if not totally, external and beyond the control of individual industrial enterprise and their managements. These are essentially the 'givers' within which firms and their management must operate in a specific country and they vary, often greatly, from country to country".

**(ii) According to William F. Glucck,** "Business environment as the process by which strategists monitor the economic, governmental, market, supplier, technological, geographic and social settings to determine opportunities and threats to their firms".

**2. Factors affecting business environment.**

*Ans :*

It is very important for business firms to understand their environment and changes occurring in it. Business -enterprises which know their environment and are ready to adapt to environmental changes would be successful. On the other hand, firms which fail to adapt to their environment are unlikely to survive in the long- run. There are two broad components of business environment:

1. Internal Factors, and
2. External Factors

**3. Define economic environment.**

*Ans :*

Economic environment refers to those economic factors which have impact on the working of business. Economic environment is complex in nature.

Economic environment consists of economic factors that influence the business in country. These factors include gross national product, corporate, profits, inflation rate, employment, balance of payments, interest rates consumer income, etc.

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In a developing country, the low income may be the reason for the very low demand for a product. Economic environment of business has reference to the board characteristics of the economic system in which the business operates. The business sector has economic relation with the government, capital market; household sector and global sector. These sectors together influence the trends and structure of the economy. The form and functioning of the economy vary widely.

**4. Importance of Economic Environment.**

*Ans :*

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

**(i) Capitalizing early opportunities**

Environment friendly enterprise is 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.

**(ii) Activating management to changing needs**

The knowledge of environmental changes sensitizes the management to make strategy to cope with the emerging problems.

**(iii) 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.

**5. Define Capitalism.**

*Ans :*

The economic system in which business units or factors of production are privately owned and governed is called Capitalism. The profit earning is the sole aim of the business units. Government of that country does not interfere in the economic activities of the country. It is also known as free market economy. All the decisions relating to the economic activities are privately taken. Examples of Capitalistic Economy: England, Japan, America etc.

Capitalism is variously defined by sources. There is no consensus on the definition nor on how the term should be used as a historical category. There is general agreement that capitalism is an economic system that includes private ownership of the means of production, creation of goods or services for profit or income, the accumulation of capital, competitive markets, voluntary exchange, and wage labor. The designation is applied to a variety of historical cases, varying in time, geography, politics and culture. There is general agreement that capitalism became dominant in the Western world following the demise of feudalism.

**6. Define Socialism.**

*Ans :*

Under socialism economic system, all the economic activities of the country are controlled and regulated by the Government in the interest of the public. The first country to adopt this concept was Soviet Russia.

A socialist economic system would consist of an organization of production to directly satisfy economic demands and human needs, so that goods and services would be produced directly for use instead of for private profit driven by the accumulation of capital, and accounting would be based on physical quantities, a common physical magnitude, or a direct measure of labour-time. Distribution of output would be based on the principle of individual contribution.

As a political movement, socialism includes a diverse array of political philosophies, ranging from reformism to revolutionary socialism. Proponents of state socialism advocate for the nationalization of the means of production, distribution and exchange as a strategy for implementing socialism. Social democrats advocate redistributive taxation in the form of social welfare and government regulation of capital within the framework of a market economy. In contrast, anarchism and libertarian socialism propose direct worker's control of the

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means of production and oppose the use of state power to achieve such an arrangement, opposing both parliamentary politics and state ownership over the means of production.

**7. What is Mixed Economy?**

*Ans :*

The economic system in which both public and private sectors co-exist is known as Mixed Economy. Some factors of production are privately owned and some are owned by Government. There exists freedom of choice of occupation and consumption. Both private and public sectors play key roles in the development of the country.

The basic plan of the mixed economy is that the means of production are mainly under private ownership; that markets remain the dominant form of economic coordination; and that profit-seeking enterprises and the accumulation of capital would remain the fundamental driving force behind economic activity. However, the government would wield considerable indirect influence over the economy through fiscal and monetary policies designed to counteract economic downturns and capitalism's tendency toward financial crises and unemployment, along with playing a role in interventions that promote social welfare. Subsequently, some mixed economies have expanded in scope to include a role for indicative economic planning and/or large public enterprise sectors.

**8. Define Industrial Policy.**

*Ans :*

**Introduction**

The Industrial Policy plan of a nation, sometimes shortened IP, denotes a nation's declared, official, total strategic effort to influence sectoral development and, thus, national industry portfolio. These interventionist measures comprise "policies that stimulate specific activities and promote structural change".

Industrial policy means rules, regulations, principles, policies, and procedures laid down by government for regulating, developing and controlling industrial undertakings in the country. It prescribes the respective roles of the public, private joint and cooperative sectors for the development of industries.

It also indicates the role of the large , medium , and small sector. It incorporates fiscal and monetary policies, tarif policy, labour policy and the government attitude towardsforeign capital, and role to be played by multinationalcorporations in the development of the industrial sector.

**Definition**

(i) **According to World Bank,** "Industrial policy comprises government efforts to alter industrial structure to promote productivity based growth".

(i) **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".

(ii) **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".

**9. Objectives of Industrial Policy.**

*Ans :*

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.

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**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.

**10. Fiscal Policy.**

*Ans :*

**According to Harvey and Johnson M,** defined fiscal policy as the changes in government expenditure and taxation designed to influence the pattern and level of activity. An effective fiscal policy includes policy decisions associated with the whole financial structure of the government such as tax revenue, public expenditures, loans, transfers, debt management, budgetary deficit etc.

**Objectives**

The following are the objectives of fiscal policy:

1. To achieve the growth of public sector for achieving the aim of socialistic pattern of society.
2. To gather the needed resources for financing different programmes and projects used for economic development.
3. To control inflationary pressures in economy for achieving economic stability.
4. To minimize unequal distribution of income and wealth.

**11. Define Monetary Policy.**

*Ans :*

Monetary policy refers to the process by which the monetary authority of a country controls the supply of money, often targeting a rate of interest to attain a set of objectives oriented towards the growth and stability of the economy.

**Definitions of Monetary Policy**

Many economists have given various definitions of monetary policy. Some prominent definitions are as follows:

**(i) According to Prof. Harry Johnson,** "Monetary policy is a policy employing the central banks control of the supply of money as an instrument for achieving the objectives of general economic policy is a monetary policy."

**(ii) According to A.G Hart,** "Monetary policy is a policy which influences the public stock of money substitute of public demand for such assets of both that is policy which influences public liquidity position is known as a monetary policy."

**12. Define Legal Environment.**

*Ans :*

Legal Environment refers to the set of laws and regulations which influence the business organization and their operations. Every business organization has to obey and work within the framework of law. The legal environment is derived partly from the political climate in a country and as three distinct dimensions to it:

(a) The laws of the home country

(b) The laws of the foreign markets

(c) International law in general

The legal environment of a business refers to the relevant laws and regulations under which the business operates. Legal environment includes factors that provide rules, and penalties for violations, designed to protect society and consumers from unfair business practices and to protect businesses from unfair competitive practices. It assures uniform application of the laws by regulating the behavior and interactions of individuals against each other.

**13. Consumer.**

*Ans :*

'Consumer' means any person, who –

(i) Buys any goods for a consideration (a) Which has been paid or promised or partly paid and

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partly promised, or (b) Under any system of deferred payment. The use of such goods must be made with the approval of the buyer.

'Consumer' does not include a person who obtains goods for resale or for any commercial purpose.

'Commercial purpose' does not include use by a person of goods bought and used by him and services availed by him exclusively for the purposes of earning his livelihood by means of self employment.

(ii) Hires or avails of any service for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment. 'Consumer' also includes any beneficiary of such services other than the person who hires or avails of such services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment. Further such services must be availed of by the beneficiary with the approval of the hirer but does not include a person who avails of such services for any commercial purpose.

**14. Rights of Consumer.**

*Ans :*

**1. Right to Safety**

The right to be protected against goods which are hazardous to life and property.

**2. Right to Information**

The right to be informed about the quality, quantity, purity, price and standards of goods.

**3. Right to Choose**

The right to be assured access to a variety of products at competitive prices, without any pressure to impose a sale, i.e., freedom of choice.

**4. Right to be Heard**

The right to be heard and assured that consumer interests will receive due consideration at appropriate forums.

**5. Right to Seek Redressal**

The right to get relief against unfair trade practice or exploitation.

**6. Right to Education**

The right to be educated about rights of a consumer.

**15. Social stratification.**

*Ans :*

Social stratification can be described as the processes in a social system by which scarce and valuable resources are distributed unequally to status positions that become more or less permanently ranked in terms of the share of valuable resources each receives. It can also be described as perceived hierarchies in which consumers rate others as higher or lower in social status. Those who earn a higher status due to work or study have 'achieved' status, whereas those who are lucky to be born wealthy or beautiful achieve 'ascribed' status.

**16. Corporate Social Responsibility**

*Ans :*

Rule 2(c) of the Companies (Corporate Social Responsibility Policy) Rules, 2014 defines the term "Corporate Social Responsibility (CSR)" which means and includes but is not limited to :

(i) Projects or programs relating to activities specified in Schedule VII to the Act; or

Projects or programs relating to activities undertaken by the board of directors of a Company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

**Applicability**

Under Section 135 of the Companies Act, 2013 every company:

- having net worth of ` 500 crore or more ; or
- having turnover of ` 1000 crore or more; or
- having net profit of ` 5 crore or more

during any financial year shall constitute a CSR committee of the Board.

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# Choose the Correct Answer

1. Which is the process of analyzing the environment for the identification of factors which have impact on or have implication for the business? [ c ]
   (a) Forecasting (b) Assessment
   (c) Scanning (d) None of these
2. Which government's strategy in respect of public expenditure and revenue have a significant impact on business? [ b ]
   (a) Monetary policy (b) Fiscal Policy
   (c) Trade policy (d) Foreign exchange policy
3. Which Act was replaced with the introduction of Competition Act 2002? [ b ]
   (a) FERA (b) MRTP
   (c) POTA (d) None of these
4. Which is an Act to control and regulate the concentration of economic power to the common detriment? [ d ]
   (a) IRDA Act (b) FERA
   (c) ILO Act (d) MRTP
5. CSR is _____ . [ c ]
   (a) The same as business ethics
   (b) A theory about ethics
   (c) The integration of social and environmental concern in the daily business of the firm
   (d) The title of a Govt. Committee
6. An environment which is increasingly complex and turbulent displays [ d ]
   (a) More orderly competition
   (b) More predictable demand
   (c) A reduced risk of product obsolescence.
   (d) Increased speed of innovation
7. What does the PFI initiative refer to? [ a ]
   (a) Private Finance Initiative (b) Private Fiscal Initiative
   (c) Public Financial Initiative (d) Private Foundation Investment
8. What refers to the external forces which have a beating on the functioning of the business? [ a ]
   (a) Environment (b) Culture
   (c) System (d) None of these

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9. Which are forces in the company's immediate environment that affect the performance of the Company? [ a ]

(a) Macro environment (b) Micro environment

(c) Technological environment (d) Natural environment

10. What is concerned with the obligation and duties of business to the society? [ c ]

(a) Authority (b) Status

(c) Social responsibility (d) None of these

11. External Environment of Business is? [ d ]

(a) Physical (b) Demographical

(c) Economic (d) All of these

12. Administrative control contains? [ a ]

(a) Industrial Policy (b) Economic planning

(c) GNP (d) GDP

13. Which among the following Industrial Policy resolution/statement was based upon the Mahalanobis Model of growth? [ a ]

(a) Industrial Policy resolution – 1956 (b) Industry Policy statement – 1973

(c) Industrial Policy statement -1977 (d) Banking Policy 1969

14. Which is an economic system based on the principal of free enterprise? [ a ]

(a) Capitalism (b) Socialism

(c) Mixed Economy (d) Marxism

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# *Fill in the blanks*

1. _____ is the sum of all living and non-living things that surround an organism or group of organisms.
2. _____ environment refers to those economic factors which have impact on the working of business.
3. _____ system is a social organism through which people make their living.
4. _____ means rules, regulations, principles, policies, and procedures laid down by government
5. _____ expenditure plays a crucial role in the economic development of a developing country like India.
6. _____ is an effective tool in the hands of government to regulate business.
7. The _____ is the smallest unit of society.
8. CSR stands for _____ .
9. Business _____ encompasses all those factors that affect a company's operations
10. MRTP stands for _____ .

**ANSWERS**

1. Environment
2. Economic
3. Economic
4. Industrial policy
5. Public
6. Licensing
7. Family
8. Corporate Social responsibility
9. Environment
10. Monopoly Restrictive Trade Practice Act

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UNIT II

**LIBERALIZATION:**

Industrial Policy1991 and its implementation—Industrial growth and structural changes-Economic Planning—NITI Aayog—Economic reforms – liberalization—Second Generation reforms-Balance of Payments-importance-components.

## 2.1 LIBERALIZATION

**Q1. Define Liberalization. Explain the nature of Liberalization.**

*Ans :* **(May-15, May-13, Imp.)**

Liberalization 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.

Liberalization refers to the relaxation of the previous government restriction usually in area of social and economic policies. When government liberalized trade, it means it has removed the tariff, subsidies and other restriction on the flow of goods and services between the countries. Economic liberalization, in its modem form, usually describes internal economic reform such as deregulation and privatization 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.

Liberalization 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 liberalization 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. Liberalization means removal of control and not of regulations. Liberalization 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.

**Definition**

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

**Nature of Liberalization**

The nature of liberalization is as follows:

**1. Freedom in Fixing Prices**

Liberalization 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 liberalization, 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.

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**5. Increase of Foreign Investment**

Liberalization simplified the policies to attract foreign capital and technology to India.

**Q2. Explain the impact of Liberalization in India.**

*Ans :* **(Dec.-20)**

The main aim of liberalization 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 liberalization 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 liberalization in India is as follows:

**1. Positive Impact of Liberalization in India**

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

**i) Improvement in Healthcare**

Liberalization 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 globalization 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 globalization, Indian agriculture has improved to some extent which has helped to reduce the poverty problems of the rural masses.

**iii) Liberalization and Employment**

Liberalization has also put a favourable effect on the employment scenario of the country. Over the years, due to the liberalization 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) Liberalization and Economic Growth**

It was in the 1990s that the first economic liberalization policies were initiated by the then Finance Minister Dr. Manmohan Singh to encourage the wake of globalization 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 4th 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) Liberalization and Mergers in India**

The extents to which cross-border mergers and acquisitions are growing are all due to the globalization 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 Liberalization in India**

The negative impact of liberalization in India is as follows:

**i) Reduced Profits**

Liberalization is often opposed by domestic industries that would have their

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profits and market share reduced by lower prices for imported goods.

**ii) Exploitation of Workers**

Socialists frequently oppose liberalization on the ground that it allows maximum exploitation of workers by capital.

**iii) Reduces Economic Freedom**

Liberalization is opposed by many anti-globalization 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 liberalization 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**

Liberalization makes it easier to move capital from one country to another. Global institutions such as the World Trade Organization 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.

**Q3. Explain the Features of Liberalization**

*Ans :*

i) Liberalization is freeing the industry from government restrictions.

ii) It provides a conductive economic and business climate necessary for continuous growth.

iii) It promotes a cost effective business environment, encourage competition and enhanced efficiency.

iv) Liberalization of trade and investment regimes as well as deregulation.

v) It obtains reciprocal market openings, by trading partners particularly in the context of multilateral, regional and bilateral negotiations.

vi) Wider choice of goods and services and reduced prices resulting from increased international competition and specialization.

**Q4. State the advantages and disadvantages of Liberalization.**

*Ans :*

**Advantages of Liberalization**

The several advantages of Liberalization are:

i) In the medium and long term lower cost services provided to users.

ii) The overall the quality of service is improved due to competition.

iii) It avoids drawbacks of natural monopolies.

iv) Helps for freeing up government funds for other social expenditures / investments.

v) The creation of new revenue streams for governments through PPP in investments commonly undertaken with private sector.

vi) Transfer of risk to private operators through PPP or BOT.

vii) It increases entrepreneurship in country.

viii) Attract foreign capital by potential investors, better suited to carry out investment.

ix) Helps to increase the foreign investment.

x) Increase the foreign exchange reserve.

xi) Increase fit consumption and Control over price.

xii) Reduction in dependence on external commercial borrowings.

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### Disadvantages of Liberalization

The several disadvantages of Liberalization are:

i) Increase in unemployment.

ii) Loss to domestic units.

iii) Increase dependence on foreign nations.

iv) Unbalanced development.

v) Risk to create new types of private or other state controlled monopolies (players with dominant position in the market) or oligopolies.

vi) Short term impacts can be negative.

vii) Government has rushed to get rid of operation or investment in anticipation of high fee offered by bidder and soon discovers the incapacity-inability of bidder to respect contract terms.

viii) Transfer of risk not sufficiently covered in contract, therefore reverting the operation or investment to state.

ix) Renegotiation of contract required due to insufficient financial feasibility study or due to rushed government decision.

x) Just before the transfer of investment or operation to state, its proper maintenance is "forgotten".

## 2.2 Industrial Policy

**Q5. Define Industrial Policy. What are the objectives of Industrial Policy ?**

*Ans :*

### Introduction

The Industrial Policy plan of a nation, sometimes shortened IP, "denotes a nation's declared, official, total strategic effort to influence sectoral development and, thus, national industry portfolio. These interventionist measures comprise "policies that stimulate specific activities and promote structural change".

Industrial policy means rules, regulations, principles, policies, and procedures laid down by government for regulating, developing and controlling industrial under takings in the country. It prescribes the respective roles of the public, private joint and cooperative sectors for the development of industries.

It also indicates the role of the large, medium, and small sector. It incorporates fiscal and monetary policies, tarif policy, labour policy and the government attitude towards foreign capital, and role to be played by multinational corporations in the development of the industrial sector.

### Definitions

i) **According to World Bank,** "Industrial policy comprises government efforts to alter industrial structure to promote productivity based growth".

ii) **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".

iii) **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".

### 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 Utilization of Resource**

Prevent the wasteful use of scarce resources and ensure their conservation and judicious utilization.

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**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.

**Q6. Explain the features of industrial policy.**

*Ans :*

A well-designed industrial policy is important for several reasons:

**1. Establishes Co-ordination**

Industrial policy establishes co-ordination between:

**i) Industry and Agricultural Development**

It is helpful in establishing co-ordination between industrial development and agricultural development.

**ii) Public and Private**

It is helpful in establishing co-ordination between public sector and private sector.

**iii) Capital and Physical Resources**

It is helpful in establishing effective co-ordination between capital and physical resources on one hand and natural and social resources on other hand.

**2. Directs National Resource**

It is helpful in directing national resources in desired direction. It can direct the flow of scarce resources in the most desirable areas of investment in accordance with national priorities.

**3. Helps in Industrial Development**

It can help correct the lopsided development of industrial structure and thereby bring about desirable balance and diversification in the country's economic structure. It is helpful in formulating a plan of industrial development. It is helpful in formulating rules, principles and policies for the management regulation and control of industrial undertakings. It is helpful in formulating the target and programme of industrial development.

**4. Prevents Economic Power Concentration**

It is helpful in preventing the concentration of economic power. It can prevent, through industrial licensing and other supporting measures of fiscal and monetary policies, the concentration of wealth and economic power

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in few hands so that the emergence and evils of monopoly capitalism can be effectively curbed.

**5. Proper Control**

It empowers the State to regulate and control the establishment and expansion of the industrial undertakings in the private sector, in accordance with national planned objectives. It can help to demarcate the areas of economic activity between different sectors of the economy.

**6. Promotes Export**

It is helpful in promoting exports and reducing the dependence on imports. It is helpful in maintaining regional balances.

**7. Prevents Duplication of Economic Resources**

It can prevent duplication or uneconomic use of resources so that the country can ensure conservation and the judicious use of the country's limited resources (both exhaustible and renewable).

In short, industrial policy provides guidelines for effective coordination and integration of the activities of the various sectors of the economy with a view to achieving a balanced and self-reliant pattern of development that can ensure rapid growth of output and employment.

## 2.2.1 Industrial Policy 1991 and its Implementation

**Q7. Explain the salient features of new industrial policy 1991.**

*Ans :* **(Dec.-20, May-19, May-18, May-13, Imp.)**

A major shift in the industrial policy was made by the Congress (I) Government led by Mr. P.B. Narasimha Rao on July 24, 1991. The main aim of this policy was to unshackle the country's industrial economy from the unnecessary bureaucratic control, introduce liberalization with a view to integrate the Indian economy with the world economy, to remove restrictions on direct foreign investment and also to free the domestic entrepreneur from the restrictions of MRTP Act. Besides, the policy aims to shed the load of the public enterprises which have shown a very low rate of return or are incurring losses over the years.

**Salient Features of New Industrial Policy**

The Industrial Policy, 1991, is called the New Industrial Policy (NIP). Its main features are:

**1. Doing Away with Industrial Licensing Requirements**

In a major move to liberalize the Indian economy, the new industrial policy abolished all kinds of industrial licensing irrespective of the level of investment in all except 18 industries related to security and strategic concerns, safety, environmental issues, etc. In continuation of the 1991 policy with regard to delicense, there are only six industries related to health, strategic and security considerations that remain under the purview of industrial licensing.

**2. Diminishing Role of Pubic Sector**

The spirit of the 1991 policy is diametrically opposite to that of 1956 policy with regard to the role of the public sector in economic growth and development. The 1956 resolution reserved 17 industries in the public sector whereas the 1991 policy reduced this to eight and by 2001, the number reserved for public sector is just three. The government decided to open the arms and ammunition industry also to the private sector. The government also made its intentions clear to further reduce the importance of the public sector by introducing a 'divestment' wherein private sector participation is encouraged in the important areas of the economy. The divestment scheme includes offering the shareholding in public enterprises to mutual funds, financial institutions, employees and general public.

**3. Incentives and Concessions for Foreign Investment and Technology**

The New Industrial Policy prepared a specified list of high technology and high investment priority industries where automatic permission

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was to be made available for foreign direct investment upto 51 per cent foreign equity. At present, foreign equity upto 100 per cent has been permitted in infrastructure industries such as electricity generation, transmission and distribution, construction and maintenance of roads, highways, vehicular bridges, ports and harbours. The main purpose of announcing these investments is to make the Indian industry more vibrant, modem and efficient.

**4. Drastic Amendments to MRTP Act**

The Monopolies and Restrictive Trade Practices (MRTP) Act has been amended in tune with the spirit of the NIP. Earlier, there were restrictions on the size of assets of MRTP companies (which are very strong in terms of assets and market hold). Such restrictions have now been lifted and the companies operate freely.

**For example,** foreign equity has gone upto a maximum limit of 51 per cent in most industries. In the case of Export Oriented Units (EOUs) and life saving drugs and equipment manufacturers, there is provision for 100 per cent foreign equity. The now amended act emphasises prevention of restrictive and unfair trade practices.

**5. Removal of Compulsory Convertibility Clause**

In India, a greater part of the industrial investment used to be made in the form of loans from banks and financial institutions. These institutions followed compulsory practice of including a convertibility clause in their lending operations for new projects. This clause provided these institutions an option of converting part of their loans into equity if it was thought necessary by their respective managements. Although this option was not generally exercised, it carried a threat of takeover of private firms by financial institutions. The new industrial policy, therefore, stated that financial institutions will not impose this mandatory convertibility clause.

**Q8. Explain the various functions of new industrial policy 1991.**

*Ans :*

**1. Encourage foreign Investment**

Foreign investment would be encouraged in high priority areas up to a limit of 51 per cent equity. Government will encourage foreign trading companies to assist Indian exporters in export activities.

**2. Provide Automatic Approval**

With a view to injecting the desired level of technological dynamism in Indian industry, the government will provide automatic approval for technology agreements related to high priority industries.

**3. Relaxation of MRTP and FERA**

Relaxation of MRTP Act (Monopolies and Restrictive Practices Act) which has almost been rendered non-functional. Dilution of foreign exchange regulation act (FERA) making rupee fully convertible on trade account.

**4. Other Functions: Other functions of New Industrial Policy are given as follows:**

i) Disinvestment of Public Sector Units' shares.

ii) Closing of such public sector units which are incurring heavy losses.

iii) Abolition of C.C.I, and wealth tax on shares.

iv) General reduction in customs duties.

v) Provide strength to those public sector enterprises which fall in reserved areas of operation or in high priority areas.

vi) Constitution of special boards to negotiate with foreign firms for large investments in the development of industries and import of technology.

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**Q9. Explain the implication of new industrial policy in India.**

*Ans :*

The 1970s was considered a time of stagnation and liberalization was thought to have commenced slowly in the 1980s enabling the industry to recover. Those who have agreed with this view say strong efforts should be made to liberalize the entire economy in order to speed-up industrialization and economic growth. Those who appreciate the NIP feel that Indian companies such as Wipro, Infosys and Satyam Computers would not have seen the light of the day but for liberalization.

The following are some of the merits of NIP 1991:

**1. Growth of New Economy Companies**

The 'new economy' companies such as Infosys have grown in size and stature, thanks to liberalization and NIP.

**2. Economy Bailed Out**

If is a fact that the NIP bailed out the Indian economy from economic crisis and degradation.

**3. New Breed of Entrepreneurs**

As a result of liberalized economic policies since 1991, Indian economy could recover fast and develop a new breed of entrepreneurs such as Narayana Murthy, of Infosys.

**4. FDI and New Technologies**

It was felt that the changes in respect of foreign investment and foreign technology agreements introduced in 1991 via the New Industrial Policy were basically meant to attract Foreign Direct Investment (FDI), superior technology and managerial expertise.

**5. Greater Competitive Strength**

It enabled Indian entrepreneurs to have international exposure, withstand competition from multinationals with greater confidence and take the multinational route.

**6. Healthy Competition**

It is also felt that the amendments to the MRTP Act will encourage healthy competition. Hitherto, the MRTP Act served no clear purpose even though one of its basic objectives was to check and curb monopolies and restrictive trade practices. In fact, the Act obstructed the growth of Indian companies for a long time. Recently, a new law when called 'competition law' has been enacted with the clear objective of encouraging competition among companies and penalizing those that come to the way of healthy competition.

**7. Sustained Economic Growth**

It was felt that the NIP, alongwith other reforms such as in the financial sector, fiscal policy, and monetary policy, would lead to increased productivity, efficiency, employment and sustained economic growth.

**However, the NIP was also criticised vehemently on the following grounds:**

1) It buried once and for all the 1956 policy resolution that was considered to be the 'economic constitution' of the nation.

2) The unrestricted entry of multinationals most probably will decimate the indigenous industry in the country.

3) The absence of effective legal framework may lead to frequent frauds and scams demoralising the investor class.

4) The multinationals may exploit that Indian consumer by encouraging conspicuous consumption. They may not be helpful in technology transfer. With their superior technologies, they may dominate the Indian market especially in consumer durable segment. If MNCs are allowed to operate freely, indigenous research and development may be the first casualty.

5) It may lead to lopsided development and social and economic inequalities. These may disturb social harmony causing irreparable damage in the long-run.

6) The MNCs may tend to put their brands on goods manufactured by the small industry and use Indian markets for enhancing their

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profits. In other words, instead of developing India as a major production and export base, many MNCs may actually end-up as trading intermediaries making huge profits in the process.

Originally, the licensing system was introduced to achieve socio-economic objectives of balanced regional development, equitable distribution of income and wealth, prevention of concentration of economic power in the hands of few, etc.

## 2.3 Industrial Growth and Structural Changes

**Q10. Explain briefly about Industrial Growth since independence.**

*Ans :*

The economic development in India followed socialist-inspired politicians for most of its independent history, including state-ownership of many sectors; India's per capita income increased at only around 1% annualized rate in the three decades after its independence.Since the mid-1980s, India has slowly opened up its markets through economic liberalization.

The change in Industrial structure (or) Industrial development (or) growth during the planning era can be divided into four phases as under:

**Phase I-High Growth Phase (1950-51 to 1965-66)**

Building up of Strong Industrial Structure: It was the period from the beginning of the 1st plan to the end of 3rd plan which laid the foundation for the industrial development by building up a strong industrial structure .There was a noticeable acceleration in industrial output because of Two major factors - First and most important factor responsible for high growth was the emphasis on industrialisation; particularly since the Second five year plan. High priority was given to industrial growth vis-a-vis other objectives in first three plans. Substantial investments were made in the industrial sector, in general and in heavy industries in particular. The scale of investment efforts in certain heavy industries was thought to be beyond the capital-raising capacity of the private sector. As a result 17 industries were reserved for the public sector. These industries included the bulk of infrastructure, namely-Defence, Atomic Energy, Iron and Steel, Heavy Machinery, Coal, Railways, Airlines, Telecommunication and Electricity. In this period substantial investments were made in manufacturing and supporting infrastructure. The complementary character of public and private sector investment is an important factor in increasing the overall growth rate in Industry.

Secondly, this was a period of price stability and the food grain prices remained stable. The agriculture output showed a higher trend compared to pre-independence period. In case of any shortage, the domestic supply was supplemented by PL-480 imports. There is adequate inflow of foreign aid from other countries. Moreover, public sector investment was through non-inflationary means.

**Phase II-Industnal Deceleration and Structural Retrogression (1966-80)**

This phase is also known as Low Growth Phase or Industrial Deceleration, particularly the period from 1965-1974 as shown in table 1. The rate of growth fell steeply from 9.0% per annum during the 3rd plan to a mere 4.1% per annum during the period 1%5 to 1974. It is also important to point out that even this meagre rate of Industrial growth does not express the true situation as there was a sharp increase of 10.6% in Industrial production in the year 1976-77. If this year is left out then the rate of Industrial growth over the 10 year period 1%5 to 1974 declines further to a meagre 3.7% per annum. In a similar way, the rate of growth of 6.1% per annum during the Vth Plan owes considerably to the 10.6% increase recorded in the year 1976-77. If this year is left out, the rate of Industrial growth for the remaining 4 years comes down considerably. It is clear from earlier table, the last year of phase II, i.e., 1979-80 recorded a negative rate of growth of Industrial production of -1.6% over the preceding year.

In addition to the phenomenon of deceleration in industrial growth during the period 1965-1980, Table 1 also brings out clearly the phenomenon of structural retrogression that plagued the Industrial Sector during this period. From the

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point of view of long run Industrial Development, the most important group of industries is the group of capital goods industries. This group registered a consistent and considerable increase from 9.8% per annum in the 1st plan to 13.1% per annum in the 2nd plan and further to a phenomenal 19.6% in the 3rd plan. However, in the next 11 years the capital goods sector grew at an annual rate of only 2.6%. If we consider the Vth plan period, the rate of growth of capital goods industries goes up to 5.7% per annum, even this substantially lower than the rates of growth recorded m: the 1st three plans. The same story is found in the case of basic industries.

**Table 1**
**Annual Compound Growth Rates in Index Numbers of Industrial Production-[1951-1980]**

| Use-Based or Functional Classification | 1951 to 1955 (4 years) | 1955 to 1960 | 1960 to 1965 | 1965 to 1974 | 1974 to 1979 (V Plan average) | 1979-80 |
|---|---|---|---|---|---|---|
| 1. Basic goods | 4.7 | 12.1 | 10.4 | 6.5 | 8.4 | -0.5 |
| 2. Capital goods | 9.8 | 13.1 | 19.6 | 2.6 | 5.7 | -2.3 |
| 3. Intermediate goods | 7.8 | 6.3 | 6.9 | 3.0 | 1.3 | 1.9 |
| 4. Consumer goods | 4.8 | 4.4 | 4.9 | 3.4 | 5.5 | -4.4 |
| (a) Consumer durable goods | – | – | – | 6.2 | 6.8 | 5.6 |
| (b) Consumer non-durable goods | – | – | – | 2.8 | 5.4 | -6.1 |
| 5. General Index | 5.7 | 7.2 | 9.0 | 4.1 | 6.1 | -1.6 |

**Phase III—The Period of Industrial Recovery (1981-1991)**

The period of 1980s can broadly be termed as a period of Industrial Recovery. This is clearly brought out by a study of the revised index of industrial production (base 1980- 81). Rates of Industrial growth based on this index are presented in the following table:

**Table 2**
**Role of Growth of Industrial Production (Use-Based) during period III 1981 to 1991**

(% per annum)

| Use-Based or Functional Classification | 1981-85 | 1985-90 | 1990-91 |
|---|---|---|---|
| 1. Basic Goods | 8.7 | 7.4 | 3.8 |
| 2. Capital Goods | 6.2 | 14.8 | 17.4 |
| 3. Intermediate Goods | 6.0 | 6.4 | 6.1 |
| 4. Consumer Goods : | 5.1 | 7.3 | 10.4 |
| (a) Durable | 14.3 | 11.6 | 14.8 |
| (b) Non-Durable | 3.8 | 6.4 | 9.7 |
| General Index | 6.4 | 8.5 | 8.3 |

Table 2 shows that the rate of Industrial growth was 6.4% per annum during 1981-85, 8.5% per annum during the VIlth plan and 8.3% in 1990-91. This is a marked upturn from growth rates of around 4% achieved during the latter half of Sixties and the Seventies. This performance is also an improvement upon the growth rates achieved during the first and second five year plans. Similar trends of Industrial Recovery in 80s are noted by some other Economists as well. As per Ahluwalia, a very important aspect of the growth revival during the first half of the 80s was that it was not associated with an acceleration in the growth of the factor inputs but was, rather, based on better productivity performance. Thus, total factor productivity which registered a negative and negligible growth of -0.2 to -0.3% per annum in the period 1966-67 to 1979-80 showed a marked improvement in the first half of the 80s when it registered a growth of 3.4% per annum.

**Phase IV-Reforms Phase (July 1991 onwards)**

The worst industrial growth was observed in 1991-92. The recovery in Industrial growth started in 1992-93 when it grew at a rate of 2.3% followed by 6.0% in 1993-94. These werethe initial adjustment years in response to the reforms. The industrial growth then accelerated to 9.1% in 1994-95 and 13.0% in 1995-96 surpassing the growth rates of 80s. After the initial birth-pangs of a competitive economy were over the benefits of liberating Indian Industry from the shackles of Controls Raj were clearly visible by mid 90s. When most of experts expected that India will enter in a period of sustainable growth, the growth performance slowed down. The Indian Industrial growth declined to 6.1% in 1996-97 which was much lower than the 13% growth of the previous, year. The deceleration of Industrial growth continued in 1997-98 as well. The main reason for the slowdown may be the tightening of the monetary policy in 1995-96 and consequent credit squeeze with high interest rates. The slowdown of industrial growth in 1996-97 to 1998-99 did not cause much panic as it was expected to be a cyclical downturn of a normal business cycle. It was not indicative of an Industrial Recession. The slowdown in 1998-99 was more pronounced for the manufacturing sector in particular. This did not prove to be a sustained Industrial Recovery.

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**Table 3**

**Annual Growth Rates of Industrial Production in Major Sectors of Industry (%)**

| Period | Overall | Manufacturing |
|---|---|---|
| 1990-1991 | 8.2 | 9.0 |
| 1991-1992 | 0.6 | –0.8 |
| 1992-1993 | 2.3 | 2.2 |
| 1993-1994 | 6.0 | 16.1 |
| 1994-1995 | 9.1 | 9.1 |
| 1995-1996 | 13.0 | 14.1 |
| 1996-1997 | 6.1 | 7.3 |
| 1997-1998 | 6.7 | 6.7 |
| 1998-1999 | 4.1 | 4.4 |
| 1999-2000 | 6.7 | 7.1 |
| 2000-2001 | 5.0 | 5.3 |
| 2001-2002 | 2.7 | 2.9 |
| 2002-2003 | 5.7 | 6.0 |
| 2003-2004 | 7.0 | 7.4 |
| 2004-2005 (April-Dec.) | 8.4 | 9.0 |

The Industrial growth slowed down in 2000-01 and 2001-02 and this slow down was widespread covering all broad sectors such as Manufacturing, Electricity and Mining and all end use groups such as capital goods, intermediate goods and consumer goods, both durable and non-durables. Manufacturing sector growth fell to 2.9% in 2001-02, which was lowest growth in the past ten years.

**Q11. Explain the factors influencing structural changes.**

*Ans :*

**1. Changing Sectoral Distribution of Domestic Product:**

Change in composition of domestic product or change in national income by industry of origin refers to change in relative significance (share) of different sectors of the economy. Generally, an economy is divided into three major sectors viz. primary, secondary and tertiary sectors.

Primary sector includes agricultural and allied activities, secondary sector includes manufacturing industries and tertiary sector includes services. With the development process, significance of primary sector declines while that of secondary and tertiary sectors increases. After independence, Indian economy has also experienced such changes.

**2. Growth of Basic Capital Goods Industries**

When country attained independence, the share of basic and capital goods industries in the total industrial production was roughly one-fourth.

Under the second plan, a high priority was accorded to capital goods industries, as their development was considered a pre-requisite to the overall growth of the economy. Consequently, a large number of basic industries which produce capital equipment and useful raw materials have been set up making the country's industrial structure pretty strong.

**3. Expansion in Social Overhead Capital**

Social overhead capital broadly includes transport facilities, irrigation systems, energy production, educational system and organisation and health facilities. Their development creates favourable conditions for growth and also for better human living. The transport system in India has grown both in terms of capacity and modernisation.

The railways route length increased by more than 9 thousand kms and the operation fleet practically doubled. The Indian road network is now one of the largest in the world as a result of spectacular development of roads under various plans. India has also seen growth in Life- lixpectancy and Literacy Rate but education has not expanded at a desired rate.

**4. Progress in the Banking and Financial Sector**

Since independence, significant progressive changes have taken place in the banking and financial structure of India. The growth of commercial banks and cooperative credit societies has been really spectacular and as a result of it the importance of indigenous bankers and money-lenders has declined.

## 2.4 ECONOMIC PLANNING

**Q12. Define Economic planning. What are the objectives of economic planning.**

*Ans :* **(Imp.)**

Economic planning is a term used to describe the long-term plans of an incumbent government to coordinate and develop the economy. Economic planning is commonly a feature of big government as it usually involves increased spending on things such as public work schemes and government programmes. Economic planning is the process by which key economic decisions are made or influenced by central governments. It contrasts with the laissez-faire approach that, in its purest form, avoid any attempt to guide the economy, relying instead on market forces to determine the speed, direction, and nature of economic evolution.

The government has to prepare and implement a comprehensive economic plan

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integrating the private sector with the public sector. It is for these reasons that we have been having economic planning since 1951 when the First Five Year Plan was launched.

Economic planning is defined as "the making of major economic decisions - what and how much is to be produced, how, when, and where it is to be produced and to whom it is to be allocated by the conscious decision of a determinate authority on the basis of a comprehensive survey of the economic system as a whole".

### Definitions

**(i) According to Dickinson,** "Economic planning is the making of all major economic decisions by conscious decisions of comprehensive survey of the economic system as a whole".

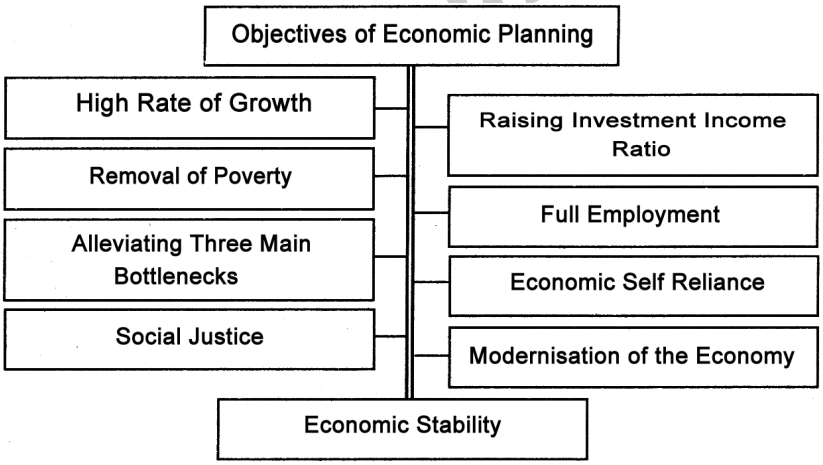
**(ii) According to the Indian Planning Commission,** "Economics planning is, essentially a way of organizing and utilizing resources to maximum advantage in terms of defined social ends".

**(iii) According to Fedynand Zweig,** "Economic planning in this sense would mean drawing-up economic schemes with foresight and on a large scale it may be called planning within the economy".

**(iv) According to Prof. Lews Lordwin,** "Planned economy is a scheme of economic organization in which individual and separate plants, enterprise of industries are treated as coordinated units of one single system for the purposes of utilizing available resources to achieve the maximum satisfaction of the people's needs with in given time".

### Objectives of Economic Planning

Planning without an objective is like driving without any destination. The long-term objectives of economic planning are as follows:




### 1. High Rate of Giowth

All the Indian Five Year Plans have given primary importance to higher growth of real national income. During the British rule, Indian economy was stagnant and the people were living in a state of abject poverty. The Britisher's exploited the economy both through foreign trade and colonial administration. While the European industries flourished, the Indian economy was caught in a vicious circle of poverty. The pervasive poverty and misery were the most important problem that has to be tackled through Five Year Plan.

### 2. Raising Investment Income Ratio

Achieving a planned rate of investment within a given period to bring the actual investment as proportion of national income to a higher level has been regarded significant due to two reasons.

Firstly, such an increase in output capacity is deemed to be needed to increase the output. Secondly it is needed to bring the capital stock of the economy to ensure the growth of future output capacity.

**3. Removal of Poverty**

Up to the end of the Fourth Five Year Plan, it was felt that the benefits of development have received a raw deal to tackle the problem of poverty. In the Fifth Plan, there was a visible shift in the approach which resulted in the Minimum Needs Programme. Earlier to it, there was 20 Point Economic Programme to uplift village community, The Sixth Plan (1980-85) document mentioned that the incidence of poverty in the country is still very high and necessary measures need to be adopted to combat poverty. Similarly, seventh, Eighth and Ninth Plan Stressed for the removal of poverty in the country.

**4. Full Employment**

Unemployment problem is a chronic problem in undeveloped countries. Though, India has emerged as a new developing country, yet it is in the grip of acute problem of disguised unemployment. Thus, the crucial objective of Indian Planning is the creation of conditions for attaining full employment and the elimination of unemployment, underemployment and disguised unemployment.

**5. Alleviating Three Main Bottlenecks**

Another objective of planning is the adoption of various measures to alleviate the three 'bottlenecks' viz., agricultural production, the manufacturing capacity for producer goods and the balance of payments. The various plans have in one way or other been concerned with the removal of these three principal barriers for achieving stability-both internal and external in the economy.

**6. Economic Self Reliance**

Self reliance means to stand on one's own legs. In the Indian context, it implies that dependence on foreign aid should be as minimum as possible. At the beginning of planning, we had to import food grains from USA to meet our domestic demand. Similarly, for accelerating the process of industrialization, we had to import, capital goods in the form of heavy machinery and technical know-how. For improving infrastructure facilities like roads, railways, power, we had to depend on foreign aid to raise the rate of our investment. As excessive dependence on foreign sector may lead to economic colonialism, the planners rightly mentioned the objective of self-reliance from the third Plan onwards. In the Fourth Plan much emphasis was given to self-reliance, more especially in the production of food grains. In the Fifth Plan, our objective was to earn sufficient foreign exchange through export promotion and important substitution.

**7. Social Justice**

Social justice means to equitably distribute the wealth and income of the country among different sections of the society. In India, we find that a large number of people are poor; while few lead a luxurious life. Therefore, another objective of development is to ensure social justice and to take care of the poor and weaker sections of the society. The Five-Year Plans have highlighted four aspects of social justice.

They are:

i) Application of democratic principles in the political structure of the country;

ii) Establishment of social and economic equity and removal of regional disparity;

iii) Putting an end to the process of centralization of economic power; and

iv) Efforts to raise the condition of backward and depressed classes.

Thus the Five Year Plans have targeted to uplift the economic condition of socio-economically weaker sections like scheduled caste and tribes through a number of target oriented programmes. In order to reduce the inequality in the distribution of landed assets, land reforms have been adopted. Further, to

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reduce regional inequality specific programmes have been adopted for the backward areas of the country.

**8. Modernization of the Economy**

Before independence, our economy was backward and feudal in character. After attainment of independence, the planners and policy makers tried to modernize the economy by changing the structural and institutional set up of the country. Modernisation aims at improving the standard of living of the people by adopting a better scientific technique of production, by replacing the traditional backward ideas by logical reasoning's and bringing about changes in the rural structure and institutions.

These changes aim at increasing the share of industrial output in the national income, upgrading the quality of products and diversifying the Indian industries. Further, it also includes expansion of banking and non-banking financial institutions to agriculture and industry. It envisages modernisation of agriculture including land reforms.

**9. Economic Stability**

Economic stability means to control inflation and unemployment. After the Second Plan, the price level started increasing for a long period of time. Therefore, the planners have tried to stabilize the economy by properly controlling the rising trend of the price level. However, the progress in this direction has been far from satisfactory.

Thus the broad objective of economic plans has been a non-inflationary self-reliant growth with social justice.

**Q13. What are the Merits and Limitations of Economic Planning?**

*Ans :*

**Merits**

**1. It promotes equality among consumers**

Since the government controls all aspects of production, there will be no chance of monopoly to occur, which means that the gap between the rich and the poor will be reduced, as all government policies will be designed to bring about social equality.

**2. It allows the government to monitor all aspects of economy**

In a centrally planned economy, the government will be able to keep proper tabs on the supply, demand, prices and other aspects surrounding goods and services. It can also indirectly keep a watch on any signs of inflation that might occur.

**3. It does not hinder economic projects to be carried out immediately**

There will be no need to wait for private investments for particular projects to go underway, unlike in other economic systems, such as capitalism. Here, the government reigns supreme, which means that it can start and end a project that the country might require, such as infrastructures, health facilities and sanitation services.

**Limitations**

**1. It is known to be inefficient in distributing resources**

This economic system sees planners not being able to accurately predict shortages, surpluses and consumer preferences, which entails that they cannot also allocate resources efficiently. This would result in some areas having abundance of goods that cannot be sold and other areas experiencing shortages. On the other hand, a free market allocates resources based on the price system, making sure they will go where demand and supply are dictated.

**2. It would go against some people's rights as consumers**

Opponents say that this system will lead to dissent among citizens, as their basic right of free will is going to be challenged. This means that it will eventually lead to the citizens revolting against the government.

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**3. It suppresses economic freedom**

It has been observed that a centrally planned economy can stifle economic freedom, as citizens would have no incentive to take entrepreneurial risks or innovate. As you can see, central planners suppress the profit motive by considering decisions from entrepreneurs and transferring them to the state. As economists believe, society functions best when the economy is guided by invisible hand, which rewards personal economic freedom, but central planning restricts this strategy.

## 2.5 NITI AAYOG

**Q14. Explain the composition of NITI Aayog.**

*Ans :*

NITI Aayog (or) National Institution for Transforming India Aayog is basically a policy think tank of Government of India and State Governments that replaces 65-year old Planning Commission. Union Government of India had announced formation of NITI Aayog on 1st January, 2015.

The NITI Aayog will have a governing council comprising all State Chief Ministers and Lt. Governors of Union Territories and will work towards fostering a 'Co-operative federalism' for providing a "national agenda" to the Centre and States.

The body is comprised of a CEO and a Vice Chairperson, to be appointed by the Prime Minister, in addition to some full-time members and two part-time members, while four Union Ministers would serve as ex-officio members. Besides, there would be specific regional councils, while experts and specialists from various fields would be called as special invitee nominated by the Prime Ministers.

NITI Aayog will serve as a "think tank" of the government as a "directional and policy dynamo" and would provide both to the governments at the centre and in the states with strategic and technical advice on key policy matters including economic issues of national and international importance.

Its primary job would be to undertake long term policy and design frameworks and take necessary initiatives for attaining faster development and finally to monitor these activities sincerely.

Thus, NITI Aayog will actively monitor and evaluate implementation of the Government programmes and initiatives. The Planning Ministry of present NDA Government is of the view that "with central plan expenditure of the order of Rs 5.75 lakh crore was being channelized per year for development, it was absolutely necessary that there is concurrent, comprehensive, credible and reliable evaluation".

This step mainly focuses on strategies to spread awareness about and use of evaluation as a tool for enhancing result from policies and programmes of good governance. So it was time to consider developing a National Evaluation Policy that would provide direction to Monitoring and Evaluation (M & E) activities in the country, laying stress upon quality standards and sound ethical procedures and provide for appropriate institutional mechanisms.

**Q15. What are the objectives of NITI Aayog?**

*Ans :* **(Imp.)**

**Objectives of NITI Aayog**

1. NITI Aayog sets its aims to provide a critical directional and strategic input into the development process of the country.
2. NITI Aayog aims to serve as a "think tank" of the government both at central and state levels with relevant strategic and technical advice on key policy matters including economic issues of national and international importance.
3. NITI Aayog now seeks to replace the centre-to-state one way flow of policy framed by the Planning Commission by an amicable settled policy framed by a genuine and continuing partnership of states.
4. The NITI Aayog will also seek to put an end to slow and tardy implementation of policy by fostering better Inter-Ministry co-ordination and better centre-state co-ordination. It will help evolve a shared vision

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of national development priorities, and foster co-operative federalism, in order to focus on the view that strong states make a strong nation.

5. The NITI Aayog has set it objectives to develop mechanisms to formulate credible plans to the village level and aggregate these progressively at higher levels of government. This Aayog will ensure special attention to the sections of society that may be at risk of not benefitting adequately from economic progress.

6. The NITI Aayog, will create a knowledge, innovation and entrepreneurial support system through a collaborative community of national and international experts, practitioners and partners. The Aayog will offer a platform for resolution of inter-sectoral and inter-departmental issues in order to accelerate the implementation of the development agenda.

7. The NITI Aayog will monitor and evaluate the implementation of programmes, and focus on technology upgradation and capacity building.

**Q16. What are the functions of NITI Aayog?**

*Ans :* **(Imp.)**

- To evolve a shared vision of national development priorities sectors and strategies with the active involvement of States in the light of national objectives
- To foster cooperative federalism through structured support initiatives and mechanisms with the States on a continuous basis, recognizing that strong States make a strong nation
- To develop mechanisms to formulate credible plans at the village level and aggregate these progressively at higher levels of government
- To ensure, on areas that are specifically referred to it, that the interests of national security are incorporated in economic strategy and policy
- To pay special attention to the sections of our society that may be at risk of not benefiting adequately from economic progress
- To design strategic and long term policy and programme frameworks and initiatives, and monitor their progress and their efficacy. The lessons learnt through monitoring and feedback will be used for making innovative improvements, including necessary mid-course corrections
- To provide advice and encourage partnerships between key stakeholders and national and international like-minded Think tanks, as well as educational and policy research institutions.
- To create a knowledge, innovation and entrepreneurial support system through a collaborative community of national and international experts, practitioners and other partners.
- To offer a platform for resolution of inter-sectoral and inter- departmental issues in order to accelerate the implementation of the development agenda.
- To maintain a state-of-the-art Resource Centre, be a repository of research on good governance and best practices in sustainable and equitable development as well as help their dissemination to stake-holders
- To actively monitor and evaluate the implementation of programmes and initiatives, including the identification of the needed resources so as to strengthen the probability of success and scope of delivery
- To focus on technology upgradation and capacity building for implementation of programmes and initiatives.

**Q17. How NITI Aayog focus on Economic Development of India?**

*Ans :*

India will grow at around 7.8 per cent in the next calendar year and investment cycle that has already started picking up will gather further strength

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Niti Aayog plans to focus in the new year on steps required to push economic growth, promote e-mobility and ensure expeditious implementation

India will grow at around 7.8 per cent in the next calendar year and investment cycle that has already started picking up will gather further strength and we will see more private investments,"

India grew at 6.7 per cent in the last fiscal year ended March 2018.

## 2.6 Economic Reforms

**Q18. Define Economic Reforms. Explain the nature of Economic Reforms.**

*Ans :*

India's business environment has evolved and transformed itself at a much faster pace in the recent years. India is now one of the most attractive destinations for doing business because of its booming economy, a relatively good GDP and other economic indicators. All of this has become possible because of the economic reforms which were initiated in 1991. India has not looked back since then. Introduction of economic reforms has enabled India to break free from the shackles of financial turmoil and head towards attaining economic self-sufficiency.

**Nature of Economic Reforms**

Economic reforms in India refer to the set of instruments and strategies adopted since 1991. Liberalization, privatization and globalization are the three constituents of economic reforms. Let us discuss all these three constituents one by one.

**1. Liberalization of the Economy**

In the context of economic reforms, liberalization refers to shifting of license dominated regime to de-licensing, deregulation and de-bureaucratization. It has taken following measures towards liberalizing the economy.

**i) Removal of Industrial Licensing**

Except 18 industries relating to security and strategic concerns, social reasons, hazardous chemicals and over-riding environmental, all industrial licensing was abolished.

**ii) De-reservation of SSI Items**

The items earlier reserved for SSI sector are gradually being de-reserved. Thus, the small scale industry has been forced to face both domestic and international competition.

**iii) Withdrawing MRTP Restrictions**

The provisions for MRTP companies for clearance of investment proposals have been withdrawn. This has freed big business houses to undertake expansion and establishment of new undertakings as well as to undertake mergers, amalgamations and takeovers.

**2. Privatization of the Economy**

Privatization refers to any process that reduces the involvement of state/public sector in economic activities of a nation. The following measures have been taken towards privatization of the Indian economy:

**i) Entry of Private Players**

Permitting the entry of the private corporate sector in such core sectors as steel, telecommunications, ports, airlines and power; and

**ii) No Budget Support**

No fresh budgetary support for Public Sector Enterprises (PSEs). This will lead to:

a) Dilution of government equity in most of those PSEs which decide to go in for new projects and expansion;

b) No new Central Public Sector undertakings (Ps Us) will be set up in the country;

c) Issue of equity to the public by the identified PSUs; and

d) Outright sale of identified PSUs.

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**iii) Disinvestment**

As part of the ongoing privatization, the shares of public sector undertakings are being sold in the market with the objective of obtaining revenue to reduce budget deficit.

**3. Globalization of the Economy**

Globalization means the economic integration of the country with the rest of the world. The following measures have been taken towards globalization of the Indian economy:

**i) Automatic Approval for FDI**

Automatic approval for direct foreign investment up to 51 per cent foreign equity ownerships in a wide range of industries. Earlier, all foreign investments were limited to 40 per cent.

**ii) Automatic Approval for Foreign Technology Agreements**

Automatic permission for foreign technology agreements royalty payments up to 5 per cent of domestic sales or 8 per cent of export sales or lump sum payment of Rs.10 million. Automatic approval for all other royalty payments will also be given if the projects can generate internally the foreign exchange.

**iii) Allowance of Foreign Equity Holdings**

With a view to provide access to international markets, majority foreign equity holdings up to 51 per cent equity would be allowed for trading companies primarily engaged in export activities.

**iv) Reduced Tariff Rates**

As a part of shift in policy orientation from import substitution to export promotion, tariff rates were reduced and quantitative controls over imports were removed. Quantitative restrictions were replaced by price-based system.

**Q19. What are the objectives of Economic Reforms.**

*Ans :*

Economic reform is a comprehensive as well as continuous process that enfolds the elements which play an important role in improving the economic and financial activities. The main objectives of economic reforms are:

1. Liberalization and opening-up of the economy.
2. Improving the availability of resources.
3. Proper redistribution of resources so as to minimize inequality across the different rungs of the society as well as across sectors.
4. Balance between different sectors of the economy.
5. Making the corporate and the public sector more effective.
6. Minimizing poverty by reducing the rate of unemployment.
7. Minimizing budget deficits by generating more revenue.
8. To improve efficiency, productivity and international competitiveness of Indian industries and to impart dynamism to overall growth process.
9. To decontrol the Indian industrial economy from unnecessary bureaucratic controls.
10. To introduce liberalization with a view to integrate the Indian economy with the world economy.
11. To remove the restrictions on foreign direct investment.
12. To remove the restrictions of MRTP Act.
13. To shed the load of public sector enterprises which have shown a very low rate of return and incurring losses over the years.

**Q20. Explain the Economic Reforms of various sectors.**

*Ans :*

Since 1991, following economic reforms concerning liberalization, privatization, and globalization have also been undertaken:

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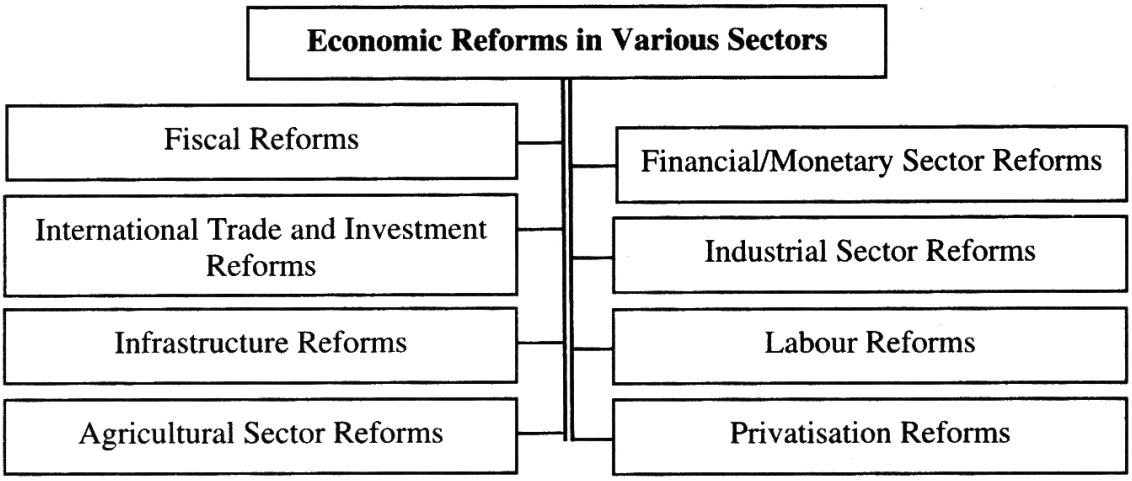


**1. Fiscal Reforms**

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 per cent of GDP in 1990-91, to 3 per cent. 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 JD. 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 per cent to 30 per cent,

ii) Taxation system has been simplified,

iii) Custom duties were brought down from 250 per cent to 10 per cent,

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 Sector 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 per cent to 25 per cent. Likewise Cash Reserve Ratio (CRR) has been brought down from 12 per cent to 5 per cent.

ii) Reduction in Bank Rate: Bank rate has been brought down to 6 per cent.

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.

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### 3. International Trade and Investment Reforms

India's trade policy prior to the 1991 reforms was characterized 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 has and 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 labor unions are vocal supporters of such small-scale industries and fight against liberalizing 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 liberalization of the 1990s. The early reforms crystallized 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 transition 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 privatized, 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 organizations 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 labour force is "organized" 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

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favour of labour. While Rao recognizes the need for labour reform, he had hesitated to implement reforms like laying-off public sector workers or closing down or privatizing 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 labor policy is an important impediment to India's growth.

**7. Agricultural Sector 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 modernize 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. For example, Prime Minister Singh recently attempted to decrease government fertilizer subsidies but was stopped by a farmers' lobbying group from wealthy agricultural states.

**8. Privatization 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.

**Q21. State the various challanges faced by Economic Reforms.**

*Ans :*

The EPW Research Foundation has pointed-out that "the new economic policy is seriously flawed in conception in its contents, strategy and approach and in many other respects". The shortcomings can be broadly classified under five major categories:

**1. Absence of a Broader Development Strategy**

The focus of both macro-economic stabilization and liberalization is to create a competitive environment in industry in which entrepreneurial decision-making will depend entirely on the market forces. The government's new industrial policy, therefore, lacks a well-defined strategy. On the basis of our experience in the past it is patently wrong to conclude that a well-articulated industrial strategy and heavy state intervention have no positive role to play in accelerating industrial growth.

**2. Wrong Sequencing of Reforms**

As a result of wrong sequencing of reforms, serious distortions have surfaced in economic management.

**3. Hasty Pace of Reforms**

The rapid pace of reforms has been determined by the controversial goal to globalize the Indian economy quickly. This has led to rapid deterioration in the quality of industrial structure.

**4. Prerequisites of Reforms Ignored**

The literature on stabilization and structural reforms is full of evidence that the shocks of these policies are better absorbed and their consequences for the well-being of the masses are very much reduced if the society has already reached a certain minimal level of human development. In contrast, the Indian situation is not at all encouraging from the point of view of human development and socio-economic structures.

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**5. Absence of Human Development Goals as an Integral Part of the Strategy**

The stabilization and structural reform program in India is being implemented against a background of incomplete structural transformation, widespread poverty, low-level of human development and distorted pattern of expenditure on health and education oriented towards the relatively well-off sections of the society.

## 2.7 Second Generation Reforms

**Q22. State the objectives of Second Generation Reforms.**

*Ans :*

Finance Minister Yashwant Sinha in his budget speech 2000-01 stated very clearly that National Democratic Alliance (NDA) Government intends to carry forward the process of implementation of the Second Generation Reforms. Elaborating on the philosophy of the Second Generation Reforms, he stated:

"Growth is not just an end in itself. It is the critical vehicle for increasing employment and raising the living standards of our people, especially of the poorest. Sustained, broad-based growth, combined with all our programmes for accelerating rural development, building roads, promoting housing, boosting knowledge-based industries and enhancing the quality of human resources, will impart a strong impetus to employment expansion. There can be no better cure for poverty than this in our country."

**For implementation, the Finance Minister laid down the following objectives:**

1. Strengthen the foundations of growth of our rural economy, especially agriculture and allied activities.
2. Nurture the revolutionary potential of the new knowledge-based industries such as infotech, biotechnology and pharmaceuticals.
3. Strengthen and modernise traditional industries such as textiles, leather, agro-processing and the SSI sector.
4. Mount a sustained attack on infrastructure bottlenecks in power, roads, ports, telecom, railways and airways.
5. Accord the highest priority to human resource development and other social programmes and policies in education, health and other social services, with special emphasis on the poorest and weakest sections of society.
6. Strengthen our role in the world economy through rapid growth of exports, higher foreign investment and prudent external debt management.
7. Establish a credible framework of fiscal discipline, without which other elements of our strategy can fall.

**Q23. Explain the Policy Measures of Second Generation Reforms.**

*Ans :*

**1. Fiscal Policy Reforms**

The Government initiated various fiscal measures in order to reduce the fiscal deficit from 8.4 per cent of GDP in 1990-91 to 5.0 per cent in 1996-97 and to 3.7 per cent in 2006-2007. In order to achieve this target, the Government introduced various controls over public expenditure and took initiative to raise both its tax and non-tax revenue.

The other measures include imposition of fiscal discipline by both Central and State Governments, reduction of subsidies, developing a more efficient expenditure system, encouraging state governments to streamline the working State Enterprise, more particularly State Electricity Boards and State Transport Corporations and withdrawal of budgetary support to Central public sector enterprises and to improve their profitability and efficiency.

**2. Monetary Policy Reforms**

The Government pursued a restrictive monetary policy for reducing inflationary pressures and also for improving balance of payment position.

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**3. Pricing Policy Reforms**

In order to reduce budgetary provision for subsidies and to promote a more flexible price structure, the Government increased the administered prices of various commodities and inputs (petroleum products and fertilizers) and gave greater freedom to public sector enterprises to set price as per market forces.

**4. External Policy Reforms**

The government introduced stabilization and import compression measures in order to reduce the current account deficit in balance of payments to 2.1 per cent of GDP in 1991-92 and then to 2 per cent of GDP in 1992-93.

**5. Industrial Policy Reforms**

In order to make necessary reforms in its industrial policy, the Government introduced its new industrial policy on July 24, 1991.

The various measures under industrial policy reforms include:

(a) Abolition of the scheme of industrial licensing for all industrial projects excepting 18 industries related to security, strategic or environmental concerns etc.;

(b) De-reservation of the area of public sector from 17 to 8 industries in order to open up area of investment for the private sector;

(c) Elimination of the system of pre-entry scrutiny of investment decisions of the MRTP companies and controlling only "unfair or restrictive business practices";

(d) Liberalization of location policy;

(e) Abolition of phased manufacturing programmes earlier enforced to increase the pace of indigenization and

(f) Removal of mandatory convertibility clause.

**6. Foreign Investment Policy Reforms**

The new industrial policy, 1991 made provision for increased flow of foreign investment in connection with technology transfer, marketing expertise and introduction of modern managerial techniques. Accordingly, the new policy included 34 priority industries in Annexure III to give automatic permission for foreign direct investment up to 51 per cent foreign equity.

In respect of foreign technology agreements automatic permission will be provided in high priority industry for royalty payments up to 5 per cent on domestic sales, 8 per cent on export sales or a maximum payment of Rs. 1 crore. Moreover, in order to promote exports of Indian commodities in international market, foreign trading companies were also allowed to raise their foreign equity holdings up to 51 per cent for export activities.

**7. Public Sector Policy Reforms:**

Considering the huge amount of losses incurred by a good number of public sector enterprises, the Government has taken various policy measures of making necessary reforms of the public sector.

These policy measures include:

(a) Reservation of list of industries under public sector reduced to 8 as against 17 industries reserved earlier;

(b) Review of those public investments be made in order to avoid those areas where social considerations are not so paramount and where private sector investment would be more efficient;

(c) Enterprises earning higher profit and judged appropriate, will be provided with much higher degree of arrangement autonomy through the system of MOD;

(d) Progressive reduction of budgetary support of public enterprises;

(e) Inviting private sector participation to increase market discipline and also the competitive capacity of these public sector enterprises through disinvestment of part of equity of selected enterprises;

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(f) Referring the chronically sick public enterprises to the board for Industrial and Financial Reconstruction (BIFR) for its rehabilitation, reconstruction or rationalization.

**8. Trade Policy Reform**

In the context of globalization of the economy and also to promote international integration of our country, phasing out of excessive and indiscriminate protection given to domestic industry become necessary. This would develop a vibrant export sector and create a regime of price based system.

The main objective is to eliminate progressively the system of licenses and quantitative restrictions, particularly for capital goods and raw materials so that these items can be placed easily on open general license (OGL). The new policy made provision for reduction of the scope of public sector monopoly sharply for most export items and also a good number of import items.

In this context, the Government has introduced Export-Import Policy, 1992-97 and 1997-2002 for the coming five years and on 13th April 1998 the Government has further modified this new Exam Policy (1997-2002) and also announced its annual Exim Policy, 2000-01 and also in 2001-2002; Again on 31st March, 2002, the Government announced its new Exim Policy, 2002-07 so as to achieve 1 per cent share in global exports by 2007.

**9. Social Policy Reforms**

To meet the objective of poverty alleviation as a part of our adjustment process, the government has allocated a higher amount of outlays on elementary education, rural drinking water supply, assistance to small and marginal farmers, programmes for the welfare of scheduled caste and scheduled tribe and other weaker sections of the society, programme for women and children and also on infrastructure and employment generation projects.

As a part of this programme, the 1995-96 Budget has introduced a National Social Assistance Scheme in the form of housing assistance, old age pension, maternity benefit, group insurance for schemes etc. for those living below the poverty line.

## 2.8 Balance of Payments (BOP)

**Q24. Define Balance of Payment. Explain the nature of Balance of Payment.**

*Ans :* **(Imp.)**

**Introduction**

Balance of payment refers to the net results that are drawn recording all the visible and invisible items that are imported and exported from the country. Balance of payment, such as, provides a comprehensive statement over the net results of foreign trade and gives a true picture as to where the country stands in the international trade. Balance of payment clearly exposes the economic viability, strength, and capability by correctly measuring its imports and exports, competency in goods and services as well as technical know-how. By services we mean the services of shipping lines, insurance companies banking concerns, and others. Balance of payment also includes the foreign loan that is either provided by it or accepted from other country (or) countries.

**Definitions**

**According to Kindleberger,** "Balance of payment is a systematic record of all economic transactions between the residents of the reporting country and residents of foreign countries during a given period of time".

In other words, the balance of payments is a comprehensive record of economic transactions of the residents of a country with the rest of the world during a given period of time. The aim is to present an account of all receipts and payments on account of goods exported services rendered and capital by resident of a country and goods imported, services

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received and capital transferred by residents of the country.

The balance of payments is an accounting statement that summarises all the economic transactions between residents of the home country and residents of all other countries. It is a measure of all transactions between domestic country and international countries.

**Nature of BOP**

The nature of balance of payments is as follows:

**1. Systematic Record**

It is a systematic record of receipts and payments of a country with other countries.

**2. Fixed Period of Time**

It is a statement of an account pertaining to a given period of time, usually a year.

**3. Comprehensiveness**

It includes all the three items, i.e., visible, invisible and capital transfers. The balance of payments is a comprehensive record of economic transactions of the residents of a country with the rest of the world during a given period of time. The aim is to present an account of all receipts and payments on account of goods exported services rendered and capital by resident of a country and goods imported, service received and capital transferred by residents of the country.

**4. Double Entry System**

Receipts and payments are recorded on the basis of double entry system. The basic convention applied in constructing a balance of payments statement is that every recorded transaction is represented by two entries with equal values. One of these entries is designated a credit with a positive arithmetic sign; the other is designated a debit with a negative sign.

In principle, the sum of all credit entries is identical to the sum of all debit entries, and the net balance of all entries in the statement is zero.

**5. Self-Balanced**

From the point of view of accounting, double entry system keeps automatically debit and credit sides of the accounts in balance.

**6. Adjustment of Differences**

Whenever there are differences in actual total receipts and payments, need is felt for necessary adjustment.

**7. All Items Government and Non-Government**

Balance of payments includes receipts and payments of all items government and non-government.

### 2.8.1 Importance

**Q25. Explain the importance of Balance of payment.**

*Ans :*

**1. Forecasting**

The BOP helps forecast a country's market potential, especially in the short run. A country experiencing a serious BOP deficit is not likely to import as much as it would if it were running a surplus.

**2. Indicator of Pressure**

The BOP is an important indicator of pressure on a country's foreign exchange rate, and thus on the potential of a firm trading with or investing in that country to experience foreign exchange gains or losses. Changes in the BOP may presage the impositions (or removal) of foreign exchange controls.

**3. Signal of Imposition**

Changes in a country's BOP may also signal the imposition (or removal) of controls over payment of dividends and interest, license fees, royalty fees, or other cash disbursements to foreign firms or investors.

**4. Judging the Stability**

Judging the stability of a floating exchange rate system is easier with BOP as the record of exchanges that take place between nations help to track the accumulation of currencies

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in the hands of those individuals more willing to hold on to them and judging the stability of a fixed exchange rate system is also easier with the same record of international exchange. These exchanges again show the extent to which a currency is accumulating in foreign hands, raising questions about the ease of defending the fixed exchange rate in a future crisis.

### 2.8.2 Components

**Q26. State the various components of balance of payment.**

*Ans :* **(Imp.)**

**1. Current Account**

Current account is typically divided into three sub-categories; the merchandise trade balance, the services balance and the balance on unilateral transfers. Entries in this account are "current" in value as they do not give rise to future claims. A surplus in the current account represents an inflow of funds while a deficit represents an outflow of funds. The capital account can be divided into three categories:

**i) Merchandise**

Balance of merchandise trade refers to the balance between exports and imports of tangible goods such as automobiles, computers, machinery and so on. A favourable balance of merchandise trade (surplus) occurs when exports are greater in value than imports. An unfavourable balance of merchandise trade (deficit) occurs when imports exceed exports. Merchandise exports and imports are the largest single component of total international payments for most countries.

**ii) Invisibles**

Services represent the second category of the current account. Services include interest payments, shipping and insurance fees, tourism, dividends and military expenditures. These trades in services are sometimes called invisible trade.

**iii) Unilateral Transfers**

Unilateral transfers are gifts and grants by both private parties and governments. Private gifts and grants include personal gifts of all kinds and also relief organization shipments. For example, money sent by immigration workers to their families in their native country represents private transfer. Government transfers include money, goods and services sent as aid to other countries.

**2. Capital Account**

The capital account is an accounting measure of the total domestic currency value of financial transactions between domestic residents and the rest of the world over a period of time. This account consists of loans, investments, and other transfers of financial assets and the creation of liabilities. It includes financial transactions associated with international trade as well as flows associated with portfolio shifts involving the purchase of foreign stocks, bonds and bank deposits.

The capital account can be divided into three categories: direct investment, portfolio investment and other capital flows.

**i) Direct Investment**

Direct investment occurs when the investor acquires equity such as purchases of stocks, the acquisition of entire firms, or the establishment of new subsidiaries. Foreign direct investment (FDI) generally takes place when firms tend to take advantage of various market imperfections. Firms also undertake foreign direct investments when the expected returns from foreign investment exceed the cost of capital, allowing for foreign exchange and political risks. The expected returns from foreign profits can be higher than those from domestic projects due to lower material and labour costs, subsidised financing, investment tax allowances, exclusive access to local markets, etc.

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**ii) Portfolio Investment**

Portfolio investments represent sales and purchases of foreign financial assets such as stocks and bonds that do not involve a transfer of management control. A desire for return, safety and liquidity in investments is the same for international and domestic portfolio investors.

International portfolio investments have specifically boomed in recent years due to investor's desire to diversify risk globally. Investors generally feel that they can reduce risk more effectively if they diversify their portfolio holdings internationally rather than purely domestically. In addition, investors may also benefit from higher expected returns from some foreign markets.

**iii) Capital Flows**

Capital flows represent the third category of capital account and represent claims with a maturity of less than one year. Such claims include bank deposits, short-term loans, short-term securities, money market investments and so forth. These investments are quite sensitive to both changes in relative interest rates between countries and the anticipated change in the exchange rate.

**For example,** if the interest rates rise in India, with other variables remaining constant, India will experience capital inflows as investors would like to deposit or invest in India to take advantage of the higher interest rate. But if the higher interest rate is accompanied by an expected depreciation of the Indian rupee, capital inflows to India may not materialize.

**3. Official Reserve Account**

Official reserves are government owned assets. The official reserve account represents only purchases and sales by the central bank of the country (for example, The Reserve Bank of India). The changes in official reserves are necessary to account for the deficit or surplus in the balance of payments. For example, if a country has a BOP deficit, the central bank will have to either run down its official reserve assets such as gold, foreign exchange and SDRs or borrow fresh from foreign central banks. However, if a country has a BOP surplus, its central bank will either acquire additional reserve assets from foreigners or retire some of its foreign debts.

**4. Other Items in the Balance of Payments**

The remaining items that cannot be categorized into the preceding categories constitute the other items in the balance of payments. They are included since the full balance of payments account must balance. These items are as follows:

**i) Errors and Omissions**

These are to take into account the difficulty of accurately recording all the wide variety of transactions that take place in the accounting period. They may arise due to the presence of sampling of transactions rather than recording each individual transaction (e.g., instead of recording each of a thousand exports of lemons, they may multiply an average lemon export figure by thousand), due to dishonesty, i.e., businessmen under reporting sales abroad to avoid taxes, or when smuggling occurs, etc.

**ii) Official Reserve Transactions**

All transactions except those in this category may be termed as autonomous transactions. They are so called because they are entered into with some independent motive, i.e., not with a view to bring their consequences on the balance of payments or on the exchange rate. In contrast to this, official reserve transactions are carried-out by the government and the central banks in pursuit of some international economic policy objective; while keeping

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an eye on the effect of such transactions on the BOP and the exchange rate. As a result such transactions are not autonomous. The first of these items is the change in the domestic country's official reserve assets. These reserves of a country are held in the form of foreign currency or foreign currency securities, gold and Special Drawing Rights (SDR) with the IMF. SDR allows a country to avail of foreign exchange in proportion to the quantum of the country's deposit of its currency with the IMF under the SDR scheme. The changes in the country's reserves must reflect the net value of all other items in the BOP. Reduction in these assets will be used to finance expenditures abroad. Reductions appear as a credit item in the BOP (because their sale causes foreign exchange inflow into the country). An increase in these reserves will appear as a debit because of purchasing assets.

**Q27. Explain the position of India's balance of payments.**

*Ans :*

The position of India's balance of payments in post-independence was unfavourable. Before independence, India exported more goods to the other nations rather than importing. Moreover, the deficit of balance of payments is explained in different plans. They are as follows,

**1. Pre Planning Period**

The period between 1947-1951 is said to be pre-planning period. The deficit of India's balance of payments on current account was upto value of ` 240 crore. The rupee was devalued and economic situation had no improvement.

**2. First Plan (1951-56)**

During the 1st five year plan, the deficit of balance of payment was about ` 42 crore.

**3. Second Plan (1956-61)**

In this time period, the balance of payments deficit increased to ` 1,725 crore because of heavy imports of machines, raw materials and food grains.

**4. Third Plan (1961-66)**

The balance of payments deficit increased to ` 1,951 crores in this plan because of shortage of food grains and heavy import of military machineries during Indo-China and Indo-Pak war.

**5. Three Annual Plans (1966-69)**

The balance of payment deficit on current account increased to ` 2,015 crores. This increment was due to large imports of foodgrains to support the famine conditions prevailing in the country.

**6. Fourth Plan (1969-74)**

The balance of payments found to be favourable for the first time after independence during 1969-1974. The factors which helped to attain favourable balance of payments were raise in exports, decrease in imports, considerable increase in receipts.

**7. Fifth Plan (1974-78)**

During this five year plan, the balance of payments found to be favourable and increased. The value increased to ` 3,082 crores. The various factors which were helpful for such favourable balance of payments position are reduction in the deficit of balance of trade, restrictions on smuggling, more indians residing abroad etc.

**8. Sixth Plan (1980-85)**

The balance of payment deficit increased to ` 11,384 crores and said to be unfavourable.

**9. Seventh Plan (1985-90)**

The balance of payment deficit of current account amounted to ` 38,313 crores. The main reasons for deficit is due to fall in invisible receipts of other countries, high rising

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prices of petrol and highly affected balance of trade and balance of payments.

**10. Eighth Plan (1992-97)**

The eighth plan was planned to start for the year 1990. However, it was launched from the year 1992. During the 1990-1991, there was an increase in the deficit amounted to ` 17,366 crore but simultaneously foreign exchange reserves decreased to ` 4,388 crore.

**11. Ninth Plan (1997-2002)**

This plan experienced the balance of payments deficit on current account and was about ` 62,715 crores. The year between 2001-02 said to positive shift as there was increase in balance of payments on current accounts of about ` 6,719 crores.

**12. Tenth Plan (2002-07)**

In the consecutive years 2002-03 and 2003-04, the balance of payment on current account was about surplus of ` 19,987 crores and 45,343 crores.

**13. Eleventh Plan (2007-12)**

During this eleventh plan, the growth rate of exports adversely affected due to which the balance resulted to be negative and the balance of payments on current account resulted as a deficit of ` 68,914, ` 1,31,614 crores during (2008-09) year.

**Q28. List out the various reasons for the deficit in current account and capital account.**

*Ans :*

**Reasons for Deficit in Current Account**

The various reasons for deficit in current account are as follows,

1. In the year 1985, the Indian government had liberalized imports by initiating the liberalized import/ export policy which led to the significant increase in imports.
2. Inspite of the progress of the exports in the Indian economy, there was an increased demand for raw materials, the components and capital goods which led to the broadening of the import regime. The rate of annual growth of imports was 16.8% which was found to be at much low rate when compared to the annual growth rate of exports which was 18.7% during the seventh five year plan.
3. The Indian economy was affected unfavourably due to outbreak of gulf war in 1990. Because of the adverse affect of such war, the deficit was encountered in the BOP.
4. By adopting several liberalization measures for bringing rapid industrialization, there was an increased demand for capital goods, technology, machinery and technical personnel thereby increasing the country's expenditure for importing such requirements.
5. The deficit of balance of payments was increased due to the gradual growth rate of invisible accounts and interest burden of the country.
6. During imports, if Indian rupee has undergone devaluation against the currency of an imported country then India had to pay more amount for importing the capital goods.
7. The balance of payment crisis that occurred during the year 1990-1991 due to prevailing political instability in 1990 made the government to borrow heavily from IMF.
8. Even after the adoption of positive measures by the government, there was not much improvement in the performance of the exports causing to the emergence of deficit in the BOP.
9. During the year 2005-2006, there was a heavy import of capital goods because of the fast growth of Indian economy.

**Reasons for the Deficit in Capital Account**

The reasons for deficit in capital account are as follows,

1. During the period of 1956-1957 to 1979-1980, most of the deficit of capital account was financed with the inflow of concessional assistance, due to which there was a reduction in the debt servicing.

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2. During 1980-1981 to 1997-1998, the loans at market interest rates were used to finance the complete deficit.
3. During the year 1980, the loans at concessional rate was around 90% of the total debt which was declined to just 35% in 1990.
4. There was a sharp decline in the loans maturity period from 40.8 years (in 1980) to 29.1 years (in 1990).
5. There was an increase in the interest rates during 1980-1981 and 1998-1999, when compared to the interest rates of 1956-1957 and 1979-1980.
6. During the 1980-1981 to 1998-1999, the quality of external financing was adversely effected.
7. In 1980-1981, the total debt was 19,470 crores and increased to 3,36,646 crores in 1996-1997.

**Q29. What is meant by equilibrium of payment and disequilibrium of payment? State the causes and consequences of dis-equilibrium of payments.**

*Ans :* **(Imp.)**

**Equilibrium of Payment**

When receipts are equal to the payments in international transactions then it is called the equilibrium in the balance of payment.

**Disequilibrium of Payment**

When the receipts and payments in international transactions are not equal then it is called as disequilibrium of payment. When the payments are more than receipts then it is known as deficit in the balance of payment. Similarly, when the receipts exceed the payments then it is termed as the "surplus in the balance of payment".

**Causes of Disequilibrium in BOP's**

The disequilibrium in the BOP's arises because of the following factors:

**1. Economic Factors**

The economic factors that are responsible for creating disequilibrium in the balance of payment includes:

**(a) Development Disequilibrium**

The various developmental activities are undertaken by the developing countries, which involves the road construction, development of industries, construction of power plants, bridges and providing the facilities of infrastructure such as educational institutions and the like. Initially, all these activities increases the import of machinery, equipment and capital goods, and the expenditure incurred on these developmental activities leads to the generation of aggregate demand, income of people and so on. As, the expenditure is directly related to the quantity of imports, any change (either increase or decrease in the expenditure) causes the imports to fluctuate. If less expenditure is borne on the developmental activities, surplus in capital account is obtained. Similarly, deficit is noticed when more amount of developmental activities are undertaken by the government causing drastic increase in imports.

**(b) Cyclical Disequilibrium**

Business or trade cycles also bring the variations in imports and exports of a country. In a country, the growth in the activities of business, results into the development of aggregate demand, increases the consumption and price of consumer goods which sometimes may exceed the production rate. Thus, to meet the increased demand, the countries import the consumer goods. However, they might be increasing the imports of capital goods for the purpose of developing new or expanding the existing capacities of production. When the business is operating in the depression phase of an economy, its production will always be higher than its demand and consumption. Hence, the business must identify new markets wherein its produced products can be demanded. This leads to the increased

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exports of the country thereby resulting in disequilibrium in the country.

**(c) Secular Disequilibrium**

The secular trends are also one of the factors causing disequilibrium in the balance of payments. In developed countries, for example, in USA, the disposable income of the individual is more, which results into an increase in the cost of factors of production and prices of goods. Therefore, the developed countries import the goods from such countries which manufacture the quality goods at lower costs.

**(d) Structural Disequilibrium**

The structural variations in the economy involves the establishments of alternative supply sources, establishment of efficient substitutes, modification in the transport channels and costs and so on. For balancing the requirements of the altered economic structure, import of capital and consumer goods increases which led to the development of the deficit balance of payments.

**2. Political Factors**

Even the political factors such as political instability, uncertainties and the outbreak of wars and conflicts hold critical impact on the investments and industrial growth. All such factors result in the increased capital outflows, decreased domestic production and increased import of capital goods, thereby causing the disequilibrium in the balance of payments.

**3. Social Factors**

The changes in the tax rates, preferences and fashion of the people results in the increased imports and hence increased deficit is found in the balance of payments.

**Consequences of Disequilibrium in BOP's**

The various consequences of disequilibrium in BOP's can be explained as follows,

(i) The speed of economic development of a country decreases.

(ii) The economic dependency of the country on foreign countries increases.

(iii) The international economic credibility of a country decreases due to disequilibrium of BOP.

(iv) The foreign dependence acts as political dependence sometimes.

(v) The disequilibrium of BOP's results in the exploitation of a country's economy.

(vi) The country's foreign exchange reserves decreases.

**Q30. Explain in detail remedies for correcting disequilibrium in balance of payments.**

*Ans :*

To correct the disequilibrium in the balance of payments, various policy measures have been undertaken by the Indian government. Some of them are,

**(i) Adjustment Under Gold Standard**

In the traditional system of gold standard, the mechanism of price specific-flow was used to correct the disequilibrium. According to this mechanism, whenever a deficit is seen, gold outflows leading to decrease in the supply of money which also decreases the price level. Such reduction in price encourages the exports and reduces imports, thereby enabling the country to overcome the problem of deficit.

**(ii) Adjustment Under Flexible Exchange Rate**

In this measure, the domestic currency is depreciated because of which the deficit gets automatically corrected.

**(iii) Income Adjustment Mechanisms**

Due to increment in exports, the earnings that could be generated through exports also increases leading to the increased purchasing

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power and imports. When marginal tendency is nearly or exactly equal to zero then the changes in imports becomes directly related to the changes in exports.

**(iv) Adjustment Under Gold Exchange Standard (Fixed Exchange Standard)**

After the World War-II, the gold exchange standard was developed and it was followed till the year 1971. The fixation of exchange rate was done on the basis of dollar or gold. While offsetting the receipts and payments of the balance of payments ± 1% variation was allowed under the automatic adjustment mechanism. For example, when the exports move up, the income level also improves and this will lead to increased prices of the products in the surplus country. Such increased prices causes the hindrances in the exports and improvements in the imports.

**(v) Expenditure Changing Policy**

The policies related to expenditure adjustments can be established by using the fiscal and monetary devices. Reduced investment and income levels causes the reduction in imports which may be due to the adoption of restrictive monetary policy. Such policy is used for correcting the external deficit.

| S.No. | Situations of BOP | Internal Balance Policies | Impact on External Balance |
|---|---|---|---|
| 1. | Combination of recession and deficit balance | Expansion of internal | Reduction in external balance |
| 2. | Combination of recession and surplus | Expansion of internal balance | Improves the external balance |
| 3. | Combination of inflation and surplus | Reduction in internal balance | Reduces the external balance |
| 4. | Combination of inflation and deficit | Reduction in internal balance | Increases the external balance |

**Table: Expenditure Changing Policy**

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From the above table it can be understood that the situation number (i) and (iii) are contradictory and conflicting in nature, wherein the utilization of fiscal and monetary policies for the attainment of the internal balance may also bring improvement in the external balance. But it should not be misinterpreted that it would completely remove the external imbalance. Measures have to be adopted by the government so that simultaneous internal and external balances can be achieved. Some of them are as follows,

**(a) Expenditure Switching Policy**

The primary focus of the expenditure switching policy was to alter the relative prices of exports and imports by implementing changes in the exchange rates, import control, devaluation, export control and export promotion.

**(b) Devaluation**

The official decrease in the external value of currency related to gold or any other currency is usually referred as devaluation. It helps in reducing the prices of exports and improving the prices of imports, but it consists of various restrictions. If there exists an adequate employment rate in the economy, then the devaluation can be measured accurately. The cash balance effect was used to automatically reduce the domestic expenditure or absorption, by using money illusion, income distribution or by the adoption of the expenditure reducing policies.

**(c) Depreciation**

A non-official decline in the external value of country's currency by the demand and supply factors is known as depreciation.

**(d) Exchange Control**

The state or government intervention for controlling and regulating the exchange rates and the currency conversion is commonly known as "exchange control". Under this system, the Central Bank is entitled to fix the exchange rates of foreign countries which also helps in bringing equilibrium between the demand and supply of foreign exchanges.

**(e) Direct Control**

Direct control may be practised as capital control, exchange control and commodity control. Through different measures the imports and exports can be controlled.

**(f) Deflation**

There may be intentional deflation of home currency so as to reduce the prices for the promotion of exports and the restriction of imports.

**(g) Import Restriction and Export Promotion**

The growth of import can be restricted by imposing the tariffs, duties, quotas and other restrictive mechanisms, whereas the exports can be promoted by providing tax concessions, incentives and quality improvements.

Each measure stated above has its own limitations. For instance, the deflation is risky, depreciation is temporary in nature, devaluation may be inflationary and the administration of exchange control may not be easy. It is aptly said that control of output in employment is easy when compared to the control of BOP.

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# Short Question and Answers

**1. Define Liberalization.**

*Ans :*

Liberalization 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.

Liberalization refers to the relaxation of the previous government restriction usually in area of social and economic policies. When government liberalized trade, it means it has removed the tariff, subsidies and other restriction on the flow of goods and services between the countries. Economic liberalization, in its modem form, usually describes internal economic reform such as deregulation and privatization 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.

Liberalization 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 liberalization 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. Liberalization means removal of control and not of regulations. Liberalization 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.

**Definition**

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

**2. Features of Liberalization**

*Ans :*

i) Liberalization is freeing the industry from government restrictions.

ii) It provides a conductive economic and business climate necessary for continuous growth.

iii) It promotes a cost effective business environment, encourage competition and enhanced efficiency.

iv) Liberalization of trade and investment regimes as well as deregulation.

v) It obtains reciprocal market openings, by trading partners particularly in the context of multilateral, regional and bilateral negotiations.

vi) Wider choice of goods and services and reduced prices resulting from increased international competition and specialization.

**3. Advantages of Liberalization.**

*Ans :*

The several advantages of Liberalization are:

i) In the medium and long term lower cost services provided to users.

ii) The overall the quality of service is improved due to competition.

iii) It avoids drawbacks of natural monopolies.

iv) Helps for freeing up government funds for other social expenditures / investments.

v) The creation of new revenue streams for governments through PPP in investments commonly undertaken with private sector.

vi) Transfer of risk to private operators through PPP or BOT.

vii) It increases entrepreneurship in country.

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viii) Attract foreign capital by potential investors, better suited to carry out investment.

ix) Helps to increase the foreign investment.

x) Increase the foreign exchange reserve.

**4. Various functions of new industrial policy 1991.**

*Ans :*

**1. Encourage foreign Investment**

Foreign investment would be encouraged in high priority areas up to a limit of 51 per cent equity. Government will encourage foreign trading companies to assist Indian exporters in export activities.

**2. Provide Automatic Approval**

With a view to injecting the desired level of technological dynamism in Indian industry, the government will provide automatic approval for technology agreements related to high priority industries.

**3. Relaxation of MRTP and FERA**

Relaxation of MRTP Act (Monopolies and Restrictive Practices Act) which has almost been rendered non-functional. Dilution of foreign exchange regulation act (FERA) making rupee fully convertible on trade account.

**4. Other Functions: Other functions of New Industrial Policy are given as follows:**

i) Disinvestment of Public Sector Units' shares.

ii) Closing of such public sector units which are incurring heavy losses.

iii) Abolition of C.C.I, and wealth tax on shares.

iv) General reduction in customs duties.

v) Provide strength to those public sector enterprises which fall in reserved areas of operation or in high priority areas.

**5. Define Economic planning.**

*Ans :*

Economic planning is a term used to describe the long-term plans of an incumbent government to coordinate and develop the economy. Economic planning is commonly a feature of big government as it usually involves increased spending on things such as public work schemes and government programmes. Economic planning is the process by which key economic decisions are made or influenced by central governments. It contrasts with the laissez-faire approach that, in its purest form, avoid any attempt to guide the economy, relying instead on market forces to determine the speed, direction, and nature of economic evolution.

The government has to prepare and implement a comprehensive economic plan integrating the private sector with the public sector. It is for these reasons that we have been having economic planning since 1951 when the First Five Year Plan was launched.

Economic planning is defined as "the making of major economic decisions - what and how much is to be produced, how, when, and where it is to be produced and to whom it is to be allocated by the conscious decision of a determinate authority on the basis of a comprehensive survey of the economic system as a whole".

**Definitions**

**(i) According to Dickinson,** "Economic planning is the making of all major economic decisions by conscious decisions of comprehensive survey of the economic system as a whole".

**(ii) According to the Indian Planning Commission,** "Economics planning is, essentially a way of organizing and utilizing resources to maximum advantage in terms of defined social ends".

**(iii) According to Fedynand Zweig,** "Economic planning in this sense would mean drawing-up economic schemes with foresight and on a large scale it may be called planning within the economy".

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**(iv) According to Prof. Lews Lordwin,** "Planned economy is a scheme of economic organization in which individual and separate plants, enterprise of industries are treated as coordinated units of one single system for the purposes of utilizing available resources to achieve the maximum satisfaction of the people's needs with in given time".

**6. Objectives of NITI Aayog.**

*Ans :*

**Objectives of NITI Aayog**

1. NITI Aayog sets its aims to provide a critical directional and strategic input into the development process of the country.
2. NITI Aayog aims to serve as a "think tank" of the government both at central and state levels with relevant strategic and technical advice on key policy matters including economic issues of national and international importance.
3. NITI Aayog now seeks to replace the centre-to-state one way flow of policy framed by the Planning Commission by an amicable settled policy framed by a genuine and continuing partnership of states.
4. The NITI Aayog will also seek to put an end to slow and tardy implementation of policy by fostering better Inter-Ministry co-ordination and better centre-state co-ordination. It will help evolve a shared vision of national development priorities, and foster co-operative federalism, in order to focus on the view that strong states make a strong nation.
5. The NITI Aayog has set it objectives to develop mechanisms to formulate credible plans to the village level and aggregate these progressively at higher levels of government. This Aayog will ensure special attention to the sections of society that may be at risk of not benefitting adequately from economic progress.

**7. Define Economic Reforms.**

*Ans :*

India's business environment has evolved and transformed itself at a much faster pace in the recent years. India is now one of the most attractive destinations for doing business because of its booming economy, a relatively good GDP and other economic indicators. All of this has become possible because of the economic reforms which were initiated in 1991. India has not looked back since then. Introduction of economic reforms has enabled India to break free from the shackles of financial turmoil and head towards attaining economic self-sufficiency.

**8. Objectives of Second Generation Reforms.**

*Ans :*

1. Strengthen the foundations of growth of our rural economy, especially agriculture and allied activities.
2. Nurture the revolutionary potential of the new knowledge-based industries such as infotech, biotechnology and pharmaceuticals.
3. Strengthen and modernise traditional industries such as textiles, leather, agro-processing and the SSI sector.
4. Mount a sustained attack on infrastructure bottlenecks in power, roads, ports, telecom, railways and airways.
5. Accord the highest priority to human resource development and other social programmes and policies in education, health and other social services, with special emphasis on the poorest and weakest sections of society.
6. Strengthen our role in the world economy through rapid growth of exports, higher foreign investment and prudent external debt management.
7. Establish a credible framework of fiscal discipline, without which other elements of our strategy can fall.

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**9. Define Balance of Payment.**

*Ans :*

Balance of payment refers to the net results that are drawn recording all the visible and invisible items that are imported and exported from the country. Balance of payment, such as, provides a comprehensive statement over the net results of foreign trade and gives a true picture as to where the country stands in the international trade. Balance of payment clearly exposes the economic viability, strength, and capability by correctly measuring its imports and exports, competency in goods and services as well as technical know-how. By services we mean the services of shipping lines, insurance companies banking concerns, and others. Balance of payment also includes the foreign loan that is either provided by it or accepted from other country (or) countries.

**Definitions**

**According to Kindleberger,** "Balance of payment is a systematic record of all economic transactions between the residents of the reporting country and residents of foreign countries during a given period of time".

**10. Current Account.**

*Ans :*

Current account is typically divided into three sub-categories; the merchandise trade balance, the services balance and the balance on unilateral transfers. Entries in this account are "current" in value as they do not give rise to future claims. A surplus in the current account represents an inflow of funds while a deficit represents an outflow of funds. The capital account can be divided into three categories:

**i) Merchandise**

Balance of merchandise trade refers to the balance between exports and imports of tangible goods such as automobiles, computers, machinery and so on. A favourable balance of merchandise trade (surplus) occurs when exports are greater in value than imports. An unfavourable balance of merchandise trade (deficit) occurs when imports exceed exports. Merchandise exports and imports are the largest single component of total international payments for most countries.

**ii) Invisibles**

Services represent the second category of the current account. Services include interest payments, shipping and insurance fees, tourism, dividends and military expenditures. These trades in services are sometimes called invisible trade.

**iii) Unilateral Transfers**

Unilateral transfers are gifts and grants by both private parties and govern- ments. Private gifts and grants include personal gifts of all kinds and also relief organization shipments. For example, money sent by immigration workers to their families in their native country represents private transfer. Government transfers include money, goods and services sent as aid to other countries.

**11. Capital Account.**

*Ans :*

The capital account is an accounting measure of the total domestic currency value of financial transactions between domestic residents and the rest of the world over a period of time. This account consists of loans, investments, and other transfers of financial assets and the creation of liabilities. It includes financial transactions associated with international trade as well as flows associated with portfolio shifts involving the purchase of foreign stocks, bonds and bank deposits.

The capital account can be divided into three categories: direct investment, portfolio investment and other capital flows.

**i) Direct Investment**

Direct investment occurs when the investor acquires equity such as purchases of stocks, the acquisition of entire firms, or the establishment of new subsidiaries. Foreign direct investment (FDI) generally takes place when firms tend to take advantage of various

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market imperfections. Firms also undertake foreign direct investments when the expected returns from foreign investment exceed the cost of capital, allowing for foreign exchange and political risks. The expected returns from foreign profits can be higher than those from domestic projects due to lower material and labour costs, subsidised financing, investment tax allowances, exclusive access to local markets, etc.

### ii) Portfolio Investment

Portfolio investments represent sales and purchases of foreign financial assets such as stocks and bonds that do not involve a transfer of management control. A desire for return, safety and liquidity in investments is the same for international and domestic portfolio investors.

International portfolio investments have specifically boomed in recent years due to investor's desire to diversify risk globally. Investors generally feel that they can reduce risk more effectively if they diversify their portfolio holdings internationally rather than purely domestically. In addition, investors may also benefit from higher expected returns from some foreign markets.

### iii) Capital Flows

Capital flows represent the third category of capital account and represent claims with a maturity of less than one year. Such claims include bank deposits, short-term loans, short-term securities, money market investments and so forth. These investments are quite sensitive to both changes in relative interest rates between countries and the anticipated change in the exchange rate.

**For example,** if the interest rates rise in India, with other variables remaining constant, India will experience capital inflows as investors would like to deposit or invest in India to take advantage of the higher interest rate. But if the higher interest rate is accompanied by an expected depreciation of the Indian rupee, capital inflows to India may not materialize.

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# Choose the Correct Answers

1. The Govt. introduced the import liberalization policy in the year? [ a ]
   (a) 1977- 78 (b) 1991-92
   (c) 1988-89 (d) 2001-02
2. EPZ stands for? [ a ]
   (a) Export Processing Zone (b) Export Promotion Zone
   (c) External Promotion zone (d) None of these
3. Which among the following Industrial Policy resolution/ statement was based upon the Mahalanobis Model of growth? [ a ]
   (a) Industrial Policy resolution – 1956
   (b) Industry Policy statement – 1973
   (c) Industrial Policy statement -1977
   (d) Banking Policy 1969
4. Which of the following planning is executed at the grass root level? [ b ]
   (a) Centralized planning (b) Decentralized planning
   (c) Fixed planning (d) Imperative planning
5. Industrial relations cover the following areas of ? [ d ]
   (a) Collective bargaining (b) Labour legislation
   (c) Industrial relations training (d) All of the above
6. Liberalization does not include? [ c ]
   (a) Removing trade barriers (b) Liberal policies
   (c) Introducing quota system (d) Disinvestment
7. Which among the following is not opened for private sector participation? [ d ]
   (a) Power sector (b) Telecommunication sector
   (c) Education sector (d) Railways
8. Relaxing the restrictions and controls imposed on business and industry means? [ a ]
   (a) Liberalization (b) Privatization
   (c) Globalization (d) None of the above
9. The pre-liberalization era of Indian Economy was under the grip of? [ d ]
   (a) Unemployment
   (b) Underemployment
   (c) Fiscal deficit
   (d) Unfavorable and alarming balance of payment

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10. Planning is a _____ process? [d ]

(a) Goal oriented (b) Flexible

(c) Time bound (d) All of the above

11. In India, Liberalization & Privatization began from? [ a ]

(a) 1991 (b) 1971

(c) 1981 (d) 1947

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# Fill in the blanks

1. _____ refers to the relaxation of the previous government restriction usually in area of social and economic policies.
2. _____ is the process by which key economic decisions are made or influenced by central governments.
3. NITI Aayog stands for _____ .
4. _____ reforms in India refer to the set of instruments and strategies adopted since 1991.
5. Pst's stands for _____ .
6. _____ refers to the net results that are drawn recording all the visible and invisible items that are imported and exported from the country.
7. The _____ account is an accounting measure of the total domestic currency value of financial transactions between domestic residents and the rest of the world over a period of time.
8. When receipts are equal to the payments in international transactions then it is called the equilibrium in the _____ .
9. In the traditional system of gold standard, the mechanism of price specific-flow was used to correct the _____ .
10. Govt Introduced Industrial Policy 1991 on _____ .

## ANSWERS

1. Liberalization
2. Economic planning
3. National Institution for Transforming India Aayog
4. Economic
5. Public Sector Enterprise
6. Balance of payment
7. Capital
8. Balance of payment.
9. Disequilibrium
10. 24th July 1991

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UNIT III

**Privatization and Globalisation**

Privatization-concepts - nature - objectives - forms - Theories of International Trade - Government intervention in International Trade-tariff and non-tariff barriers - Scope and importance of international business - Globalization-meaning - drivers - Modes of Entry.

## 3.1 PRIVATIZATION

### 3.1.1 Concepts

**Q1. What do you understand by Privatization?**

*Ans :* **(April-19, May-16, May-13)**

**Introduction**

Privatization 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, privatization will be part of the emerging post-welfare state. "Privatization where applied has achieved some measures of success in the local government".

Privatization is the process of involving the private sector in the ownership (or) operation of a state-owned (or) in a broader sense, it connotes private ownership. In other words Privatization 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 Privatization is opening-up of an industry that has been reserved for the public sector to the private sector.

**Definitions**

i) **According to Stuart M. Butler,** Privatization is "the transfer of government assets or functions to the private sector".

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

### 3.1.2 Nature

**Q2. Explain the nature of Privatization.**

*Ans :*

The various mature of Privatization is as follows:

**1. Transfer of Ownership**

Privatization 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 Privatization 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 Privatization 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 Privatization process and the host country.

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### 3.1.3 Objectives

**Q3. What are the Objectives of Privatization?**

*Ans :*

**1. 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.

**2. 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.

**3. 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.

### 3.1.4 Forms

**Q4. Explain the various forms of privatization.**

*Ans :* **(May-19)**

Privatization 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

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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 realize 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.

**Q5. State the various modes of privitazation.**

*Ans :* **(Imp.)**

Privatisation mainly takes the following routes:

**1. Initial Public Offering (IPO)**

Under this method, the shares of Public Sector Undertakings (PSUs) are sold to the retail investors and institutions.

**2. Strategic Sale**

In this method, the government sells its share in the PSU to a strategic partner. As a result, the management passes over to the buyer.

**3. Sale to Foreigners**

This is a variant of the strategic sales method where the buyer is not a domestic company but a foreign company.

**4. Equal-Access Voucher Programmes**

This form of privatisation involves distribution of vouchers across the population and attempts to allocate assets approximately evenly among voucher holders.

**5. Management-Employee Buy-Outs**

In this route to privatisation, managements and employees themselves buy major stakes in their firms.

**6. Divestiture**

This is also known as privatisation of ownership. The Public Enterprises sell their equities to the public or private enterprises. In countries where there are well developed capital markets, this form of privatisation is popular.

**7. Managerial Privatisation**

While the ownership of Public Enterprises remains with the Government, the top executives and the Board of Directors are drawn from the private sector.

**8. Cold Privatisation**

In this case the Public Enterprises are required to relate their activities to market conditions. Public Enterprises are distanced from the Government, though the ownership continues to be with the Government.

**9. Denationalisation**

In this case, the ownership of a public enterprise is transferred to the private sector. A large number of Public Enterprises were denationalised in countries like Chile, Bangladesh and Pakistan.

**10. Franchising**

Public Enterprises may develop new technology in products/services, which are then franchised to private sector companies for more production, so that the Public Enterprises do not invest in additional manufacturing facilities.

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**11. Leasing**

In this case, the ownership remains with the Public Enterprises. They lease out the assets, particularly idle and under-utilised ones, to the private sector.

**12. Contracting Out**

Another form of privatisation is contracting out. Contracting out is common in public works, defence and many specialised services. Contracts for road construction, bridge construction and maintenance are common in countries like India, Brazil and Kenya.

**13. Liquidation**

Liquidation is another important form of privatisation of Public Enterprises. Liquidation may be either formal or informal. Formal liquidation refers to the closure of an enterprise and the sale of its assets.

**Q6. State the Advantages and Disadvantages of Privatization.**

*Ans :*

**Advantages of Privatization**

**1. Improved Efficiency**

The main argument for privatization 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.

**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 privatization 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, privatization 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 Privatization**

**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.

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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 privatizing 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 privatized 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**

Privatization 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.

**Q7. Explain the impact of privatization in India.**

*Ans :* **(Imp.)**

**Impact of Privatization 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, Modem 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 Privatization 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.

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iii) **Fosters Sustainable Competitive Advantage:** Privatization 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:** Privatized 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 privatization 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 critiealitiss.

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:** Privatization 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:** Privatization loses the mission with which the enterprise was established and profit maximization 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.

**Q8. State the various problems of privatization.**

*Ans :*

The following reasons have been identified in this regard:

**1. Absence of Strategy**

There is no proper strategy for disinvestment. There were no pre-defined norms, standards, or procedures regarding how to disinvest, what to disinvest, when to disinvest, and to whom to disinvest.

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**2. Unclear Objectives**

There were no clear objectives, whether it was to meet fiscal deficit, to generate revenue, to increase productivity, to make them more competitive, etc.

**3. Improper Timing**

The government was not concentrating on the timing of disinvestment and as a result, most of the private sector investors are shying away from the process because of unattractive offers made by the government. Because of wrong timing, many PSUs were privatised at low price, such as ITDC, Maruti, etc. A good price can be obtained if privatisation is done when the performance, market capitalization and the industry prospects are good.

**4. Difference of Opinion**

There was no consensus over the disinvestment among the various political parties.

**5. Lack of Proper Labour Strategy**

Before foraying into disinvestments, labour was not taken into confidence. No proper strategy was formed for their redeployment, training and development. There was labour unrest in BALCO on the issue of disinvestment, and a nationwide strike in PSU banks on the issue of privatisation and consolidation.

**6. Wrong Objectives**

The entire proceeds of disinvestments are being used to mitigate fiscal deficit instead of using them for development of the social sector and building infrastructure.

**7. Opaque**

Lack of transparency in the entire process raises many eyebrows of many and has become a big hurdle.

**8. Lack of Marketing**

The government has done little and failed to attract foreign suitors for the disinvestment process in India.

### 3.1.5 Disinvestment

**Q9. Define disinvestment. What are the objectives of disinvestment.**

*Ans :* **(April-19, May-14, May-12, Imp.)**

The performance of the public sector was far from satisfactory. Diseconomies of scale crept into the public sector. The nine high-performing public sector enterprises account for nearly 75% of profits of all public sector enterprises. Most of the others are running in losses. The profitability and ROI of profit-making units too is very low compared to industry standards. Of the various factors responsible for low profits in the public sector undertakings, the following are particularly important:

1. Price policy of public sector undertaking
2. Under utilization of capacity
3. Problems related to planning and construction of projects.
4. Problems of labour, personnel and management.
5. Lack of autonomy.

In order to alleviate these problems, the government decided to disinvest its sake in PSUs.

Disinvestments connote reducing government stake in the public sector. Disinvestment involves the conversion of money claims or securities into money or cash. They may or may not lead to privatisation, i.e., transfer of control in private hands. As in the case of Maruti Suzuki and BALCO, disinvestments led to the transfer of control into private hands, but in the case of public sector banks and most of the oil companies, disinvestments resulted in the issue of shares through the IPO route to general public and financial institutions, and therefore, majority stake and control remained with the government.

The disinvestment programme was started in 1991-92. The total realisation to the government from various rounds of disinvestments till 1998-99 was ` 16,809 crores.

**Objectives of Disinvestment**

The following are the main objectives of the disinvestment policy:

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1. To reduce the financial burden on government
2. To improve public finances
3. To introduce competition and market discipline
4. To improve growth
5. To encourage wider share of ownership
6. To de-politicise essential services.

Arun Shourie, former Disinvestment Minister, on December 9, 2002, stated the following objectives of disinvestment:

The main objective of disinvestment is to put national resources and assets to optimal use and in particular, to unleash the productive potential inherent in public sector enterprises. The policy of disinvestment specifically aims at:

1. Modernisation and upgradation of public sector enterprises;
2. Creation of new assets;
3. Generating of employment; and
4. Retiring of public debt.

The government would continue to ensure that disinvestment does not result in alienation of national assets, which, through the process of disinvestment, remain where they are. It will also ensure that disinvestment does not result in private monopolies.

In order to provide complete visibility to the government's continued commitment of utilization of disinvestment proceeds for social and infrastructure sectors, the government would set up a Disinvestment Proceeds Fund. This Fund will be used for financing fresh employment opportunities and investment, and for retirement of public debt.

**Q10. Explain the methods of disinvestment in India.**

*Ans :*

There are three methods adopted by the government for the valuation of shares for disinvestment. They are:

**1. Net Asset Method**

This will indicate the net asset of the enterprise as shown in the books of accounts. It shows the historical value of the assets. It does not reflect position of profitability.

**2. Profit Earning Capacity Value Method**

The profit earning capacity is generally based on the profits actually earned or anticipated.

**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.

## 3.2 INTERNATIONAL BUSINESS

**Q11. What do you mean by International Business. Explain the need for International Business.**

*Ans :*

**International Business**

The business activities which are carried out across countries/national boundaries is called as 'International Business'. The business activities may comprise of transaction of economic resources such as goods, capital services and commercial transactions such as sales, investment, production of physical goods or provision of services which includes banking, finance, insurance, construction, trading etc. Thus, international business is a wider term as it includes international trade and Foreign Direct Investment (FDI).

**Need for International Business**

International business has became one of the crucial and inseparable concept in the present scenario. In this present world, every country (i.e., either developed or developing) need to import goods which are not available in its boundaries.

For this purpose, they need to carried out international business with the other countries which means doing business beyond the boundaries. The following are some points which explain and highlight the need for international business,

1. To increase the business volume of country through exporting and importing of goods and services.
2. To satisfy the requirement and needs of the people and offer them different choices or brands.

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3. To promote the concept of foreign direct investment (FDI) especially in the developing countries.
4. To spread the ideas and circulate the capital investment allover the world.
5. To reallocate the resources for competing at the global level.
6. To provide employment opportunities.
7. To allow the acquisition of huge variety of products in the country.

### 3.2.1 Scope and Importance of International Business

**Q12. Explain the scope and Importance of International business.**

*Ans :* **(Dec.-20, Imp.)**

**Scope of International Business**

International business is an integrative study that has the potential to provide you with an overall business perspective (as opposed to functional view like marketing, financing, management etc) grounded in global environment. To be realistic, it involves the broadest and most generalized study of the field of business, adapted to a fairly unique across the border environment. Many conditions and environmental variables that are significant in internal business (such as foreign legal System, foreign exchange markets, inflationary trends, and cultural differences) are mostly irrelevant to domestic business. However, global integration in trade, investment, factor, technology and communication has been in practice for economies together. International business can well be broken down into foreign trade, trade in services, portfolio investment and direct investments (FDIS).

The fundamental and the largest international business activity in many countries is the foreign trade comprising exports and imports. Physical goods / commodities or merchandise leave the country in export. Imports are those goods brought across the national borders into a country

The international firms also trade in services banking, insurance, consulting, travel and transportation etc. earn in the form of feel or royalties. The fees are earned through short or long term contractual agreements such as consultancy or management contracts or turn key projects. Royalties are received from the use of one company's name, trademark, patent or process by someone else. Alternatively a firm can earn royalties from abroad by licensing the use of its technology information, Franchise in overseas markets.

Portfolio investments are financial investments made in foreign countries. The investor purchases debt or equity in the expectation of financial return on the investment.

Foreign direct investment or direct investment is one in which investor is given collecting interest in foreign company. FDI maybe in the form of a Joint Venture or a wholly owned subsidiary. Joint venture is a shared ownership stake with equal share in a foreign business. Indian joint ventures abroad are operated in more than 868 projects / enterprises. A wholly owned subsidiary can be established in foreign markets either in the form of totally new operation or acquisition of an established firm and use the firm to promote its products. The subsidiary, if it is established starting from the ground up is called a Greenfield investment.

However, there needs to be the perspective of the international business. That is, the firm's senior management should clearly define the firm's guiding principles in terms of international mandate rather than to allow firm's international activities to develop as an incidental or adjunct to its domestic activities. This would help to focus the attention of mangers on the opportunities and threats external to domestic economy. i) Sell in those global markets when prices are highest. ii) Reuse finances globally. iii) Forge international strategic alliances. iv) Take on the best talent from all over the world. You will have achieved the stature of a true MNC.

**Importance of International Business**

**1. A Profit Advantage**

When intro-national business is less profitable than domestic, there is an increase in total prom. There are many firms which make major share of their profits from the foreign markets for instance certain MNCS which earn percent profits from foreign markets. In certain cases when exporting even on no-loss-no -profit basis is available ,because by

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optimum utilization of the capacity the profitability of domestic business is increased. While in some cases, the whole manufacturing of a product or only certain stages of it are done abroad to reduce the cost of production.

**2. Growth Opportunities**

Foreign markets both developed country & developing country provide substantial growth opportunities for the firms from developing country. MNCS are interested in no. of developing countries due to fastly rising in their income and population of the estimated 1 billion increase in world population during 1999 to 2014; only about 3% Will be in the high income countries, Foreign markets, both developed and developing countries after ample opportunities for developing country firms also.

**3. Limitations of Domestic Market**

Some demographic trends such as contraction in birth rate decline in domestic demand, fully tapped market potential have adverse effects on some businesses. When domestic market is small, international business is the alternative for growth. Recession in the home market drives companies to explore foreign markets.

**4. Competition**

A protected market does not lead company to seek business outside the home market. The economic liberalization in since 1991 invited competition from foreign firms as well as from domestic ones. The counter competitor so as to diminish its competitive strength.

**5. Govt. Policies**

Many Govt. provide incentives to domestic company to export and invest in foreign countries while some countries give no importance. Domestic foreign company are permitted to enter certain industries subject to certain conditions for export. in many cases Govt. gives permission to cos to earn foreign exchange for their imports and make payments for royalty, divided etc. as per foreign exchange requirements.

**6. Strategic Management**

There are many global corporations which plan for manufacturing facilities, logistical systems, finance flows and marketing policies considering the entire world as a single market.

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**Q13. What are the various approaches to international business? Discuss.**

*Ans :*

International business approaches and stages of internationalization go side by side. According to Douglas Wind and Palmature, there are four approaches to international business,

(i) Ethnocentric approach

(ii) Polycentric approach

(iii) Regiocentric approach and

(iv) Geocentric approach.

**(i) Ethnocentric Approach**

The host countries strategy is to produce the kind of goods that are suitable to national markets, customers and competitors. If the production exceeds the demand on account of changing customer preferences or heavy competition, then the firms export their products globally. The firm which export its products globally considers export business as an extension or a new region. The role played by the

executive at the head office toward exports takes decisions regarding how much to export etc. The marketing personnel belonging to domestic country supervises export operations with the assistance given by export department.

The firms do not change the products which are to be exported and such maintenance towards international business is referred as 'ethnocentric approach'. This approach works best for those companies which are small and to those who are in the initial phase of internationalization.

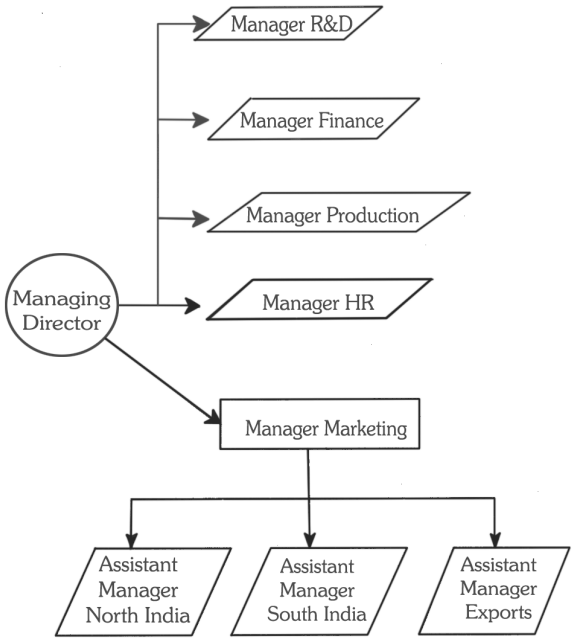


**Fig.: Organization Structure of Ethnocentric Company**

### (ii) Polycentric Approach

After certain stage, the domestic companies which are using ethnocentric approach to export products to foreign markets, feel to have other approach towards exports. They setup subsidiary company to delegate the powers of decision-making and policy-making to executives. The company appoints the staff working in the business and chief executive who can meet and report to him directly regarding business affair. Usually, the company appoints the employees who belong to the domestic country to carry out the operations. The role played by executives of the subsidiary includes framing the policies and strategies, designing the product as per host country's environment and customer's preference. Polycistronic approach is therefore related to analyze condition of the host country in terms of policy formulation strategy implementation and operations.

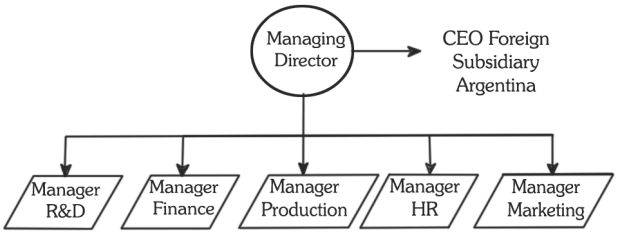


**Fig.: Organization Structure of Polycentric Company**

### (iii) Regiocentric Approach

Successful exporting operations in foreign companies is the companies strategy towards regiocentric approach. It wants to expand its exporting business in the neighbouring countries of the domestic country. While framing policies and strategies, the foreign subsidiary considers regional environment.

Regiocentric approach uses the polycentric approach for the existing products but uses different marketing strategies for introducing the products in other countries of the region.

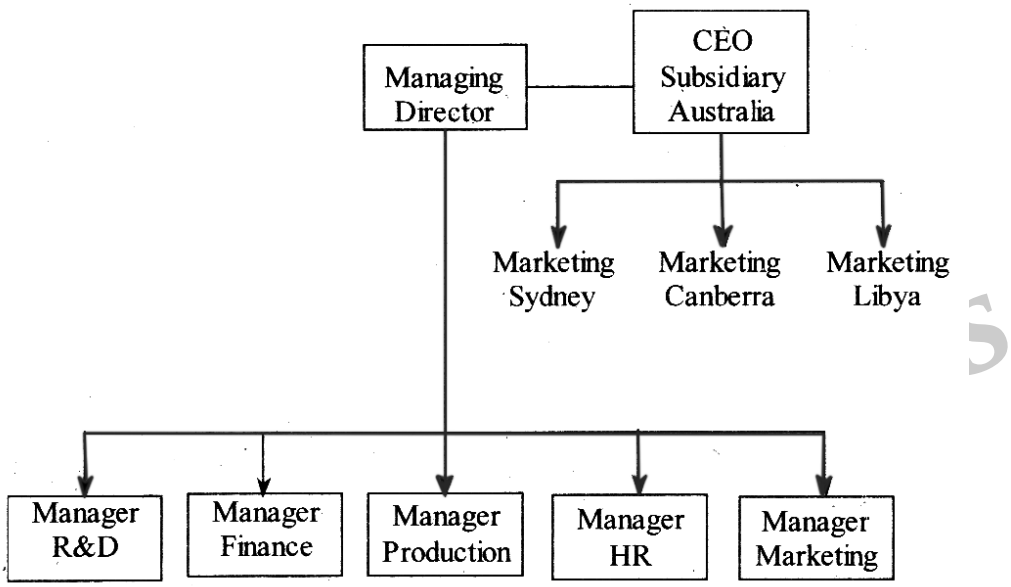


**Fig.: Organization Structure of Regiocentric Company**

### (iv) Geocentric Approach

The companies treat the whole world as a single country under this approach. The company selects its employees from across the world and carry out the process by establishing many subsidiaries. The subsidiary activities are directed by Managing Director (head quarters). Each subsidiary is given the power to operate the business independently and can also participate in framing policies regarding HR, strategic and HR, product-design and making decision etc.

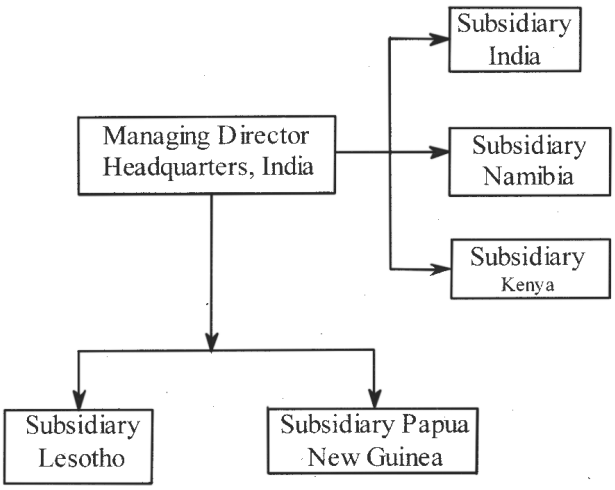


**Fig.: Organization Structure of Geocentric Company**

**Q14. Explain the differences between domestic business and international business.**

*Ans :*

The following are the differences between domestic business and international business,

| Basis | Domestic Business | International Business |
|---|---|---|
| **1. Approach** | Domestic business follows ethnocentric approach and performs it operations specifically for domestic country. | International business approach follows polycentric or regiocentric or geocentric approach depending upon its operations. |
| **2. Geographic scope** | The geographic scope of domestic business is limited to country itself. | The geographic scope of International business is wider as its operations are beyond the national boundaries. |
| **3. Environ-ment** | Domestic business deals with domestic environment. | International business deals with international environment. |
| **4. Quotas** | The domestic businesses are not infl -uenced quotas imposed on their ex-ports and imports by different countries. | The international businesses get influe-nced by quotas imposed on their exports and imports by different countries. |
| **5. Tariffs** | The tariff rates related to various countries do not directly influence domestic business. | The tariff rates related to various countries directly influence international business. |
| **6. Foreign exchange rates** | The changes in foreign exchange rates do not directly influence domestic business. | The changes in foreign exchange rates influence international business directly. |
| **7. Culture** | Domestic culture has its impact on business operations. | Cultures of various countries have their impact on business operations of foreign market. |
| **8. Export - import procedures.** | Domestic business does not have its impact on export import procedures. | International business has its impact on export Import procedures. |
| **9. Human resources** | Domestic business considers human resources of the country itself. | International business considers human resources of various countries. |
| **10. Markets and customers** | Since domestic business is involved in operating the business as per the market demand and customers, understanding of market and customers is not necessary for domestic business. | International business must understand both the market as well as the needs of customers related to various countries. |

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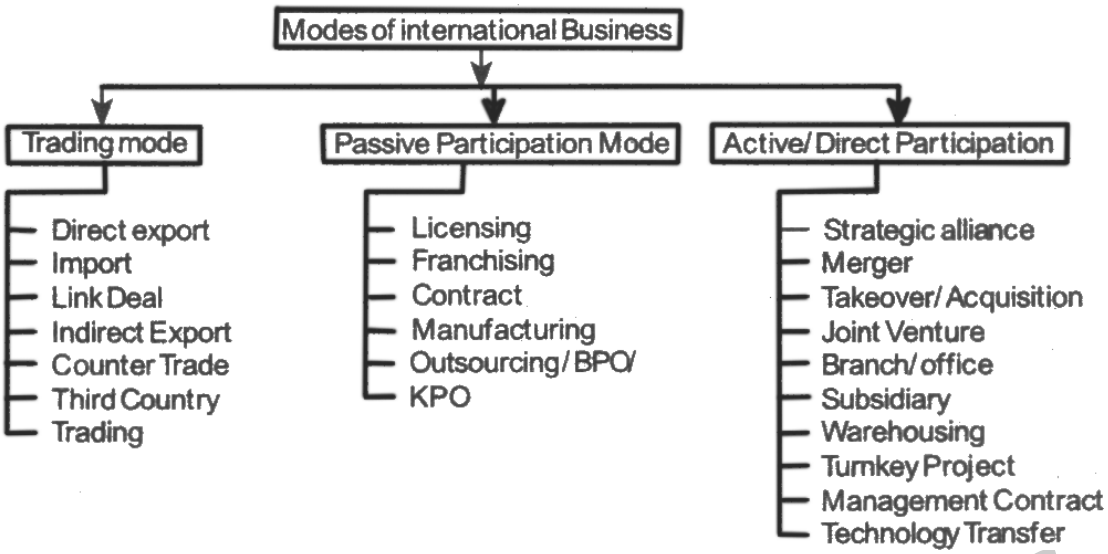
### 3.2.2 Modes of Entry

**Q15. Explain the different modes of international business.**

*Ans :* **(Dec.-20, Imp.)**

The different modes of international business are classified under three heads as represented in the following figure,




**Figure**

## 1. Trading Mode

It includes the following,

**(i) Direct Export:** The first step towards international business is 'direct export'. Under direct export, the responsibility of exporting goods to foreign market rests with the company. The direct export takes place by having an export agreement/contract which specifies details regarding product specification, pricing, payment mode etc., between the exporter and the buyer. The export takes place between the countries either on F.O.B (Free On Board) or CIF (Cost, Insurance and Freight) depending upon the cargo.

**(ii) Indirect Export:** If the company lacks behind infrastructure which acts as a barrier to have direct export, then the company move towards indirect export. Exports company cannot sell its products directly to foreign market instead they use intermediaries to sell the products on their behalf. Indirect export is a tripartite agreement among manufacturer, intermediary and importer. The benefits arising from export transactions are shared by manufacturer and middlemen on agreed terms. The well-established export houses in India are Tata Exports, Adana Exports and MMTC.

**(iii) Import:** The opposite of export transaction is import transaction. One country export is another country's import and vice-versa. The importer has a critical role to play in import transaction. If exports/imports are undertaken on F.O.B contract, then the importer has to bear freight and insurance charges.

**(iv) Link Deal:** Link deal is similar to 'barter trade'. Under link deal, goods are converted into value by way of price and exchange rate. The worth of goods are seen in value belonging to different goods of different companies and are shared equally. Difference in value is settled through mutual agreement between companies. Under Link Deal, parties involved in transaction operate both export mode and import mode.

**(v) Counter Trade:** If link deal covers basket of goods then it becomes counter trace. It is a bilateral agreement related to exchange of basket of goods between countries.

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**(vi) Third Country Trading:** Third country trading is usually referred as 'Offshore trading' or 'Merchanting trade'. It is a tripartite agreement in which three companies are involved. The transactions are carried out by only two companies/countries whereas a third party is manufacturer who deals with supply of goods.

**2. Passive participation Mode**

Passive participation mode includes the following,

**(i) Licensing:** Licensing refers to an arrangement where company transfers its expertise, know-how managerial skills, manufacturing design and brand name to other company which may be located in other countries. The company transferring its technology to another company is called 'Licensor and the company receiving it is referred as 'Licensee'. Company licenses its technology in turn they get amount for it. Licensing is usually known as 'technical collaboration'.

**(ii) Franchising:** The extension of licensing is 'Franchising'. The person transferring business system and technology is called 'franchiser' and the person receiving it is called 'franchisee. Under franchising, the franchisee acquires tech-nology, expertise, know-how, manufacturing design and intellectual property rights to market the products in the country.

Franchising is usually carried out in service industries whereas licensing is more suitable for manufacturing industries.

**(iii) Contract Manufacturing:** Contract manufacturing acts as better substitute for licensing, FDI and direct export. Under contract manufacturing, the home country places order to host country in relation to the production of goods. The produced goods can be sold locally or internationally depending upon the home country.

**(iv) BPO/KPO:** BPO (Business Process Outsourcing) and KPO (Knowledge Process Outsourcing) are same as contract manufacturing. In simple words, it is a contract process and net manufacturing. BPO refers to outsourcing process of other companies and the process are done by BPO for a contract period in exchange of fees. BPO generally contracted with IT of ITES or system solution in order to provide low cost sources for countries. The extended form of BPO is call-center (for customer's service).

KPOs are knowledge process outsourcing and mainly outsource to corporate or organizational research. It is of recent origin. Organizational research can be anything such as corporate growth process, financial management of a company etc.

**3. Active/Direct Participation Mode**

Active/direct participation mode includes the following,

**(i) Strategic Alliance:** Strategic alliance is referred as reciprocal relationship between two or more companies having same goals to achieve in the process and shares profits/losses on an agreed basis. This type of alliance benefits the parties involved in the process.

**(ii) Joint Venture (JV):** A Joint Venture (JV) is a venture of two or more business companies who join together to set up a new company. The contribution as well as profits/losses are shared on an agreed basis.

**(iii) Takeover or Acquisition:** A company taking over another company in terms of resources, management and control is called 'takeover or acquisition'. Takeover can be of two types,

(a) Friendly takeover

(b) Hostile takeover.

If the takeover of one company by another company is through mutual agreement it is called 'friendly takeover'. If the takeover is through stock market operations of financial institutions it is called 'hostile takeover'.

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**(iv) Merger**

A merger is defined as a "combination of two or more companies" where in one company possesses the assets and liabilities of other in exchange for shares or cash or if the company incurring losses/dissolved then a new company is setup by taking over the assets and liabilities of the dissolved companies. Merger can be through acquisition, amalgamation or consolidation.

**(v) Subsidiary**

A subsidiary is parallel in terms of rules and regulations, taxes and financial audit as that of local company or business unit related to host country. The parent company has control over subsidiary company depending upon whether it is fully owned or partly owned.

**(vi) Branch/Office**

The parent company has its branches in foreign country/host country. The parent company has direct control over its branches and is responsible for managing all the activities including financial transactions.

**(vii) Technology Transfer**

Technology transfer refers to transfer of technology, managerial skills in production, functioning of process from one company to another. It is usually possible through joint-venture, acquisition, licensing, franchising and subsidiary.

**(viii) Turnkey Project**

The extension of technology transfer is turnkey project. In this type of project, the home country is responsible for installation of whole plant and its implementation. It is otherwise called "complete or comprehensive technology transfer". Turnkey project is more useful when installation of plant is difficult to operate due to advanced equipments.

**(ix) Management Contract**

Management contract refers to transfer of managerial skills, supplier skills, expertise to another company. The management contract is usually seen in turnkey project or technology transfer when the host country is unable to manage the working capital of the company. Management contracts benefit developing countries in terms of utilizing skills, potentials and technology and in improve the areas related to manufacturing management and marketing.

**(x) Warehousing**

Warehousing refers to "location decisions". The location decisions include where to have location distribution centres to access rapidly. The warehousing decision is required for the company for determining long-term investment for marketing and sales. Warehousing is viewed as a supporting pillar as it maintains all logistics efforts.

**Q16. Explain the advantages and disadvantages of licensing.**

*Ans :*

**Advantages**

- Licensing mode carries relatively low investment on the part of licensor.
- Licensing mode carries low financial risk to the licensor.
- Licensor can investigate the foreign market without much efforts on his part.
- Licensee gets the benefits with less investment on research and development.
- Licensee escapes himself from the risk of product failure.

**Disadvantages**

- Licensing agreements reduce die market opportunities for both the licensor and licensee. Pepsi-cola cannot enter Netherlands and Heineken cannot sell Coca-cola.
- Both the parties have the responsibilities to maintain the product quality and promoting the product. Therefore, one party can affect the other through their improper acts.
- Costly and tedious litigation may crop up and hurt both the parties and the market.

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- There is scope for misunderstanding between the parties despite the effectiveness of the agreement. The best example is Oleg Cassini and Jovan.
- There is a problem of leakage of the trade secrets of the licensor.
- The licensee may develop his reputation.
- The liensee may sell the product outside the agreed territory and after the expiry of the contract.

## 3.3 INTERNATIONAL TRADE

**Q17. Define International Trade (or foreign trade). State the characteristics of foreign trade.**

*Ans :*

**International Trade**

The process of exchanging goods and services among individuals or firms located in two or more countries is known as 'Foreign Trade' or 'International Trade'.

**Some of the definitions of foreign trade or international trade are as follows,**

**(i) According to Robertson** "Foreign trade is an engine of economic growth".

**(ii) According to Wassermann and Haltman** "International trade consist of transaction between residents of different countries".

**(iii) According to Anatol Marad** "International trade is a trade between nations".

**Characteristics of Foreign Trade**

The following are the characteristic features of foreign trade or international trade,

**1. Immobile Means of Production**

The factors of production are immobile between different countries. While the factors of production such as capital, labour can move easily from one location to another, within a country. It cannot move freely in international trade.

The reasons for such immobility could be difference of language, legal restrictions, high cost of transport, climate, cultural differences and so on.

**2. Different Geographic Resources**

Another feature of foreign trade is that each country possesses a different geographic and climatic conditions, which is suitable for the production of a certain product. For example, the climate of Brazil is favourable for growing coffee, Bangladesh for jute, U.S.A for apples, India for Mangoes and so on.

**3. Different Natural Resources**

Another feature of international trade is that different countries are gifted with different resources and countries generally export the goods which they possess in abundance.

For example, the climate and land of Saudi Arabia is dry and infertile and is not suitable for agriculture whereas it has the largest reserves of petrol, which is its exports.

**4. Different Markets**

Different countries possess different type of markets for different goods. For example, in the U.S.A. left hand cars are manufactured. These kind of cars are not suitable in the Indian automobile market as Indians are habituated of which follows right hand driving.

**5. Currency Difference**

In international trade, the legal tender to trade would change according to the country. For example, an American trader need to pay in Indian rupees when trading with India.

**6. Different Government Systems**

Another feature of foreign trade is that different countries follow different government systems. Thus, the question of social welfare and national interest does not arise in case of foreign trade.

**7. Multiple Trade Policies**

In case of domestic trade, a country will follow a single domestic trade policy. Whereas in case of international trade, different policies may be adopted with regard to exports, imports, taxation, transfers etc.

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**Q18. Discuss the merits and demerits of foreign trade.**

*Ans :*

**Merits/Advantages of Foreign Trade**

The various advantages/merits of foreign trade are as follows,

**1. Optimum Allocations of World Resources**

The global resources can be optimally allocated with the help of international specialization and geographical division of labour and it also helps in making optimum use of resources.

**2. Benefits of Specialisation**

When the total output increases due to the division of labour and specialization, all the trading countries would be benefitted in several ways.

**3. Enhanced Wealth**

Foreign trade facilitates in foreign exchange by means of imports and exports that leads to the growth of wealth of each trading country.

**4. Larger Output**

Foreign trade is one of the significant means for increasing total output globally.

**5. Employment Generation**

Foreign trade provides a number of employment opportunities through the expansion and growth of industrial and agricultural activities. It also provides direct employment to several intermediaries employed in export and import trade.

**6. Higher Standard of Living**

The countries that do not produce some specific goods, can obtain the same from other countries through foreign trade. Foreign trade allows the citizens of a country to enjoy more variety of goods and services. A country will have higher standard of living due to the exchange of goods and services between countries.

**7. Price Equalisation**

Foreign trade facilitates in equalising commodity prices across the world markets after making allowance for transport and custom duties. If there is an increase in the commodity price of a country, then the imports can be increased to determine the rise in prices. Likewise, if the commodity prices decline, the export can be increased to determine the fall in price. In this manner, extreme price fluctuations can be decreased.

**8. Security from Natural Calamities**

A country's production may be affected by natural calamities such as flood, famine, earthquakes etc. This leads to the scarcity of essential commodities in the country. In such situations, foreign trade protects a country from starvation by importing essential goods from other countries.

**9. International Brotherhood**

Various countries come in contact with each other through foreign trade. People from different countries exchange culture and ideas and create mutual understanding. Thus, foreign trade contributes to international peace and cooperation.

**10. Development of Communication and Transportation**

Developed means of communication and transportation is required for foreign trade. This causes the development of country's communica-tion and transportation.

**11. Welfare Contour**

Foreign trade is essential for the development and economic welfare of the world.

**12. Cultural Values**

When different countries have mutual trading among them, then it would lead to respect for each other's cultures and develop cordial relations among various countries.

**Demerits/Disadvantages of Foreign Trade**

The various disadvantages/drawbacks of foreign trade are as follows,

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**1. Exhaustion of Resources**

The important and essential raw material and minerals of a country would decrease in case of greater and consistent exports, until and unless the new resources are being exploited or developed.

**2. Blow to Infant Industry**

The new and developing domestic industries may get greatly effected by the foreign competition.

**3. Dumping**

The development of poor countries would get distracted due to the adoption of dumping techniques by the developed countries.

**4. Diversification of Savings**

An increase in import may decrease the level of domestic savings of a country, which would greatly effect the rate of capital formation and development process.

**5. Reduction in Domestic Employment**

It is being observed that any country which emphasizes upon few particular products would ultimately result in the reduction of job opportunities.

**6. Import of Harmful Goods**

A country may get affected due to the import of lux goods and spurious drugs.

**7. Rivalry Among Nations**

Rivalry among nations arises due to the extreme competition for exports and the competi-tion in foreign markets.

**8. Misuse of Natural Resources**

Excessive exports may result in depletion of country's natural resources.

**9. Invasion of Culture**

The country's culture may get disturbed due to foreign trade. People belonging to poor nations may be forced to follow foreign patterns and lifestyles.

**10. Over Interdependence**

In an economy, foreign trade does not promote self-sufficiency and self-reliance. The economic independence of a country is lost when countries opt to be inter dependent.

### 3.3.1 Theories of International Trade

**Q19. Explain the theory of Mercantilism.**

*Ans :*

The theory of Mercantilism acts as the basis for the economic thought and is the oldest theory of international traderlt states that the exports of the country should be more than their imports and the value of trade profits should be recei ved in the form of gold from the countries having trade deficits. The government for avoiding trade deficits, imposes restrictions on imports and promotes the exports.

British utilised colonial powers for carrying out trade with the colonies like India, Srilanka etc., by importing the raw materials from and exporting the finished products to colonies. The colonies must export less valuable products and must import more valuable goods. The colonical powers were benefitted from this theory but it caused a dissatisfaction in the colonies.

**The following are the limitations of the theory of merchantilism,**

(i) This theory recommends that a favourable balance of trade can be maintained if the gold is imported for the export of goods and services. But the validity of this theory was decreased due to decline of gold standard.

(ii) This theory was criticized on the basis that a nation's wealth depends on the existing goods and services instead of gold.

**Q20. Explain the Relative factor endowment theory.**

*Ans :*

The theory of comparative advantage with money failed to explain the way in which the countries can attain the comparative advantage. Thus, the criticisms made against comparative cost advantage theory resulted in the development of other theory known as Hecksher ohlin relative factor endowments theory. This theory was developed by the Eli Heckscher and Bertil Ohlin who were Swedish economists. The relative factor endowments include land, labour, capital, natural resources etc. Heckscher and Ohlin made certain observations and found that,

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(i) Different countries possess different factor endowments. For instance, India is rich in labour, while the USA has abundant capital resources etc.

(ii) The economists stated that, in a country, if labour is present in large quantity in comparison to the capital and land, then the price of the labour will be less and the price of capital and land will be higher. And in the countries in which the land and capital is in large quantity in comparison to the labour then the price of labour will be more.

(iii) The relative factor costs help the countries to produce the products at less costs.

(iv) The countries attain the comparative advantage on the basis of the factors endowed and the prices of the factors. They usually attain the comparative advantage in the products for which the factor endowed by the countries are utilized as inputs. Example: China and India have comparative advantage in labour intensive industry, such as textile and tobacco while the Saudi Arabia has comparative advantage in Oil. So these countries usually export the goods for which they possess comparative advantage because of the endowed factors.

(v) The products that are produced by the country at lower cost, will be exported and the products which are produced at higher cost will be imported by the country.

**Q21. Explain the New trade cycle theory.**

*Ans :*

During 1970s and 1980s, foreign trade was described through a new trade theory which states that,

(a) Profits should be generated from specialization and economies of scale.

(b) The first entrant who is entering into the market can generate entry barriers to others.

(c) The government has the responsibility to support its home based firms. As this theory focuses on productivity instead of resources of the country, it is similar to the comparative advantage theory but it is in conflict with the factor endowments model.

As per this theory, a firm can maximization its output through specialization and its subsequent increase in capability. Increase in output will reduce fixed cost per unit as fixed cost spread across huge number of output units. It facilitates the firm to decide a competitive price for its product.

The organization becomes capable to influence potential competitors to manufacture at same level and fix same cost for product. It is clear that, the individual who enters first into the market acquires first mover benefit in terms of economic and strategic advantage and also create challenging barriers for competitors.

Business people seek support of government so that first mover can maintain its competitive advantage.

The new trade theory is still new and there is no appropriate proof to justify its importance and applicability. The important aspects of this theory that is the first mover advantage will not be correct always.

**Q22. Briefly explain Adam Smith's Absolute cost advantage theory of international trade.**

*Ans :* **(Imp.)**

In order to overcome the shortcomings of mercantilism theory, Adam Smith, a Scottish economist developed the Absolute Cost Advantage theory. This theory is based on the principle of division of labour, which states that the countries should produce those goods in which they have a cost advantage over other nations. Adam Smith stated that, a country must produce only those products which can be manufactured at less cost when compared to other nations and can be exchanged by the products that are produced by other nations at less costs. Trade is performed between two nations when one nation manufactures the product at less costs and other nation possess absolute cost advantage over the first country in the production of other products.

The nation can attain absolute cost advantage because of the following reasons,

1. The labour specialisation in manufacturing specific products helps in increasing the productivity and reducing the cost of labour per unit of output.

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2. The suitability of the country's labour skill in manufacturing specific products.
3. Decrease in the labour cost per-unit of output due to economies of scale.

**Assumptions of the Theory**

The various assumptions of the theory of absolute cost advantage are as follows,

1. Trade is carried out between two countries.
2. Trade is performed only by two commodities traded.
3. Free-trade is carried out between the countries.
4. Labour is the only element of production cost.

**Implications of the Theory**

The various implications of the theory are as follows,

1. The trade helps the two countries to produce more quantities of both the products.
2. The trade helps in enhancing the standard of living of the people of both the countries.
3. Trading assists in enhancing the global effectiveness and efficiency.
4. The productivity of labour and other resources can be increased globally through trading.

**Limitations/Criticisms**

**The following are the limitations of theory of absolute cost advantage,**

1. This theory states that one country must be able to manufacture atleast one product with low cost. But in actual practise though the developing countries participate in the international trade, most of them do not attain the absolute advantage in manufacturing products at low cost.
2. This theory focuses only on labour, the other resources such as technology, natural resources etc., are not at all considered.
3. The large scale economies decrease the production cost and is regarded as the part of absolute advantage. But, this aspect is completely ignored in this theory.
4. The transportation costs play a key role in international trade but it is not taken into account in this theory.

**Q23. Discuss in detail about comparative cost advantage theory.**

*Ans :* **(Imp.)**

**Comparative Advantage Theory**

The comparative cost advantage theory was introduced by David Ricardo who is British economist. This theory outlined the situation in which a country have cost advantage in manufacturing several products. The absolute cost advantage theory was unable to explain this situation. So, Mr. David Ricardo expanded this theory to clarify this situation and created the Comparative cost advantage theory.

**Assumptions of the Theory**

The following are the assumptions of comparative cost advantage theory,

(i) The trade barriers does not exist.

(ii) There is full employment.

(iii) Labour is the only element of production cost, while production is affected by the law of constant returns.

(iv) Trade is not related to the production cost.

(v) Trade is done only by two products.

(vi) The cost of transportation does not exist.

(vii) Trade is done only between two countries.

According to the theory of comparative cost advantage, a country must manufacture and export the products for which it has more productivity when compared to other countries and the country should import only those products for which the other countries are more productive. "The relative productivity differences" act as the basis of the comparative cost advantage theory and include the opportunity cost concept.

The theory of comparative cost advantage can be explained in relation to the theory of absolute cost advantage.

| | Output per one day of labour | |
|---|---|---|
| | Japan | India |
| Pencils | 50 | 40 |
| Radios | 8 | 2 |

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The above table indicates that Japan has an absolute cost advantage in both the pencils and radios as it is producing 50 pencils or 8 radios per day of labour. In both the products, Japan is more productive than India. Hence, trade should not occur between Japan and India according to the absolute cost advantage theory.

In the production of radio, Japan is four times better than India and in the production of pencils it is 1.25 times better than India, whereas in production of radio, India is only 0.25 as good as Japan but 0.8 as good as in pencil production. Hence, comparatively Japan is better than India.

If there is no trade between the two countries, then labour of Japan can produce either 50 pencils or 8 radios or alternatively 50% of both i.e., 25 pencils and 4 radios. In the same way, India can also produce 40 pencils and 2 radios or 50% of both i.e., 20 pencils and 1 radio. The opportunity cost is taken into consideration, when there is no trade between Japan and India for determining the trading benefit foregone by both the countries.

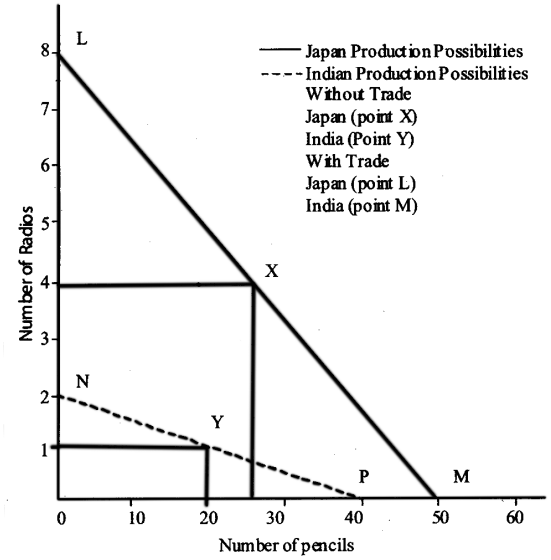


**Fig.: Production Possibilities with Comparative Cost Advantage**

Both the countries can obtain the benefits if they produces those goods in which they have comparative advantage. As India can produce 40 pencils or 2 radios for one day of labour, it implies that the cost of 2 radios is equal to 40 pencils. Therefore, cost of one radio is equal to 20 pencils in India. In the same way, cost of one radio in Japan is 6.25 pencils. Hence, the price of one radio is 20 pencils in India and 6.25 pencils in Japan. Assume that Japan offers one radio for 10 pencils, then India must accept the offer and should export 10 pencils for 1 radio as it is advantageous to both India and Japan.

**Gains from Trade Based on Comparative Cost Advantage**

| | Prices without Trade | Prices with Trade |
|---|---|---|
| Japan | 1 radio = 6.25 pencils | 1 radio = 10 pencils |
| India | 1 radio = 20 pencils | 1 radio = 10 pencils |

Japan can enjoy the benefit of more pencils for one radio (10 - 6.25 = 3.75). India also gets the benefit of spending only 10 pencils for one radio instead of 20 pencils. Hence, the comparative cost advantage encourages the trade between the countries.

**Implication of the Theory**

The following are the implications of the theory,

1. Global resources are allocated efficiently.
2. Global production is enhanced.
3. In world markets, the prices of product become equal.
4. The countries must specialize in the products in which they are perfect and then export them.

Hence, comparative cost advantage theory is a progress over the Adam Smith's theory of absolute cost advantage. But it is not an extension to the principles of division of labour and specialisation. Even though it employs opportunity cost concept, the concept of money value of cost of production is not considered by Ricardo but later on it was covered up by Taussig.

**Limitations/Criticisms**

Though the comparative cost advantage theory is useful for international trade, it has certain limitations which are as follows,

1. This theory is based on the assumption that only two countries take part in the International trade but in real life situation, more than two countries are involved in international trade.
2. It also assumes that two products are involved in international trade but in reality several products are involved in international trade.
3. This theory assumes that the transportation cost does not exist. But transportation cost is an important part of global trade which cannot be ignored.
4. This theory states that the trading nations obtain benefits from the international trade but the percentage at which they receive the benefit is not clearly specified in the theory.
5. Attaining economic efficiency may not be the main aim of the Nations in International trade. The nations might have other goals as well, such as, providing assistance to the poor nations, carrying out trade with the friendly nations etc.

**Q24. Analyze the product life cycle theory of international trade in detail.**

*Ans :* **(Imp.)**

The product life cycle theory was developed by Raymond Vernon of Harvard Business School. It is the second firm-based theory of international trade. This theory involves four stages which are as follows,

1. New product introduction
2. Growth
3. Maturity
4. Decline.

**1. New Product Introduction**

The companies usually develop new products on the basis of the needs and problems in the home country. For instance, in United States of America, personal computer and photocopier were developed on the basis of the perceived needs of the individuals.

**Location of Innovation**

The companies prefer to locate the manufacturing facilities in the home country as it would be easier for the firms to obtain quick feedback of the market about their products and to alter and create the product as per the demands of the customers. This also helps in saving the time and transportation cost. In industrially developed countries, innovations takes place due to the availability of research and development facilities, increased-competition, customer demands etc.

**Importance of Innovation**

The main source of competitive advantage is innovation. In order to move ahead in the market, the firms constantly innovate and create new products. The developing nations can utilize such innovations by importing the products or technology from the technologically advanced nations. The companies in this stage, sell a significant part of their product in their home country and only a limited part is sold in other nations.

**Labour as a Primary Input**

In this stage, the product is modified on the basis of customer feedback as the production process is labour intensive at this stage. The product is not standardized due to frequent alterations in the design of the product. For instance, LG T.V was altered more than 10 times during this stage.

Feed's in other countries so as to achieve low cost of transportation, good quality of product etc. During this stage, the competitors emphasize more on process technology instead of product technology.

**3. Maturity**

This stage experiences a decline in the exports due to an increase in the world wide production. The standardization of product increases and cost decreases due to an increase in the competition. The technology becomes standardized at this stage, so the producers start establishing their manufacturing undertaking in developing nations for attaining the benefits of low labour costs. This also helps in decreasing the production cost and enhancing the cost competition.

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**4. Decline**

During the decline stage, the markets for product is located in developing nations as the customers in developed countries have switched their demand towards the new products. Hence, the production facilities are located mostly in developing nations and there is a significant decrease in the exports during this stage. Hence, there will be a decline in the volume and direction of international trade.

**Suitability of the Theory**

This theory was practically unsuitable for various electronics, synthetic materials and some consumer durables. But some studies have found that the production movements do not exist in the model of product life cycle.

**Limitations of Product Life Cycle Theory**

There are certain limitations due to which the production movements do not occur in the product life cycle. Such limitations are as follows,

1. Decrease in the cost of the luxury products is not taken into consideration by the consumers.
2. The higher cost of transportation reduces the volume of exports.
3. The production facilities are not shifted to foreign countries for attaining the cost reduction because of short life-cycle of product.
4. The chances of shifting to the foreign countries for decreasing the cost will be decreased by the non-cost strategies such as advertising.
5. Multi-national corporations which carry out their production process in several nations for taking the advantage of human resources, raw materials etc., do not consider the predictions of product life cycle model.

### 3.3.2 Government Intervention in International Trade

**Q25. What is the role of Government Intervention in International Business ?**

**(OR)**

**Examine the rationale for understanding Government Intervention in International Business ?**

*Ans :* **(Imp.)**

Economic reasons for the government intervention in an international business have been categorized as follows:

1. Fighting unemployment
2. Protecting infant industries
3. Promoting industrialization and
4. Improving comparative position.

**1. Fighting Unemployment**

Unemployment forms a major reason for imposing restrictions on imports. For instance, in US trade displaced workers are either unable to find alternative jobs at reasonable salary or find a new job at 13 percent less salary than their old jobs or above one third faced around 30 percent fall in their salaries. Similar impacts have been observed in countries like Canada, Germany and France to create domestic employment. Import restrictions are necessary. However, import restrictions cause certain problems. Some of them are,

(a) Retaliation by other countries when import restrictions made to generate domestic employment. For instance, when US imposed import restrictions on steel products then countries like Japan, Brazil and EU have threatened US by restricting the purchase of US based products (like oranges).

**(b) Retaliation influence can be affected by two factors.**

(i) Role of small trading countries, for instance, when US restricts further import of cloth either from China or Mauritius, then US opt Mauritius because China is more powerful than Mauritius to retaliate. Furthermore, US economy is adversely affected by the Chinese trade restrictions than Mauritius restrictions.

(ii) If retaliation reduces the employment opportunities in a capital intensive industry then it may not be able to influence the employment in the equal proportions of the most probable trade loss. In simple words, the trade lost during retaliation may not occur in an equal proportion as that of its impact employment opportunities.

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(c) Import restrictions increase the procurement cost of several components thereby reduces the sales in other industries.

For instance, import restrictions on steel in the US has given emergence to many complicated issues for US automobile manufacturing companies such as GM, Ford, Toyota, Honda, Daimler Chrysler and Nissan. As, their sales were severely affected, they have undertaken various actions for convincing the government authorities to remove such restrictions.

(d) Export jobs reduced to a greater extent due to less incomes abroad.

**Analyzing the Trade Offs**

Government should make comparison between the costs of unemployment and cost incurred on the import restrictions such as higher prices and higher taxes. After conduction thorough comparison, Government should decide whether to restrict imports or not.

Problems of unemployment can also be solved by dealing with monetary and fiscal policies.

If it gets solved by restricting imports, then citizens have to bear and pay higher taxes. Further, when managers assume that trade protection is a long term policy then they don't invest in technological innovation. As it mayn't act as a source for gaining competitive advantage for them.

**2. Protecting "Infant Industries"**

The infant industry argument refers to a guaranteed market share provided by the government of domestic country so that they can be protected from the foreign competition. Government provides its assistance till they I will be able to compete with others in the market.

➢ **Underlying Assumptions**

Infant industry argument assumes that the output cost of initiation is very high causing the output to become non competitive in the markets.

However, competitive advantage cannot be attained overnight. It requires time for its attainment. Thus, government must protect them against the competitive industries. If the infant industries are carefully opting those strategies which enable them to achieve economies of scale and the translation of their employees experience into higher productivity, then they could achieve higher share in the markets without governments intervention.

➢ **Risk in Designating Industries**

Production cost may decrease overtime and it is risky to produce competitive products at international level as it is usually associated with less probability of cost decline. Two problems are involved with such risk, which include,

**(a) Determining Probability of Success**

Government should find out the possibility of success in newly emerging industries and protect these industries to compete internationally (from its own). For instance, after providing government assistance, few industries have become competitive such as Automobile production in Brazil and South Korea. Whereas, the other industries such as Automobile production in Malaysia and Australia remains inefficient even after getting government aid for a long-period of time.

Security of government protection against import competition prevents managers to implement innovations essential to compete internationally as well as supplying their customers with high quality products at lesser price.

**(b) Identifying Qualified Industries**

When policy makers find that infant industries can succeed themselves without any governmental aid and assistance, then the firms need not follow such industries for becoming successful.

Even, there are several companies that have become successful without attaining government's aid.

Few policy makes are in favour of government assistance for the new or infant industries as the domestic entrepreneurs are unable to face high entry barriers and efficient foreign rivals.

**3. Promoting Industrialization**

Most of the countries normally have large manu-facturing base which contributes heavily towards the income of the nation compared with some other countries. For instance, US and Japan established wide industrial base by imposing several restrictions on imports. Developing countries imitate

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this strategy by using trade protection to encourage domestic industrialization. They perform their operations under the following set of assumptions,

➢ **Surplus Workers**

Surplus workers increase the productivity especially when a country is shifted from agriculture to industrial sector then it is simple to improve and promote the manufacturing output compared to agricultural productivity. This type of sector transit may lead to,

(a) Increase in demand for social and political service in cities.

(b) When marginal productivity of agricultural employees is less, there is an increase in its output level (industrial).

(c) Less concerned towards the development in agricultural sector.

➢ **Investment Flows**

Industrial sector undergoes growth and develop-ment when there is adequate inflows of foreign investment.

When trade restrictions are imposed on foreign products especially on imports then foreign companies invest in the production operations of the host countries. For example, when Thailand was restricted to import its automobile products, then foreign automakers got a chance to invest in the production of automobile components in the host country.

➢ **Diversification**

Most frequent fluctuations are observed in the price and sales pattern of agricultural products and raw materials which leads to the detrimental impact on the economies, that are mostly dependent on the exports of primary products. For this reason, some developing countries shift from agricultural commodities to industrial products.

➢ **Growth in Manufactured Goods**

While shifting from agricultural to industrial products, rapid growth of the industrial goods is observed when compared to agricultural products because markets for industrial products grow rapidly than the agricultural products.

➢ **Import Substitution and Exportled Development**

Finally, domestic industries prefer to minimize imports to greater extent so as to maximize their exports. This could be achieved by promoting local industrialization wherein the local consumers have to pay higher price and higher takes for the products.

➢ **Nation Building**

Industrial activity forms the basis for nation building and industrialization focusing mainly on, Selling of the products at national level (or) at international level i.e., exporting the products.

**4. Improving Comparative Position**

Generally, government of any country holds control over the economic welfare and compares its performance with that of the performance of other countries thereby developing trade positions by imposing trade restrictions. Thus, the economic relationships among the member countries can be improved by any of the following alternatives.

➢ **Balance of Trade Adjustments**

Trade deficits may generate different issues for those countries that have low foreign exchange reserves. In this perspective the government takes several steps to create balance in its trade either by increasing exports (or) by reducing imports. It has two strategic options which greatly influence its competitive status which include,

(a) Depreciate or devalue its currency, where domestic products are relatively cheaper when compared to the foreign products.

(b) Depends on monetary and fiscal policy to increase the prices slowly when compared with other countries.

➢ **Comparable Access or "Fairness"**

Domestic producers gain competitive advantage when their access to foreign markets is more than the accession of foreign producers towards their domestic/ local markets.

The comparable access argument is used in the semiconductor, chemicals, aircraft, softwood lumber, energy and telecommunication industries.

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**Restrictions as a Bargaining Tool**

Utilizing restrictions as a bargaining tool by considering the following two conditions,

**(a) Believability**

Either have accession to the alternative sources available for the product (or) consumers without considering restrictions. For instance, during trade retaliations between US and EU, EU's economy was adversely affected when it had been threatened to regulate trade restrictions on soyabeans produced by US.

**(b) Importance**

Export restrictions may be important for some parties in producer country that can hold significant influence on the country's trade policy.

**Price Control Objectives**

Export restrictions may lead to the following conditions,

(i) Increases world prices

(ii) Needs additional control mechanisms to stop smuggling and other trade malpractices.

(iii) May result in substitution.

(iv) Increases the supply at domestic level by lowering their prices.

(v) Provides lesser incentive to the producers for increasing the productivity.

(vi) Shift the foreign production and sales.

**Import restrictions can cause,**

1. Prohibition of dumping which helps in removing domestic producers out of competition
2. Provide opportunities to the foreign producers for reducing their prices.

**Q26. What are the various forms adopted by governments for intervening in International Business (IB)? State their effects.**

*Ans :*

Tariffs and non-tariff trade barriers constitute the important instruments of trade intervention and the main forms of protectionism measures. Usually, these trade barriers may be imposed by the individual countries or the groups of countries in the form of trading blocks. Example, European Union. Barriers acts as obstacles in way of cross border business. Following are the common forms of government intervention,

**1. Tariff**

Tariffs are those taxes which are levied on imported products with an objective of discouraging high level of imports of products which will restrict the trading of domestic goods. It increases the cost of goods for importer, exporter and the buyer of the product which helps in generating huge trading revenues for government. Most of the nations fix the tariff rate as a fixed percentage on imports. For example, Switzerland charges about 32 to 34% of tariff on its imports.

**2. Quota**

When the government of any country fixes quantitative limits on the import of products then it is usually termed as quota. Quota is specifically charged during a particular period of time. It is mostly useful for early importers as they have power and ability to earn huge profits in the form of high tariff rates. However, it may not be useful for the late importers as they are not able to attain desired profit margins.

**3. Local Content Requirements**

Local content requirements refers to the percentage of added value which can be obtained from the local sources and acts as a basic requirement for the manufacturer. It discourages the imports of raw materials, parts, components, and supplies which causes huge decline in the sourcing options of the manufacturer. Most of them lead to higher costs and lower product quality for importers and buyers, as they have to procure them from the available number of sources.

**4. Regulations and Technical Standards**

For imports, governments of different countries fix safety, health or technical standards which they need to fulfill. It may delay or restrict the entry of imported products and minimizes the available quantity of products (if they are not as per the

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prescribed standards). If the quantity gets reduced it may lead to higher costs for importers and buyers.

**5. Administrative and Bureaucratic Procedures**

Administrative and bureaucratic procedures are those complicated procedures or requirements that are levied on importers or foreign investors which restricts them from trading and performing their investment activities. Lengthy and complex procedures slows down the imports of products or services and restricts the investment activities of the firm.

**6. FBI and Ownership Restrictions**

It basically includes rules and regulations specifically designed for the foreign investors which restrict them from investing in some specific industries or in the acquisition of local firms. Such restrictions limit the amount of capital that has to be invested in a country, It may need a foreign firm to invest in the country for the purpose of doing business.

**7. Subsidy**

It refers to the financing or other resources that have been provided by the government of the country. Such subsidies are required for the survival or growth of the firm or the group of firms. Firms that have obtained subsidies are found to attain competitive advantage in much easy manner than those which are without subsidies.

**8. Countervailing Duty**

Countervailing duties are the extended duties levied on the imports so as to set off the subsidies provided to the producers or exporters in the exporting country. It decreases the competitive advantage provided by the subsidies.

**9. Antidumping Duty**

Antidumping duty is a type of tax which is imposed on an imported product that is found to be less costly than the normal market prices. It decreases the competitive advantage of imported products that are charged at abnormally low levels.

### 3.3.3 Tariff and Non-Tariff Barriers

**Q27. What are Tariff Barriers. Explain different types of Tariff Barriers.**

*Ans :*

Tariff is derived from a French word which means rate, price or list of changes. It is a customers duty or a tax on products that move across borders. Tariffs can be classified in several ways.

**1. Import and Export Tariffs**

Tariffs are often imposed on the basis of the direction of product movements 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 about 20 percent on a number of goods sold in cash transactions and an average export tariff 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 US car sold in Japan easily cost twice as much as its price in the United States. The US tax is a revenue tariff whereas the Japanese tax is more of a protective tariff.

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### 3. Tariff Surcharge Versus Countervailing Duty

Protective tariffs can be further classified according to length of time. A tariff surcharge is a temporary action, whereas a countervailing duty is 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 an export subsidy by rebating certain taxes if goods are exported.

### 4. Specific, and Combined duties

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 percentage of this price will fall.

On the other hand, for a cheap product whose value is low, the duty percentage will rise accordingly.

Combined rates (or compound duty) are a combination of the specific and Ad Valorem duties on a single product. They are duties based on both the specific rate and the Ad Valorem rate that are applied to an imported product.

For example, the tariff may be 10 paise per kilogram plus 5 percent Ad Valorem. Under this system, both rates are used together, though in some countries only the rate producing more revenue may apply.

### 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, cascaded 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.

A Value Added Tax (VAT) is a multi-stage tax on consumption. It is an national tax levied at each stage of the production and distribution system, though only on the value added at that stage. In other words, each time a product changes hands, even between middlemen, a tax must be paid.

But the tax collected at a stage is based on the added value and not the total value of the product at that points. Sellers in the chain collect, the VAT from a buyer, deduct the amount of VAT they have already paid on their purchase of the product and remit the balance to the government.

The VAT is supposed to be non-discriminatory because it applies to both products sold on the domestic market and imported goods. The importance of the value added tax is due to the fact that GATT allows a producing country to rebate the VAT when products are exported.

Foreign firms trying to get a refund from European government have found the refund process to be anything but easy.

Since the tax applies to imports at the border but because it si fully rebated on exports, the VAT may improve a country's trade balance. The evidence, however, offers a mixed picture. A study in Europe showed no evidence that the VAT had any material impact on the balance of trade.

Regarding Korea and the Philippines, the rebated VAT, by increasing profits from exports compared with the previous tax regime, may have encouraged exporting.

Cascade taxes are collected at each point in the manufacturing and distribution chain and are levied on the total value of a product, including taxes borne by the product at earlier stages. Of all the tax systems examined, this appears to be the most severe of them. For over thirty years to now a defunct cascade tax system of taxation in Italy hurted the development of large-scale wholesale business there.

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**Q28. What are Non-Tariff Barriers. Explain different types of Non-Tariff Barriers.**

*Ans :* **(Imp.)**

**Non-Tariff Barriers (NTBs)**

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. Non-tariff barriers are of two kinds. They are,

1. Price influencing NTB s
2. Quantity influencing NTBs.

**1. Price Influencing Non-tariff Barriers (NTBs)**

The NTB's which influence price includes as,

(i) Subsidies

(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) Subsidies**

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 subsidies

(b) Export subsidies

(c) Conditional subsidies.

The above three are the different types of subsides given.

**(a) Indirect Subsidies**

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 Subsidies**

It have been said as china sells com 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 Subsidies**

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

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declare invoice price. And if the doubt arises on the authencity of it then assessment 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 competiveness 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.

**2. Quantity Influencing Non-tariff Barriers (NTBs)**

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 (MFA)**

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)
- 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.

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### (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 govern-ment. 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.

**Q29. Distinguish between tariff and non-tariff barriers used to restrict inputs.**

*Ans :* **(Imp.)**

Difference between Tariff and Non-tariff Barriers

| Points of Difference | Tariff Barriers | Non-tariff Barriers |
|---|---|---|
| 1. Meaning | Tariffs are the taxes levied on the imported goods. | Non-tariff barriers are the barriers which restricts the international trade through laws, government regulations, policies or procedures. |
| 2. Nature | Tariff barriers act as strong barriers during international trade. | Non-tariff barriers act as a protection mechanism for domestic countries during international trade. |
| 3. Impact on price and quantity | Tariff barriers have an impact on the prices of the goods. It does not affect the quantity on the price or on the of the goods. | Non-tariff barriers may either have a direct impact quantity of the goods supplied. |
| 4. Transparency | Tariff barriers are more transparent and can be easily identified. | Non-tariff barriers are less transparent. So it is very difficult to identify them. |
| 5. Impact on trading countries | Tariff barriers have an impact on importing countries | Non-tariff barriers have severe impact on exporting countries. |
| 6. Types | There is no differentiation between price and quantity influencing tariff barriers. | There are two types of non-tariff barriers, the one influencing the price and the other influencing the quantity. |
| 7. Market fragm-entation | Tariff barriers do not have much effect on market fragmentation. | Non-tariff barriers are regarded as one of the most effective methods of market fragmentation. |
| 8. Economics of scale | Removal of tariff barriers will not leads to the achievement economics. | Removal of non-tariff barriers lead to more economics of scale of scale. |
| 9. Impact on international trade | Tariff barriers have an unequal impact on the cost of domestic production and the cost of imports. | Non-tariff barriers have an equal impact on both the cost of the domestic production and imports. |
| 10. Effect on demand and supply | As, tariff acts as an expenditure for a foreign producer, its cost increases due to the per unit sale of his products which makes the supply curve to shift upwards as shown in figure 1(a). | Non-tariff barriers decrease the demand for imports. So, the demand curve moves towards left side, as shown in figure 1(b). |

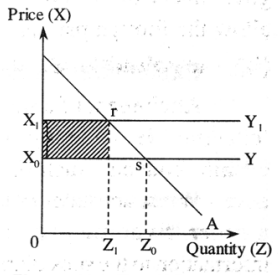


Figure 1(a): Tariff Barrier

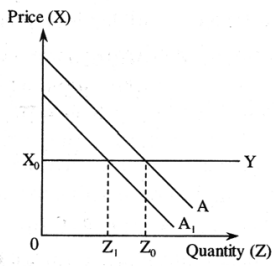


Figure 1(b): Non-tariff Barrier

## 3.4 GLOBALIZATION

### 3.4.1 Meaning

**Q30. Define Globalization. Explain the nature of Globalization.**

*Ans :*

**Globalization**

Globalization 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 "globalization" 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 "globalization," with some policy makers, 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.

Globalization 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.

**Definition**

**According to International Monetary Fund (IMF),** "Globalization 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,** "Globalization is the shift towards a more integrated and interdependent world economy. Globalization has two main components - the globalization of markets and the globalization of production".

Globalization 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.

**Nature of Globalization**

The idea of globalization 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 Organizations (NGOs) and Multinational Corporations:** As global awareness of certain issues has risen, so too has the number of organizations that

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aim to deal with them. So called non-governmental organizations bring together people unaffiliated with the government and can be nationally or globally focused.

5. **Growing Worldwide Interconnections:** This is one characteristic of globalization. Some interconnections can be predicted, others cannot. Moreover, factors other than globalization also shape events.

6. **Rapid, Discontinuous Change: Another** characteristic of globalization 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 globalization 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" characterization of globalization exposes most of us. To many more people and ideas whose perspectives on globalization 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.

**Q31. What are the characteristics of Globalization.**

*Ans :* **(May-13)**

1. Over the past two decades, there is a rapid globalization of markets and production.
2. The globalization of markets implies that national markets are merging into one huge marketplace.
3. Erosion of national sovereignty and national borders through international agreements leading to organizations like the World Trade Organization (WTO) and European Union (EU).
4. Development of Global Financial System.
5. Reduced transportation costs, especially from development of containerization for ocean shipping.
6. The globalization of production implies that firms are resorting to specialised world locations for particular activities than involving their own resources. As a consequence, it looks increasingly irrelevant to talk about American products, Japanese products, or German products, since these are being replaced by "global" products.
7. Two factors seem to underlie the trend toward globalization: declining trade barriers and changes in communication, information, and transportation technologies.
8. Since the end of World War II, there has been a significant lowering of barriers to the free flow of goods, services, and capital.
9. Increase in international flow of capital.
10. Increase in the share of the world economy controlled by multinational corporations.
11. Increased role of international organizations such as WTO, WIPO and IMF that deal with international transactions.
12. Increase of economic practices like outsourcing by multinational corporations.
13. Intellectual Property Restrictions.
14. Harmonization of intellectual property laws across nations (generally speaking, with more restrictions).
15. Supranational recognition of intellectual property restrictions (e.g. patents granted by China would be recognized in the US).
16. Following globalization of production and markets, world trade has grown faster than world output in the last decade. Foreign direct investment has surged, imports have penetrated more deeply into the world's industrial nations, and competitive pressures have increased.
17. The development of the microprocessor and related developments in communication and information processing technology have helped firms link their worldwide operations into sophisticated information networks.

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18. Development of a global telecommunications infrastructure and greater transborder data flow using technologies such as Internet communication satellites and telephones.
19. Increases in the number of standards applied globally, e.g., copyright laws and patents.
20. The most dramatic environmental trend has been the collapse of communist power in Eastern Europe, which has created enormous long-run opportunities for international businesses. In addition, the move towards free market economies in China, Latin America and India is creating opportunities (and threats) for Western international businesses,
21. The benefits and costs of the emerging global economy are being hotly debated among business people, economists, and politicians. The debate focuses on the impact of globalization on jobs, wages, the environment, working conditions, and national sovereignty.
22. Some argue that even terrorism has adopted globalization with attacks in foreign countries that have no direct relation with another.
23. Culturally
    (i) Greater international cultural exchange.
    (ii) Spreading of multi culturalism, and better individual access to cultural diversity.
    (iii) The imported culture can easily supplant the local culture, causing reduction in diversity through hybridization or even assimilation.
    (iv) The most prominent form of this is Westernization.
    (v) Greater international travel and tourism.
    (vi) Greater immigration including illegal immigration.
24. Managing an international business is different from managing a domestic business for at least four reasons:
    (i) Countries are different
    (ii) The range of problems confronted by a manager in an international business is wider and the problems themselves more complex than those confronted by a manager in a domestic business.
    (iii) Managers in an international business must find ways to work within the limits imposed by governments' intervention in the international trade and investment system.
    (iv) International transactions involve converting money into different currencies.

**Q32. What is the Globalization of production facilities?**

*Ans :*

Companies globalize the production facilities due to the following reasons:

- Imposition of restrictions on imports by the foreign countries forces the MNCs to establish manufacturing facilities in other countries. *For example,* Toyota of Japan established its plants in the USA and the UK due to the import restrictions.
- Availability of high quality raw materials and components in other countries.
- Availability of inputs at low cost in foreign countries.
- Availability of skilled human resources at low cost.
- Liberal labour laws in the foreign countries.
- To reduce the cost of transportation and easy logistics management.
- Facility of exporting to other neighbouring foreign countries.
- To design, and produce the products as per the varying tastes of customers in foreign countries.

**Q33. Explain the advantages and disadvantages of Globalization.**

*Ans :* **(May-12)**

**Advantages of Globalization**

The advantages of globalization can be summarized as follows:

**(a) Promise of Increase Productivity and Higher Living Standards:** Globalization brings in new opportunities such as access to markets and technology transfer. These

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opportunities hold out the promise of increased productivity and higher living standards.

(b) **Increase in Trade in Goods and Services:** There is tremendous growth in trade in goods and services. "Trade in goods and services has grown twice as fast as global GDI in the 1990s and the share attributable to developing countries has climbed from 230 to 29 percent''. Increased international competition in services will lead to reduction in prices and improvements in quality. This will increase the competitiveness of down-stream industries. Both industrial and development economics will gain by opening their markets.

(c) **Provide New Opportunities for Growth:** For developing countries, trade is the primary vehicle for realizing the benefits of Globalization. Imports bring additional competition and variety to domestic markets, which benefit consumers. Exports, on the other hand, enlarge foreign markets and benefit business. Further trade exposes domestic firms to the best practices of foreign firms and encourages greater efficiency. Trade gives forms access to improved capital inputs such as machine tools, which boosts productivity. Trade encourages the redistribution of labour and capital too relatively to more productive sectors. It has contributed to the ongoing shift of some manufacturing and services activities from industrial to developing countries, providing new opportunities for growth.

(d) **Globalization of Financial Markets:** Globalization of finance markets affects development because finance plays an important role in economic growth and industrialization. Financial Globalization affects growth in two ways. First, it increases the global supply of capital. Second, it promotes domestic financial development and hence, improves allocative efficiency, creates new financial instruments, and raises the quality of baking services.

(e) **Increased Flow Of foreign Market Capital:** Globalization leads to increased flows of capital across countries. Flows of foreign capital offer substantial economic gains to all parties. Foreign investors diversify their risks outside their home market and gain access to profitable opportunities throughout the world. Economies receiving inflows raise the level of investment. When there is foreign investment it is generally accompanied by management expertise, training programs and important linkages to suppliers and international markets.

(f) **Impact on Poverty:** The fast growth and overall development resulting from liberalization, increased flow of trade ad capital could have a major impact on poverty. It is likely to reduce the number of people living in absolute poverty.

(g) **Increase the Level of Interdependence and Competitiveness:** Globalization is supposed to accelerate and increase the level of interdependence and competitiveness among nation. It is a change from plan to market.

As a consequence, markets for merchandise trade are expanding, more and more service are being traded internationally, and capital is flowing in quicker and increasingly diverse ways across countries and regions. There is increasing integration of countries into World markets for goods, services and capital. In short, Globalization widens and intensifies international linkages in trade and finance.

(h) **Induce Domestic Firms to Improve Technology:** The better technology brought in by the MNCs may induce or provoke the domestic firms to absorb similar technology. This may improve their competitiveness and expansion.

### Disadvantages of Globalization

The universal acceptance of the market economy and the Globalization led by private enterprises tend to have some harmful effects on the economy of developing countries. They are discussed below:

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(a) **Takeover of National Firms:** There are a large numbers of cases of takeover of national firms by foreign firms. In some cases, the domestic firms had to handover the majority of equity to foreign partners of joint ventures due to their inability to bring in additional capital.

(b) **Ruin of Traditional Crafts and Industries:** Globalization has lead to replacement of traditional and indigenous products by modern products. This has resulted in the ruin of traditional crafts and industries and the livelihood of the people depended on these sectors.

(c) **Brings Instability:** Globalization sometimes brings instability and unwelcome change in the economy. It exposes workers to competition from imports, which can threaten their jobs. The inflow of foreign capital into the country through Globalization may undermine banks.

(d) **Widens the Disparity:** Globalization will widen the disparity between one who are associated with market and one who are not. With the expansion of trade and foreign investment, the gaps among the developing countries will widen .it has brought in increased income inequality in many industrial countries it is argued that the developing countries and the poor people are not in a position of achieving benefits from Globalization. The only beneficiaries of it are the developed countries and the MNCs.

### 3.4.2 Drivers

**Q34. Explain the drivers of globalization.**

*Ans :* **(Dec.-20, Imp.)**

**1. Development of WTO (World Trade Organization)**

The Uruguay round negotiations were concluded by the governments of the member countries of the General Agreement of Trade and Traffic (GATT) on 15 th December 1994. The outcome of the meeting was supported politically by the ministers by signing the Final Act in Marrakesh, Morocco, on the 15th April, 1994.

Marrakesh declaration outlined that the Uruguay round results will encourage the world economy and results in increased trade, investment, employment, and income growth all over the world.

WTO was established on 1st January 1995 to promote the implementation, administration, operation and the objectives of the multinational trade agreements and plurilateral trade agreements.

During 1995 and 2006, the development of W.T.O. increased the exports by 2.5 times and imports by 10 times.

**2. Regional Economic Integration**

When the countries belonging to the same region or area are integrated regionally and economically then it would result in an increase in the market size, demand for various products and services, production quantity, employment and the economic activity of that region. It also increases, the purchasing power and improves the living standards of the people. The important regional integrations are European Union (EU), NAFTA and ASEAN.

**3. Declining Trade Barriers**

It is one of the major driver of globalization. Before the World War-II, the exports and imports between various countries was very less, as the government at that time imposed trade barriers like quotas, tariffs etc., to protect and safeguard its domestic business from the international business.

But this situation was completely changed after world war II, as the advanced countries decided and agreed to reduce the tariffs so that the goods can be flowed easily or freely among various countries. In Uruguay round of negotiations, the trade barriers were reduced to a significant extent and GATT was extended to cover manufactured goods and services.

By the end of 2000, the tariff rates were reduced to 3.9% by the advanced countries, due to which the international trade was increased about 25 times in between 1950

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and 2004. These reductions in tariffs and trade barriers lead to the growth of global business.

**4. Declining Investment Barriers**

In order to perform global business the firms have to invest capital in the foreign countries for carrying out manufacturing and other related tasks. But the foreign governments imposes barriers on foreign investment to safeguard its domestic business.

However, several countries have eliminated these barriers on foreign investment for improving and encouraging global business.

Between 1991 and 2000, about 1,121 changes were made in the laws governing Foreign Direct Investment (FDI) and 95% of the changes were made for supporting FDI.

In 1980 there were about 181 bilateral treaties among 164 countries but this number was increased to 2081 in 2006. These treaties helps in encouraging and safeguarding the investment among the countries and allows the speedy growth of global trade and production. This in turn increased the global trade to about 8 times in between 1950 and 2006.

**5. Growth in Foreign Direct Investment (FDI)**

The investment made by a firm in a foreign country is known as FDI.

The following are the reasons for the growth of FDI,

(a) To increase the sales and profits.

(b) To enter the fast growing markets.

(c) To decrease the costs.

(d) To integrate the trade blocks.

(e) To safeguard domestic markets.

(f) To increase the knowledge of technology and management.

In the last 25 years, the flow of FDI has increased significantly with a remarkable growth during 1990's. In between 1990 and 2006, the outflow of FDI was about 18 times higher when compared to the outflow during 1970's which increased from US$ 564 billion in 1980 to US $19,636 billion in 2006.

The advanced countries were the key players in the flow of FDI. They are the main providers and recipients of FDI as 84% of FDI was given by developed countries and 64% of FDI in 2006.

Developing countries are now receiving higher FDI when compared to the FDI received in 1980. Hence, the growth and wide spread of FDI in the last few years has significantly increased globalization of production and marketing.

**6. Strides in Technology**

Technology which has grown immensely after 1980 has bought revolutionary changes in various areas like telecommunication, Information Technology (IT) and transportation technology.

The latest developments made in the Information Technology (IT) industry facilitated the global company to grow into a virtual global company.

**(a) Microprocessors and Telecommunications:** The development of microprocessors resulted in the growth of high power, high-speed, low cost computing and holding or storing large amount of information.

The improvements and developments achieved in the growth of microprocessor lead to the growth telecommunication which enhanced the speed and efficiency of organizing the operations of global business firms.

**(b) The Internet and World Wide Web:** The internet and world wide web are regarded as the back bone of global business as they coordinate, control and monitor the various activities of global business.

The different facilities offered by internet and world wide web are voice data mail, real time video communication like video conferencing helps the global business companies to carry out its activities efficiently.

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**(c) On-line Globalization:** The companies operating globally can transfer and send various information relating to the changes in raw materials, customer preferences, changes in product design etc., to all the parts of the globe through internet.

Internet also enables the companies to receive and answer the customer complaints and their queries. Thus, internet helps us carrying out the globalization process at a faster rate and at a low cost.

**(d) Transportation Technology:** The significant improvements and develop-ments which were made in transportation technology are introduction of commercial jet aircraft, super fighters containers etc., these developments has reduced the distance between the various countries.

These development also helps in making the transportation from one mode to the other mode easily and decreased the travel time between the various countries.

**7. Growth of Multinational Companies (MNC)**

Multinational company/corporation is an organiza-tion which carry out its business in more than one coun-try. It produces markets, invests and operates all over the world.

Because of the international market expansion, market superiority and financial superiority MNC's are developing and spreading its activities all over the world.

In 2007 EU had 163 out 500 top MNC's of the world, USA had (162), Japan had (67) whereas developing countries has around 53 MNC's among the top 500 MNC's.

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# Short Question and Answers

**1. Privatization.**

*Ans :*

**Introduction**

Privatization 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".

Privatization is the process of involving the private sector in the ownership (or) operation of a state-owned (or) 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.

**Definitions**

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

ii) **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".

**2. Define disinvestment.**

*Ans :*

The performance of the public sector was far from satisfactory. Diseconomies of scale crept into the public sector. The nine high-performing public sector enterprises (navratnas) account for nearly 75% of profits of all public sector enterprises. Most of the others are running in losses. The profitability and ROI of profit-making units too is very low compared to industry standards. Of the various factors responsible for low profits in the public sector undertakings, the following are particularly important:

1. Price policy of public sector undertaking
2. Underutilisation of capacity
3. Problems related to planning and construction of projects.
4. Problems of labour, personnel and management.
5. Lack of autonomy.

In order to alleviate these problems, the government decided to disinvest its sake in PSUs.

Disinvestments connote reducing government stake in the public sector. Disinvestment involves the conversion of money claims or securities into money or cash. They may or may not lead to privatisation, i.e., transfer of control in private hands. As in the case of Maruti Suzuki and BALCO, disinvestments led to the transfer of control into private hands, but in the case of public sector banks and most of the oil companies, disinvestments resulted in the issue of shares through the IPO route to general public and financial institutions, and therefore, majority stake and control remained with the government.

**3. Define Globalization.**

*Ans :*

Globalization 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 "globalization" 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 "globalization," with some policymakers, scholars, and activists seeing it as a

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force for advancing the world economy while others, again all three, seeing it as a serious danger to the world economic system.

Globalization 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.

**Definition**

**According to International Monetary Fund (IMF),** "Globalization 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,** "Globalization is the shift towards a more integrated and interdependent world economy. Globalization has two main components - the globalization of markets and the globalization 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.

**4. Nature of Privatization.**

*Ans :*

The various mature of privatisation is as follows:

**i) 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.

**ii) 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.

**iii) 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.

**iv) Increased Opportunities**

The worldwide privatisation wave creates opportunities for international diversification.

**5. Advantages of Privatization**

*Ans :*

**i) 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.

**ii) 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.

**iii) 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.

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**iv) 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.

**v) 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.

**6. Objectives of Disinvestment**

*Ans :*

The following are the main objectives of the disinvestment policy:

i) To reduce the financial burden on government

ii) To improve public finances

iii) To introduce competition and market discipline

iv) To improve growth

v) To encourage wider share of ownership

vi) To de-politicise essential services.

**7. Methods of disinvestment in India.**

*Ans :*

There are three methods adopted by the government for the valuation of shares for disinvestment. They are:

**1. Net Asset Method**

This will indicate the net asset of the enterprise as shown in the books of accounts. It shows the historical value of the assets. It does not reflect position of profitability.

**2. Profit Earning Capacity Value Method**

The profit earning capacity is generally based on the profits actually earned or anticipated.

**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.

**8. What are Tariff Barriers.**

*Ans :*

Tariff is derived from a French word which means rate, price or list of changes. It is a customers duty or a tax on products that move across borders. Tariffs can be classified in several ways.

**i) Import and Export Tariffs**

Tariffs are often imposed on the basis of the direction of product movements 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 about 20 percent on a number of goods sold in cash transactions and an average export tariff of about 30 percent for goods sold to non-cash (barter) transactions.

**ii) 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

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taxes. Even the cost of shipping is taxed, since Japan considers that the shipping cost adds value to a car.

As a result, a US car sold in Japan easily cost twice as much as its price in the United States. The US tax is a revenue tariff whereas the Japanese tax is more of a protective tariff.

**iii) Tariff Surcharge Versus Countervailing Duty**

Protective tariffs can be further classified according to length of time. A tariff surcharge is a temporary action, whereas a countervailing duty is 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 an export subsidy by rebating certain taxes if goods are exported.

**9. Theory of Mercantilism.**

*Ans :*

The theory of Mercantilism acts as the basis for the economic thought and is the oldest theory of international traderIt states that the exports of the country should be more than their imports and the value of trade profits should be recei ved in the form of gold from the countries having trade deficits. The government for avoiding trade deficits, imposes restrictions on imports and promotes the exports.

British utilised colonial powers for carrying out trade with the colonies like India, Srilanka etc., by importing the raw materials from and exporting the finished products to colonies. The colonies must export less valuable products and must import more valuable goods. The colonical powers were benefitted from this theory but it caused a dissatisfaction in the colonies.

**The following are the limitations of the theory of merchantilism,**

(i) This theory recommends that a favourable balance of trade can be maintained if the gold is imported for the export of goods and services. But the validity of this theory was decreased due to decline of gold standard.

(ii) This theory was criticized on the basis that a nation's wealth depends on the existing goods and services instead of gold.

**10. New trade cycle theory.**

*Ans :*

During 1970s and 1980s, foreign trade was described through a new trade theory which states that,

(a) Profits should be generated from specializa-tion and economies of scale.

(b) The first entrant who is entering into the market can generate entry barriers to others.

(c) The government has the responsibility to support its home based firms. As this theory focuses on productivity instead of resources of the country, it is similar to the comparative advantage theory but it is in conflict with the factor endowments model.

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# Choose the Correct Answer

1. The approach which is based on the belief that one's own culture is considered as superior to others is, [ a ]

   (a) Ethnocentrism (b) Geocentrism

   (c) Regiocentric (d) Polycentricism

2. A firm which manufactures products globally and concentrates on domestic marketing of these products is, [ c ]

   (a) Transnational company (b) Multinational company

   (c) Global company (d) Domestic company

3. According to Porter's diamond theory, a firm can attain competitive advantage over its rivals from the following factors, [ d ]

   (a) Demand conditions (b) Factor conditions

   (c) Related and supporting industries (d) All the above

4. The positive effects of MNE's are, [ c ]

   (a) Providing FDI (b) Promote competition

   (c) Both (a) and (b) (d) Cultural imperialism

5. _____ system deals with the laws and rules which regulates the organisation and individual behaviour, [ a ]

   (a) Legal (b) Cultural

   (c) Economic (d) Political

6. The process of shifting the ownership of private property from private individuals to government, [ b ]

   (a) Confiscation (b) Nationalisation

   (c) Expropriation (d) Domestication

7. _____ helps Indian entrepreneur to know about the competitor, recent trends, quality of products [ c ]

   (a) Privatasation (b) Liberalisation

   (c) Globalisation (d) All

8. Globalization can create problem for business because? [ a ]

   (a) It can result in more competition

   (b) It increases vulnerability to political risk and uncertainty when operating abroad

   (c) It means that they can increase price

   (d) All the options are correct.

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9. Globalization is beneficial for firms because? [ c ]
   (a) It protects them against foreign competition
   (b) It cushions them from the effects of events in other countries.
   (c) It opens up new market opportunities
   (d) It increases the risk and uncertainty of operating in globalizing world economy.

10. Globalization refers to? [ a ]
   (a) A more integrated and interdependent world
   (b) Lower income world wide
   (c) Less foreign trade and investment
   (d) Global warming

11. The transfer of asset from public sector to the Private sector is referred to as? [ d ]
   (a) Individualization (b) De regulation
   (c) Nationalization (d) Privatization

12. Globalization has led to higher standards of living of? [ a ]
   (a) Well-off consumers (b) Poor consumers
   (c) Big producers (d) Small producers

13. The past two decades of globalization has seen rapid movements in? [ b ]
   (a) Goods, services and people between countries
   (b) Goods, services and investments between countries
   (c) Goods, investments and people between countries
   (d) None of these

14. Government can make globalization more 'fair' by: [ c ]
   (a) Increasing competition (b) Increasing employment
   (c) Implementing the labour laws (d) Imposing trade barriers

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# Fill in the blanks

1. FIPB stands for _____ board.
2. Liberalisation simplified the policos to attract _____ and _____ to India capital.
3. NGO's stands for _____.
4. _____ helps Indian entrepreneur to known about the competitors recent tends and quality of products.
5. _____ of the company is a very important determinant of success in global business.
6. _____ refers to the commercial transactions which are performed beyond the national boundaries more specifically across the countries all over the world.
7. _____ produces, market, invest and operates worldwide as an integrated global enterprise which initially connects global resources with global market profitably.
8. The movement of capital across the national boundaries which provides control to the investor over the acquired assets is related to _____.
9. _____ states that the holdings of a nation's treasure, basically in the form of gold signifies the wealth of the country.
10. _____ theory emphasizes more on the decisions of the firm to obtain and establish the competitive advantage.

**ANSWERS**

1. Foreign investment promotion
2. Foreign
3. Non-governmental organisations
4. Globalization
5. Competitive advantage
6. International business
7. Transnatinal company
8. Foreign Direct Investment
9. Theory of Mercantilism
10. Global Strategic Rivalry

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UNIT IV

**FOREIGN CAPITAL:**

Foreign Direct Investment: types-trends-costs and benefits to home and host countries-policy of Government - Foreign Portfolio Investment – FEMA - Objectives – Provisions – International Economic Institutions - IMF - World Bank - UNCTAD.

## 4.1 Foreign Direct Investment

### 4.1.1 Types

**Q1. Define Foreign Direct Investment. Explain different types of FDI.**

*Ans :* **(May-19, May-14)**

**Introduction**

An investment made by a company or entity based in one country, into a company or entity based in another country. The foreign direct investment means cross border investment made by a resident in one economy in an enterprise in another economy, with the objective of establishing a lasting interest in the investee economy.

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.

**Definitions**

**(i) According to the International Monetary Fund's Balance of Payments Manual,** "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".

**(ii) According to the United Nation's World Investment Report (UNCTAD, 1999),** "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)".

There are two main reasons for firms to go multinational to serve a foreign market and to get lower cost inputs.

**Types of FDI**

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. It 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.'

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### 4.1.2 Trends of FDI

**Q2. Explain the Trends of FDI.**

*Ans :* **(May-16, May-12, Imp.)**

**1. 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.

**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 world. 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.

**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.

**(a) 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.

**(b) 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

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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.

**(c) 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.

**Q3. Explain the various factors that influence the foreign direct investment.**

*Ans :* **(May-15)**

**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.

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**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 Costs of FDI

**Q4. Explain the various costs of FDI to home and host countries.**

*Ans :*

Foreign direct investment may be very advantageous to the host country that is the country which receives the investment flows in terms of helping the country progress economically and financially. However, foreign direct investment can remain beneficial only when the governments of the host countries put in needed regulations so as to prevent the country from being exploited and used as a profit generating machine for such corporate giants. The past has given many examples of how foreign direct investment can also at times be detrimental to the economy of a country.

The negative impact of FDI to host country is as follows:

**1. 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 judgments and policies in their favour.

**2. 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.

**3. 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. Also, these companies are global players who have their operations spread across countries and have effective supply chains which enable them to have economies of scale which smaller players in the domestic market of the host country cannot compete with. All this results in the MNC having cheaper products and more visibility due to the higher amounts of advertising and have been known to push out smaller industries out of business.

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**4. 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.

**5. 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.

**6. 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.

**7. 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.

**8. 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.

**Cost to Home Countries**

Foreign direct investment may be very advantageous to the home country, that is the country which provides the investment flows with respect to the profits, dividends and gains being repatriated to it, however, having operations in another country gives rise to additional risks which at times may prove very costly for the home country. The negative ways in which foreign direct investment impact the home country is as follows:

**1. 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.

**2. 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.

**3. 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.

**Examples:** A Canadian textile company moving clothing operation to Latin America results in textile workers in Canada losing their jobs, Gildan T-shirts in Honduras, Nicaragua, Haiti and the Dominican Republic.

**4. 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.

**5. 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. In such cases, the profits or gains made in the foreign country remain there and cannot be deployed elsewhere in the event that there are more profitable opportunities available.

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**6. Possibility of Loosing Competitive Advantage**

This problem is especially true for technologically advanced developed countries. Development of new technology is a costly affair along with it requiring a significant investment of time and effort.

Many times, these technologically advanced developed countries have to license these technologies to the developing countries as a part of their FDI strategy; this give these countries access to vital information on these technologies which can be imitated by the host country.'

### 4.1.4 Benefits to Home and Host Countries

**Q5. State the benefits of FDI to Home and Host Countries.**

*Ans :*

**Benefits to Host Countries**

The positive impact of FDI to the host country is now discussed below:

**1. Brings in Important Factors of Production**

FDI brings to the host country important factors of production such as capital, foreign exchange, skilled labour, managerial competence and willingness to bear risk. These factors supplement the domestic resources and are helpful in promoting the economic development of the host country.

**2. 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. This operates through following two channels:

i) The spillovers and other externalities absorbed by the host country's business sector, and

ii) The direct impact on structural factors in the host country.

**3. 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.

**4. 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. As these persons move-on to other firms, the enhancement of human capital in the host country gains momentum.

**5. 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.

**6. Promotion of Competitive Environment**

The entry of foreign competitors in the host country acts as a spur to competition in the host country economy. Local firms attempt to raise their productivity and enhance the quality of their products to face competition from foreign MNCs. FDI thus has a positive impact on competition by creating a better competitive environment in the host country. Such competition leads to increased efficiency and productivity, lower prices and more efficient resource allocation.

**7. 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

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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.

**8. 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.

**9. Improvement in the Balance of Payments**

FDI helps 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.

**10. 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.

**Benefits to Home Country**

FDI or Foreign Direct Investment is defined like a firm that invests in establishing and building new branches in several other nations. This kind of international investment benefits both the organisation and also the countries where the investment is made. **For example,** investing in an underdeveloped country offers income to local people while protecting the organisation from recessions. More impact of FDI to home country is listed below:

**1. 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 lifestyle 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.

**2. 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.

**3. 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.

**4. 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.

**5. 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 UK. They helped Japan for positive balance of payments.

**6. 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.

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**7. 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.

**8. Improved Political Relations**

FDI is a complement to foreign aid; it helps develop closer political ties between the home country and the host country which is beneficial for both the countries.

**Q6. Explain the various theories of FDI.**

*Ans :*

The various theories that have been introduced in favorite of FDI includes the following,

**(i) MacDougall-Kemp Hypothesis**

Mac Dougall had proposed an earlier theory of FDI which was further developed by Kemp in 1964. According to the two country model, one country represents an investing country while the other acts as a host country. This hypothesis states that the marginal productivity between the two countries become equal if there is a free flow of capital between the two. This results in improving the effective utilization of resources which in turn brings improvement in the welfare of the countries. Eventhough, the output of the parent firm decreases due to FDI, the national income of the investing country remains constant because the returns earned from the invested capital becomes equal to the marginal productivity of the capital. Both the countries can see a rise in national income after their investment in foreign market till the income from the investments exceed the loss incurred in output.

**(ii) Industrial Organization Theory**

Generally, FDI theories are based on the assumptions of imperfect/oligopolistic markets. In these markets, there is a lot of possibility for the market imperfections such as, product development, marketing skills, managerial skills, better access to capital, technological advantage and so on, which may help the investing country to gain competitive advantage over the rivals in the host country. Such advantages enable the MNC to compensate with the costs incurred in operating the business in an unfavourable markets.

Hymer developed an earlier theory based on which he viewed that an MNC consists of all characteristics of an oligopolistic firm and have superior qualities to maintain a dominant position in the market and to gain control over the market, so as to maximize the profits. In fact, the foreign market poses certain challenges on MNCs while accessing the market which could be due to various cultural and legal aspects, comparatively less knowledge about language and consumer's wants and needs etc. Though there are number of disadvantages for an MNC operating in foreign markets, it also consists of several untapped opportunities whose exploitation helps the firm in gaining large portion of market share.

Caves (1971) proposed that for successful transmission of specific advantages from one unit to other, the MNC is required to invest in the process of production abroad rather than practising FDI through exporting/ licensing.

**(iii) Location-specific Theory**

This theory was proposed by Hood and Young based on the importance of locational factors in the foreign investments. The assumptions of this theory include,

(a) It is advisable for the firm which possess low cost technology to invest in those countries where the labours are cheaply available.

(b) In order to avoid trade barriers regarding the imports, the firms investing in foreign countries have to indulge themselves into the process of production of host countries instead of importing raw materials from parent country. Because the abundant availability of raw materials could also be considered as the driving factor behind the FDI of an MNCs.

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**(iv) Product Cycle Theory**

The product life cycle theory was developed by Raymond Vernon of Harvard Business School. It is the second firm-based theory of international trade. This theory involves four stages which are as follows,

Stage 1: New product introduction

Stage2: Growth

Stage3: Maturity

Stage4: Decline.

**(v) Internalization Approach**

Buckley and Carson have proposed the internalization approach. This approach is also based on the assumptions of market imperfections but according to them the imperfect situations arise as a result of variable transaction costs which would be incurred during the transfer of intermediate products (knowledge, expertise etc.) within the firm.

For international firms, the transaction cost is zero as it incurs no cost while transferring the knowledge and technology from one unit to other. Whereas, in case of interfirm transmission of technology, it is found to have been associated with high costs which affects the profits of the firm. This internalization helps the MNCs to avoid transaction costs which in turn helps in the creation of profits.

**(vi) The Eclectic Paradigm**

The eclectic paradigm was given by Dunning. It is a combination of imperfect market-based theories of FDI and location specific theory. The assumptions of this approach include,

(a) The investment of any MNC in a foreign country mainly depends on the OLI configuration of the country,

O = Represents ownership advantages

L = Location specific advantages and

I = Internalization advantages.

(b) There exist variations within the composition of these advantages in different countries. If the OLI advantages are more then the investor can invest substantially large amounts in that country.

(c) Dunnings added another variable to these three variables i.e., OLI. It is a variable responsible for implementing the strategic change which is either autonomous or strategy induced.

Generally, the outcome of international production depends mostly on the strategic response of the firm and the changes in OLI configuration according to the environmental changes. This eclectic approach has a wide scope and has been tested empirically for generating satisfactory results.

**(vii) Currency-based Approaches**

The two factors that forms the basis for the evolution of currency based theories include the imperfect foreign exchange and capital mark.

Aliber proposed that the process of internationalization could be justified by determining the strength of different currencies. The firms whose currency is relatively strong can mobilize their funds in a weak currency country to gain high rate of returns. This theory has been empirically tested. However, it was not successful in explaining the existence of FDT in the same currency countries.

Froot and Stein also proposed another currency based theory which states that even the minute decline in the real value Of country's currency may leads to a decrease in the domestic wealth thereby influencing the wealth of the foreigners. This helps the MNCs to gain the assets of the domestic firms at a very low rate.

Caves also proposed another currency based theory which states that there are two reasons or means through which the exchange rates of a country affects the FDI. They are,

(a) The exchange rate variations help in affecting the cost and revenue of the firm. If there is an expansion in imports

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then there will be equal depreciation of domestic currency which in turn reduces the national income of a country. If there is an expansion in exports there will be an equivalent increase in the national income.

(b) The variations in exchange rate influences the FDI through the generation of capital gains.

This theory does not hold good as its empirical results have revealed that there exists negative correlation between the level of exchange rate and the level of FDI in USA.

**(viii) Politico-economic Theories**

Politico-economic theories emphasis more on political risk and changes in political conditions of a country. The stability in the political conditions of a host country encourage the foreign investments. At the same time the instability in the political conditions of a home country will lead to high investment in foreign countries.

According to Schneider and Frey, the foreign investments are not only influenced by the political conditions but are also found to have been influenced by the economic conditions. However, the impact of economic conditions are more intense than that of political conditions.

**(ix) Modified Theories for Third World Firms**

All the above theories are applicable to the firms which have their subsidiaries in developing countries. These theories still require modifications to better suit the needs and requirements of the modem trends. The international firms always used to import technology from developed countries in order to meet the changing needs of the domestic markets. The difference between product cycle theory and modified theories is that modified theories do not focus on the innovation of the products but they focus on modifying the products according to the customer preferences.

The modification is scaling-up in case of developed countries and scaling-down in case of developing countries.

### 4.1.5 Policy of Government

**Q7. Explain the policy on FDI in India.**

*Ans :* **(May. 19, Imp.)**

India has among the most liberal and transparent policies on FDI among the emerging economies. FDI upto '400% 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).

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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-IL. 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, pisiculture, 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, isocynates and diisocynates 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

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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.

**Q8. Discuss the problems and consequences of foreign direct investment with reference with India.**

*Ans :* **(Imp.)**

**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

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relations with foreign investors will always bring in new challenges in investments.

**Consequences of FDI**

**1. 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.

**2. 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.

**3. 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.

**4. 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.

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## 4.2 Foreign Portfolio Investment (FPI)

**Q9. What is Foreign Portfolio Investment (FPI)**

*Ans :* **(Dec.-20)**

Foreign portfolio investment (FPI) consists of securities and other financial assets held by investors in another country. It does not provide the investor with direct ownership of a company's assets and is relatively liquid depending on the volatility of the market. Along with foreign direct investment (FDI), FPI is one of the common ways to invest in an overseas economy. FDI and FPI are both important sources of funding for most economies.

- Foreign portfolio investment (FPI) involves holding financial assets from a country outside of the investor's own.
- FPI holdings can include stocks, ADRs, GDRs, bonds, mutual funds, and exchange traded funds.
- Along with foreign direct investment (FDI), FPI is one of the common ways for investors to participate in an overseas economy, especially retail investors.
- Unlike FDI, FPI consists of passive ownership; investors have no control over ventures or direct ownership of property or a stake in a company.

**Q10. Who is a Foreign Institutional Investor?**

*Ans :*

FII is an institution like a mutual fund, insurance company, pension fund etc. According to SEBI, "an FII is an institution established or incorporated outside India which proposes to make investments in India in securities". FII is an institution who is registered under the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995. FIIs comprised of a pension fund, a mutual fund, investment trust, insurance company or a reinsurance company.

**Q11. State the Characteristics of Foreign Portfolio Investment (FPI)**

*Ans :* **(Dec.-20)**

1. The primary intention is not to control a foreign business enterprise but to gain from profit making opportunities available in foreign markets.
2. FPI is represented by monetary flows from individuals, mutual funds, portfolio management companies, pension funds, equity funds etc.
3. Due to the short term nature of such investments the fund flows are less predictable.

   This may result in volatility in both the foreign exchange and capital markets.
4. There is no interface between the management and the foreign investor. The transactions represent a change in ownership of existing equity from one investor to another. It has no impact on the balance sheet of the company.
5. Conventionally, all such investments represent secondary market transactions. However, regulators may permit investments through the primary market with quantitative restrictions.
6. FPI transactions result in replacement of an existing investor. Thus they do not directly contribute to economic growth. However, the greater demand for shares of the target company increases their market price leading to a higher PE Ratio. This helps the target company to raise capital at lower cost.

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**Q12. What are the difference between FDI and FPI.**

*Ans :*

| S.No. | Foreign Direct Investment (FDI) | S.No | Foreign Portfolio Investment (FPI) |
|---|---|---|---|
| 1. | Foreign Direct Investment is the investment made by a foreign investor in the enterprise of another country to obtain a substantial interest in that enterprise. | 1. | Foreign Portfolio Investment is when an international investor invests in the passive holdings of an enterprise of another country. |
| 2. | FDI investors play an active role in the management of the investee company | 2. | FPI investors play a passive role, in the foreign company. |
| 3. | Since the FDI investors gain both ownership and management right through investment, the level of control is relatively high. | 3. | In FPI the level of control is less as the investors obtain only ownership right. |
| 4. | Investments are difficult to liquidate. FDIs are less accessible as a large investment capital is required. | 4. | They are easy to liquidate and thus can be sold. FPIs are more accessible for an average investor as the investment capital required is not very large. |
| 5. | Entry and exit in FDIs is relatively difficult. | 5. | Entry and exits in this case are easy |
| 6. | In FDI, investment is made in physical assets and financial assets. | 6. | The investment in FPIs is made in financial assets only. |
| 7. | FDI investments are long term. | 7. | FPI investments can be short term. |
| 8. | Projects are efficiently managed. | 8. | Projects are less efficiently managed. |
| 9. | FDIs are almost always undertaken by multi national companies. | 9. | FPIs come from more diverse sources, for example - a small company's pension fund or through mutual funds held by individuals; investment via equity instruments or debt of a foreign enterprise. |

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## 4.3 FEMA

**Q13. What is FEMA. Explain the scope of FEMA.**

*Ans :* **(May-17, May-16, Imp.)**

The Foreign Exchange Regulation Act of 1973 (FEMA) 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 Coporate world found themselves as 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.

**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.

### 4.3.1 Objectives

**Q14. Explain the objectives and features of FEMA.**

*Ans :* **(May-18)**

**Objectives**

The objective of FEMA are :

1. To facilitate external trade and payments.
2. To promote the ordely development and maintenance of foreign exchange market.

**Features**

(a) Any person may sell or draw foreign exchange, without prior permission and can later on inform RBI. This makes it a more positive feature.

(b) Under this act Enforcement Directorate (F, D) will be more investigating in nature.

(c) FEMA recognized the possibility of even the Capital Account convertibility i.e. It classifies foreign exchange transaction and current account transactions.

(d) The violation of FEMA is a civil offence.

### 4.3.2 Provisions

**Q15. Explain the Provisions of FEMA.**

*Ans :*

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.

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- **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.

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**Q16. Distinguish between FERA and FEMA.**

*Ans :* **(May-18, Imp.)**

| 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 |

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**Q17. What is capital account transaction ? Discuss the role of FEMA in regulating capital and current account transactions.**

*Ans :*

**(A) Capital Account Transaction**

Section 2(e) states that 'Capital Account Transaction' means:

- A transaction that alters the assets or liabilities, including contingent liabilities outside India of a person residing in India.
- A transaction that alters the assets or liabilities in India of persons residing outside India.
- Transfer or issue of any foreign security by a person residing in India.
- Transfer or issue of any security by a person residing outside India.
- Transfer or issue of any security or foreign security by any branch, office or agency in India or a person residing outside India.
- Any borrowing or lending in foreign exchanges in whatever form or by whatever name known.
- Any borrowing or lending in rupees in whatever form or by whatever name known between a person residing in India and a person residing outside India.
- Deposits between persons residing in India and person residing outside India.
- Export, import or holding of currency or currency notes.
- Transfer of immovable property outside India, other than lease not exceeding five years, by a person residing in India.
- Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India.
- Giving of guarantee or surety in respect of any debt, obligation or other liability incurred, by a person residing in India and owed to a person residing outside India, by a person residing outside in India.

**Regulation of Capital Account Transaction**

Subject to the provision of sub-section (2), any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction.

The RBI may, in consultation with the Central government, specify:

1. Any class or classes of capital account transaction that are permissible;
2. The limit up to which foreign exchange shall be admissible for such transactions.

Provided that the RBI shall not impose any restrictions on the withdrawal of foreign exchange for payments due on account of amortisation of loans for depreciation of direct investment in the ordinary course of business.

Without prejudice to the generality of the provision of sub-section (2), the Reserve Bank may, by regulations prohibit, restrict or regulate the following:

1. Transfer or issue of any foreign security by a person residing in India.
2. Transfer or issue of any security by a person residing outside India.
3. Transfer or issue of any security or foreign security by any branch, office or agency in India of a person residing outside India.
4. Any borrowing or lending in foreign exchange in whatever form or by whatever name known.
5. Any borrowing or lending in rupees in whatever form or by whatever name known between a person residing in India and a person residing outside India.
6. Deposits between persons residing in India and persons residing outside India.
7. Export, import or holding of currency or currency notes.
8. Transfer of immovable property outside India, other than lease not exceeding five years, by a person residing in India.

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9. Acquisition or transfer of immovable property in India, other than a lease not exceeding five years by a person residing outside India.
10. Giving a guarantee or surety in respect of any debt, obligation or other liability incurred:
    (i) By a person residing in India and owed to a person residing outside India; or
    (ii) By a person residing outside India.

FEMA has eased the regulation over transactions in foreign exchange and security. Transactions in current account have been made restrictions-free:

**No restriction on current account transaction unless specified:** Any person can sell or draw foreign exchange to or from authorised persons if such sale or withdrawal is a current account transaction. Reasonable restrictions on current account transaction can be imposed by the Central government in public interest, in consultation with the RBI.

**(B) Current Account Transaction:**

Section 2(j) states that current account transaction means a transaction other than a capital account transaction. It includes the following:

1. Payment due in connection with foreign trade, other current businesses, services and short-term banking, and credit facilities in the ordinary course of business.
2. Payment due as interest on loans as net income from investment.
3. Remittances for living expenses of parents, spouse'and children residing abroad.
4. Expense in connection with foreign travel, education and medical care of patents, spouse and children.
5. The definition is 'inclusive', i.e., besides aforesaid expenses, any expenditure that is not a 'capital account transaction' will be a-current account transaction. For examples, expenditure incurred on own expenses on foreign travel, education, and medical care are covered as 'current account transaction' not specified above.
6. Any person may sell or withdraw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction.

**(i) Foreign Currency/Security/Property by Resident :** A person resident in India may hold, own transfer or invest in foreign currency, foreign security or any immovable property situated outside India, if such currency, security or property was acquired, held or owned by such person when he was residing outside India or inherited from a person who was residing outside India [section 6(4)].

**(ii) Indian Currency/Security/Property by Non-resident :** A person residing outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was residing in India or inherited from a person who was residing in India. [Section 6(4)].

**(iii) Restrictions on Branches, Offices of Non-residents :** The RBI may prohibit, restrict or regulate establishment of branch, office or other place of business by a person residing outside India; for carrying on any activity relating to such branch, office or other place of business. [Section 6(6)].

**Q18. Discuss how the directorate of enforcement puts FEMA into effect.**

*Ans :*

**(i) Directorate of Enforcement**

The Directorate of Enforcement has been formed to ensure that the provisions of the Act are adhered to. In the Directorate of Enforcement, an Additional Director, a special Director and Assistant Directors of Enforcement are appointed by the Central govt., under section 36.

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These officers can investigate contraventions of FEMA. They have powers similar to those conferred on Income Tax authorities under the Income Tax Act. These powers can be exercised subject to limitations laid down under Income Tax Act. (Section 37)

The following powers are available under the Income Tax Act - powers to requisition books of accounts, power to call for information, power to inspect registers of companies [Sections 131 to 136 of Income Tax Act].

**(ii) Penalties under the Act**

An Adjudicating Authority appointed by the Central Government under FEMA can impose penalties for violating any provision of the Act or contravention of any rule, regulation, direction or order issued under the power conferred by the Act.

**(iii) Departmental Adjudication**

The Central government can authorise certain officers as Adjudicating Authority' under Section 16(1). Their jurisdiction will be prescribed by the Central government [Section 16 (2)]. They can adjudicate cases in respect of violation of FEMA. These officers are quasi-judicial and have to follow the principle of natural justice by giving the opportunity of making representation. The Adjudicating Authority can hold an enquiry only upon receiving a complaint from an authorised officer [Section 16 (3)].

**(iv) Powers of Adjudicating and Appellate Authorities**

The adjudicating authority, Special Director (Appeals) and Appellate Tribunal have the following powers of the civil court:

1. Summoning witnesses and enforcing attendance of any person and examining them on oath.
2. Requiring discovery and production of any document.
3. Receiving evidence on affidavits.
4. Requisition of any public record or document or copy of such record/document from any office (subject to sections 123 and 124 of the Indian Evidence Act).
5. Reviewing its decisions.
6. Dismissing a representation of default or deciding it ex parte.
7. Setting aside any order of any representation for default or any order passed by it ex parte.
8. Any other matter as may be prescribed by the Central government.

## 4.4 INTERNATIONAL ECONOMIC INSTITUTIONS

### 4.4.1 International Monetary Fund (IMF)

**Q19. Describe the organization Structure of the International Monetary Fund (IMF).**

*Ans :* **(Imp.)**

**Introduction**

The International Monetary Fund was established by an international treaty in 1945. It works to foster global growth and economic stability. Fleadquartered in Washington D.C., it is governed by its almost global membership of 187 countries.

The IMF is the central institution of the international monetary system. It provides policy advice and financing to members in economic difficulties and also works with developing nations to help them achieve macroeconomic stability and reduce poverty.

**An Overview**

The IMF was conceived in July 1944 at an international conference held at Bretton Woods, New Hampshire, USA, when delegates from 44 nations agreed on a framework for economic cooperation partly designed to avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s.

During that decade, as economic activity in major industrial countries weakened, countries attempted to defend their economies by increasing

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restrictions on imports; but this further worsened the downward spiral in world trade, output, and employment. To conserve dwindling reserves of gold and foreign exchange, some countries curtailed their citizens' freedom to buy from abroad, some devalued their currencies, and some introduced'complicated restrictions on their citizens' freedom to hold foreign exchange.

As World War II came to a close, the leading allied countries considered various plans to restore order to international monetary relations, and at the Bretton Woods Conference the IMF emerged. The country representatives drew up the charter (or Articles of Agreement) of an international institution to oversee the international monetary system and to promote both the elimination of exchange restrictions relating to trade in goods and services, and the stability of exchange rates.

The IMF came into existence in December 1945, when the first 29 countries signed its Articles of Agreement.

**(i) Organization of IMF**

The IMF is accountable to its member countries, and this accountability is essential to its effectiveness. The day-to-day work of the IMF is carried out by an Executive Board, representing the IMF's 187 members, and an internationally recruited staff under the leadership of a Managing Director and three Deputy Managing Directors—each member of this management team being drawn from a different region of the world.

The powers of the Executive Board to conduct the business of the IMF are delegated to it by the Board of Governors, which is where ultimate oversight rests.

**(ii) Board of Governors**

The Board of Governors are represented by all member countries and it is the highest authority governing the IMF. It usually meets once a year, at the Annual Meetings of the IMF and the World Bank. Each member country appoints a Governor—usually the country's minister of finance or the governor of its central bank—and an Alternate Governor. The Board of Governors decides on major policy issues but has delegated day-to-day decision-making to the Executive Board.

**(iii) The Executive Board**

It consists of 24 Executive Directors, with the Managing Director as Chairman. The Executive Board usually meets three times a week, in full-day sessions, and more often if needed, at the organization's headquarters in Washington D.C. The IMF's five largest shareholders—the United States, Japan, Germany, France, and the United Kingdom—along with China, Russia, and Saudi Arabia, have their own seats on the Board. The other 16 Executive Directors are elected for two-year terms by groups of countries, known as constituencies.

Key policy issues relating to the international monetary system are considered twice—yearly in a committee of Governors called the International Monetary and Financial Committee, (IMFC) (until September 1999, known as the Interim Committee) and a joint committee of the Boards of Governors of the IMF and World Bank called the Development Committee. It advises and reports to the Governors on development policy and other matters of concern to developing countries.

**(iv) Managing Director**

The Executive Board selects the Managing Director, who besides serving as the chairman of the Board, is the chief of the IMF staff and conducts the business of the IMF under the direction of the Executive Board. Appointed for a renewable five-year term, the Managing Director is assisted by a First Deputy Managing Director and two other Deputy Managing Directors.

IMF employees are international civil servants whose responsibility is to the IMF, not to national authorities. The organization has about 2,800 employees recruited from 141 countries. About two-thirds of its professional staff are economists. The IMF's 26 departments and offices are headed by directors, who report to the Managing Director. Most staff work in Washington,

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although about 90 resident representatives are posted in member countries to help advise on economic policy. The IMF maintains offices in Paris and Tokyo for liaison with other international and regional institutions, and with organizations of civil society. It also has offices in New York and Geneva, mainly for liaison with other institutions in the UN system.

**Q20. Explain the purpose of International Monetary Fund (IMF).**

*Ans :*

The purposes of the International Monetary Fund are:

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
2. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions, which hamper the growth of world trade.
5. To provide confidence to members by making general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with an opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

**Q21. Describe the role of special drawing right (SDR) in functioning of the International Monetary Fund (IMF).**

*Ans :*

The SDR, (or) Special Drawing Right, is-an international reserve asset introduced by the IMF in 1969 (under the First Amendment to its Articles of Agreement). The SDR was introduced as a supplementary reserve asset, which the IMF could 'allocate' periodically to members when the need arose, and cancel, as necessary.

SDRs–sometimes known as 'paper gold' although they have no physical form—have been allocated to member countries (as bookkeeping entries) as a percentage of their quotas. The SDR is also the IMF's unit of account.

The SDR's value is set daily using a basket of four major currencies: the Euro, Japanese Yen, Pound sterling, and Dollar. The composition of the basket is reviewed every five years to ensure that it is representative of the currencies used in international transactions, and that the weights assigned to the currencies reflect their relative importance in the world's trading and financial systems.

**Q22. Discuss the role of quotas in the International Monetary Fund (IMF).**

*Ans :*

A member quota is broadly determined by its economic position relative to other members. When a country joins the IMF, it is assigned an initial quota in the same range as the quotas of existing members considered by the IMF to be broadly comparable in economic size and characteristics. Quotas are denominated in Special Drawing Rights (SDRs).

**Functions of Quotas**

A members quota delineates some basic aspects of its financial and organizational relationship with the IMF, including:

**1. Subscriptions**

A member's quota subscription determines the maximum amount of financial resources the member is obliged to provide to the IMF.

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A member must pay its subscription in full upon joining the Fund: up to 25 % must be paid in SDRs or widely accepted currencies (such as the US dollar, the euro, the yen, or the pound sterling), while the rest is paid in the member's own currency.

**2. Voting power**

The quota largely determines a members voting power in IMF decisions. Each IMF member has 250 basic votes plus one additional vote for each SDR 100,000 of quota. Accordingly, the United States has 371,743 votes (17.1 percent % of the total), and Palau has 281 votes (0.013 % of the total).

**3. Access to financing**

The amount of financing a member can be obtained from the IMF. Its access limit is based on its quota.

**Q23. State the criticism of IMF.**

*Ans :*

It is said that IMF policy makers support capitalist dictatorship, and is friendly to American and European corporations. Critics claim that financial aid from the IMF is always come bound with conditionalities, throwing the IMF's stated goals to the winds.

The IMF frequently advocates currency devaluations, criticised by proponents of supply-side economics as inflationary. Secondly, they link higher taxes under 'austerity programmes' with economic contraction.

It is believed that IMF interventions aggravate poverty and the debts of developing nations. Argentina, which had been considered by the IMF to be a model country in its compliance to policy proposals by the Bretton Woods institutions, experienced a catastrophic economic crisis in 2001, generally believed to have been caused by IMF induced budget restrictions which undercut the government's ability to sustain national infrastructure even in crucial areas such as health, education, and security and privatisations of strategically vital national resources. The crisis added to widespread hatred of this institution in Argentina and other South American countries, with many blaming the IMF for the region's economic problem.

It is alleged that the IMF intervenes only in countries which face severe financial straits. These financial crisis are the result of years of mismanagement. When the IMF intervenes to improve grim financial conditions, its suggestions for the State are implemented by those officials who are responsible for the mismanagement body. As a result, sometimes the IMF's remedy doesn't work. Not only this, politicians also use the IMF as an easy target to hide their faults.

The Fund has totally failed to solve the problems of the underdeveloped, chronically debtor countries. In these countries, the remedy is to stimulate economic growth by long-term international lending. But the Fund primarily aims at short-term accommodation only.

### 4.4.2 World Bank

**Q24. Explain the composition of World Bank.**

*Ans :* **(Dec.-20)**

The World Bank is one of the world's largest sources of finance and knowledge to its member countries to improve the condition of health centres, provide water and electricity, fight disease, and protect the environment. The World Bank is not a "bank" in the common sense. The World Bank is an international organization owned by 187 countries both developed and developing that are its members. Since inception in 1944, the World Bank has expanded from a single institution to a closely associated group of five development institutions.

In June 1944, 17 countries met in Atlantic City, USA to prepare the agenda for the Bretton Woods conference, and 44 countries which signed the final agreement established the Bank. India was one of the 17 countries and one of the 44 countries which signed the agreement. It was India which suggested the name "International Bank for Reconstruction and Development" (IBRD) to the drafting committee. The Indian delegation was led by Sir Jeremy Raisman, Finance Member of the Government of India and included Sir C. D. Deshmukh (Governor of the Reserve Bank of India, later to become India's Finance Minister), Sir

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Theodore Gregory (the first Economic Advisor to the Government of India), Sir R.K. Shanmugan Chetty (later independent India's first Finance Minister), Mr. A.D. Shroff (one of the architects of the Bombay Plan) and Mr B.K. Madan (later India's Executive Director in IMF).

IBRD is made up of two unique development institutions owned by 187 member countries the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). Each institution plays a different but supportive role in the mission of global poverty reduction and the improvement of living standards. Besides, it also has three affiliates named:

- The International Finance Corporation (IFC),
- The International Centre for Settlement of Investment Disputes (ICSID),
- The Multilateral Investment Guarantee Agency (MIGA).

All five of these institutions together make up the World Bank Group.

**Total member countries in each institution:**

1. The International Bank for Reconstruction and Development (IBRD) - 187.
2. The International Development Association (IDA) - 169.
3. The International Finance Corporation (IFC) - 182.
4. The Multilateral Investment Guarantee Agency (MIGA) - 175.
5. The International Centre for Settlement of Investment Disputes (ICSID) - 157.

**Q25. Explain the purpose of World Bank.**

*Ans :* **(Dec.-20)**

The purposes of the Bank as described in its articles are:

1. To assist economies in the reconstruction and development by facilitating the investment of capital for productive purposes. It also helps in reconstruction of economies destroyed or disrupted by war, and it encourages the development of productive facilities and resources in less developed countries.
2. To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.
3. To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labour in their territories.
4. To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with the first.
5. To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate post-war years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

### 4.4.2.1 International Bank for Reconstruction and Development (IBRD)

**Q26. Explain the composition of IBRD.**

*Ans :*

The World Bank's two closely affiliated entities—the (IBRD) and the International Development Association (IDA)—provide low or no interest loans and grants to Countries that have unfavourable or no access to international credit markets.

- **Fund Generation**

IBRD raises most of its funds by selling AAA-rated bonds in the world's financial markets. While IBRD earns a small margin on this lending, the greater proportion of its income comes from lending out its own capital. This capital consists of reserves

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built up over the years and money paid in from the bank's 187 member country shareholders. IBRD's income also pays for World Bank operating expenses and has contributed to IDA and debt relief.

IDA, the world's largest source of interest-free loans and grant assistance to the poorest countries, is replenished every three years by 40 donor countries. Additional funds are regenerated through repayments of loan principal on 35 to 40 year, no-interest loans, which are then available for re-lending. IDA accounts for nearly 40% of our lending.

➢ **Loans**

IBRD offers two basic types of loans and credits.

**Investment loans** are given to countries for goods, works and services in support of economic and social development projects in a broad range of economic and social sectors.

**Development policy loans** (formerly known as adjustment loans) provide quick-disbursing financing to support countries' policy and institutional reforms.

The Bank may guarantee, participate in, or make loans to any member or any political sub-division thereof and any business, industrial, and agricultural enterprise in the territories of a member.

Each borrower's project proposal is assessed to ensure that the project is economically, financially, socially and environmentally sound. During loan negotiations, the bank and borrower agree on the development objectives, outputs, performance indicators and implementation plan, as well as a loan disbursement schedule. The Bank ensures that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without any regard to political or other non-economic influences or considerations.

➢ **Grants**

Grants are given for development projects by encouraging innovation, co-operation between organizations and local stakeholders' participation in projects. In recent years, grants have been used for numerous purposes. Some of them are: .

1. To relieve the debt burden of heavily indebted poor countries,
2. To improve sanitation and water supplies,
3. To support vaccination and immunisation programs to reduce the incidence of communicable diseases like malaria,
4. To combat the HIV/AIDS pandemic,
5. To support civil society organizations,
6. To create initiatives to cut the emission of greenhouse gasses.

➢ **Analytic and Advisory Services**

IBRD also provides analysis, advice and information to member countries. IBRD does this in several ways—through economic research on broad issues such as the environment, poverty, trade and globalisation and through country-specific economic and sector work, where it evaluates a country's economic prospects by examining its banking systems and financial markets, as well as trade, infrastructure, poverty and social safety net issues.

IBRD has a big knowledge bank which contains wealth of contacts, knowledge, information and experience that it has acquired over the years, country by country and project by project. Through its knowledge bank, it educates clients so that they can solve their development problems and promote economic growth.

Following are some more ways through which it provides, analyses and advice knowledge to members:

- Poverty Assessment
- Social and Structural Reviews
- Public Expenditure Reviews
- Sector Reports
- Conuntry Economic Memoranda
- Knowledge Sharing

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### 4.4.2.2 International Development Association (IDA)

**Q27. Explain the composition of IDA.**

*Ans :*

The IDA is the soft loan section of the World Bank established in I960. Its loans are different from World Bank loans in several manners. It provides concessional loans which have a maturity of up to 40 years compared with 15 to 25 years' maturities of IBRD. The IDA can also grant grace period of 10 years before repayment of principal or interest begin, whereas the grace period of World Bank usually does not exceed 5 years.

Most of the loans granted by IDA are interest-free or attract very less interest. Borrowers from IDA are the poorest of the developing countries. The IDA supports economic growth, reduces poverty and improves living conditions. IDA's grants go to poor countries already vulnerable to debt or confronting the ravages of HIV/AIDS or natural disasters. IDA considers three things before granting concessional loans:

1. Countries whose Gross National Product (income) per person is below an established threshold US $875, as of September 2002.
2. Countries that lack creditworthiness to borrow on market terms, and
3. Countries that have good implementation of economic and social policies that promote growth and poverty reduction.

**IDA Capital Sources**

The IDA cannot raise capital in competitive capital markets and depends on subscriptions donated by the developed countries and some LDCs. Generally, developed countries make contributions in convertible currencies and LDC members donate their own currencies.

IDA resources are renewed periodically by a process called replenishment whereby supporting nations donate money. It is the largest source of money for IDA. The second-largest source are internal resources (repayments from graduated and crrent IDA borrowers, investment income, and other resources including residual resources from past replenishments). An additional source of funds is transfers from IBRD net income. Fourteenth replenishment of IDA (IDA14) resources have been approved on April 2005 which will be effective for three years.

### 4.4.2.3 International Finance corporation (IFC)

**Q28. Explain briefly about IFC.**

*Ans :*

The IFC's main function is to assist the economic advancement of LDCs by promoting growth in the private sector of their economies by helping to mobilise domestic and foreign capital for this purpose. It was established in July, 1956, to help and strengthen the private sector in developing countries, through the provision of long-term loans, equity investments, guarantees, standby financing, risk management and quasi-equity instruments such as subordinated loans, preferred stock and income notes, through advice and technical assistance to business and government.

IFC is the largest multilateral source of loan and equity financing for private sector projects in developing countries. IFC charges market rates for its products and does not accept government guarantees. To be eligible for IFC financing, projects must be profitable for investors, benefit the economy of the host country, and comply with stringent environmental and social guidelines.

IFC finances all types of projects such as manufacturing, service, tourism, hotel, education, health, etc. IFC also finances companies having some government equity participation provided there is private sector participation and the project is run on a commercial basis. The IFC's policy is to favour joint ventures that have some local capital committed at the outset or at least the probability of local capital involvement in the foreseeable future. This is not to say that IFC will not cooperate with capital sources outside the host country (the country in which investment is made).

In return for its investment in a company, the IFC takes securities in the form of stock (equity ownership) or bonds (debt). The IFC also attracts investment by other private investors in the designated project as investment by IFC increases the confidence level of other lenders and

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shareholders. IFC mobilises financing directly for sound companies in developing countries by syndicating loans with international commercial banks and underwriting investment funds and corporate securities issues.

### 4.4.2.4 Multilateral Investment Guarantee Agency (MIGA)

**Q29. Explain briefly about MIGA.**

*Ans :*

The Multilateral Investment Guarantee Agency (MIGA), established in 1988, with an objective to Sneate an attractive investment climate and to encourage equity investment and other direct investment flows to developing countries. MIGA offers investors guarantees against non-commercial risks (political risk), advises developing member governments on the design and implementation of policies, programmes, and procedures related to foreign investment and sponsors a dialogue between the international business community and host governments on investment issues. To promote FDI, MIGA provides three key services:

- **Political Risk Insurance:** To promote foreign investment in developing countries.
- **Technical Assistance:** To promote and create conducive climate for foreign investment and to establish new investment opportunities in developing countries.
- **Dispute Mediation:** It provides dispute mediation services to remove obstacles and to unlock bottlenecks in the way of foreign investment.

### 4.4.2.5 International Centre of Settlement of Investment Disputes (ICSID)

**Q30. Explain the composition of ICSID.**

*Ans :* **(Imp.)**

The International Centre of Settlement of Investment Disputes (ICSID) came into existence in 1966 with an objective to work as a facilitator in settlement of investment disputes between governments and foreign investors. ICSID has an Administrative Council and Secretariat. The President of World Bank is also the Chairperson of Administrative Council. All the members of ICSID are also the members of World Bank. ICSID provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries.

To seek settlement from ICSID is entirely voluntary. But once the ICSID is approached for settlement no party can unilaterally withdraw its consent. All ICSID contracting states, whether or not party to the dispute, are required by the Convention to recognise and enforce ICSID arbitral awards. Governments of member countries and investors from other member countries usually keep the provision of ICSID arbitration in investment contracts between them. Advance consents by governments to submit investment disputes to ICSID arbitration can also be found in about twenty investment laws and in over 900 Bilateral Treaties.

In a globalised world, the role of international organizations like the World Bank is increasing day-by-day. Today, every nation is striving to increase its share in world trade and LDCs are opening their economies with the hope of development and growth. There are LDCs competing with each other to attract FDI. Most of these LDCs are struggling with widespread poverty, illiteracy and health problems in their countries. Their dependence on import and adverse balance of payment make the condition more grim.

On the other hand, there are LDCs who are developing rapidly and are providing stiff competition to developing countries in many fields. All this has increased international economic complexities. If there was no international organization to make international business rules, to monitor and settle disputes, or to finance development, then these economic complexities would lead to political tension. History teaches us that unresolved economic issues or problems create tensions that lead to global wars.

### 4.2.2.6 Asian Development Bank (ADB)

**Q31. Describe the functions and operations of ADB.**

*Ans :*

Asian Development Bank is a multilateral development finance institution dedicated to reducing poverty in Asia and the Pacific region. From

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31 members at its establishment in 1966, ADB has grown to encompass 67 members - of which 48 are from within Asia and the Pacific and 19 outside. ADB's development work is aimed at improving the welfare of the people of Asia and the Pacific, especially of the 1.4 billion poor living on less than a dollar a day.

**ADB has the following objectives:**

1. Economic Growth
2. Human Development
3. Gender and Development
4. Good Governance
5. Environmental Protection
6. Private Sector Development
7. Regional Cooperation

**Each priority is related directly to the three ways of poverty reduction strategy:**

1. Pro-poor, sustainable economic growth
2. Inclusive social development
3. Good governance

**Functions and Operations**

The Asian Development Bank has the following functions:

- extends loans and equity investments to its Developing Member Countries (DMCs) for their economic and social development
- provides technical assistance for the planning and execution of development projects and programmes and for advisory services
- promotes and facilitates investment of public and private capital for development, and responds to requests for assistance in coordinating development policies and plans of its developing member countries.

**Operations of ADBs**

ADB's operations are diverse, covering:

- Agricukure and Natural Resources
- Education
- Energy
- Finance
- Health, Nutrition, and Social Protection
- Industry and Trade
- Law, Economic Management, and Public Policy
- Transport and Communications
- Water supply, Sanitation, and Waste Management.
- Activities Involving Multiple Sectors.

### 4.4.3 United Nations Conference on Trade Development (UNCTAD)

**Q32. Explain the functions of United Nations Conference on Trade Development (UNCTAD).**

*Ans :* **(Imp.)**

UNCTAD stands for United Nations Conference on Trade and Development. It was established in Geneva in 1964 because of the following reasons:

1. To reduce the trade gap between the developed and the developing countries.
2. Discontentment of developing countries with GATT.
3. To promote economic cooperation among the trade members so as to decrease the trade gap between developing countries.
4. It was established to solve the problems of developing countries related to trade and development which helps them to incorporate into the world economy.

UNCTAD lays emphasis on analytical research on trade, investment, technology, entrepreneurship and development strategies for nations and it discusses the problems of developing nations in all these UN conferences.

**Functions of UNCTAD**

Following are the important functions of UNCTAD,

(i) Supporting and boosting developing countries in trade negotiations.

(ii) Trade analysis and deserving.

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(iii) Analysing the impact of trade and development on environment.

(iv) Emphasizing on the shifting of under developed countries to the main stream of WTO.

(v) Evaluating Macroeconomic and developmental policy for the member countries.

(vi) Facilitating developing countries by offering advisory services on technology.

(vii) Analyzing investment policies of developing countries.

(viii) providing training to the developing nations in the various aspects of international trade.

(ix) Helping the under developed countries in formulating the strategies for development which is used to reduce the poverty.

(x) Supporting developing countries in modernizing customs clearance procedures.

(xi) To provide support to the international trade so as to increase the speed of economic development.

(xii) To discuss various trade related consequences in multinational trade agreements.

(xiii) It helps in the formulation of principles and policies on international trade so as to identify associated problems of economic development.

(xiv) To design and plan for the practical applications of its principles and policies.

(xv) To act as hub within the UN specifically meant for dealing with trade and development activities and the associated issues in the fields of finance technology, investment and continuous development.

(xvi) To set up meetings where in the inter-governmental discussions considerations with experts takes place. In such meetings experts interchanges their experiences for the achievement of unity/harmony.

(xvii) To carryout research, policy analysis, and data collection so as to facilitate discussions of experts and government representatives which helps in providing continuous inputs.

(xviii) To establish cooperation among developed and developing countries wherein the developed countries cater to the needs of developing countries.

(xix) To focus more on the less developed countries and also on the countries whose economy undergoes transitions.

**Q33. What are the objectives of United Nations Conference on Trade Development (UNCTAD).**

*Ans :*

(a) To foster international trade among the developed countries.

(b) To recognize the policies and principles to solve the problems of international trade and economic development.

(c) To implement those strategies that are required for the execution of preset principles and policies.

(d) To establish an appropriate framework which facilitates the trading mechanisms.

(e) To help economic and social council of the UNO.

(f) To nourish and promote the development process of Least Developed Counties (LDCs).

(g) Helps in improving the investment mechanism in the least developed countries.

(h) To stabilize the prices of the key products in the markets.

(i) To increase the speed of economic development among the developing countries.

(j) To analyze and combine the activities of international trade and foreign operations of other institutions within the united nations system.

(k) To discuss and follow multi-lateral trade agreement by providing less concern towards the existing international organization like IMF, World bank, GATT etc.

(l) To bring proper alignment of the trade and the associated development policies of various

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member nations with that of the regional economic blocks like SAARC, ASEAN, etc.

(m) To solve the Balance of Payments (BOP) problems of the developing countries which help them to gain remunerative prices of their exports of primary and manufactured goods.

The countries that are the part of UNCTAD meets once in every four years. In its recent conference, it laid emphasis on the role of youth in bringing the development of nations by focusing on certain issues like AIDS, poverty and national debts.

UNCTAD plays a crucial role in educative, signaling, watch-dog functions of the developing countries.

To ensure the efficient functioning of multilateral leading system, UNCTAD and WTO have integrated. How ever, in 2003 both the bodies signed the Memorandum of Understanding [MOU], To facilitate cooperation and consultations on their technical assistance so as to carry out joint studies on specific issues.

UNCTAD and WTO interact on a regular basis in order to foster free trade across nations.

**Q34. Explain the basic principles and activities of United Nations Conference on Trade Development (UNCTAD).**

*Ans :*

The implementation programme and significance of UNCTAD are mentioned in the various recommendations undertaken by the first conference held in the year 1964. These recommendations are made on the basis of basic principles of UNCTAD listed down below.

1. The economic relationship between the countries comprising of trade relations will be on the basis of self- determination of people, admire towards the principles of sovereign equality of states and non-interruption in the internal matters of other nations.
2. Each and every nation possesses a sovereign right to utilize its natural resources for the development of economy and for welfare of its people. Each and every country also has right to transfer its natural resources to other nations/countries.
3. There will be no differenciation on the ground of socioeconomic systems and follow up of various techniques. Trading policies will be based on this principle.

Thus, the above are the three basic principles of UNCTAD.

**Activities of UNCTAD**

Some of the significant activities of UNCATD are,

1. Giving technical explanation about new trade schemes like new import preference system.
2. Research and support in relation to negotiation of commodity agrement.
3. Numerous promotional activities are developed to help the countries in the developing stage in the matters like trade and capital flows.

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# Short Question and Answers

**1. Define Foreign Direct Investment.**

*Ans :*

**Introduction**

An investment made by a company or entity based in one country, into a company or entity based in another country. The foreign direct investment means cross border investment made by a resident in one economy in an enterprise in another economy, with the objective of establishing a lasting interest in the investee economy.

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.

**Definitions**

**(i) According to the International Monetary Fund's Balance of Payments Manual,** "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".

**(ii) According to the United Nation's World Investment Report (UNCTAD, 1999),** "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)".

**2. Types of FDI.**

*Ans :*

**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. It 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. What is Foreign Portfolio Investment (FPI).**

*Ans :*

Foreign portfolio investment (FPI) consists of securities and other financial assets held by investors in another country. It does not provide the investor with direct ownership of a company's assets and is relatively liquid depending on the volatility of the market. Along with foreign direct investment (FDI), FPI is one of the common ways to invest in an overseas economy. FDI and FPI are both important sources of funding for most economies.

- Foreign portfolio investment (FPI) involves holding financial assets from a country outside of the investor's own.

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- FPI holdings can include stocks, ADRs, GDRs, bonds, mutual funds, and exchange traded funds.
- Along with foreign direct investment (FDI), FPI is one of the common ways for investors to participate in an overseas economy, especially retail investors.
- Unlike FDI, FPI consists of passive ownership; investors have no control over ventures or direct ownership of property or a stake in a company.

**4. Who is a Foreign Institutional Investor.**

*Ans :*

FII is an institution like a mutual fund, insurance company, pension fund etc. According to SEBI, "an FII is an institution established or incorporated outside India which proposes to make investments in India in securities". FII is an institution who is registered under the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995. FIIs comprised of a pension fund, a mutual fund, investment trust, insurance company or a reinsurance company.

**5. What is FEMA.**

*Ans :*

The Foreign Exchange Regulation Act of 1973 (FEMA) 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 Coporate world found themselves as 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.

**6. Scope of FEMA.**

*Ans :*

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.

**7. Objectives and features of FEMA.**

*Ans :*

**Objectives**

The objective of FEMA are :

1. To facilitate external trade and payments.
2. To promote the ordely development and maintenance of foreign exchange market.

**Features**

(a) Any person may sell or draw foreign exchange, without prior permission and can later on inform RBI. This makes it a more positive feature.

(b) Under this act Enforcement Directorate (F, D) will be more investigating in nature.

(c) FEMA recognized the possibility of even the Capital Account convertibility i.e. It classifies foreign exchange transaction and current account transactions.

(d) The violation of FEMA is a civil offence.

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**8. International Monetary Fund (IMF)**

*Ans :*

**Introduction**

The International Monetary Fund was established by an international treaty in 1945. It works to foster global growth and economic stability. Fleadquartered in Washington D.C., it is governed by its almost global membership of 187 countries.

The IMF is the central institution of the international monetary system. It provides policy advice and financing to members in economic difficulties and also works with developing nations to help them achieve macroeconomic stability and reduce poverty.

**An Overview**

The IMF was conceived in July 1944 at an international conference held at Bretton Woods, New Hampshire, USA, when delegates from 44 nations agreed on a framework for economic cooperation partly designed to avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s.

During that decade, as economic activity in major industrial countries weakened, countries attempted to defend their economies by increasing restrictions on imports; but this further worsened the downward spiral in world trade, output, and employment. To conserve dwindling reserves of gold and foreign exchange, some countries curtailed their citizens' freedom to buy from abroad, some devalued their currencies, and some introduced'complicated restrictions on their citizens' freedom to hold foreign exchange.

**9. World Bank.**

*Ans :*

The World Bank is one of the world's largest sources of finance and knowledge to its member countries to improve the condition of health centres, provide water and electricity, fight disease, and protect the environment. The World Bank is not a "bank" in the common sense. The World Bank is an international organization owned by 187 countries both developed and developing that are its members. Since inception in 1944, the World Bank has expanded from a single institution to a closely associated group of five development institutions.

In June 1944, 17 countries met in Atlantic City, USA to prepare the agenda for the Bretton Woods conference, and 44 countries which signed the final agreement established the Bank. India was one of the 17 countries and one of the 44 countries which signed the agreement. It was India which suggested the name "International Bank for Reconstruction and Development" (IBRD) to the drafting committee. The Indian delegation was led by Sir Jeremy Raisman, Finance Member of the Government of India and included Sir C. D. Deshmukh (Governor of the Reserve Bank of India, later to become India's Finance Minister), Sir Theodore Gregory (the first Economic Advisor to the Government of India), Sir R.K. Shanmugan Chetty (later independent India's first Finance Minister), Mr. A.D. Shroff (one of the architects of the Bombay Plan) and Mr B.K. Madan (later India's Executive Director in IMF).

**10. Purpose of World Bank.**

*Ans :*

The purposes of the Bank as described in its articles are:

1. To assist economies in the reconstruction and development by facilitating the investment of capital for productive purposes. It also helps in reconstruction of economies destroyed or disrupted by war, and it encourages the development of productive facilities and resources in less developed countries.

2. To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable

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conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.

3. To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labour in their territories.

**11. Asian Development Bank.**

*Ans :*

Asian Development Bank is a multilateral development finance institution dedicated to reducing poverty in Asia and the Pacific region. From 31 members at its establishment in 1966, ADB has grown to encompass 67 members - of which 48 are from within Asia and the Pacific and 19 outside. ADB's development work is aimed at improving the welfare of the people of Asia and the Pacific, especially of the 1.4 billion poor living on less than a dollar a day.

**ADB has the following objectives:**

1. Economic Growth
2. Human Development
3. Gender and Development
4. Good Governance
5. Environmental Protection
6. Private Sector Development
7. Regional Cooperation

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# Choose the Correct Answer

1. FEMA was passed in the year? [ a ]
   (a) 1999 (b) 1989
   (c) 2000 (d) 1997
2. The Government of India has replaced FERA by? [ b ]
   (a) The Competition Act (b) The FEMA
   (c) The Monopolies Act (d) The MRTP Act
3. The portfolio investment by foreign institutional investors is called? [ a ]
   (a) FDI (b) FII
   (c) Balance of payment (d) SDR
4. Which of the following plan is also known as rolling plan? [ c ]
   (a) First five year plan (b) Second five year plan
   (c) Sixth five year plan (d) Tenth five year plan
5. MNC stands for [ a ]
   (a) Multinational Corporation (b) Multination Corporation
   (c) Multinational Cities (d) Multinational Council
6. Investment made by MNCs is called? [ c ]
   (a) Investment (b) Foreign Trade
   (c) Foreign Investment (d) Disinvestment
7. Tax on imports is an example of? [ c ]
   (a) Investment (b) Disinvestment
   (c) Trade barrier (d) Privatization
8. FEMA signifies? [ b ]
   (a) Free Export management act (b) Foreign Exchange management act
   (c) Foreign Exchange monitoring act (d) Free Export marketing act
9. FDI is classified into _____ types [ c ]
   (a) 3 (b) 4
   (c) 2 (d) 5
10. The UNCTAD is established in [ b ]
   (a) 1965 (b) 1964
   (c) 1963 (d) 1960

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# *Fill in the blanks*

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. The International Monetary Fund was established by an international treaty in _____ .
7. SDR stands for _____ .
8. The World Bank is an international organization owned by _____ countries.
9. The IDA is the soft loan section of the World Bank established in _____ .
10. The Multilateral Investment Guarantee Agency (MIGA), established in _____ .

**ANSWERS**

1. Natural resources
2. Horizontal FDI
3. FDI
4. FEMA
5. Current account
6. 1945
7. Special Drawing Rights
8. 187
9. I960
10. 1988

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UNIT V

**WTO AND TRADE POLICY**

World Trade Organisation – functions – objectives – AOA – GATS – TRIPS – TRIMS - Regional Economic Integration-levels-trade creation and diversion effects-Regional Trade Agreements-EU-ASEAN-SAARC-NAFTA-BRICS–India's Trade Policy.

## 5.1 World Trade Organization (WTO)

**Q1. Explain briefly about WTO.**

*Ans :* **(May-14)**

The formation of WTO on 1st January, 1995 was regarded as the greatest reform of international trade, since 1948. Initially, international commerce was under the guidance of GATT which assisted in developing a productive multilateral trading system. However, it needed examination by the end of 1980's.

The Uruguay round was conducted for performing the examination. This negotiation was one of the largest trade negotiations. Initially, some people felt that Uruguay round would fail but, at the end it was successful. WTO includes many things along with GATT. GATT was considered as a small and provisional institution which was not recognized as an international organization. GATT is now replaced with WTO. The agreement of GATT was modified and transformed into the new WTO agreements. GATT deals only with trade in goods, whereas WTO agreements involves service and intellectual property.

**Development of WTO**

The Uruguay round was the eighth round of multilateral trade negotiations held under GATT and continued for seven years. The Uruguay round led to the development of new legal agreements for trade and reinforced the settlement system.

A ministerial conference was conducted in Marrakesh Morocco in April 1994, in which 125 government representatives participated from all around the world for signing the formation of a new successor institution to GATT i.e., the World Trade Organization (WTO). It is an embodiment of the Uruguay round results. On 1st January, 1995, when WTO came into existence all the assets and liabilities of GATT were transferred to WTO.

Geneva was considered as its headquarters. WTO committees replaced all the GATT committees. In the beginning, there were four subcommittees which are as follows,

1. Finance, administration and budget
2. Institutional, procedural and legal matters
3. Trade and environment
4. Services.

WTO makes sure that every member country will negotiate with its trading partners for the purpose of making an entry into the multilateral trading system and gaining a schedule for goods and services which is convenient for market. All the member countries makes significant efforts for ending the domestic rectification of the WTO agreement quickly.

**Q2. What is meant by GATT ? Explain the objectives of GATT.**

*Ans :*

**General Agreement on Trade and Tariffs (GATT)**

The General Agreement on Trade and Tariffs was formed in 1947 The main objective behind the formation of GATT was to liberalize the trade globally. The Bretton Woods Conference of 1944,

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suggested the formation of International Monetary Fund (IMF), World Bank and International Trade Organization (ITO). Even though, the IMF and World Bank was formed in 1946, the ITO charter was not approved due to the arguments that its enforcement provisions will intervene with the power of domestic policy making. So, till the ITO charter was approved, the GATT which was established as a provisional agreement in 1947 for reducing the gap between the countries, became the underlying structure for international trading system.

GATT was modified into a World Trade Organization (WTO) which came into effect from 1st January, 1995. WTO is more stronger and powerful than GATT and performs several functions.

**Objectives of GATT**

The main aim of GATT was to increase international trade by eliminating restrictions on trade for attaining economic growth all over the world. The opening statement of the GATT outlined the following objectives as the primary objectives of GATT.

1. To increase the standard of living of the people all over the world.
2. To make sure that there is full employment and uniform growth in the real income all over the world.
3. To make effective utilization of the resources.
4. To increase the production and international trade.

GATT includes some conventions and general principles which controls international trade between the countries which are tied up in the agreement.

According to the rules of conventions of GATT,

(i) The tariff or any other commercial policy of a member country cannot be changed without consulting other parties of the agreement.

(ii) The countries which are included in GATT must aim at decreasing the tariffs and other trade barriers.

**Q3. What are the principles of GATT ?**

*Ans :*

**1. Non-discrimination**

The non-discrimination principle states that there shall be no discrimination between the member countries while conducting the global business.

In order to follow the principle of non-discrimination, the member countries of GATT have made an agreement to apply the Most Favoured Nation (MFN) on all its custom and excise duties with an exception that the quantitative restrictions would be applicable on all the member countries.

Another exception was that the GATT allows for economic integration only when the integration aims at increasing the trade among the member countries and reduces or removes the trade barriers of the other countries.

**2. Prohibition of Quantitative Restrictions**

GATT prevents the quantitative restrictions and restricts the trade to the less rigid tariffs. There exists few exceptions to this principle i.e., it prevents quantitative restrictions to the countries who are suffering from the problem of balance of payment and also to the third world countries.

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Besides this, certain significant restrictions were made applicable on agricultural and fishery products where the local production of such products was subjected to equivalent restrictive production or marketing controls.

**3. Consultation**

All the GATT disagreements were resolved with the help of continues consultation. Till date, eight trade negotiations were conducted under the guidance and protection of GATT.

All the rounds of GATT took many years to complete. The last round i.e., the Uruguay round took nearly seven years to draw a conclusion, while the estimated time of the round was more than four years.

**Q4. Explain the organization structure of WTO.**

*Ans :*

The WTO is operated by the government's of the member countries. WTO is a member driven, consensus -based organization in which the important decisions are taken by consensus by the members as a whole either by ministers or their ambassadors. There are four hierarchical levels in the organizational structure of the WTO. The following are the hierarchies of WTO from top to bottom,

**1. Ministerial Conference**

Ministerial conference is on the top of hierarchy in the organizational structure of WTO. It is represented by all the member countries of WTO. Ministerial conference has the power to make the decisions on all the matters of multilateral trade agreements. Usually, ministerial conference meets once in two years. Hence, ministerial conference is a body which develops strategies and policies, these strategies and policies are performed by the next level i.e., general council.

**2. General Council**

General council acts as an executive body of WTO which discloses its decisions and activities to the ministerial conference. General council is also represented by all the members of WTO, it has two different forms which are as follows,

(i) Dispute settlement body controls the dispute settlement procedures and is guided by the dispute settlement panels and appellate body.

(ii) Trade policy review body examines the trade policies of individual WTO members regularly.

**3. Councils**

In the hierarchy of the organizational structure of WTO, the third level is occupied by the councils. Usually, councils are of three types they are,

**(a) Councils for Trade in Goods:** The authority of implementing and operating all the agreements which are related to trade in goods is held with the council for trade in goods.

**(b) Councils for Trade in Services:** The implementation of all the agreements relating to trade in services is supervised by the council for trade in services.

**(c) Council for Trade Related Intellectual Property Rights:** In this council, the implementation and the operations of all agreements relating to intellectual property rights are supervised.

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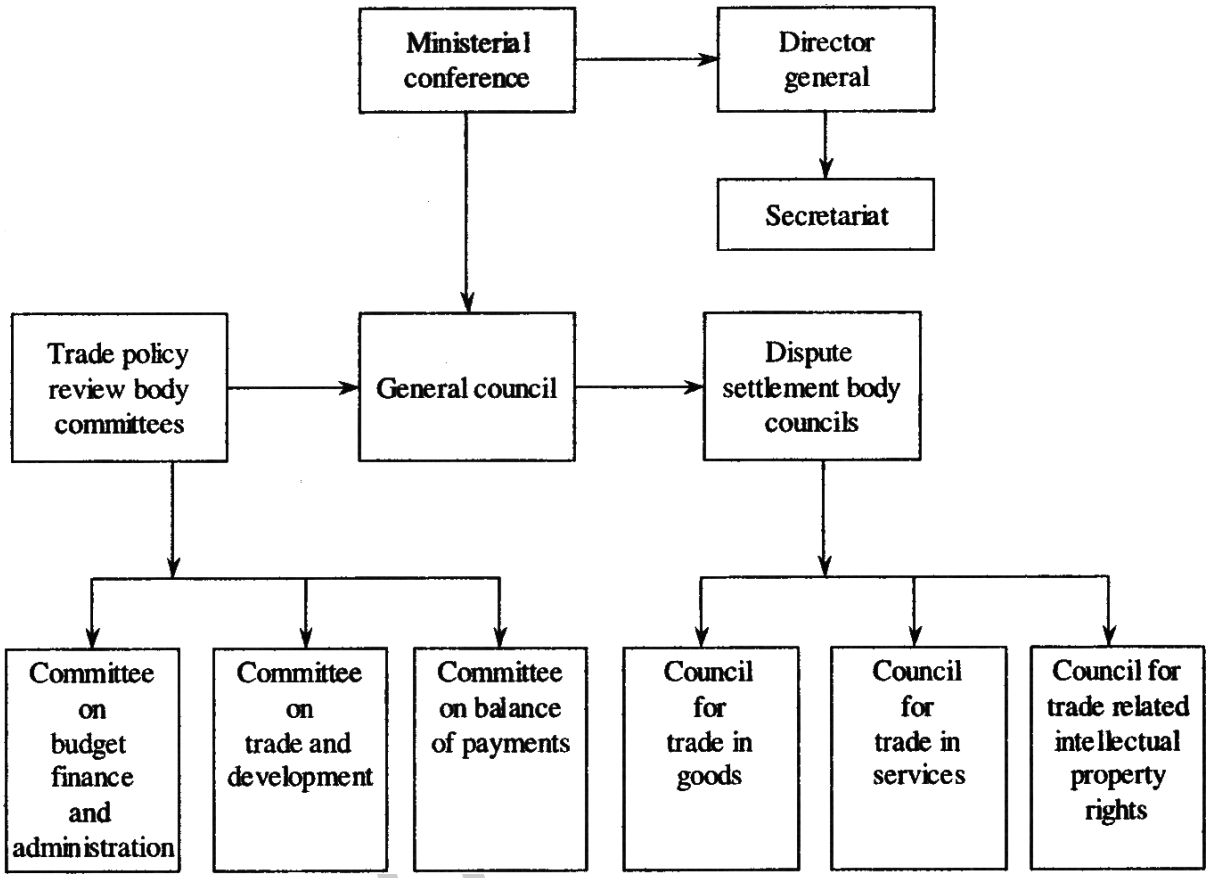


**Fig.: Organizational Structure of WTO**

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## 4. Committee and Management Bodies

The committees and management bodies are held with the responsibilities, power and authorities which are transferred by the general council. The following are the different committees and the management bodies,

**(i) Committees:** The councils establishes the committees for organizing the arrangements, ministerial conference created three committees which are as follows,

**(a) Committee on Trade and Develop-ment:** This committee deals with all the problems or issues relating to the developing countries and specifically least developed countries.

**(b) Committee on Balance of Pay-ments:** In order to solve the problems of balance of payments, some member countries of WTO adopts trade restrictive measures. The committee on balance of payments makes arrangements for conducting meetings among these countries.

**(c) Committee on Budget, Finance and Administration:** All the matters relating to the budget, finance and administration of WTO are handled by this committee.

**(ii) Management Bodies:** In WTO, the plurilateral agreements have their own management bodies which are accountable to general council. Some plurilateral agreements which have their management bodies are civil air-craft, government procurement, dairy products, bovine-meat, etc.

### 5.1.1 Objectives and Functions of WTO

**Q5. Explain the objectives and functions of WTO.**

**(May-19, May-15, May-13, May-12, Imp.)**

*Ans :*

**Objectives of WTO**

Important objectives of WTO are mentioned below:

(i) To implement the new world trade system as visualized in the Agreement.

(ii) To promote World Trade in a manner that benefits every country.

(iii) To ensure that developing countries secure a better balance in the sharing of the advantages resulting from the expansion of international trade corresponding to their developmental needs.

(iv) To demolish all hurdles to an open world trading system and usher in international economic renaissance because the world trade is an effective instrument to foster economic growth.

(v) To enhance competitiveness among all trading partners so as to benefit consumers and help in global integration.

(vi) To increase the level of production and productivity with a view to ensuring level of employment in the world.

(vii) To expand and utilize world resources to the best.

(viii) To improve the level of living for the global population and speed up economic development of the member nations.

**Functions of WTO**

The WTO provides the common institutional framework for the conduct of trade relations among its Members in matters related to the Agreements negotiated during the Uruguay Round. It monitors and oversees, through its various bodies, the implementation, operation and administration of the various agreements. It also administers the trade policy review mechanism and the dispute settlement mechanism. In addition, the WTO provides the forum for further negotiations between its Members, in matters dealt with under the Agreements and also more generally concerning their multilateral trade relations:

1. **Implementation, administration and operation of the covered agreements:** The WTO facilitates the implementation, administration and operation of the WTO Agreement and the Multilateral Trade Agreements, and furthers their objectives. It also provides the framework, for those of its Members that have accepted them, for the implementation, administration and operation of the Plurilateral Trade Agreements.

2. **Forum for negotiations:** The WTO provides the forum for negotiations on multilateral trade relations in matters covered by its various agreements. It may also, on decision by the Ministerial Conference, provide a forum for further negotiations, and a framework for the implementation of their results, on other issues arising in the multilateral trade relations among its Members.

3. **Dispute settlement:** The WTO administers the integrated dispute settlement system, which is a central element in providing security and predictability to the multilateral trading system, serving to preserve the rights and obligations of the Members of the WTO.

4. **Review of national trade policies:** The WTO administers the Trade Policy Review Mechanism, which is designed to contribute to greater transparency and understanding of the trade policies and practices of WTO Members, to their improved adherence to the rules, disciplines and commitments of the multilateral trading system, and hence to the smoother functioning of the system.

5. **Coherence in global economic policy-making:** A Ministerial Declaration adopted at the Marrakesh Ministerial Meeting recognizes the role of trade liberalization in achieving greater coherence in global economic policy-making. For this purpose, the WTO cooperates, as appropriate, with the International Monetary Fund and with the World Bank.

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**Q6. What are the principles of WTO ?**

*Ans :*

The WTO agreements are elaborated and difficult in nature as they are legal and includes great variety of activities. The WTO agreements are basically concerned with agriculture, textiles and clothing, industrial standards and product safety, food sanitation regulations, intellectual property and so on. Few primary/fundamental principles are followed for all these documents. These primary principles acts as the foundation/basis of WTO. The principles are as follows,

**1. Non-discrimination**

This principle is framed on the basis of the concept of normal trade relations, earlier known as the Most Favoured Nation (MFN) rule. According to this rule, the WTO members must provide the similar favourable trade terms to all the members as the ones which they have provided to any individual member. The principle of non-discrimination is beneficial to importers and consumers as they can make use of low cost goods regardless of the country in which they are being produced. Another important perspective of principle of non-discrimination is the national treatment. National treatment integrates all the member countries in order to consider the imported and local goods equally. The national treatment can be implemented only after the product, service or an item of intellectual property enters the market.

**2. Transparency**

Transparency is one of the essential pillar of WTO. The WTO members are supposed to publish their trade regulations in order to create and sustain those institutions which monitors the administrative decisions, which influences the trade, to give response to information appeals made by the other members and to inform about the changes of the trade policies to the WTO. Continuous checking of the monitoring of the national trade policies with the help of trade policy review mechanism, results in acting as a sources of increasing transparency both at the domestic level as well as at the multilateral level.

**3. Binding and Enforceable Commitments**

In the WTO, when the countries enters into a mutual agreement of opening their markets for goods and services then in that case they bind their commitments. The bindings amount with respect to the goods refers to the highest limit of customs tariff rates. Mostly, the developing countries charge tax on the imports at the lower rates than the bond rates. While the developed countries, rates the charges same as the bond rates. A country can make alternations in its bindings but only after negotiating with its trading partners, which would either result in compensating the trading partners for the loss that they incur.

**4. Reciprocity**

Reciprocity functions at the time of negotiating between the countries wherein the governments negotiate in the WTO rounds. Reciprocity is carried out with the intention of achieving mutually beneficial arrangements with the help of reciprocal deductions in the tariff bindings. In short, the government identifies those negotiators who are looking for balance of concessions, wherein the tariff deductions are provided by one country is balanced against an equal concession from its trading partner.

**5. Safety Values**

Safety value principle is the one which explains that the government must be able to restrict the trade under certain conditions. There are four types of provisions with respect to this principles. They are,

(i) Those goods and services which are produced for the non-economic objective like public health and national security.

(ii) Industries which may be damaged through competition of imports.

(iii) The articles which aims at assuring fair competition. The following measures would be used in such a condition, the

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right to impose countervailing duties on imports which have been subsided and the anti-dumping duties on imports, which needs to be dumped.

(iv) Provisions allowing intervention in trade for economic criterias. The economic criterias consists of the measures to correct the balance of trade or the wish to safeguard the infant industry.

**Q7. State the various benefits of WTO.**

*Ans :* **(Imp.)**

**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 while 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. 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.

**5. 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.

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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.

**6. 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.

**7. 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.

**Q8. Discuss the role of India WTO and WTO's role in India's socio - economic development**

*Ans :*

WTO is an international body consisting of about 134 member countries with India as one of its members. It came into effect from 1st January 1995. It mainly deals with certain rules that each member country has to follow while carrying out their international trade. According to Mr. Michael Moore, the Director General of World Trade Organization, India is playing an active role in the activities and policy decisions of World Trade Organization (WTO) by effectively participating in the discussion and negotiations of Green Room.

**Role played by India can be studied as follows.**

**1. India's Role in Agriculture**

India played a crucial role during various conferences of WTO by proposing various recommendations on agriculture. The agricultural support provided by India to the developing countries has helped them in increasing the standards of living of their farming community.

**2. Acts as a Natural Representative**

India has the capacity of bringing many developing countries to a broad base. So, Michael Moore considered India as a 'natural representative' of the developing world.

**3. Reduces Trade Tariffs**

The Indian influential groups helped other developing countries to liberalize their trade operations and also promoted their market accessions. The market reforms of India helped in increasing foreign exchange by channelizing the trade between United States and India.

**4. Role in Non-agricultural Sectors**

India has occupied a significant market access during non-agricultural market access negotiations for developing countries by decreasing the tariff peaks, tariff escalation, high tariffs and non-tariff barriers in developed countries on the products of their export interest.

**5. Negotiating Role**

India took part in the negotiation agreements of the WTO such as G-4, G-20, G-33 core group on services and played a helpful role in favour of the national interests of the country. India will attain a great market place in future by occupying a major proportion of share in the increasing economic output of the world.

Thus, in future, India will play a role of a leader in the developing world and the role of an integrator for the economic

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development of both the developed and the developing countries during W.T.O's negotiations and activities.

**WTO's Role in Social Development of India**

WTO plays a very important role in the social development of India. The following points help us to know the role of WTO in the social development of India.

1. WTO has helped India and other developing countries to obtain food at low cost by reducing domestic support and eliminating export subsidies for their farmers. This has also helped India to export their surplus grains to attain a competitive advantage over other developed countries.
2. WTO has removed restrictions imposed on services and movement of individuals from one country to other country which helped India to increase its market access for banking, insurance and other types of innovative services. Even Indian citizens have greater job opportunities to work in other countries.
3. The tariffs and our barriers which has obstructed the flow of nonagricultural goods from one country to other country was reduced and eliminated by WTO. This helped India to effectively carry out international trade and increase its standard of living.
4. India, China and Brazil have access to innovative technology for manufacturing important medicines and drugs which were previously produced by Western multinational companies at a very high cost. By becoming a member of WTO India can export these medicines without seeking compulsory licenses from the license holders.
5. WTO helps in strengthening the Indian export industry by increasing the job opportunities, developing the skills and technological innovation. This in turn helped in the development of the country.
6. WTO consists of multilateral set of rules which protects India from bilateral pressures and trade restrictions. These rules can also be used for predicting and stabilizing the international trading system.
7. As, India is the member of WTO, it can obtain the advantage of International Trade Center. The international trade center helped India in developing and executing export promotion programmes, import operations and techniques.

**Q9. Explain the role of WTO Global Agro-Based business.**

*Ans :*

Whereas, most of the agricultural stipulations took place in Uruguay round between 1986-1994. The WTO's agreement on agriculture estimated and forecasted that the subsidy of the developed countries would decline by 20 percent in the next six years and by 13 percent in case of developing countries in the next ten years after 1994. The developed countries have evaded this agreement by providing green box and blue box subsidies to support agriculture.

**(a) Green Box Subsidies**

Such type of subsidies are mainly charged on government and public sector services like research, disease control, infrastructure and food security. Even, it also includes all those payments that has to be directly made to the fanners who are unable to motivate the production growth due to lack of appropriate infrastructural facility. These subsidies help the farmers to restructure their agricultural programmes. Such subsidies have wide scope of operation which includes all government subsidies.

**(b) Blue Box Subsidies**

The blue box subsidies are the direct payments made to the farmers wherein the farmers are subjected to restrict production. This can be done through government oriented programmes, helpful in assisting and promoting agriculture and rural development of the third-world countries. Besides these, it also includes providing assistance to the small-scale industries where, 15 percent or less assistance was provided to the developed countries while 10 percent or less assistance had been provided to the developing countries.

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Developed countries were allowed to maintain about 64 percent of their subsidy outlays on the base level while the underdeveloped countries were not allowed to increase their export subsidy level. As a result, the imports from the agricultural sector were found to be at much lower rates than the market price in the domestic economy.

**According to the human development report (1997), a survey and review was conducted over the problem and the following aspects were revealed.**

1. According to the OECW, "The per capita transfer to US farmers amounted to $29,000 in 1995. In the main maize producing areas of Mindanao and Cagayen valley, the average per capita income amount to less than $300. So, each US farmer receives in subsidies roughly 100 times the income of a maize farmer in Philippines".
2. For free traders in real world, survival in the existing agricultural market is mainly dependent on subsidies rather than on cost advantages. Liberalizing local food markets in unequal competition acts as a source of destroying the livelihood of locals rather than acting as a prescription for enhancing efficiency.
3. Even after the next five years of the implementation of the Uruguay round agricultural agreement, agriculture served as a critical sector where still export dumping acted as a "legitimate trade practice".

Initially, the agricultural prices of India were much lower than the international prices, but due to the heavy subsidization of agricultural exports by the developed countries, the scenario was quite opposite.

**Q10. Compare and contrast GATT and WTO.**

*Ans :*

WTO is an improvement of GATT. It completely changes the predecessor and has a distinct character. GATT is considered as a provisional and ad hoc approach as it is a legal agreement. Whereas, WTO involves commitments which are full and permanent.

The following are the differences between GATT from WTO,

| Sl.No. | GATT | Sl.No. | WTO |
|---|---|---|---|
| 1. | GATT is a multilateral agreement which includes a set of rules. | 1. | WTO is an institution which is permanent in nature. |
| 2. | The dispute settlement system of GATT is slow and manual. | 2. | The dispute settlement system of WTO is fast and automatic. |
| 3. | The rules of GATT are exercised when merchandise goods are traded. | 3. | The rules of WTO are exercised for trade in merchandise, trade in services and trade in relevant aspects of the intellectual property. |
| 4. | It was used on a provisional basis. | 4. | The activities of WTO are full and permanent. |
| 5. | It was created for developing international trade organization. | 5. | It is formed for attaining its own objectives. |
| 6. | GATT was a multilateral instrument, but newagreements were added to make it plurilateral. | 6. | WTO agreements are practically multilateral agreements. |
| 7. | GATT has only a small associated secretariat. | 7. | WTO has its own secretariat. |
| 8. | GATT is not an institution. | 8. | WTO is a permanent institution. |

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## 5.2 WTO Agreements

### 5.2.1 Agrement on Agriculture (AOA)

**Q11. Explain briefly about agrement on agriculture (AOA).**

*Ans :* **(May-16, Imp.)**

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 electrification". 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 varieties 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

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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 General Agreement on Trade in Services (GATS)

**Q12. Explain briefly about General Agreement on Trade in Services (GATS)**

*Ans :*

The General Agreement on Trade in Services (GATS), negotiated during the Uruguay round, is the first step of multilaterally Agreed and legally enforceable rules and disciplines ever negotiated to cover international trade in services. The agreement contains three elements: A Framework of general rules and disciplines, Annexes addressing special conditions relating to individual sectors (the sectors covered are movement of natural persons, cross-border trade, consumption abroad, and commercial presence) and National schedules of market access commitments. A council for trade in services oversees the operation of the agreement.

The General Agreement on Trade in Services (GATS) which extends multilateral rules and disciplines to services is regarded as a landmark achievement of the Uruguay Round (UR), although it achieved only little in terms of immediate liberalization. On account of the special characteristics and the socio-economic and political implications of certain services, they have been generally subject to various types of national restrictions. Protective measures include visa requirements, investment regulations, restrictions on repatriation, marketing regulations, restrictions on employment of foreigners, compulsions to use local facilities, etc. Heavily protected services in different countries include banking and insurance; transportation; television, radio, film and other forms of communication, and so on.

**The GATS defines services as the supply of a service:**

1. From the territory of one member (country) into the territory of any other member.
2. In the territory of one member to the service consumer of any other member.
3. By a service supplier of one member, through commercial presence in the territory of any other member,
4. By a service supplier of one member, through presence of natural persons of a member in the territory of any other member,

The GATS expressly recognises the right of members to regulate the supply of services in pursuit of their own policy objectives, and does not seek to influence these objectives. Rather, the Agreement establishes a framework of rules to ensure that services regulations are administered in a reasonable, objective and impartial manner and do not constitute unnecessary barriers to trade.

**Q13. State the various modes of General Agreement on Trade in Services.**

*Ans :*

**Modes of GATS**

The GATS covers four modes of international delivery of services:

1. **Cross-border Supply (Trans-border Data Flows, Transportation Services):** Cross-border supply is defined to cover services flows from the territory of one Member into the territory of another Member (e.g., banking or architectural services transmitted via telecommunications or mail).
2. **Commercial Presence (Provision of Services Abroad through FDI or representative offices):** Commercial presence implies that a service supplier of one member establishes a territorial presence, including through ownership or lease of premises, in another member's territory to provide a service (e.g., domestic subsidiaries of foreign insurance companies or hotel chains).

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3. **Consumption Abroad (Tourism):** Consumption abroad refers to situations where a service consumer (e.g., tourist or patient) moves into another member's territory to obtain a service.

4. **Movement of Personnel (Entry and Temporary Stay of Foreign Consultants):** Presence of natural persons consists of persons of one member entering the territory of another member to supply a service (e.g., accountants, doctors or teachers). The Annex on Movement of Natural Persons specifies, however, that members remain free to operate measures regarding citizenship, residence or access to the employment market on a permanent basis.

Apart from the traditional concept of cross-border trade, three additional modes of supply and the supply of many services is possible only through the simultaneous physical presence of both producer and consumer.

There are thus many instances in which, in order to be commercially meaningful, trade commitments must extend to cross-border movements of the consumer, the establishment of a commercial presence within a market, or the temporary movement of the service provider himself.

**Q14. What are the various services covered by General Agreement on Trade in Services.**

*Ans :*

The GATS practically covers all types of services. The services covered are currently classified under the following twelve broad sectors, each divided into several sub-sectors:

1. **Business Services**

Professional services, including legal services, accounting, auditing and book-keeping, architectural and real estate services, engineering services, medical and dental services, veterinary services, other professional services, computer and related services, research and development services, real estate services and rental/leasing services and other business services, such as management consultancy, advertising, technical testing, maintenance and repair, packaging and printing services, convention services, cleaning services.

2. **Communication Services**

All forms of basic and value-added telecommunication services, including online information and date processing services postal and courier services audio-visual services: radio and television services, motion picture and video tape production and distribution services, satellite communication.

3. **Construction and Related Engineering Services**

General construction work for buildings, general construction work for civil engineering, installation and assembly work, building completion and finishing work.

4. **Distribution Services**

Including retail, wholesale, and franchising.

5. **Educational Services**

Primary education, secondary education services, higher education services, adult education.

6. **Environmental Services**

Such as sewage, disposal, and sanitation services.

7. **Financial Services**

Direct insurance underwriting, reinsurance and insurance intermediation and other insurance auxiliary services, banking and other financial services, including securities-related services, provision of financial information, and asset management.

8. **Health-Related Services and Social Services**

Hospital services, other human health services, social services.

9. **Tourism and Travel-Related Services:**

Travel agencies and tour operators, hotels and restaurants, catering, tourist guide services.

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**10. Recreational, Cultural, and Sporting Services**

Including entertainment services, news agency services, museums and other services; sporting services, and recreational services.

**11. Transport Services**

Maritime, internal waterways, air, space, and road transport services, pipeline transport, multi-modal transport, and services auxiliary to all modes of transport.

**12. Other Services**

This category covers any other services not specified elsewhere. It would certainly cover here energy, transport and distribution, and other energy-related services, which can also be covered under the residual categories of services of distribution, transport, environmental, and other business services.

### 5.2.3 Trade Related Intellectual Property Rights (TRIPS)

**Q15. Write a short note on TRIPS.**

*Ans :* **(May-19, Imp.)**

The General Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) was developed in the Uruguay round agreement for protecting the intellectual property rights. WTO defined intellectual property rights as "the rights given to persons over the creations of their minds. They usually give the creator an exclusive right over the use of his/her creation for a certain period of time". Even intellectual properties are included in the UR agreement on TRIPs which are as follows,

(i) Copyright and related rights

(ii) Trademarks covering service marks

(iii) Geographical indications

(iv) Industrial designs

(v) Patents covering the protecting of new types of plants.

(vi) Layout designs of integrated circuits

(vii) Trade secrets and test data or any other unraveled information.

**Q16. Explain various provisions of Trade Related Intellectual Property Rights (TRIPS).**

*Ans :* **(Dec.-20, May-15)**

**1. Patents**

A patent is an exclusive right granted by a country to the owner of an invention to make, use, manufacture and market the invention, provided the invention satisfies certain conditions stipulated in the law. Exclusive right implies that no one else can make, use, manufacture or market the invention without the consent of the patent holder. This right is available for a limited period of time.

The patent right is territorial in nature and inventors their assignees will have to file separate patent applications in countries of their interest, along with necessary fees, for obtaining patents in those countries. A new chemical process or a drug molecule or an electronic circuit or a new surgical instrument or a vaccine is a patentable subject matter provided all the stipulations of the law are satisfied.

**2. Copyrights**

Copyright is a right, which is available for creating an original literary or dramatic or musical or artistic work. Cinematographic films including sound-track and video films and recordings on discs, tapes, perforated roll or other devices are covered by copyrights. Computer programs and software are covered under literary works and are protected in India under copyrights.

The Copyright Act, 1957 as amended in 1983, 1984, 1992, 1994 and 1999 governs the copyright protection in India. For cinematographic films, records, photographs, posthumous publications, anonymous publication, works of government and international agencies the term is sixty years from the beginning of the calendar year following the year in which the work was published. For broadcasting, the term is twenty five years from the beginning of the calendar year following the year in which the broadcast was made.

**3. Industrial Design**

Many varieties and brands of the same product (e.g., car, television, personal computer, a piece of furniture, etc.) in the market can be seen,

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which look quite different from each other. If the products have similar functional features or have comparable price tags, the eye appeal or visual design of a product determines the choice. Even if the similarities are not close, a person may decide to go for a more expensive item because that item has a better look or colour scheme.

Design as per the Indian Act means the features of shape, configuration, pattern, ornament or composition of lines or colours applied to any article - whether in two dimensional or three dimensional or in both forms - by any industrial process or means, whether manual, mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye.

**4. Trademarks**

A trademark is a distinctive sign, which identifies certain goods or services as those produced or provided by a specific person or enterprise. Trademarks may be one or combination of words, letters, and numericals. They may also consist of drawings, symbols, three dimensional signs such as shape and packaging of goods, or colours used as distinguishing feature. Collective marks are owned by an association whose members use them to identify themselves with a level of quality. A trademark provides to the owner of the mark by ensuring the exclusive right to use it to identify goods or services, or to authorise others to use it in return for some consideration (payment). Well-known trademark in relation to any goods or services, means a mark which has become so to the substantial segment of the public which uses such goods or receives such services.

**5. Geographical Indications**

Indications which identify a good as originating in the territory of a member or a region or a locality in that territory, where a given quality reputation or other characteristics of the good is attributable to its geographical origin. The concept of identifying GI and protecting them is a new concept in India, perhaps in most developing countries, and has come to knowledge in these countries after they signed the TRIPS Agreement.

The term GI has been defined as "Geographical Indications", in relation to goods, means an indication which identifies such goods as agricultural goods, natural goods or manufactured goods 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 and in case where such goods are manufactured goods one of the activities of either the production.

**6. Integrated Circuit Layout Design (IC)**

It provides protection for semiconductor IC layout designs. India has now in place Semiconductor Integrated Circuits Layout Design Act, 2000 to give protection to IC layout design. Layout design includes a layout of transistors and other circuitry elements and includes lead wires connecting such elements and expressed in any manner in a semiconductor IC. Semiconductor IC is a product having transistors and other circuitry elements, which are inseparably formed on a semiconductor material or an insulating material or inside the semiconductor material and designed to perform an electronic circuitry function. The term of the registration is ten years from the date of filing.

**Q17. Explain the various requirements of Trade Related Intellectual Property Rights (TRIPS).**

*Ans :*

TRIPS require member states to provide strong protection for intellectual property rights. For example, under TRIPS:

1. Copyright terms must extend to 50 years after the death of the author, although films and photographs are only required to have fixed 50 and to be atleast 25 year terms, respectively.
2. Copyright must be granted automatically, and not based upon any "formality", such as registrations or systems of renewal.
3. Computer programs must be regarded as "literary works" under copyright law and receive the same terms of protection.
4. National exceptions to copyright (such as "fair use" in the United States) are constrained by the Borne three-step test.

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5. Patents must be granted in all "fields of technology," although exceptions for certain public interests are allowed and must be enforceable for atleast 20 years.

6. Exceptions to the exclusive rights must be limited, provided that a normal exploitation of the work and normal exploitation of the patent is not in conflict.

7. No unreasonable prejudice to the legitimate interests of the right holders of computer programs and patents is allowed.

8. Legitimate interests of third parties have to be taken into account by patent rights.

9. In each state, intellectual property laws may not offer any benefits to local citizens which are not available to citizens of other TRIPs signatories by the principles of national treatment (with certain limited exceptions). TRIPS also have a most favoured nation clause.

Many of the TRIPS provisions on copyright were imported from the Berne Convention for the Protection of Literary and Artistic Works and many of its trademark and patent provisions were imported from the Paris Convention for the Protection of Industrial Property.

### 5.2.4 Trade Related Investment Measures (TRIMS)

**Q18. Write a short note on Trade Related Investment Measures (TRIMS).**

*Ans :* **(May-19, Imp.)**

The Agreement on Trade Related Investment Measures (TRIMs) is one of Agreements covered under Annex IA to the Marrakech Agreement, signed at the end of the Uruguay Round (UR) negotiations. The Agreement addresses investment measures that are trade related and that also violate Article III (National treatment) or Article XI (general elimination of quantitative restrictions) of the General Agreement on Tariffs and Trade. International businesses are aware of the many restrictions on their investments in foreign countries. Trade Related Investment Measures (TRIMS) are those restrictions a nation places on foreign investment that adversely affect trade in goods and services. WTO measures on TRIMs have been entered into the agreement as a part of the Uruguay Round agreements.

This agreement does not set broad rules for investors in a WTO country. It simply prohibits laws or regulations that condition a firm's right to import foreign goods based on the volume of goods exported.

For example, Argentina may not say to a US based MNC: 'You may only import foreign raw materials on condition that you export an equal volume of finished goods from our country'.

The requirements would violate the prohibition of quantitative restrictions of GATT. Also prohibited are laws that condition the receipt of foreign exchange on the company's foreign exchange revenues.

**Q19. State the features of Trade Related Investment Measures (TRIMS).**

*Ans :* **(Dec.-20)**

The main features of TRIMs are:

**1. Coverage**

TRIMs applies only to investment measures related to goods. It does not cover trade in services. Measures concerning service industries are addressed by the GATS, which does not contain explicit rules dealing with TRIMs. The TRIMs Agreement prohibits the application of certain investment measures related to trade in goods to enterprises operating within the territory of a Member.

**2. Treatment to Entities**

TRIMs agreement is concerned with the discriminatory treatment of imported and exported goods and is not specifically concerned with the treatment of foreign legal or natural persons.

**3. Substantive Obligations**

The TRIMs Agreement prohibits trade-related investment measures that are inconsistent with the basic propositions of GATT 1994. TRIMs forbidden by the agreement include those

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which are mandatory or enforceable under domestic law and those which are required in order to obtain to obtain an advantage, such as subsidies or tax breaks.

**4. Transparency**

Members commit to comply with GATT 1994, regarding Notification, Consultation, Dispute Settlement and Surveillance. Members must notify the Secretariat of the publications in which TRIMs may be found, including those applied by regional and local governments. Adequate opportunity for consultation should be granted by members to any request for information raised by any other member.

**5. Establishment of Committee**

TRIMs establishes Committee on Trade-Related Investment Measures responsible for the monitoring of operations and the implementation of the Agreement s commitments. The committee is open to all members and reports annually to the Council for Trade in Goods and it meets at least twice a year and at the request of any member.

**Q20. State the various agreement on TRIMS.**

*Ans :*

The Agreement on TRIMS provides that no contracting party shall apply any TRIMS which is inconsistent with he WTO Articles. An illustrative list identifies the following TRIMS as inconsistent:

1. Local content requirement (i.e., a certain proportion of local inputs be used in products),
2. Trade balancing requirement (i.e., imports shall not exceed a certain proportion of exports),
3. Trade and foreign exchange balancing requirements,
4. Domestic sales requirements (i.e., a company shall sell a certain proportion of its output locally).

The Agreement requires the notification of all WTO-inconsistent TRIMS and their phasing out within two, five and seven years by industrial, developing and least developed countries, respectively. Transition period can be extended for developing and least developed countries if they face difficulties in eliminating TRIMS. A number of TRIMS were employed in India prior to liberalization, and many of them have been phased out since then.

## 5.3 Regional Economic Integration

**Q21. Define Economic integration.**

**(or)**

**What is meant by Economic integration.**

*Ans :*

After the second world war, many countries decided to assist their neighboring counties and get assistance from them in the form of economic cooperation such as commodity arrangements and regional economic integration. Regional economic integration is the preferential political and economic agreement among the member countries to cooperate with one another and to eliminate restrictions on the flow of goods, services, labour and capital between their regions.

The economic integration exists between the countries belonging to a particular geographic region but it can be between the countries at a long distance also. Trade between the countries is the lowest level of cooperation and it is the corner stone of any form of regional economic integration. Companies should be well aware of the regional trading groups to take advantage of them while doing trade in such countries. The strategies of multinational companies are mostly affected by the regional trading groups.

Countries form trading groups when their ideologies are similar due to similar awareness to the regional problems or due to their common history. Many trading groups contain countries who share same area of the world. Distant countries may join them because their goods need to travel between such countries.

### 5.3.1 Levels of Economic Integration

**Q22. States the various levels of economic integration.**

*Ans :* **(Imp.)**

**Levels of Economic Integration**

There are five levels of economic integration as shown in the figure. Each level is described briefly.

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**1. Free Trade Area (FTA)**

It involves complete removal of tariffs on the traded goods among the member countries of Free Trade Area. They are free to impose tariff on the non-FTA countries. This aims at encouraging intra-region trade among the member countries of FTA. This agreement has an implementation period over which all the tariffs are eliminated on the products. They may also agree for the reduction of non-tariff barriers also. The examples of FTA are European Free Trade Area (EFTA), North American Free Trade Agreement (NAFTA) and the Asian Free Trade Area (AFTA).

**2. Customs Union**

This involves not only the removal of tariffs among the member countries but they also have a common barrier against the imports from nonmember countries. Thus, it differs from FTA in which a common external tariff does not exist. For example, the NAFTA between Canada, the United States, and Mexico does not have tariff barrier on trade among these three countries but they have separate tariff with other countries. This form of economic integration not only involves abolishment of tariff but also non-tariff barriers on intra-region trade.

**3. Common Market**

The common market is further one step ahead in economic integration. It involves common external tariff as well as a common market also for free movement of factors of production such as labour, capital enterprise and technology among the member countries. Due to this free mobility of the factors, there will be best allocation of resources in a common market, which will lead to maximum utilization of resources among the member countries. Thus, a common market has no barriers to trade and has a common external trade policy and free movement of factors of production among the member countries.

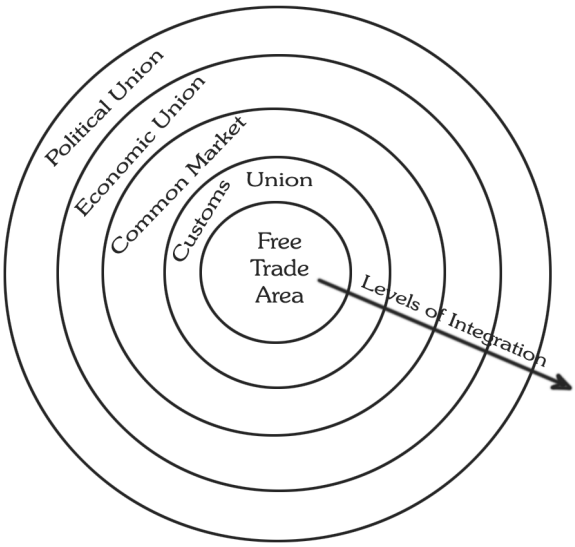


**Fig.: Levels of Economic Integration**

**4. Economic Union**

Besides eliminating internal trade barriers, adopting common external trade policies, and abolishing restrictions on the mobility of factors of production, economic union represents full integration of the economics and coordination of economic policies such as monetary policies, fiscal policies, taxation and social welfare programmes. For example, European Union has a common currency among member countries. It involves political integration also as the member countries lose a bit of their sovereignty.

It is very difficult to form a economic union as no nation wants to lose sovereign power of the state.

**5. Political Union**

It is the highest level of integration. It implies more formal political links between countries. In the pure political union, the member countries lose their national identities and come under a single state. While a limited form of political union exists when two or more countries share common decision making bodies and have common policies. The unification of East and West Germany is an example of total political union. The two nations now have one government and one set of overall economic policies. United States combined independent states into a political union.

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The time span to move from one stage to another stage varies widely depending on the subservience of the economic goals among the member states. For example, it took almost four decades for Europe to enter into a complete economic union. But after one and half decades, the South Asian Association of Regional Cooperation (SAARC) could not complete the first stage.

**Q23. Explain the benefits of Economic integration.**

*Ans :*

Economic integration is the preferential political and economic agreement among the member countries to cooperate with one another and to eliminate restriction on the flow of goods, services, labour and capital between their regions.

Economic integration has a great influence on the international business. The economic integration takes place between any two countries irrespective of their locations. But usually, it exists between the countries belonging to similar region. Such an economic integration is referred to as "Regional Economic Integration".

Even though economic integration is found to be beneficial, it has been avoided by some of the countries because of the two major reasons. Firstly, it may lead to the generation of unemployment related problems in a country and secondly, it increases the concern over the national sovereignty. The concerns over national sovereignty arises as the economic integration forces the member countries to withdraw control over certain key issues i.e., monetary policy, tax policy and trade policy.

### 5.3.2 Trade Creation and Diversion Effects

**Q24. Define trade creation.**

*Ans :*

When there is a shift from high cost domestic producers to low-cost domestic producers (or) from high-cost extemah producers to low-cost external produces within the free trade area then 'trade creation' take place (or) this process of shifting is termed as "Trade Creation".

Trade creation refers to switching the production activities to the most efficient producers as well as enabling the customer to purchase goods in bulk quantity at less price.

**Q25. Define trade diversion.**

*Ans :*

Due to trade barriers, trade gets diversed from an efficient non-member country to an inefficient member country even though it is associated with high cost. A country has been restricted to trade with low cost manufacturing country which is not a member and is allowed to trade with member country even though cost of manufacturing is very high when compared to the cost of non member country.

**Q26. How does trade creation differ from trade diversion.**

*Ans :* **(Imp.)**

**i) Trade Creation**

Trade creation occurs when the countries that have been characterized by economic integration replaces the high cost domestic producers with that of the low cost producers within the free trade area or by replacing the high- cost external producers with the low cost external producers within the free trade area. In other words, it occurs when the countries with economic integration focus on producing goods and services in which they have a comparative advantage when compared with other member countries.

The best example for trade creation is the agreement between US and Mexico. This agreement allows the cars to get assembled at Mexico and sold in US. Here, Mexico is the low cost producer supplying large quantity of vehicles to be sold in US. This leads to prosperity and growth of both the countries. A large number of US companies have moved their operations to Mexico because its producers are capable of producing the same quality products at low cost than the domestic producers.

The major advantage of trade creation is that the companies are able to export their efficient products to other member countries. This will create demand for their efficient products and a fall in the demand for their inefficient products.

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### ii) Trade Diversion

Trade diversion occurs when the countries with economic integration increases. Trading practices with the member countries thereby reduce the trading potentially with the non-members. In other words, trade diversion is simply a trade shift from countries which are not the members to countries which are the members of economic integration. The major reason for trade diversion is the elimination of trade barriers, which helps the countries to purchase at less cost from the member companies whereas, it is opposite in case of non-member countries.

Suppose, Indian companies are importing goods of similar nature from Taiwan and China. India enters into a free trade agreement with China which makes it possible for the Indian companies to import more quantity of goods from China, rather than from Taiwan due to the low tariff rates.

| Sl.No. | Basis | Trade Creation | Trade Diversion |
|---|---|---|---|
| 1. | **Meaning** | Trade creation refers to a process of creating free trade area between the member countries of economic integr-ation which would had not existed before. | Trade diversion means, a free trade area diverts trade from more efficient supplier outside FTA to less efficient inside FTA. |
| 2. | **Nature** | There is extensive exchange of goods and services among FTA countries. | There is diversion of trade from expensive to less expensive countries. |
| 3. | **Occurrence** | Trade creation occurs when countries with economic integration focus on producing goods and services in which they have comparative advantage. | Trade diversion occurs when the countries with economic integration increase trade between the members by decreasing the trade with non-members. |
| 4. | **Benefits** | Trade creation benefits a country by increasing its exports. | Trade diversion benefits a country by increasing its imports. |
| 5. | **Advantage** | Creates employment opportunities in other member countries. | Creates demand for efficient products of a country in other member countries. |
| 6. | **Disadvantage** | Specialization in production of only efficient products effects the other industries in the country. | It may must the non-member countries economically and politically and sometime may create worse relationship between the two nations. |
| 7. | **Effects** | Trade creation always has a positive effect on the economy of the country. | Trade diversion can lead to loss of production and exports, since activities are transferred from more efficient non members to less efficient member countries. |
| 8. | **Outcome** | Trade creation results in increased market share for low cost producers to inefficient member country. | Trade diversion results in lots of production and export from efficient non-member country members countries. |
| 9. | **Shifting** | Production shifts from less efficient producers to more efficient producers. | Trade shifts from non-member countries to member countries. |
| 10. | **Potential** | It creates a problem for companies in issue the domestic markets. | It creates problem for the companies in the non-member countries. |
| 11. | **Example** | The best example of trade creation is US Manufacturing cars in Mexico and belling them back in US. | Suppose U.S is importing similar nature of goods from Taiwan and China. After entering into FTA with China it imports more goods from China, rather than Taiwan due to low tariff rates. |

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## 5.4 Regional Trade Agreements

### 5.4.1 European Union (EU)

**Q27. What is European union (EU). State the objectives and Organizational Structure of European Union.**

*Ans :*

Originally the European Coal and Steel Community (ECSC) was formed with the them West Germany, France, Italy, Belgium, Netherlands and Luxembourg in 1952. The aim of the ECSC was to eliminate import duties and quotas on Coal, Iron, Steel and Scrap regarding the international trade among the member countries.

The successful functioning of ECSC stimulated the member countries to extend this facility to all commodities by the treaty of Rome in 1957. This treaty gave birth to European economic community.

The EEC is also known as European common market. Originally six countries, viz., France, Federal Republic of Germany, Italy, Belgium, Netherlands and Lexembourg formed into the European economic community. By the treaty of Rome, 1957. It came into being on Ist January 1958.

The member of member countries of the EEC increased from Six to Nine on January, 1973 as UK, Ireland, and Denmark joined the community. Greece joined the EEC in 1981 and Portugal and Spain joined in 1984, Austria, Finland and Sweden joined the community on January 1, 1986. Now the EEC has 15 members. The requirement for joining the EEC as members are :

1. The country must be European country and
2. It must be a democratic country.

**Objectives of European Union**

1. The eliminate customs duties among states.
2. The eliminate obstacles for the free flow of import and for export of goods and services among member states.
3. To establish common customs duties and unified commercial policies.
4. To facilitate free movement of factors of production within block.
5. To provide regional funds for encouraging the economic development.
6. To make common laws to maintain competition thought the community.
7. To make common measures for consumer protection.
8. To accept common agricultural policies, transport policies, technical standards, health and safety regulations and educational degree.
9. To allow greater monetary and fiscal coordination among member states and certain common monetary and fiscal policies.

**Organizational Structure and Functions of EU**

The organizational structure of EU originally consisted of the commission, the Parliament, Council of Ministers, Court of Justice, Advisory Committees and Court of Auditors.

European council is the main administrative body of the EEC. Each member country is represented by a ministry in this council. Each member country holds the presidency of the council for six-monthly period by rotation.

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A committee of permanent representations acts as the secretariat of the council. This committee is also called 'corper'. The corper makes all impartment decisions. The corper is link between the EEC and member govt.

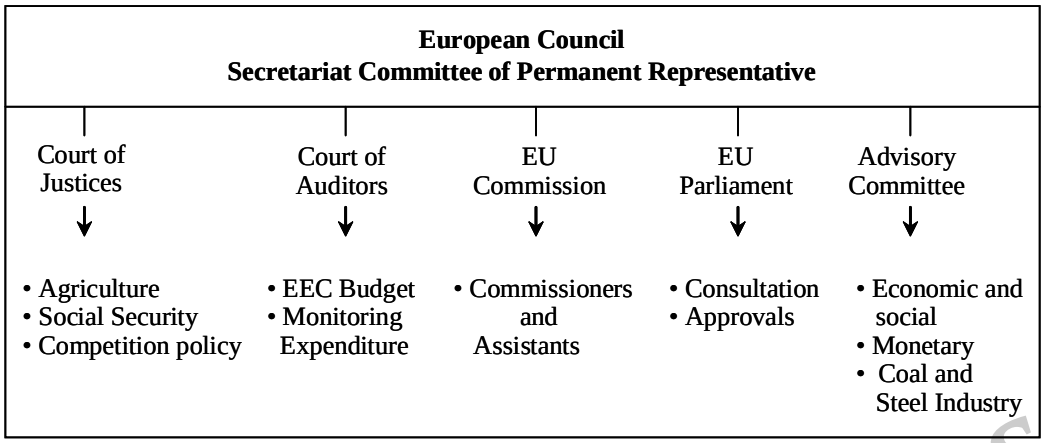


**Fig.: Organization Structure of the EEC**

## European Council

European council act as the executive agent to the EEC in

- Making routine decisions
- Formulating rules of conduct
- Preparing new legislations
- Enabling members to carry out the provisions of the treaty.

**a) Court of Justice:** There is court of Justice to Adjudicate disputes relating to Agriculture, Social security and competition policy.

**b) Court of Auditors:** Court of auditors appointed as a part of the EEC by amending the treaty of Rome. The activities of the court of the auditors include :

- Auditing the EEC budget
- Monitoring the EEC expenditure
- Laying down improved procedure for collection of duties and levies.

**c) European Commission:** This commission assists the council. There is executive body of EEC.

**d) European Parliament:** The European commission should consult the parliament before a final decision is taken. The parliament acts through the parliamentary committee. The activities of European parliament include.

- Provide consultations and information to the commission.
- Approve or reject the draft budget prepared by the commission.
- Dismiss the commission, if necessary.

**e) Advisory Committee:** There are several advisory committees to advise the European commission. These committee includes

1. Economic and social committee
2. Monetary committee
3. Consultative committee on Coal & Steel Industry.

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- **Economic and Social Com-mittee:** This committee represents the activities, like, employers, employee unions, farmers, retail traders, liberal professional and public. European commission appoints the members on this committee.
- **Monetary Committee:** This committee examines the monetary problems, problems of the balance of payments and suggests measure to overcome them.
- **Consultative committee on Coal and Steel Industry:** This committee studies the problems of Coal and Steel Industries and others suggestions.

**Q28. Explain the functioning of European Union.**

*Ans :*

**1. Common Agricultural Policy (CAP)**

In the common agricultural policy, each country has a 'Green Rate', based on which the support price is transformed into national price. There are no restrictions on the farmers with respect to the production quantity. The following are the features of this policy.

(i) There are no restrictions on the transfer of agricultural products from one member country to other member countries.

(ii) If the demand of a product exceeds its supply then imports are permitted.

(iii) If the community supply exceeds the demand, then the subsidies are permitted to export or to promote additional consumption.

(iv) EEC has gained self-sufficiency in agriculture.

(v) The policy resulted in the excess production of some products such as milk lakes, wine lakes, butter and beef mountains.

**2. Common Fisheries Policy**

The common fisheries policy was accepted by the member countries of EEC in October 1970. This policy came into force from February 1971. The following are the characteristics of this policy,

(i) This policy acts as a market for fresh frozen and preserved fish.

(ii) It provides common market standards and services for carrying out the trade among the members.

(iii) It provides equal access to the fishing areas to all nationals of EU countries.

This policy was not successful in the real world as it depended on the ad hoc settlements and allowances to the member countries.

**3. European Monetary Union**

European monetary union was initiated in March, 1979 and has the following characteristics,

**(i) Exchange Rate Mechanism (ERM):** The member countries can control the inflation and interest rates with the help of exchange rate mechanism. The member countries tries to avoid major shifts in the value of their currencies.

**(ii) European Currency Unit (ECU):** European currency unit is an alternative way for making the settlements between the central banks of the member countries. It includes all the currencies of the member countries. The official rate of the ECU is measured on daily basis.

**(iii) European Monetary Cooperation Fund:** European monetary cooperation fund is considered as a clearing house of the central banks of the member countries.

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**4. Factor Mobility**

The most important objective of EU is to have free transfer of persons, services and capital among the member countries. All the restrictions imposed on the transfer of labour were eliminated by July 1968. But, the capital mobility is not achieved by EU as it is restricted by the international monetary disturbances.

**5. Regional Development Policy**

The main aim of regional development policy of the EU is to encourage balanced development of the member countries by minimizing regional disparities and by promoting the backward regions. In order to achieve this objective EU provides financial support to the backward regions through,

(i) European investment bank

(ii) European social fund

(iii) European regional development fund.

**6. Common Transport Policy**

The main objective of common transport policy are,

(i) To eliminate the restrictions on transport for having a common market place.

(ii) To integrate the transport facilities of the whole community.

(iii) To manage and monitor the transport system within the community.

It is not possible for EEC to achieve these objectives because of the different issues relating to infrastructure pricing, entry controls for transporting the goods by rail and road.

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### 5.4.2 Association of South East Asian Nations (ASEAN)

**Q29. Explain briefly about Association of South East Asian Nations (ASEAN).**

*Ans :* **(Dec.-20)**

In January 1992, a set of six countries namely Singapore, Brunei, Malaysia, Philippines, Thailand and Indonesia made and entered into an agreement to form a Common Effective Preferential Tariffs (CEPT) plan. CEPT was used in developing an Association of South East Asian Nations (ASEAN) which was a free trade area in 15 years which commenced from January 1993. The CEPT reduced the tariffs ranging from 0.50 percent to 20 percent starting with 15 products.

The beginning and the successful functioning of EEC and NAFTA gave birth to the formation of ASEAN. The member countries of ASEAN have been economically developing at a faster pace throughout the world. Skilled and well-educated personnel are the biggest strength of these member countries which allows them to attain rapid industrialization. The ASEAN member countries are prosperous in mineral resources, agricultural goods and new industrial products. There are greater number of imports and exports which results in free flow of foreign capital among these countries.

The establishment of ASEAN has allowed the member countries to hold greater cohesiveness, exchange their economic and human resources and attain the synergy affect in the promotion of their agricultural sectors, industrial sectors and service sectors.

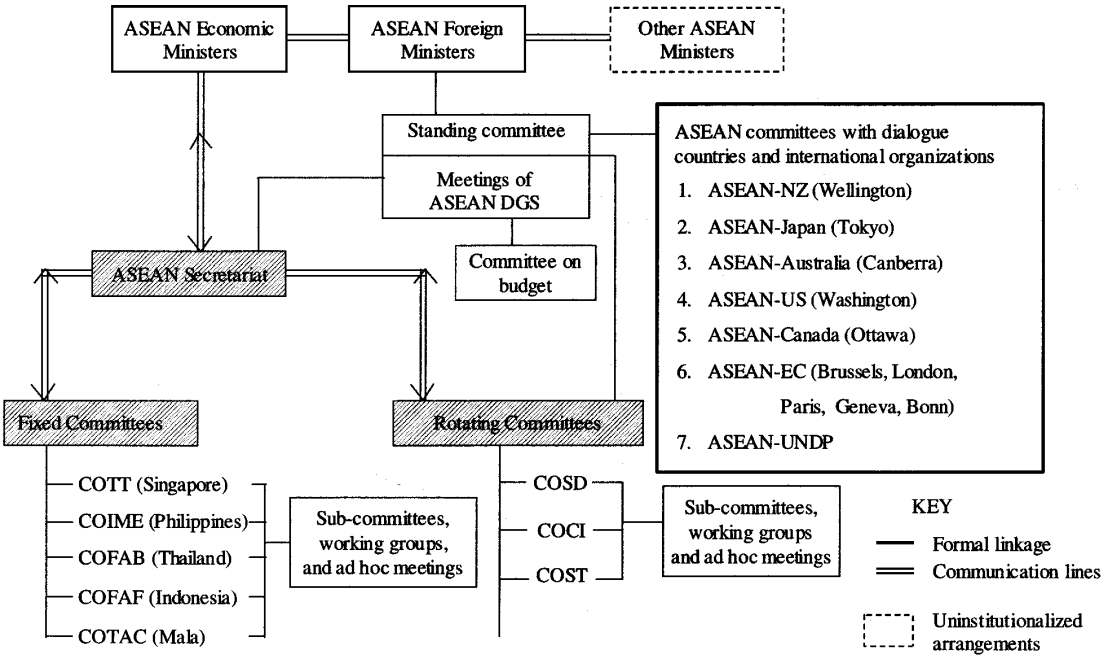


**Fig.: Organization Structures of ASEAN**

The chart depicts the subsidiary bodies of the ASEAN committees, the machinery of ASEAN economic cooperation and new organizational structure of ASEAN.

The general cultural and historical background allows the member countries to sustain their unity and solidarity by forming the trade blocks. The main goal/aim of ASEAN countries is to promote and make South East Asia a nuclear weapons free region and a peaceful zone with freedom and neutrality as its features.

### ASEAN Free Trade Areas (AFTA)

The ASEAN countries very keenly observed the developments in the international environment such as the creation of NAFTA, SAARC and EURO. With respect to these developments, the ASEAN countries created the ASEAN Free Trade Area (AFTA) in September 1994. Initially, the AFTA was created for 10 years with the main objective of developing inter ASEAN trade.

### Objectives of AFTA

1. To increase the rate of foreign investment in the AFTA area.
2. To promote free trade area among the member countries.
3. To minimize the tariff of the products which are being manufactured in ASEAN countries. In ASEAN countries if 40% value is added to the product value, then it is considered as being manufactured in the ASEAN countries.

## 5.4.3 South Asian Association for Regional Co-operation (SAARC)

### Q30. Define South Asian Association for Regional Co-operation (SAARC)

*Ans :* **(Dec.-20, Imp.)**

The South Asian Association for Regional Cooperation (SAARC) was established on December 8, 1985. It involves seven states of the Indian sub-continent - Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

The Secretariat of the Association is at Kathmandu, Nepal. Summits, which are the highest authority in SAARC, are to be held annually. The country hosting the Summit holds the Chair of the Association. The Council of Ministers comprising Foreign Ministers of member nations, meet at least twice a year. Its functions include formulating policy, reviewing progress of regional cooperation, identifying new areas of cooperation and establishing additional mechanisms that may be necessary. The Governors of the Central Banks of Member States under the auspices of SAARC FINANCE meet regularly to consider cooperation in financial matters.

Beyond official linkages, SAARC also encourages and facilitates cooperation in private sector through the SAARC Chamber of Commerce and Industry (SCCI), which is a SAARC Apex Body. Other such bodies are SAARC LAW and the South Asian Federation of Accountants (SAFA). In addition, professional groups in South Asia have been given status of SAARC Recognized Bodies. These bodies include: Architects, Management Development Institutions, University Women, Town Planners, Cardiologists, Dermatologists, Teachers, Writers, Insurance Organizations, Diploma Engineers, Radiological and Surgical Care Societies.

The SAARC Secretariat is based in Kathmandu. It coordinates and monitors implementation of activities, prepares for and services meetings, and serves as a channel of communication between the Association and its member states as well as other regional organizations.

**Areas of Cooperation**

SAARC seeks cooperation in the following thrust areas:

1. Agriculture and Rural Development
2. Health and Population Activities
3. Women, Youth and Children
4. Environment and Forestry
5. Science and Technology and Meteorology
6. Human Resources Development
7. Transport
8. Information and Communications Technology
9. Biotechnology
10. Intellectual Property Rights
11. Tourism
12. Energy

**Q31. Explain the objectives of SAARC.**

*Ans :* **(Dec.-20)**

The objectives of the Association are:

i) To promote the welfare of the people of South Asia and to improve their quality of life.

ii) To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potential.

iii) To promote and strengthen selective self-reliance among the countries of South Asia.

iv) To contribute to mutual trust, understanding and appreciation of one another's problems.

v) To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields.

vi) To strengthen co-operation with other developing countries.

vii) To strengthen co-operation among themselves in international forums on matters of common interest.

viii) To co-operate with international and regional organizations with similar aims and purposes.

### 5.4.4 North American Free Trade Agrement (NAFTA)

**Q32. Explain briefly about North American Free Trade Agreement (NAFTA).**

*Ans :* **(Imp.)**

In January 1994, Canada, the United States and Mexico launched the North American Free Trade Agreement (NAFTA) and formed the world's largest free trade area. The Agreement has brought economic growth and rising standards of living for

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people in all three countries. In addition, NAFTA has established a strong foundation for future growth and has set a valuable example of the benefits of trade liberalisation. Canada and US had signed a Free Trade Agreement which came in effect on January 1, 1989, and later Mexico approached the United States to establish one. The result was that on January 1, 1994, North America Free Trade Agreement came into effect.

**NAFTA covers the following areas**

1. **Market Access:** Within 10 years of implementation all tariffs would be eliminated on North American Industrial products traded between Canada, Mexico and United States.
2. **Non-Tariff Barrier:** A host of non-tariff barriers and other trade distorting restrictions will be eliminated. Mexican barriers such as local intent, local production, and export performance requirement, etc., have to be eliminated.
3. **Rules of Origin:** NAFTA reduces tariffs only for goods made in North America. The Rule of Origin will determine whether goods qualify for preferential tariff treatment under NAFTA.
4. **Custom Administration:** Under NAFTA, all the signatories agreed to implement uniform customs procedures and regulations.
5. **Investment:** NAFTA eliminates investment conditions that restrict the trade of goods and services to Mexico.
6. **Services:** NAFTA establishes a comprehensive set of principles governing services trade. Signatories are allowed to open wholly owned subsidiaries, and all restrictions on the services will be lifted.
7. **Intellectual Property:** NAFTA provides protection to intellectual property rights. The agreement covers patents, trademark, copyright, trade secrets, semiconductors, integrated circuits, and copyright for North American movies, computer software, and records.
8. **Government Procurement:** NAFTA guarantees fair business and open competition for procurement in North America through a transparent and predictable procurement procedure.
9. **Standards:** NAFTA prohibits the use of standards and technical regulations used as obstacles to trade.

NAFTA proved to be a boon for all the three nations. Low end manufacturing moved south (Mexico) and sophisticated manufacturing services increased in the United States and Canada. Many companies simply started moving to Mexico. General Electric divisions even advised their suppliers that they better go to Mexico as it will cut the cost, or bear the risk of being dropped as a GE supplier. Auto manufacturing from all over world began moving to Mexico. Over 500,000 Mexicans make parts and assemble vehicles for all of the world's major auto producers.

The rule of origin, which requires 62.5% regional content, forced European and Asian automakers to establish their units in Mexico as it is more cost effective. Daimler Chrysler (DC) produces 45,000 cars and 200,000 trucks in Mexico of which, between 80% to 90% is exported to USA and Canada. The story for Daimler Chrysler's production in the United States is similar. That is, the US plant of DC exported only 5,300 vehicles in 1993 and the year after the signing of NAFTA it exported 17,500 and in 2000, it exported 60,000 vehicles. Total trade among these three countries more than doubled from $306 billion to almost $621 billion between 1993 and 2002. For Mexico alone, exports to the US and Canada grew by over 200% during this period.

With a strong, stable and transparent framework for investment, the region has attracted foreign investment at record levels, not just from NAFTA partners, but from around the world. At the same time, all three countries have experienced strong economic growth. The NAFTA commission reports indicate that after signing of NAFTA, more than $189 billion was invested in the three countries in 1997. Meanwhile, total FDI into the NAFTA countries has reached $864 billion. Job creation has surged in all the three countries. Since NAFTA was implemented, employment has grown by 10.1% (1.3 million) in Canada, by 22% (2.2 million jobs) in Mexico and by over 7% (12.8 million jobs) in the United States.

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### 5.4.5 Brazil, Russia, India and China (BRIC)

**Q33. Explain briefly about BRICS.**

*Ans :* **(Imp.)**

Coordination between Brazil, Russia, India and China (BRIC) began informally in 2006, with a working meeting of the foreign ministers of the four countries on the sidelines of the United Nations General Assembly. Since then, the acronym, created a few years earlier by the financial market, no longer confined itself to identifying four emerging economies. BRIC became a mechanism for cooperation in areas that have the potential to generate concrete results for Brazilians and the peoples of the other member countries.

Since 2009, the Heads of State and Government of the group meet annually. In 2011, at the Sanya Summit, South Africa became part of the grouping, adding the "S" to the acronym, now BRICS.

**In the last 10 years, 10 Summit meetings have taken place, with the presence of all the leaders of the mechanism**:

- **1st Summit:** Yekaterinburg, Russia, June 2009;
- **2nd Summit:** Brasília, Brazil, April 2010;
- **3rd Summit:** Sanya, China, April 2011;
- **4th Summit:** New Delhi, India, March 2012;
- **5th Summit:** Durban, South Africa, March 2013;
- **6th Summit:** Fortaleza, Brazil, July 2014;
- **7th Summit:** Ufa, Russia, July 2015;
- **8th Summit:** Benaulim (Goa), India, October 2016;
- **9th Summit:** Xiamen, China, September 2017;
- **10th Summit:** Johannesburg, South Africa, July 2018; and
- **11th Summit:** Brasília, Brazil, November 2019

Since the first summit in 2009, BRICS has significantly expanded its activities in several fields, but it was the financial field that guaranteed greater group visibility from the outset. As a result of the 2008 crisis, the four member countries started to work in concert with the G20, the IMF and the World Bank, with concrete proposals for reform of global financial governance structures, in line with the increase in the relative weight of emerging countries in the world economy. The role played by BRICS was instrumental in the reform of the IMF quotas approved in Seoul in 2010.

In the same field, BRICS cooperation led to the launching of the first two institutions of the mechanism: the New Development Bank (NDB) and the Reserve Contingent Arrangement (RCA). The creation of the bank was aimed at responding to the global problem of the scarcity of resources for the financing of infrastructure projects.

Starting in 2015, BRICS began to seek new areas of cooperation, always bearing in mind the need to obtain tangible benefits for the five countries. For Brazil, the areas of health, science, technology and innovation, digital economy and cooperation in the fight against transnational crime are priority in this effort to advance new areas of action.

The Eleventh Summit will be held in Brasília, on November 13 and 14, at Palácio Itamaraty, under the theme "BRICS: economic growth for an innovative future". Before the meeting of leaders, the Brazilian presidency will organize several meetings that will have as priorities:

(i) Strengthening cooperation in science, technology and innovation;

(ii) Strengthening cooperation in digital economy;

(iii) Increased cooperation in combating transnational crime, in particular organized crime, money laundering and drug trafficking; and

(iv) Encouraging the rapprochement between the New Development Bank and the Business Council.

**Objectives**

1. The BRICS countries act as one to promote a more legitimate international system, including advocating reform of the UN Security Council.
2. The BRICS group is a South-South framework for cooperation.

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3. The BRICS group also acts as a bridge between developed and developing countries. For example, in the WTO, the BRICS countries are trying to promote a fair order regarding agricultural policies. They are attempting to promote the liberalization of the international economic order to diminish agricultural subsidies in the United States and the European Union, which would make developing countries' agricultural products more competitive.
4. The BRICS group will also play an increasingly important role in assisting developing countries in gaining an advantage in trade and climate change negotiations, as well as on issues related to the export of manufacturing products.
5. Developing countries on the periphery of the group will be able to leverage the NDB and the CRA to increase their bargaining power.
6. The group established the BRICS Business Council, made up of 25 prominent entrepreneurs from the five countries and representing many industries and economic sectors.
7. The BRICS also formed an information-sharing and exchange platform that expands beyond economic cooperation to also involve educational, cultural, and environmental engagement.
8. They have a shared interest in challenging the current governance of Western financial institutions like the International Monetary Fund and the World Bank for that they have announced the establishment of the bank
9. They will advocate for the interests of middle powers on global forum.

### 5.4.6 India's Trade Policy

**Q34. Define India's Trade Policy. State the features of India's Trade Policy.**

*Ans :* **(Imp.)**

The trade policy was used by most of the advanced countries like Germany, USA, Japan and others for two basic reasons,

1. Firstly, to ensure a quick development of home based industries by limiting their imports and providing cover up for their markets.
2. Secondly, ensuring home industries to gain market share in the foreign markets by encouraging their exports. The trade policy played a key role for developing advanced countries.

In India, the trade policy was not clearly defined. However, before independence in 1923, an import limit known as "Discriminating protection" was implemented with the sole intention of protecting the domestic industries against the foreign competition. In India, several changes took place after independence. One such change led to the formulation of trade policy, as a part of general economic policy of development.

**Features of India's Trade Policy**

The main features of India's trade policy on the two sides i.e., import side and export side were as follows,

**1. Import Side**

The Indian industries were not in a position to compete against the advanced foreign industries, that were manufacturing and selling every product at relatively low costs. Therefore, if India had any chance of developing its industry it was only by guarding it against foreign competition. As a result the following two features were introduced.

**(a) Import Restriction**

The import restriction was incorporated as an essential element of the trade policy and was commonly referred to as "protection". This was necessary for the protection of domestic industries from unnecessary competition put forth by the foreign industries, thereby encouraging their industrial development. After independence the government had taken various initiatives for the prevention of imports on a large scale by the introduction of import licensing, import quotas, import duties and also the complete ban on import of certain goods.

**(b) Mahalanobis Strategy of Economic Development**

In the second plan, India accepted the Mahalanobis strategy of economic development. This strategy dealt with the,

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(i) Prohibition or the establishment of minimum quantity for the import of non-essential consumer goods.

(ii) Practising absolute control on the imports of various items.

(iii) Encouragement of the economic growth of heavy-industries by importing machines, equipment and other development goods.

(iv) Setting up a specific period for the policy of import substitution.

**2. Export Side**

India had to expand its exports in order to make the payments for its imports and to reduce its dependence on foreign countries. The entire domestic production was not fully consumable within the Indian market and therefore search for new potential markets became necessary. Formulation of fiscal policy and other benefits and setting up of trading institutions, were some of the primary steps taken by the Indian government to encourage its exports.

Secondly, after the second plan more attention was laid on vigorous exports encouragement in order to earn foreign exchange and overcome foreign exchange crisis. In the 1970s, the increased debt service responsibility and goal of becoming self-reliant again enforced the Indian government to emphasize on the promotion of exports.

**Q35. Explain the various phases of trade policy.**

*Ans :*

The India's trade policy consisted of five different phases. The first phase range from 1947-48 to 1951-52, the second phase began in 1952-53 and ends in 1956-57, the third phase's duration is after 1956-57 to June, 1966, after the devaluation of rupee in June 1966 the fourth phase began and the last phase began after 1975-76.

**1. First Phase (1947- 48 to 1951- 52)**

In the first phase, India was not able to liberalize its imports from restrictions because of the various restrictions imposed by the U.K with regard to the utilization of the sterling balances. The balance of payment with the dollar area was very much unfavorable. Therefore, a step was taken to import goods from strong currency countries and export to dollar area in order to bridge the existing gap in an economy. This is also called for devaluation of an Indian Rupee in 1949. However, this phase continued with restrictive import policy and some restrictions were also implemented on export, because of the scarcity of resources in the domestic economy.

**2. Second Phase (1952-53 to 1956-57)**

During this phase many restrictions over the foreign trade were lifted up and liberalization of foreign trade was set as an ultimate objective of the trade policy. Procurement of import licenses were made in a more liberalized manner. Reduction in export duties, relaxing export controls, abolishment of export quotas and granting of incentives on export led to the encouragement of exports. The imports had increased tremendously as a result of liberalization measures but there were no changes in the status of exports. This phase had been witnessed with a considerable deteriorations of the foreign exchange reserves leading to the need for the reversal of a Trade policy.

**3. Third Phase (1956-57 to June, 1966)**

In this phase, the trade policy was revised. It was designed as per the requirements of the planned economic development. Imports were restricted by the introduction of more restrictive import policy. Wherein, the import of certain goods was banned and was under the careful regulatory and control mechanisms. On the other hand, the exports were liberalized and vigorously promoted. Promotion and diversifications of export were found to be the most suitable solution for the prevailing problems of balance of payments. Export was encouraged for both traditional and modem items. To reduce the dependence on foreign countries, the import substitution industries were also established. In 1962, the Mudaliar committee had thoroughly reviewed the trade policy.

**4. Fourth Phase (June, 1966 to 1975-76)**

The devaluation of Indian Rupee in June, 1966 witnessed the beginning of the fourth phase. During this phase, the trade policy had taken several measures through which not only exports, but also

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imports were liberalized. The suggestions made by the Mudaliar committee (1962) led to the rapid increase in exports. Tax exemptions on the earnings of exports, removal of disincentives, export promotion through import entitlement, increased allocation of resources towards the development of export-oriented industries and establishment of export promotion advisory council, ministry of International trade and so on, were some of the major recommendations made by the committee. (The devaluation of the Indian rupee was an important step taken by the government of India to revise imports and to increase exports, as all other measures, had proved to be ineffective in eliminating adverse balance of payments). The devaluation proved to be wrong and the adverse balance of payments further worsened the economic condition of the country. However, the fourth phase of trade policy was found to be effective and successful in regulating and controlling both the exports and imports of the country.

**5. Fifth Phase (1975-76 Onwards)**

The government of India had liberalized the imports so as to encourage exports during the fifth and last phase of the trade policy. For increasing the domestic supply of essential goods and to control the increase in the price level, the import was liberalized in 1977-79 under the government of Janata party. The following were the goals and objectives of import-export policy of India,

(a) To increase the exports further.

(b) To facilitate the growth of the local and regional industries.

(c) To optimally exploit agricultural and human resources of the country.

(d) To support technological advancement by focussing on encouragement of export and preservation of energy.

(e) To boost those industries that were engaged in exports specially those which are associated with the manufacturing units.

(f) To indulge all the possible savings of the country for imports.

Therefore, this trade policy had been focussed for the economic growth and the exports promotion by liberalizing and regulating control over the imports.

In 1985, the Abid Hussain committee helped the government in the formulation of an effective import- export policy. The committee suggested that the government had liberalized import for increasing exports. Therefore, there was a great misrepresentation for implementing the suggestions made by the committees.

The government under the leadership of Rajiv Gandhi, had made several attempts for liberalizing the exports and imports. From 1985-1990, there was a recorded annual growth of 17% in dollars. However, this growth was declined to 9% in 1990-91.

**Q36. Analyze the sector wise trade policies in India.**

*Ans :*

In India various trade policies were introduced by the government which helps in facilitating the trading mechanism of the country. However, these trade policies were set up for the different sectors based on their features.

**1. Agricultural Sector**

Indian economy is basically Agro based economy. Agricultural sector contributes about 60% of the growth of an Indian economy. There has been no progress through the adoption of the trade reform programmes in India but certain measures related to agricultural products were made during the export import policy of 2002-07.

The progress of the agricultural sector is being witnessed by,

(i) Removing regulatory mechanisms on the movement of certain food grains between the states.

(ii) In exam policy of 2002-07, restrictions on all agricultural products excluding some products like Jute and Onions were removed.

(iii) The Indian government has identified those commodities that have major impact on the economic development of various states and established Agriculture Export Zones (AEZ) to enhance the exports in this sector by reducing the tariff rates and subsidies.

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(iv) Administered the prices of exports and imports of certain products.

(v) The transport subsidy was provided for the export of fruits, vegetables, poultry and dairy products for developing the agricultural sector.

**2. Food Processing Sector**

The trade policies in this sector along with their recent developments include,

(i) Establishes the tariff reforms since 1993, in the food processing sector which reduces the tariff percentages in to a great extent. Now as per recent records the processed food have a tariff rate of 15-25%.

(ii) Removal of the restrictions while seeking the import licenses.

(iii) There has been an increase in foreign investment because of the increased participation of foreigners and Non-Resident Indians (NRI) which ranges between 51%- 100%.

**3. Mining and Petroleum Sector**

Indian economy is mostly effected by the petroleum imports. Earlier the government of India has administered the prices of petroleum but now government is taking actions for the exploration of domestic oil reservoirs so as to reduce the nation's dependability on its imports.

(i) Government is offering tax holidays as investment incentives to the companies to encourage the exploration of the domestic oil resources.

(ii) Since 1991 industrial policy underwent major changes. One such change involves to seek permission for participation of foreign investment in mining activity of about 13 minerals.

(iii) Foreign Investment Promotion Board (FIPB) must approve that foreign investment wherein the participation of foreign equity is more than 50%.

(iv) Because of the trade reforms the tariff rates for non-ferrous and iron ores were reduced from 46% in 1993-94 to 36% and for coal, a decline was witnessed from 65% (1993-1994) to 13%.

**4. Manufacturing Sector**

The trade reforms in manufacturing sector include,

(i) Reductions in the tariff rates

(ii) Delicencing the import restrictions

(iii) Reduced the provisions for seeking the compulsory industrial licensing.

(iv) Liberal foreign investment policies by including number of industries and other sectors such as automobile sector.

**5. Service Sector**

More than half of the India's national income is the resultant of the service sector. Rapid growth in the finance, information technology, commercial tourism and other service sector related areas brought the domestic growth of the service sector of all the areas, global outsourcing constitutes an important driver for achieving the growth of the service sector.

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# Short Question and Answers

**1. WTO.**

*Ans :*

The formation of WTO on 1st January, 1995 was regarded as the greatest reform of international trade, since 1948. Initially, international commerce was under the guidance of GATT which assisted in developing a productive multilateral trading system. However, it needed examination by the end of 1980's.

The Uruguay round was conducted for performing the examination. This negotiation was one of the largest trade negotiations. Initially, some people felt that Uruguay round would fail but, at the end it was successful. WTO includes many things along with GATT. GATT was considered as a small and provisional institution which was not recognized as an international organization. GATT is now replaced with WTO. The agreement of GATT was modified and transformed into the new WTO agreements. GATT deals only with trade in goods, whereas WTO agreements involves service and intellectual property.

**2. Objectives of WTO**

*Ans :*

Important objectives of WTO are mentioned below:

(i) To implement the new world trade system as visualized in the Agreement.

(ii) To promote World Trade in a manner that benefits every country.

(iii) To ensure that developing countries secure a better balance in the sharing of the advantages resulting from the expansion of international trade corresponding to their developmental needs.

(iv) To demolish all hurdles to an open world trading system and usher in international economic renaissance because the world trade is an effective instrument to foster economic growth.

(v) To enhance competitiveness among all trading partners so as to benefit consumers and help in global integration.

(vi) To increase the level of production and productivity with a view to ensuring level of employment in the world.

(vii) To expand and utilize world resources to the best.

**3. Objectives of GATT**

*Ans :*

The main aim of GATT was to increase international trade by eliminating restrictions on trade for attaining economic growth all over the world. The opening statement of the GATT outlined the following objectives as the primary objectives of GATT.

1. To increase the standard of living of the people all over the world.
2. To make sure that there is full employment and uniform growth in the real income all over the world.
3. To make effective utilization of the resources.
4. To increase the production and international trade.

GATT includes some conventions and general principles which controls international trade between the countries which are tied up in the agreement.

According to the rules of conventions of GATT,

(i) The tariff or any other commercial policy of a member country cannot be changed without consulting other parties of the agreement.

(ii) The countries which are included in GATT must aim at decreasing the tariffs and other trade barriers.

**4. Agrement on agriculture (AOA).**

*Ans :*

GATT allows countries to use some non-tariff measures such as import quota and subsidies. The Uruguay Round produced the first multilateral

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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 electrification". 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 varieties 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."

**5. TRIPS.**

*Ans :*

The General Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) was developed in the Uruguay round agreement for protecting the intellectual property rights. WTO defined intellectual property rights as "the rights given to persons over the creations of their minds. They usually give the creator an exclusive right over the use of his/her creation for a certain period of time". Even intellectual properties are included in the UR agreement on TRIPs which are as follows,

(i) Copyright and related rights

(ii) Trademarks covering service marks

(iii) Geographical indications

(iv) Industrial designs

(v) Patents covering the protecting of new types of plants.

(vi) Layout designs of integrated circuits

(vii) Trade secrets and test data or any other unraveled information.

**6. TRIMS**

*Ans :*

The Agreement on Trade Related Investment Measures (TRIMs) is one of Agreements covered under Annex IA to the Marrakech Agreement, signed at the end of the Uruguay Round (UR) negotiations. The Agreement addresses investment measures that are trade related and that also violate Article III (National treatment) or Article XI (general elimination of quantitative restrictions) of the General Agreement on Tariffs and Trade. International businesses are aware of the many restrictions on their investments in foreign countries. Trade Related Investment Measures (TRIMS) are those restrictions a nation places on foreign investment that adversely affect trade in goods and services. WTO measures on TRIMs have been entered into the agreement as a part of the Uruguay Round agreements.

This agreement does not set broad rules for investors in a WTO country. It simply prohibits laws or regulations that condition a firm's right to import foreign goods based on the volume of goods exported.

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For example, Argentina may not say to a US based MNC: 'You may only import foreign raw materials on condition that you export an equal volume of finished goods from our country'.

The requirements would violate the prohibition of quantitative restrictions of GATT. Also prohibited are laws that condition the receipt of foreign exchange on the company's foreign exchange revenues.

**Q7. Define economic integration.**

*Ans :*

After the second world war, many countries decided to assist their neighboring counties and get assistance from them in the form of economic cooperation such as commodity arrangements and regional economic integration. Regional economic integration is the preferential political and economic agreement among the member countries to cooperate with one another and to eliminate restrictions on the flow of goods, services, labour and capital between their regions.

The economic integration exists between the countries belonging to a particular geographic region but it can be between the countries at a long distance also. Trade between the countries is the lowest level of cooperation and it is the corner stone of any form of regional economic integration. Companies should be well aware of the regional trading groups to take advantage of them while doing trade in such countries. The strategies of multinational companies are mostly affected by the regional trading groups.

Countries form trading groups when their ideologies are similar due to similar awareness to the regional problems or due to their common history. Many trading groups contain countries who share same area of the world. Distant countries may join them because their goods need to travel between such countries.

**Q8. Define trade creation.**

*Ans :*

When there is a shift from high cost domestic producers to low-cost domestic producers (or) from high-cost extemah producers to low-cost external produces within the free trade area then 'trade creation' take place (or) this process of shifting is termed as "Trade Creation".

Trade creation refers to switching the production activities to the most efficient producers as well as enabling the customer to purchase goods in bulk quantity at less price.

**Q9. Define trade diversion.**

*Ans :*

Due to trade barriers, trade gets diversed from an efficient non-member country to an inefficient member country even though it is associated with high cost. A country has been restricted to trade with low cost manufacturing country which is not a member and is allowed to trade with member country even though cost of manufacturing is very high when compared to the cost of non member country.

**10. European union**

*Ans :*

Originally the European Coal and Steel Community (ECSC) was formed with the them West Germany, France, Italy, Belgium, Netherlands and Luxembourg in 1952. The aim of the ECSC was to eliminate import duties and quotas on Coal, Iron, Steel and Scrap regarding the international trade among the member countries.

The successful functioning of ECSC stimulated the member countries to extend this facility to all commodities by the treaty of Rome in 1957. This treaty gave birth to European economic community.

The EEC is also known as European common market. Originally six countries, viz., France, Federal Republic of Germany, Italy, Belgium, Netherlands and Lexembourg formed into the European economic community. By the treaty of Rome, 1957. It came into being on Ist January 1958.

The member of member countries of the EEC increased from Six to Nine on January, 1973 as UK, Ireland, and Denmark joined the community. Greece joined the EEC in 1981 and Portugal and Spain joined in 1984, Austria, Finland and Sweden joined the community on January 1, 1986. Now the EEC has 15 members. The requirement for joining the EEC as members are :

1. The country must be European country and
2. It must be a democratic country.

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**11. Objectives of European Union**

*Ans :*

i) The eliminate customs duties among states.

ii) The eliminate obstacles for the free flow of import and for export of goods and services among member states.

iii) To establish common customs duties and unified commercial policies.

iv) To facilitate free movement of factors of production within block.

v) To provide regional funds for encouraging the economic development.

vi) To make common laws to maintain competition thought the community.

vii) To make common measures for consumer protection.

viii) To accept common agricultural policies, transport policies, technical standards, health and safety regulations and educational degree.

ix) To allow greater monetary and fiscal coordination among member states and certain common monetary and fiscal policies.

**12. Objectives of SAARC.**

*Ans :*

The objectives of the Association are:

i) To promote the welfare of the people of South Asia and to improve their quality of life.

ii) To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potential.

iii) To promote and strengthen selective self-reliance among the countries of South Asia.

iv) To contribute to mutual trust, understanding and appreciation of one another's problems.

v) To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields.

vi) To strengthen co-operation with other developing countries.

**13. Features of India's Trade Policy**

*Ans :*

The main features of India's trade policy on the two sides i.e., import side and export side were as follows,

**Import Side**

The Indian industries were not in a position to compete against the advanced foreign industries, that were manufacturing and selling every product at relatively low costs. Therefore, if India had any chance of developing its industry it was only by guarding it against foreign competition. As a result the following two features were introduced.

- **Import Restriction:** The import restriction was incorporated as an essential element of the trade policy and was commonly referred to as "protection". This was necessary for the protection of domestic industries from unnecessary competition put forth by the foreign industries, thereby encouraging their industrial development. After independence the government had taken various initiatives for the prevention of imports on a large scale by the introduction of import licensing, import quotas, import duties and also the complete ban on import of certain goods.

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# Choose the Correct Answer

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. Common effective preferential trariffs plan helped in establishing _____. [ b ]
   (a) European union (b) ASEAN
   (c) NAFTA (d) SAARC
8. _____ was designed to serve as a forum in which trade related development issues were discussed and analyzed. [ 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

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# *Fill in the blanks*

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

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FACULTY OF COMMERCE

**M.Com (CBCS) (New Syllabus) II - Semester Examination**

**December - 2020**

# INTERNATIONAL BUSINESS AND BUSINESS ENVIRONMENT

**Time : 2 Hours]** **[Max. Marks : 80**

**PART - A - (4 × 5 = 20 Marks)**

**ANSWERS**

**Note :** Answer any four questions.

1. Write about Fiscal Policy **(Unit-I, SQA-10)**
2. Explain Second Generation reforms **(Unit-II, Q.No.22)**
3. Explain Globalisation **(Unit-III, SQA-3)**
4. Types of FDIs. **(Unit-IV, SQA-2)**
5. NAFTA **(Unit-V, Q.No.32)**

**PART - B - (4 × 15 = 60 Marks)**

**Note :** Answer any four questions.

6. Discuss the features of Competition Act, 2002. What are the functions of competition commission of India ? **(Unit-I, Q.No.47, 48)**
7. Explain the impact of Micro Environment of Business. **(Unit-I, Q.No.7)**
8. Discuss the effect of Industrial Policy 1991 on Industrial growth and structural Changes in India. **(Unit-II, Q.No.7)**
9. Write about the effects of Liberalization on Balance of Payments. **(Unit-II, Q.No.2)**
10. Discuss the scope and importance of International Business. **(Unit-III, Q.No.12)**
11. Discuss different modes of entry and derives of Globalization. **(Unit-III, Q.No.15,34)**
12. Explain the objectives, structure and functioning of World Bank. **(Unit-IV, Q.No.24,25)**
13. Discuss the Foreign Portfolio Investment Policy Government of India. **(Unit-IV, Q.No.9,11)**
14. Discuss any three Regional Trade Agreements. **(Unit-V, Q.No.29, 30, 31)**
15. Explain the main provisions of TRIPS and TRIMS. **(Unit-V, Q.No.16,19)**

FACULTY OF COMMERCE

**M.Com II - Semester (CBCS) Examination**

**Model Paper - I**

# INTERNATIONAL BUSINESS AND BUSINESS ENVIRONMENT

**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]**

**ANSWERS**

1. Fiscal Policy. **(Unit-I, SQA-10)**
2. Advantages of Liberalization. **(Unit-II, SQA-3)**
3. Define disinvestment. **(Unit-III, SQA-2)**
4. Define Foreign Direct Investment. **(Unit-IV, SQA-1)**
5. TRIPS **(Unit-V, SQA-5)**

## PART - B (5 × 12 = 60 Marks)

**[Essay Answer Type]**

6. (a) Define Business Environment. Explain External Factors Influencing Business Environment. **(Unit-I, Q.No.1,7)**

**(OR)**

(b) Define Monetary Policy. What are the objectives of Monetary Policy? **(Unit-I, Q.No. 28)**

7. (a) Define Liberalization. Explain the nature of Liberalization. **(Unit-II, Q.No.1)**

**(OR)**

(b) What are the functions of NITI Aayog? **(Unit-II, Q.No.16)**

8. (a) Explain the various forms of privatization. **(Unit-III, Q.No.4)**

**(OR)**

(b) Explain the scope and Importance of International business. **(Unit-III, Q.No. 12)**

9. (a) Define Foreign Direct Investment. Explain different types of FDI. **(Unit-IV, Q.No.1)**

**(OR)**

(b) Distinguish between FERA and FEMA. **(Unit-IV, Q.No.16)**

10. (a) Explain the objectives and functions of WTO. **(Unit-V, Q.No.5)**

**(OR)**

(b) States the various levels of economic integration. **(Unit-V, Q.No.22)**

# FACULTY OF COMMERCE

## M.Com II - Semester (CBCS) Examination

## Model Paper - II

# INTERNATIONAL BUSINESS AND BUSINESS ENVIRONMENT

**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]**

**ANSWERS**

1. Rights of Consumer. **(Unit-I, SQA-14)**
2. Objectives of NITI Aayog **(Unit-II, SQA-6)**
3. Advantages of Privatization **(Unit-III, SQA-5)**
4. FEMA **(Unit-IV, SQA-5)**
5. TRIMS **(Unit-V, SQA-6)**

### PART - B (5 × 12 = 60 Marks)

**[Essay Answer Type]**

6. (a) Explain internal factors influencing business environment. **(Unit-I, Q.No.6)**

**(OR)**

(b) Explain the Role of Government in Business. **(Unit-I, Q.No.33)**

7. (a) Explain the salient features of new industrial policy 1991. **(Unit-II, Q.No.7)**

**(OR)**

(b) State the various components of balance of payment. **(Unit-II, Q.No.26)**

8. (a) Analyses the product life cycle theory of international trade in detail. **(Unit-III, Q.No.24)**

**(OR)**

(b) What are Tariff Barriers. Explain different types of Tariff Barriers. **(Unit-III, Q.No.27)**

9. (a) Describe the organization Structure of the International Monetary Fund. **(Unit-IV, Q.No.19)**

**(OR)**

(b) What are the objectives of United Nations Conference on Trade Development **(Unit-IV, Q.No.33)**

10. (a) Explain the organization structure of WTO. **(Unit-V, Q.No.4)**

**(OR)**

(b) What is European union (EU). State the objectives of European Union. **(Unit-V, Q.No.27)**

# FACULTY OF COMMERCE

## M.Com II - Semester (CBCS) Examination

## Model Paper - III

# INTERNATIONAL BUSINESS AND BUSINESS ENVIRONMENT

**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]**

**ANSWERS**

1. Define Business Environment. **(Unit-I, SQA-1)**
2. Define Balance of Payment. **(Unit-II, SQA-9)**
3. What are Tariff Barriers. **(Unit-III, SQA-8)**
4. IMF **(Unit-IV, SQA-8)**
5. WTO **(Unit-V, SQA-1)**

### PART - B (5 × 12 = 60 Marks)
**[Essay Answer Type]**

6. (a) Compare and contrast capitalism, socialism and mixed economy. **(Unit-I, Q.No.18)**

**(OR)**

(b) Define Corporate Social Responsibility. Explain the list of CSR activities. **(Unit-I, Q.No.55)**

7. (a) What is meant by equilibrium of payment and disequilibrium of payment? State the causes and consequences of dis-equilibrium of payments. **(Unit-II, Q.No.29)**

**(OR)**

(b) State the objectives of Second Generation Reforms. **(Unit-II, Q.No.22)**

8. (a) Explain the advantages and disadvan-tages of Globalization. **(Unit-III, Q.No. 33)**

**(OR)**

(b) Explain the different modes of international business. **(Unit-III, Q.No. 15)**

9. (a) Discuss the problems and consequences of foreign direct investment with reference with India. **(Unit-IV, Q.No.8)**

**(OR)**

(b) Explain the Provisions of FEMA. **(Unit-IV, Q.No.15)**

10. (a) Explain briefly about North American Free Trade Agreement **(Unit-V, Q.No.32)**

**(OR)**

(b) Explain briefly about agrement on agriculture **(Unit-V, Q.No.11)**